Medium Term Budget Policy Statement

2007

National Treasury

Republic of South Africa

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Foreword

The past four years have been good for the South African economy. GDP growth has averaged 5 per cent a year. National income per person has grown 22 per cent in real terms since 1999. Housing, water, sanitation, electrification and access to education have been extended to millions of South Africans. Since 2003, 1.3 million jobs have been created, boosting employment by about 2.7 per cent a year.

Yet as the economy has grown more rapidly, it has also begun to show signs of strain, reflected in rising inflation and a high current account deficit. To progress towards sustainable growth above 6 per cent, a series of microeconomic reforms are required to raise productivity, lower the costs of doing business, cut red tape, invest more in skills and increase the labour-absorptive capacity of the economy. We also have to increase spending on social and economic infrastructure to remove constraints to growth and share the gains of this expansion more widely.

Since 2004, government has been guided by two core objectives: halving the rate of unemployment and the proportion of people living in poverty by 2014. This *Medium Term Budget Policy Statement* sets out an economic and fiscal framework aimed at accelerating progress to meet these targets.

The budget framework makes a contribution to higher growth and poverty reduction through investment in infrastructure, human development and community services. To ensure that both the public finances and economic growth are sustainable for present and future generations, the framework also signals more moderate growth in government expenditure over the medium term.

The budget priorities continue to be characterised by a pro-poor spending pattern, with strong growth in transfers to municipalities and provinces to broaden access to basic services, and to improve the quality of education, health and welfare services.

The purpose of the *Medium Term Budget Policy Statement* is to present a framework and a set of spending priorities to shape the budgets of national, provincial and local government. It is intended to encourage parliamentary and public debate on how South Africa will meet the social and economic challenges ahead.

Trevor A Manuel, MP
Minister of Finance

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Towards a higher growth path

- Strong economic growth has brought substantial benefits for South Africa, leading to sustained increases in employment, declining poverty, rising investment, rapid growth in public spending and household welfare gains. While the economic outlook remains positive, raising the momentum of growth requires structural reforms focused on trade and productive capacity.
- Transforming South Africa is a long-term project. Economic, fiscal and budget policy are about delivering sustainable economic growth, accompanied by rising welfare gains for present and future generations. Continued social progress requires a careful balance between managing the sustainability of growth, channelling spending to high-priority areas and raising the bar for government departments to deliver better value for money.
- This budget framework takes account of cyclical factors in determining government's macroeconomic and fiscal stance. We introduce the concept of a structural budget balance to help measure the impact of the fiscal stance on aggregate macroeconomic performance.
- Preparations for the 2010 FIFA World Cup provide a strong boost to growth and investment over the medium term. The 2008 budget framework sees public spending continuing to rise rapidly, by about 6.4 per cent a year. Key spending priorities include investing in human and physical capital, broadening access to household services, improving the quality of public services and targeted anti-poverty programmes, strengthening the criminal justice sector and raising economic performance.

The medium-term strategic framework

The 2007 *Medium Term Budget Policy Statement* (MTBPS) sets out the fiscal framework for the period 2008/09 to 2010/11. During this period, South Africa will see the transition to its fourth democratically elected government.

AsgiSA crystallises government's efforts to realise higher growth

The centrepiece of government's Programme of Action is to halve the rate of unemployment and the proportion of people living in poverty between 2004 and 2014[1]. To achieve these objectives, it is critical to raise the rate of economic growth and to make sound interventions in the interests of poor and marginalised communities. The introduction of the Accelerated and Shared Growth Initiative (AsgiSA) has crystallised government's efforts in this regard.

Government's priorities for 2004-2009

A framework to enhance the social, cultural and economic welfare of all South Africans

This MTBPS is informed by the priorities set out in the 2004 Programme of Action, and also takes account of strategic and policy changes announced by the President in the annual State of the Nation addresses. In summary, government's strategic framework seeks to enhance the social, cultural and economic welfare of all South Africans by:

- Accelerating the pace of growth and the rate of investment in productive capacity
- Facilitating decisive interventions to accelerate the pace of job creation
- Investing in community services and human development, and maintaining a progressive social security net
- Improving the capacity and effectiveness of the state, including combating crime and promoting service-oriented public administration
- Building regional and international partnerships for growth and development.

Solid progress in meeting major development objectives

Progress in expanding economic opportunity, creating jobs, increasing investment, reducing poverty and broadening human development is summarised in the Presidency's recently released *Development Indicators Mid-term Review.* Since 2004 government has succeeded in raising the average annual rate of economic growth to 5 per cent compared with 3.3 per cent between 1999 and 2004. Employment has risen by about 2.7 per cent a year since 2001 – faster than at any point in the previous two decades. The proportion of people living below an indicative poverty line has fallen from 52.1 per cent in 1999 to 43.2 per cent in 2006. The proportion of national income spent on fixed investment, which contributes to future production, has risen from 15 per cent in 2002 to 20.7 per cent in the first half of 2007.

Needs and expectations are still a long way from being met

While these achievements deserve to be celebrated, they do not meet the needs and expectations of all of South Africa's people. In the period ahead, the pace of economic growth must be accelerated, the labour-absorption capacity of the economy must be increased, and the quality of government's social and household services must be stepped up.

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[1] The unemployment rate was 28 per cent in 2004 and the poverty headcount index (based on a poverty line of about R3 000 per capita per year in 2000 prices) was 47 per cent. The estimated unemployment rate in March 2007 was 25.5 per cent and the poverty headcount index 43.2 per cent.

Economic policy takes account of increased uncertainty in the world economy

The 2007 MTBPS focuses on accelerating social progress through sustaining rapid economic growth and employment creation over the long term. This requires careful management of shorter-term risks on the macroeconomic front, such as crises in the financial markets of developed countries and volatile commodity prices. It also requires appropriate economic and social policy reforms to improve competitiveness, broaden participation and expand opportunities and capacity. While analysts' forecasts continue to suggest robust growth for the period ahead, there is probably greater uncertainty in the economic environment today than at any point in the past six years. More rapid and sustainable growth requires both structural reforms and improved policy implementation.

Economic risks, fiscal policy and real income growth

Sound economic management requires careful analysis of the risks, and the identification of economic and budgetary policies that will sustain high rates of growth and more rapid job creation. Concurrently, alongside South Africa's social security system, government must continue to broaden the social wage, which makes a tangible difference in poor and marginalised communities.

Rising investment and higher consumption have not been fully matched by rising savings and domestic production. The consequence of this imbalance is that the import bill has risen sharply and buoyant demand has contributed to inflationary pressures. The sustainable solution to this problem is to increase domestic productive capacity, earning export revenue to pay for rising capital imports. Although South Africa benefits from relatively high commodity prices and global growth, the size of the current account deficit signals the need to improve trade and industrial performance to compete on a broader front in the global economy.

Fiscal policy adjusts for cyclical factors

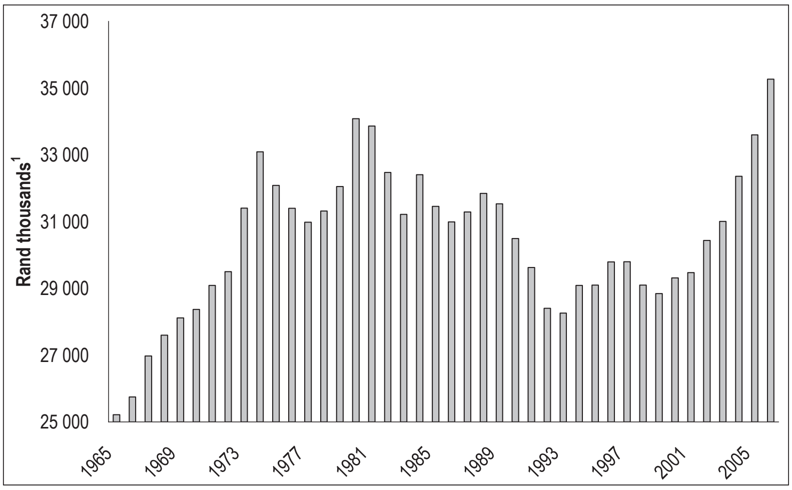
Fiscal policy over the past few years has increasingly taken account of the economic cycle. Government revenue performance fluctuates in response to economic fortunes, influenced in turn by the economic performance of our major trading partners, commodity prices, interest rate cycles, inflation trends and business profitability. These are complex factors that affect the economy and tax revenue in ways that cannot be fully modelled or predicted. In the face of potentially destabilising cyclical factors, it is important to adopt a policy stance oriented towards stable long-term growth.

Introducing the structural budget balance

In this MTBPS the National Treasury introduces the concept of a structural budget balance as a contribution to more systematic and consistent adaptation of the fiscal stance to cyclical factors. Simply put, when economic conditions are good, as they are now, we must invest and save in a manner that allows us to maintain public spending and societal welfare when economic conditions turn less favourable, as they inevitably will.

South Africans today have incomes that are, on average, about 22 per cent higher in real terms than they were in 1999. Household income at all levels has risen due to higher rates of employment, salary increases, lower real interest rates, tax relief, rising social spending, and rising house and asset prices. These gains follow improved economic performance and sound policy implementation since 1994. Yet millions of South Africans continue to live in poverty, so we must accelerate the pace of economic growth and social transformation.

Figure 1.1 Gross national income per capita, 1965 - 2006



1. Denominated in constant 2007 rand values.

Sustaining macroeconomic gains

In recognition of cyclical factors, a moderate budget surplus is proposed

To sustain these gains and make further progress in reducing poverty, a strong fiscal position needs to be carried forward over the medium term. The framework proposed for the 2008 Budget, taking into account current cyclical factors, reflects a moderate budget surplus continuing over the next three years. Government's approach is to use the windfall revenues from favourable economic conditions to invest in physical and human infrastructure – investments that will yield results for decades to come – and to increase the level of savings so that when these windfall revenues abate, resources will be available to spend on key priorities.

Public spending continues to grow strongly and in real terms is now double what it was in 1995

Public finances have benefited demonstrably from higher economic growth. Non-interest public spending has risen by an average of 9.4 per cent a year in real terms for five years and is now twice as large, in real terms, as in 1995. Per capita spending has risen from about R6 800 per person in 1995 to R10 560 per person in real 2007 prices. Higher public spending has allowed government to increase the number of police on the streets, introduce no-fee schools for the poorest 40 per cent of learners, expand the social grant system to benefit over 12 million people, scale-up the comprehensive HIV and Aids programme, build more than 2 million homes, electrify more than 3 million homes, provide water to 16 million people and deliver free basic municipal services to more than 70 per cent of the population.

South Africa experiencing an accelerated rate of urbanisation

The Community Survey released by Statistics South Africa in October 2007 reaffirms the steady progress made in extending services to the poor, and also discusses some complex features of social change. Gauteng, Western Cape and KwaZulu-Natal have all experienced strong population growth. The pace of urbanisation has accelerated over the past five years, consistent with improved economic opportunities in our major cities. Such demographic shifts have profound social and economic policy implications, and will be taken into account in the equitable share distribution between provinces.

As spending growth moderates, efficiency must improve

For several years, the rate of real growth in public spending has been substantially higher than the rate of real gross domestic product (GDP) growth. This cannot proceed indefinitely, although for the period ahead government expenditure will continue to benefit from sound fiscal policy, falling debt interest costs, efficiency gains in revenue collection and a broadening tax base as a result of the growing economy.

The fiscal framework anticipates a gradual slowdown in real growth in public spending from over 9 per cent a year to about 6.4 per cent a year, which is still somewhat higher than economic growth.

Allocating resources to ensure the greatest impact on poverty

As the rate of growth in public spending moderates, it becomes crucial to allocate money to those programmes with the highest rate of social return, or which have the greatest impact on reducing poverty and unemployment over the long term. Many social and economic investments only yield benefits well into the future. Building power plants, railway lines, ports, laboratories or further education and training centres will contribute to higher productivity in the long term. Nevertheless, these are crucial investments if our country is to raise growth and living standards for future generations.

Raising the standard for departments to be more efficient

Allocating resources correctly is only half the battle. We must also focus on using resources efficiently to deliver better value for money, and better-quality services for each rand spent. The 2008 Budget will place particular emphasis on improving the efficiency of public spending, partly by getting departments to report on their outputs in a transparent manner. In addition, national departments will be asked to find efficiency savings of about R2.3 billion over the next three years by limiting spending on unnecessary entertainment, travel and hotel accommodation; misplaced branding and communication initiatives; poorly managed consultancy services; and related frills. The intention is to shift more resources to the frontline of service delivery.

New format for the MTBPS this year

This MTBPS varies somewhat from the format of previous years. The document is more of a concise policy statement, reflecting both economic policy and budget priorities. The MTBPS is not intended to be a mini-budget; rather, it provides a perspective on government's view of the economy in the period ahead and sets out the proposed budget framework. Allocations to departments will be set out in the main budget in February and in separate budgets for each province.

Improved format for presentation of numbers

The 2007 MTBPS introduces an improvement in the format of numbers used in National Treasury documents. In line with international practice, a full stop is used to indicate a decimal point. Previously, a comma was used. A space is still used to delimit thousands (e.g. R12 345 or R12 345 678).

The remainder of Chapter 1 provides a synopsis of the subsequent chapters.

Overview

Economic policy and macroeconomic outlook

Chapter 2 discusses the macroeconomic outlook and provides a perspective on government's economic policy. It assesses the economy, presents the economic forecasts for the next three years, discusses risks to the outlook and closes with a discussion of key economic policy issues.

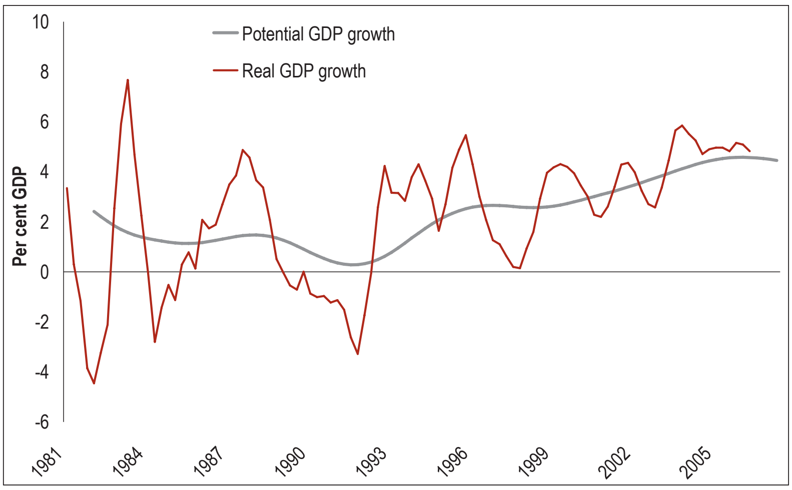
Economy must transform to absorb more labour and grow more rapidly

The core objectives of economic policy are to accelerate growth, raise employment levels and provide poor and marginalised communities with the human capital and physical infrastructure to participate in the formal economy. Recognising that deep structural flaws in the economy in place for much of the 20th century have trapped millions of people in poverty and left a significant gap in incomes, the economy needs to transform to absorb more labour and grow more rapidly to generate the resources to invest in higher production.

Structural reforms of 1990s put the country on a higher growth path

The structural reforms that were achieved during a difficult period in South Africa's economic transformation in the 1990s have placed the economy on a new growth path. Trend growth, or the rate at which the economy can grow sustainably without the occurrence of significant imbalances, has been increasing steadily since 1994. After averaging just below 3 per cent a year for the 1990s, it is now about 4.5 per cent.

Figure 1.2 Real and potential GDP, 1981 - 2007



Reforms needed to raise growth rate above 6 per cent

To raise the sustainable rate of growth above 6 per cent, a series of reforms are required. The 2007 Budget speech listed a number of requisites for more rapid growth, including:

- Exporting more goods and services, and accelerating investment in areas of competitive advantage
- Raising productivity levels and generating more jobs
- Cutting bureaucratic red tape that hobbles business
- Improving the performance of the public sector
- Enhancing infrastructure capacity, especially in relation to telecommunications, rail, roads, ports, electricity and water.

Economy likely to grow by 4.9 per cent this year

Economic growth remains strong and is projected at 4.9 per cent for the whole of 2007. The most robust activity is concentrated in construction, manufacturing and services. This is supported by strong domestic demand and rising fixed investment, which has grown by over 15 per cent in the first six months of this year, reaching 20.7 per cent of GDP. The AsgiSA target of raising the level of gross fixed capital formation to 25 per cent by 2014 is imminently achievable. The economic expansion has strengthened job creation and increased fiscal revenue, contributing to rising living standards.

High current account deficit due to import intensity of capital investment

Partly driven by capital imports, the current account deficit averaged 6.7 per cent over the first half of this year. A high current account deficit is a natural phenomenon when an economy increases investment rapidly. In the period ahead, supply-side reforms such as eliminating bureaucratic obstacles, investing in skills, and improving transport and communications will complement industrial policy initiatives to raise productivity and exports.

Global growth has slowed marginally since the February 2007 Budget. Demand in the United States, the world's largest economy, is subsiding and global financial markets are still assessing the full impact of the US subprime mortgage crisis. High oil prices and rising inflation, even in countries such as China and India, pose risks to the world outlook. Global growth is expected to slow to 4.8 per cent next year from over 5 per cent this year.

GDP growth to average about 5 per cent over next three years

Despite increased global risk and slowing international demand, the South African economy is still expected to grow by an average of about 5 per cent a year for the next three years. However, the pace of economic expansion is expected to cool somewhat in 2008, reflecting the impact of tighter monetary policy and slower growth in developed markets. Inflation has been above the target range since April 2007, driven both by higher food and fuel prices and evidence of second-round effects coming through from higher wage settlements. The price of oil is a significant obstacle to the task of bringing inflation down within the target by early next year.

Slower household consumption offset by higher fixed investment

The macroeconomic forecast for the next three years is summarised in Table 1.1 below. A central feature of this forecast is that slower household consumption growth will be offset by higher fixed investment. South Africa's investment needs and the capital imports required to support infrastructure expansion will likely exceed the economy's ability to raise export performance, resulting in a relatively large current account deficit.

Table 1.1 Macroeconomic projections, 2006 – 2010

Calendar year	2006	2007 Estimate	2008	2009 Forecast	2010
Percentage change unless otherwise indicated					
Final household consumption	7.3	6.6	4.2	4.5	5.3
Gross fixed capital formation	12.7	15.4	10.4	10.5	11.1
Real GDP growth	**5.0**	**4.9**	**4.5**	**4.8**	**5.3**
GDP at current prices (R billion)	**1 727**	**1 965**	**2 183**	**2 401**	**2 659**
CPIX	4.6	6.2	5.4	4.6	4.5
Current account balance (% of GDP)	-6.5	-6.7	-6.9	-7.7	-7.8

Fiscal policy and revenue trends

Government will balance investment with need for higher savings

Over the next three years, fiscal and tax policy will have to balance continued investment in public infrastructure and services with the need to raise government savings in response to the cyclical element of revenue collection.

During the late 1990s, government's fiscal policy aimed to reduce public borrowings to prevent a debt spiral and to take pressure off inflation and real interest rates, which curtailed both business investment and household consumption.

For a number of years government has made implicit use of cyclical factors to inform fiscal policy. This MTBPS introduces the concept of a structural budget balance to take account of these factors, mainly as they affect revenue collection. Put simply, high consumption expenditure and high commodity prices raise revenue temporarily, and these cyclical revenues need to be managed differently from structural growth in the revenue base. Otherwise, we risk living beyond our means.

Non-interest spending grows by 6.4 per cent a year over 2008 MTEF

Strong economic performance has allowed public spending to grow by more than 9 per cent a year in real terms for five years. In the period ahead, non-interest public spending continues to rise, at about 6.4 per cent a year in real terms, again focused on rising capital spending and broadening access to household services. Education, health and welfare spending increase strongly in real terms. The public sector wage bill also rises to accommodate higher salary increases for key professionals in the public service and to take account of rising employee numbers in health and criminal justice.

Government continues to budget for a surplus

The tax-to-GDP ratio has increased by nearly 5 per cent of GDP over the past six years as a result of improved revenue collections, base-broadening efforts and faster growth. This increase has mainly occurred in company taxes. Revenue has grown despite lower tax rates and substantial personal income tax relief. Higher tax revenue has allowed for an improvement in the fiscal balance, and part of this revenue has gone to fund higher public spending.

Fiscal framework projects a relative moderation in revenue buoyancy over medium term

The fiscal framework for the next three years indicates a relative moderation in revenue buoyancy due mainly to higher capital investment by companies and slightly slower growth in household consumption. Debt service costs continue to decline in line with decreasing public debt. The consolidated national budget balance (including social security funds) remains in surplus over the period at just below 1 per cent of GDP. Taking into account cyclical factors in revenue growth, the structural budget balance reflects a deficit of about 0.6 per cent of GDP over the forecast period.

Table 1.2 Consolidated national government, 2006/07 – 2010/11

R billion	2006/07 Outcome	2007/08 Estimate	2008/09 Medium-term estimates	2009/10	2010/11
Revenue	**501.6**	**575.6**	**641.1**	**707.6**	**770.3**
Percentage of GDP	*28.1%*	*28.5%*	*28.7%*	*28.8%*	*28.3%*
Expenditure	**484.0**	**559.4**	**618.5**	**686.3**	**749.0**
Percentage of GDP	*27.1%*	*27.7%*	*27.7%*	*27.9%*	*27.5%*
Budget balance[1]	**17.6**	**16.2**	**22.6**	**21.3**	**21.3**
Percentage of GDP	*1.0%*	*0.8%*	*1.0%*	*0.9%*	*0.8%*
Gross domestic product	*1 787.3*	*2 019.1*	*2 230.3*	*2 458.9*	*2 723.8*

1. A positive number reflects a surplus.

Tax policy aims to broaden the tax base, improve administration and simplify the tax system to raise compliance. Revenue gains from broadening the tax base and improvements in compliance can be used to moderate rates in certain areas. However, it would not be prudent to use cyclical revenues to provide permanent tax relief.

State-owned enterprises likely to increase borrowings for infrastructure investment

The surplus on the main budget creates room for higher investment and borrowing by businesses and the wider public sector. Taking into account substantial investment plans over the next decade, borrowing by state-owned enterprises is expected to increase. Similarly, it is anticipated that municipalities will increase borrowings now that their financial health has improved.

Medium-term budget priorities and the division of revenue

Additional R81.4 billion for public spending

The budget framework adds a further R81.4 billion to spending over the next three years. Together with strong real growth in the baseline, the additional spending allows for public expenditure to rise by about 6.4 per cent a year in real terms.

Budget priorities include the following:

- Investing in human and physical capital to ensure long-term growth
- Improving the quality of education, health and other public services and targeted anti-poverty programmes
- Extending coverage of basic household services such as water, sanitation and electricity, and reducing the number of people living in informal settlements
- Improving the efficacy of the criminal justice sector

- Supporting targeted interventions in the economy that raise productivity and efficiency, and fostering international partnerships for development.

National departments will improve efficiency and increase accountability

The 2008 Budget will also signal a renewed focus on efficiency, cost-containment and value for money. The sequencing of government's plans needs to be well managed, and spending programmes need to complement one another. Programmes that are critical to the success of other initiatives, such as system improvements in the Department of Home Affairs, or expanding early learning opportunities as a foundation for improving school performance, will find favour in the 2008 Budget.

Provincial and local government receive most of nationally raised revenue

The division of revenue continues to reflect a strong flow of nationally raised resources to provincial and local government to fund key priorities. Local government continues to receive a disproportionately large share of additional resources in the proposed framework for the 2008 MTEF. Investing in household infrastructure and services and the provision of free basic services – the broadening of the social wage – remain high on government's agenda. Increased transfers for public transport infrastructure are also supported. Municipalities are set to receive R12.6 billion or 15.4 per cent of the additional revenue allocated in the next budget.

Higher allocations support school infrastructure improvements and learners with special needs

Provinces also gain relative to the national sphere due to higher allocations for school infrastructure, early learning opportunities, occupation-specific dispensations, expanding the school nutrition programme and for more places for learners with special educational needs. Programmes aimed at preventing and treating HIV and Aids and multidrug-resistant tuberculosis receive support. The hospital revitalisation programme and tertiary health services will benefit from supplementary funding. The housing programme receives additional resources. Total additions to provincial budgets amount to R36.1 billion or 44 per cent of further allocations.

National departments receive 40 per cent of additional amounts

Additional amounts for national departments, excluding conditional grants to provinces and municipalities, amount to 40 per cent of the available pool, including further financial support for several state-owned enterprises.

Conclusion

The *Medium Term Budget Policy Statement* seeks to encourage public debate on the economic challenges ahead and government's budget priorities. Comments on the MTBPS can be emailed to tipsfortrevor@treasury.gov.za, or posted to:

"Tips for Trevor"
Ministry of Finance
Private Bag X115
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2

Economic policy and outlook

- After a period of rapid expansion in the world economy, the global outlook has become more uncertain, characterised by rising costs of credit and slower growth in major economies.
- South Africa's outlook remains favourable as a result of vigorous investment and high commodity prices. Sustained increases in public spending on economic and social infrastructure, and expanding employment, have contributed to improved welfare for millions of South Africans. Over the medium term, accelerated infrastructure development will crowd in private-sector investment and sustain healthy economic growth. A strengthened fiscal position will boost domestic savings and competitiveness. However, rising inflation and a substantial current account deficit are signs of stress in the macroeconomic balance.
- The large current account deficit is an outcome of investment growing more rapidly than domestic saving, and a signal that more needs to be done to improve the efficiency of production, expand exports and accelerate growth. To increase export levels, microeconomic and regulatory reforms are required to reduce economic costs, spur productivity, boost new business creation, and remove bottlenecks in transport and logistics networks. Continued investment and improved outcomes in education and skills development are crucial for growth.

Domestic outlook

GDP growth forecast

In recent years South Africa has benefited directly from macroeconomic stability, robust growth in the world economy and high commodity prices. Low domestic inflation and a marked increase in global liquidity contributed to comparatively low funding costs for rapidly growing investments.

Macroeconomic stability, global growth and high commodity prices have boosted domestic economy

Macroeconomic policy continues to promote growth and competitiveness. The fiscal stance reflects the use of buoyant revenue to invest in physical and human infrastructure, and to increase government savings. These policies support the continued rise in investment as a share of overall growth.

4.9 per cent GDP growth projected for 2007

GDP growth has averaged 4.5 per cent a year since 2003 and about 1.3 million new jobs were created during this period. For 2007, economic growth is expected to be 4.9 per cent. This positive outlook continues over the medium term, with GDP growing by 4.5 per cent in 2008, nearly 5 per cent in 2009, and a projected 5.3 per cent in 2010.

Growth to moderate in 2008 as a result of subprime crisis and slower growth in domestic consumption

The expected moderation in growth in 2008 is largely a result of two factors: slower growth in developed markets as a result of the subprime mortgage crisis in the United States and the associated credit crunch; and slower, more sustainable growth in domestic consumption as the effect of higher interest rates takes hold. Although commodity prices have risen over the past year, record-high oil prices will act as a drag on growth. In addition, higher oil and food prices have put pressure on unit labour costs and domestic inflation.

Inflation remained above the 3-6 per cent target range from April through September of this year. Inflationary pressures have broadened. Cumulative interest rate hikes by the Reserve Bank, totalling 350 basis points since 2006, should in time lead to a moderation of domestic demand and contain inflation expectations. CPIX inflation is expected to average 6.2 per cent in 2007, before declining within the target band over the medium term.

Positive spin-offs from hosting the 2010 FIFA World Cup will boost economic activity

Growth in output should accelerate from 2009 onwards as the global environment improves and the supply capacity of the economy expands. Positive spin-offs from 2010 FIFA World Cup preparations will also boost economic activity over the medium term.

Investment has risen from about 15 per cent of GDP in 2002 to nearly 21 per cent of GDP in the first half of 2007. Investment spending increased by 15.5 per cent in the first half of 2007 compared with the first half of 2006, driven by a 30.7 per cent rise in spending by state-owned enterprises.

Table 2.1 Key labour market indicators, September 2001 – March 2006
(Official definition of unemployment)

Labour market category Thousands	March 2003	March 2006	March 2007
Employed	**11 304**	**12 451**	**12 648**
Unemployed	*5 116*	*4 275*	*4 336*
Total economically active[1]	16 420	16 726	16 984
Not economically active	**12 337**	**13 126**	**13 211**
Total aged 15 - 65 years	28 757	29 852	30 195
Unemployment rate	**31.2**	**25.6**	**25.5**
Labour force participation rate	57.1	56.0	56.2
Labour absorption rate	39.3	41.7	41.9

Source: Labour Force Survey, March 2003, March 2006, March 2007

1. Employed and unemployed.

Investment in fixed capital has grown rapidly, including long-term infrastructure development and capacity expansion in electricity generation, transport and telecommunications. Private-sector investment is also expected to be robust, especially in services, mining, construction and manufacturing.

Expanded employment, rising wages and relatively low interest rates have contributed to rapid growth in household consumption, which has averaged 5.5 per cent a year since 2002. In the first half of 2007, household consumption expanded at a brisk 7.4 per cent, and is expected to slow to a more sustainable rate of 4-5 per cent a year over the forecast period. Real government consumption spending is projected to grow by about 6 per cent a year over the medium term.

Nearly 200 000 new jobs were created in the year to March 2007

The Labour Force Survey for March 2007 shows an increase in total employment to 12.6 million jobs compared with 11.3 million jobs in March 2003. Nearly 200 000 net new jobs were created between March 2006 and March 2007. Employment creation has been consistent with economic expansion over the past three years, but much more needs to be done to improve labour absorption.

Growth pattern has contributed to current account deficit

The specific pattern of growth in recent years has contributed to South Africa’s large current account deficit, which increased from 3 per cent of GDP in 2004 to a projected 6.7 per cent of GDP in 2007. The challenge this presents to economic policy is discussed later in this chapter. Government’s policy stance of building foreign reserves has reduced the vulnerability of the economy to external shocks and moderated the rise in the exchange rate driven by the commodity price boom. Capital inflows, which have for several years more than covered the current account deficit, are expected to remain healthy.

Table 2.2 Macroeconomic projections

Calendar year	2004	2005	2006	2007	2008	2009	2010
		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
Final household consumption	6.7	6.6	7.3	6.6	4.2	4.5	5.3
Final government consumption	6.3	5.2	5.4	6.5	6.1	5.5	5.6
Gross fixed capital formation	8.9	9.6	12.7	15.4	10.4	10.5	11.1
Gross domestic expenditure	7.9	5.9	8.7	5.5	4.8	5.9	6.4
Exports	2.9	8.0	5.5	8.4	4.8	5.3	6.3
Imports	14.5	10.7	18.4	9.8	5.6	8.5	9.1
Real GDP growth	**4.8**	**5.1**	**5.0**	**4.9**	**4.5**	**4.8**	**5.3**
GDP deflator	5.8	4.7	6.9	8.5	6.3	5.0	5.1
GDP at current prices (R billion)	**1 398.2**	**1 539.0**	**1 727.5**	**1 965.0**	**2 182.7**	**2 401.2**	**2 659.2**
CPIX (average for year)	4.3	3.9	4.6	6.2	5.4	4.6	4.5
Current account balance (% of GDP)	-3.2	-4.0	-6.5	-6.7	-6.9	-7.7	-7.8
Fiscal year			**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
			Actual	**Estimate**		**Forecast**	
GDP at current prices (R billion)			**1 787.3**	**2 019.1**	**2 230.3**	**2 458.9**	**2 723.8**
Real GDP growth			**5.2**	**4.7**	**4.5**	**4.9**	**5.4**
GDP deflator			7.6	7.9	5.7	5.1	5.1
CPIX (average for year)			4.9	6.5	4.9	4.5	4.5

Risks to the economic outlook

Global and domestic concerns may pose risks to the outlook

The primary risks to the growth forecast fall into two broad categories: firstly, global financial contagion could slow global growth, impacting on commodity prices, capital flows and emerging market prospects, and secondly, the risks associated with South Africa's current account deficit and weak export performance. In this section, we review the international economic environment and provide a synopsis of South Africa's external position.

The global economic environment

International economic growth to remain robust but slows in 2008

Global growth is forecast at 5.2 per cent in 2007 and 4.8 per cent in 2008, down from 5.4 per cent in 2006. Significant features of the international economic environment include the following:

- The credit crunch will expose some countries to heightened financial volatility, especially those economies with significant current account deficits and inflation pressures.
- The US economy has been weakening since early 2006. GDP growth is forecast to moderate to 1.9 per cent in 2007 and 2008, down from 2.9 per cent in 2006. There are risks to this outlook given the severity of the housing market correction. Table 2.3 also suggests slower growth in Europe and Asia in 2008.
- In contrast, a number of emerging market and developing economies continue to grow strongly. The Chinese economy is expanding at a feverish pace, with GDP growth of 11.5 per cent expected in 2007 and 10.0 per cent in 2008. India's economic boom is also strong although expected to moderate slightly over the next two years.

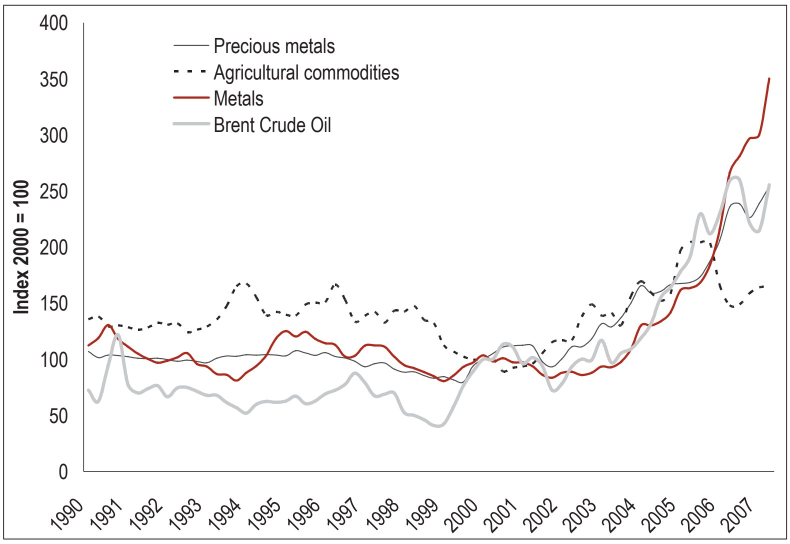
Table 2.3 Trends and projections of global growth and inflation, selected countries, 2006 – 2008

Country/region	2006*	2007	2008	2006*	2007	2008
	Growth projections			CPI projections		
World**	**5.4**	**5.2**	**4.8**	**3.6**	**3.9**	**3.6**
US	2.9	1.9	1.9	3.2	2.7	2.3
Euro zone	2.8	2.5	2.1	2.2	2.0	2.0
UK	2.8	3.1	2.3	2.3	2.4	2.0
Japan	2.2	2.0	1.7	0.3	–	0.5
Emerging markets and developing countries	**8.1**	**8.1**	**7.4**	**5.1**	**5.9**	**5.3**
Developing Asia	**9.8**	**9.8**	**8.8**	**4.0**	**5.3**	**4.4**
China	11.1	11.5	10.0	1.5	4.5	3.9
India	9.7	8.9	8.4	6.1	6.2	4.4
Africa	**5.6**	**5.7**	**6.5**	**6.3**	**6.6**	**6.0**
Sub-Saharan Africa**	**5.7**	**6.1**	**6.8**	**7.3**	**7.6**	**6.7**
South Africa*	5.0	4.9	4.5	4.6	6.2	5.4

Source: IMF, World Economic Outlook, October 2007
**National Treasury Forecast*
*** CPI projections exclude Zimbabwe*

- Sub-Saharan Africa continues to perform well. Growth is projected to rise from 5.7 per cent in 2006 to 6.1 per cent in 2007 and 6.8 per cent in 2008, partly due to the completion of new oil production facilities in Angola and Nigeria. Southern African Development Community economies are growing strongly, by an expected 6.9 in 2007 and 7 per cent in 2008.
- The outlook for metals prices remains healthy, supported by strong demand. Platinum rose above US$1 400/oz in October 2007, while gold rose to a 27-year high of US$771/oz, driven by the falling dollar and rallying oil prices. Commodity prices in general are likely to remain volatile.
- Energy and agriculture prices will continue to increase global inflation pressures. After averaging US$67/barrel in the first 9 months of the year, the price of Brent crude oil for immediate delivery rose above US$85/barrel in October.

Figure 2.1 World commodity prices, 1990 – 2007



The international economic environment holds greater risks for South Africa than it has in some time. Nonetheless, world growth is expected to remain supportive of high commodity prices as a result of continued growth in major emerging market economies and the effects of lower interest rates in some advanced economies. Higher energy and food prices will remain a longer-term source of concern.

Continued growth in major emerging markets boosts international economy

Financing the current account deficit

South Africa's balance of payments position remains positive despite the growing mismatch between savings and investment reflected in the deficit on the current account.

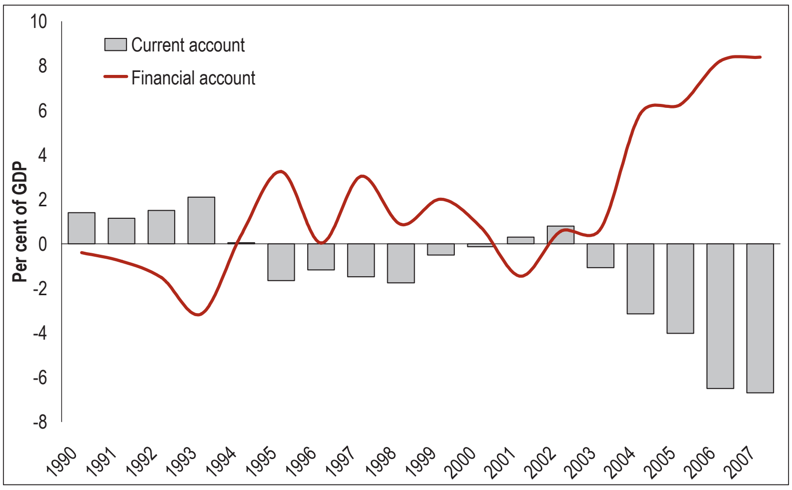
Balance of payments position remains positive

From 1994 to 2002 the current account deficit averaged 0.6 per cent of GDP. Since 2001, the economy has required higher levels of imported intermediate goods and capital goods for investment, while real income growth and lower interest rates have raised household consumption. The cumulative result has been a significant deterioration of the trade balance from a surplus in 2003 to a deficit of 2.5 per cent of GDP in 2006.

Current account rose to 6.7 per cent in first half of 2007

These same factors, alongside sharply higher oil prices, pushed the deficit on the current account to 6.7 per cent of GDP during the first half of 2007 from 6.2 per cent in the first half of 2006.

Figure 2.2 Overall balance of payments, 1990 - 2007



Strong demand for South African bonds and equities

Strong domestic growth, high commodity prices and sound macroeconomic fundamentals have stimulated global demand for South African bonds and equities. Non-residents have purchased R226 billion worth of shares on the Johannesburg stock exchange since 2004. As a result, the surplus position on the financial account remained large at 8.4 per cent of GDP in the first half of 2007, compared to 7.6 per cent for the first half of 2006.

Net portfolio inflows of R55.8 billion were recorded in the first half of 2007, compared to R82.2 billion during the same period last year. Non-residents were net purchasers of R33.2 billion worth of shares and R22.6 billion of bonds in the first half of 2007.

Net foreign direct investment amounted to R6.5 billion in the first six months of 2007.

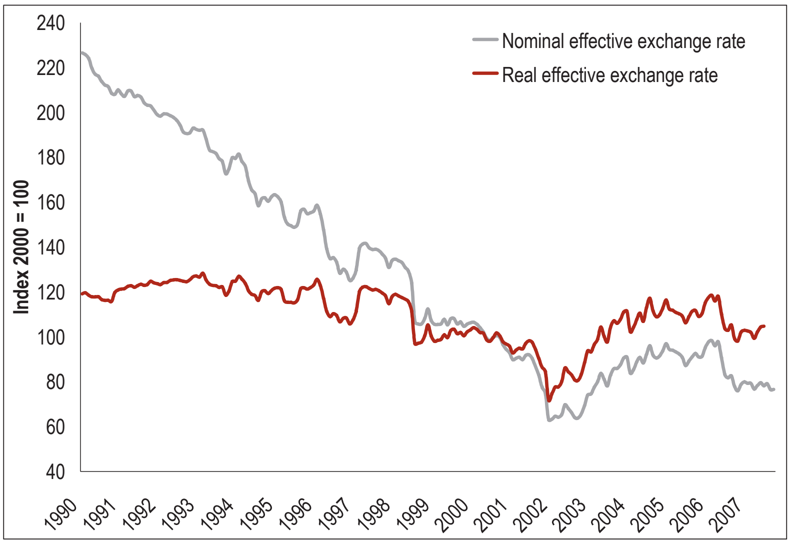
Real effective exchange rate of the rand has been relatively stable during 2007

The sustained flow of capital into South African assets has pushed the nominal exchange rate of the rand to levels consistent with its position prior to the financial contagion of 2001. Although the real effective exchange rate declined by about 10 per cent in 2006, it has rebounded somewhat, remaining relatively stable through the first nine months of 2007.

Vulnerability to external shocks has decreased as government boosts reserves

South Africa's vulnerability to external shocks has declined as government increased its foreign exchange reserves and reduced short-term foreign liabilities. Gross gold and other foreign exchange reserves reached US$30.5 billion at the end of September 2007, US$4.9 billion higher than at the end of 2006. Net reserves, or the international liquidity position, increased from US$23 billion at the end of 2006 to US$28.4 billion at the end of September 2007.

Figure 2.3 Real and nominal effective exchange rate indices, 1990 - 2007

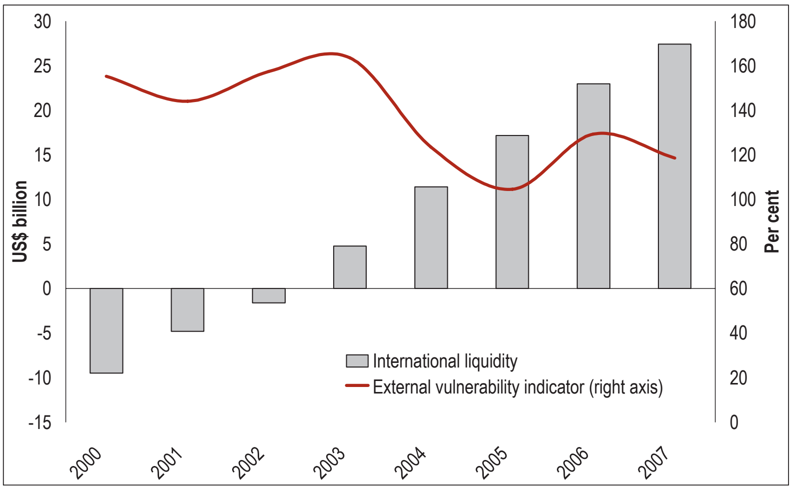


The capital inflows that finance the deficit are driven by greater portfolio investment into emerging markets generally, continued confidence in South Africa's economic outlook and rising interest rate differentials between South Africa and developed markets.

The possibility of sudden and large capital outflows cannot be eliminated

In an environment of greater uncertainty, economies with significant vulnerabilities are at greater risk of financial contagion. So while most emerging markets have benefited from improved macroeconomic fundamentals, this does not eliminate the possibility of sudden and large capital outflows. In South Africa's case, the economy is borrowing to pay for its investment, which highlights the importance of ensuring that investment will generate improved economic growth over the long term.

Figure 2.4 International liquidity position and external vulnerability, 2000 - 2007[1]



[1]External vulnerability is defined as the current account deficit plus short-term, foreign currency denominated debt (including longer-term debt maturing within 12 months), divided by gross reserves.

Greater effort is needed to boost exports and sustain investment levels

The global shift in investment to emerging market and developing economies has helped South Africa to finance domestic capital spending. However, greater effort needs to be made to boost exports to increase the sustainability of the recent domestic investment boom.

Policy challenges

Policy focuses on faster growth, job creation and reducing poverty

South Africa's primary economic policy challenges are to increase the pace of economic growth, expand employment and reduce poverty.

To meet these challenges, production needs to grow more rapidly, and businesses must use available human, physical and financial capital more efficiently. Government's macroeconomic policies aim to maintain a stable economic environment and prevent inflation from undermining competitiveness. Microeconomic interventions need to lower the cost of doing business and improve efficiency, skills, productivity and innovation, so that competitive producers of goods and services will be able to sell in international markets. Getting these policies right will in turn help to ease financing constraints for investment.

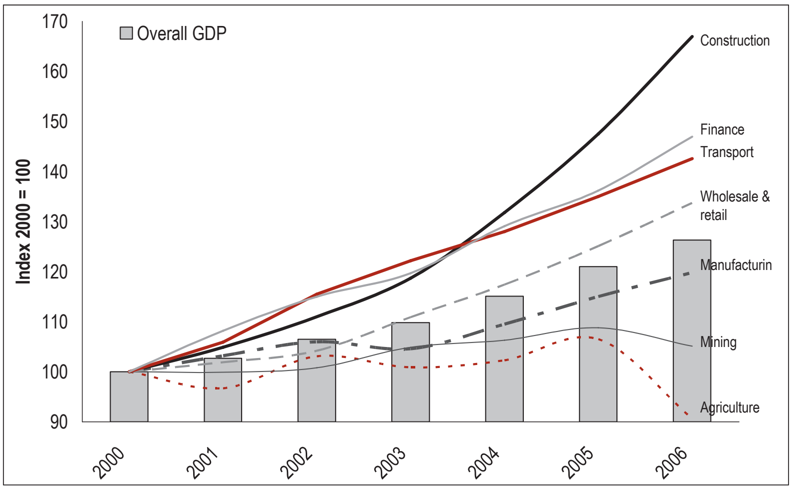
This section reviews key policy issues to be addressed to boost GDP growth above 6 per cent a year and draw more people into economic activity.

Fostering transformation and business creation

Long-term trends show a structural shift in South African economy

Long-term growth trends show a shift of the structure of the South African economy away from mining and agriculture, and towards services, as indicated in Figure 2.5. Manufacturing has remained stable as a share of the economy for several decades, although its constituent parts have changed considerably.

Figure 2.5 Sectoral trends, 2000 - 2006



Exceptional long-term growth in a given economic sector can result from two factors: a structural shift in demand for outputs, such as with the computer industry; or continuous innovation that improves each generation of product and/or reduces its cost.

In an enterprise economy, companies that are more productive succeed and expand, drawing in capital and labour from those that are less productive and less successful. Policy approaches to corporate insolvency and income loss can support the creation of new businesses, and can ease the release of capital and labour from failing firms into new ventures.

Policy stresses both productivity and a strengthened safety net

Government's approach is to support overall improvements in the productivity of the South African economy while providing a strong safety net for those who are displaced. Work on a new social security dispensation includes a review of the existing safety net, including the efficacy of unemployment insurance. Investment in skills also increases the ability of people to respond to technological change.

Developing human capital a core objective of Jipsa

Developing human capital is a core objective of government spending that underpins both the Joint Initiative on Priority Skills Acquisition and the broader skills framework. Broadening access to the labour market and economic activity for new entrants and mature workers is necessary for growth. An environment of ample skilled labour, low costs of capital, and legal and regulatory systems that facilitate competition will be more supportive of long-term expansion and productivity.

Broadening access and drawing people into formal economic activity is key

Broadening access and drawing people into more formal economic activity is crucial. Construction, financial services, transportation and communications, and wholesale and retail trade have exhibited better long-term growth than other sectors, in part because they are structurally more open to new businesses and have lower fixed costs. Here, government policies that foster transformation and enhance competition are important to economic outcomes. Black economic empowerment policies can help new market entrants and indirectly contribute to higher productivity.

Financial sector shows impressive growth

The Financial Sector Charter has helped to expand the market for financial services to many people previously excluded because of high costs and inappropriate products. For example, some 4 million people have signed up for the low-cost Mzansi accounts. This has contributed to higher industry growth rates. Value added in the finance, insurance, real estate and business services sector grew by 8.2 per cent in 2006 before easing to 6.5 per cent in the first six months of 2007. About 300 000 jobs were created in this sector between September 2001 and March 2006.

Growth in real value added by the construction sector rose to 16.5 per cent in the first half of 2007 compared to the same period in 2006. Activity has been boosted by an expansion of civil works projects and increased construction of non-residential buildings, which has compensated for a slowdown in housing-related investment.

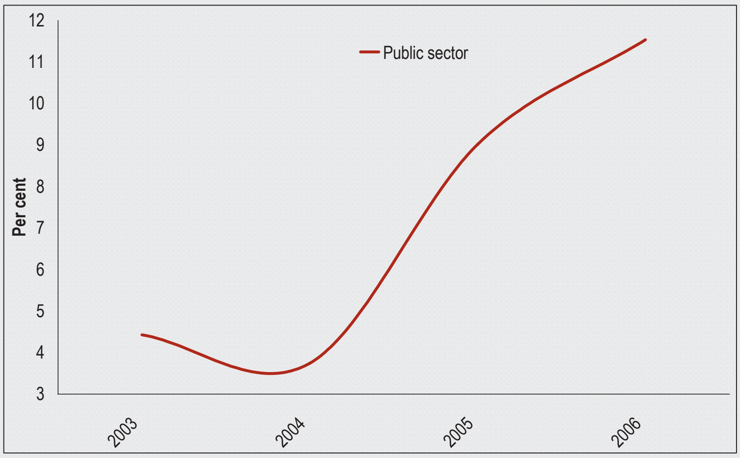
2010 FIFA World Cup infrastructure projects provide strong growth impetus

Construction-related real fixed investment increased at an exceptional rate of 32.3 per cent in the first half of 2007 after growing at an average annual rate of 16.5 per cent since 2002. Infrastructure projects related to the 2010 FIFA World Cup and the upgrading and expansion of power generation and transport infrastructure will continue to drive growth over the medium term. Employment creation in the sector has been robust, with about 320 000 jobs created since 2001.

Building supply capacity in the construction industry

The significant increase in capital investment over the past four years has resulted in increasing supply-side pressures in the construction industry. This is evident from increasing prices and shortages of skills and building materials. The construction boom has forced suppliers to import cement and to contract more workers to meet demand. These constraints are a signal to the sector of the need to increase productive capacity and intensify training to meet demand for skills.

Price escalation for construction works, 2003 - 2006

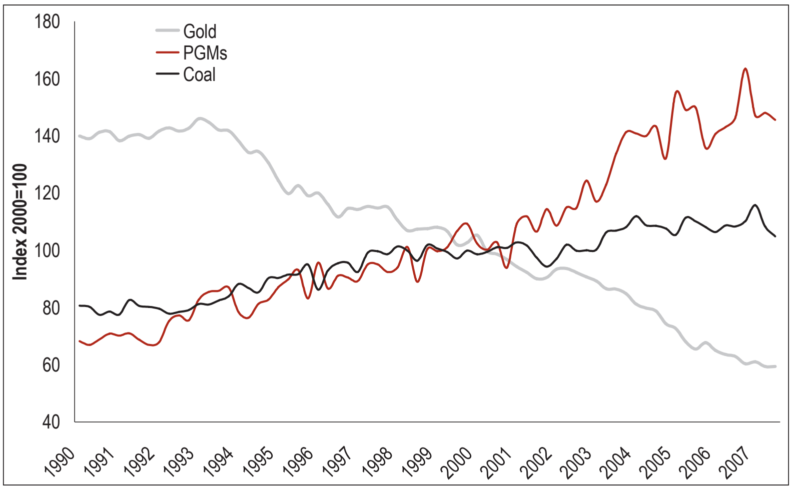


Source: SARB data

The construction industry typically operates within a volatile cycle, which inhibits investment in supply capacity. Given large-scale construction plans, government seeks to manage its fixed investment programme in a way that will sustain growth in the sector. While several infrastructure projects and stadium construction have boosted current activity, major transport and power generation investments are being planned that will extend over the next 10 years and beyond. Greater certainty about capital spending plans helps the industry to invest further in skills and supply capacity.

Mining sector production has been disappointing considering the remarkable rise in commodity prices over the past few years. Mining production increased by only 0.2 per cent in the year to August 2007, weighed down by a 6 per cent decline in gold output. Production of platinum group metals and coal increased by 1.6 and 1.8 per cent respectively.

Figure 2.6 Mining production by commodity, 1990 - 2007



After contracting sharply in 2004 and 2005, fixed investment in mining has started to respond to high commodity prices. In the first half of 2007, mining recorded an impressive 33 per cent increase in real investment, compared with 14.8 per cent for 2006 and a decline of 13.2 per cent in 2005. Signs of a recovery are evident in the employment numbers, with a 7.4 per cent increase in the number of mining jobs in June 2007 compared to the same period in 2006.

Fixed investment in mining is starting to pick up

The agriculture sector remains vulnerable to changes in global demand and shifts in the climate. Over the past two years drought took a toll on domestic agricultural production. The agriculture, forestry and fisheries sector contracted by 1.2 per cent in the first half of 2007 compared to the same period in 2006. Farmers are also grappling with rising costs for fertiliser, tractors and fuel. Over the longer term, climate change could result in reduced rainfall over parts of the country. Projected long-term shifts in weather patterns need to be factored into policy development, and support mechanisms such as crop loss insurance for new and distressed farmers may require consideration.

Effects of climate change on agriculture need to be factored into policy

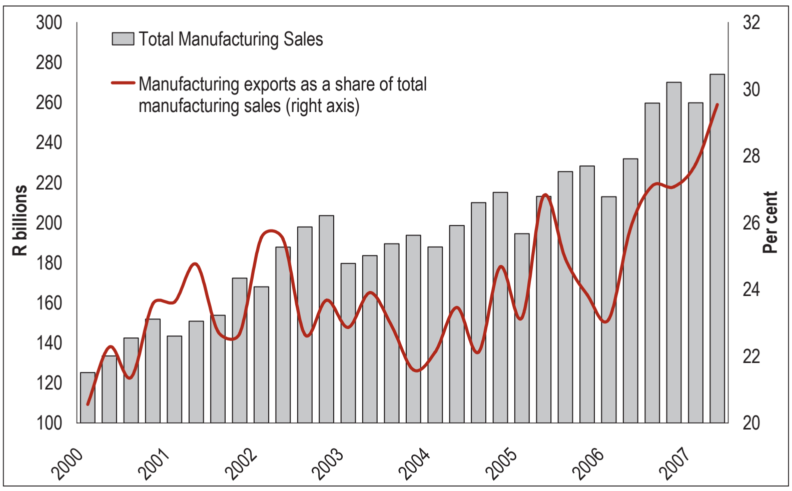
Accessing and growing global demand

Reintegration with the world economy in the 1990s had the major structural effect of helping South African exporters to take advantage of greater openness to access and to exploit global markets. Yet this shift was limited to certain sectors and (mostly large) producers. Many companies have not taken advantage of export opportunities or have struggled to gain a foothold in international markets.

Relatively few South African companies have penetrated international markets

To boost economic growth beyond 6 per cent in coming years, it is crucial for South African companies to take advantage of market access and systematically expand global market share in manufacturing, agriculture, mining and services.

Figure 2.7 Manufacturing sales and exports, 2000-2007



Policy adjustments must support developing export capacity of economy

The case for policy adjustments to develop exports is clear. South Africa's export performance is strong in base metals, minerals, automobiles and some chemicals, but inconsistent and weak in other manufactured exports.

Manufacturing gross value added has increased at an average rate of 4.9 per cent a year since 2004, and 3.9 per cent since 2000. Output grew by 5.1 per cent in the year to August 2007, driven by sustained levels of domestic expenditure and higher exports. The real value of manufactured exports increased by 18.2 per cent in the first half of the year, dominated by basic iron and steel and non-ferrous metals, which account for half of total manufacturing exports. Exports of some niche market products such as pumps and valves, gas purifying systems, and motor vehicle engines have also done well.

Research by Presidency, National Treasury stresses need for diversified manufacturing base

Economic research undertaken on behalf of the Presidency and the National Treasury has stressed the long-term importance of developing a diversified, export-oriented manufacturing base. This requires competitive input costs, markets that are open to foreign competition to create innovation incentives, and addressing market failures where they occur.

Industrial policy is part of this discussion. The basic economic idea of industrial support measures is to increase productivity, and hence the volume of production and use of inputs. Getting the balance of objectives right in industrial support programmes, and amending them when needed to increase efficiency and address flaws, is an important focus of current policy reviews.

The Motor Industry Development Programme, to take one example of South African industrial policy, has been successful in promoting exports, stabilising employment and increasing investment in related component industries. However, it has also been costly.

Government is working to develop sound and affordable industrial policy interventions

Government has taken some important steps forward in deciding what level of analysis is required to devise sound and affordable industrial policy interventions. Those incentives that result in higher levels of productivity, innovation and reduced unit costs will be favoured, with the aim of encouraging businesses to boost exports in highly competitive global markets.

Some net economic gains could be achieved through further tariff reduction and simplification that promotes innovation in production and market strategy. In some sectors, such as textiles and clothing, tariffs remain high enough to maintain producer profitability even with competition. The tariffs maintain profitability of domestic firms and boost profitability of foreign exporters at the expense of South African consumers – but there has been little new investment, while wages have stagnated and employment levels have not increased.

Depreciation allowances used to encourage investment

Investment depreciation allowances are one lever that government uses to encourage investment. Mining, manufacturing and small businesses are targeted. Depreciation allowances have contributed to higher real investment in manufacturing, which has increased at an annual average of 11.4 per cent since 2004, and 8.7 per cent in the first six months of 2007.

Table 2.4 Annual percentage change in exports and imports, 2003 – 2006

Products exported	2003	2004	2005	2006
Base metals	2.5%	30.6%	2.3%	19.6%
Chemical products	-20.3%	13.3%	21.8%	5.9%
Food products	-9.5%	-7.4%	15.7%	9.6%
Machinery	-12.6%	8.0%	11.4%	35.5%
Mineral products	-21.1%	1.3%	38.1%	22.1%
Other	-45.6%	-5.2%	9.2%	2.8%
Precious and semi-precious stones	21.9%	7.4%	2.8%	33.0%
Textiles	-15.0%	-20.2%	-9.7%	-0.3%
Transport (including motor vehicles)	-8.9%	-0.7%	28.5%	17.4%
Total	**-12.7%**	**6.9%**	**12.0%**	**20.9%**
Products imported				
Base metals	-6.1%	19.7%	13.8%	54.8%
Chemical products	-14.7%	6.7%	13.6%	20.3%
Equipment	-13.8%	10.9%	15.6%	27.0%
Machinery	-7.5%	12.8%	15.1%	32.5%
Mineral products (including oil)	-9.0%	41.9%	13.6%	67.7%
Other	-6.2%	11.4%	15.8%	21.2%
Textiles	-7.0%	23.6%	11.1%	28.1%
Transport (including motor vehicles)	17.2%	34.5%	13.8%	17.8%
Total	**-6.0%**	**18.6%**	**14.6%**	**32.5%**

Source: South African Revenue Service, January 2007

More competition has been supportive of investment and productivity in network industries. In the transport sector, for example, the relative ease of transporting freight by road instead of rail has highlighted the need for renewal of rail freight services, efficiency gains and lower costs to rail freight users.

Greater competition has supported investment and productivity in network industries

The transport sector has been a major driver of growth due to the expansion and upgrade of the main airports, the expansion of the Richards Bay Coal Terminal, 2010 FIFA World Cup site preparations and construction related to the Gautrain. Real investment by the transport sector accelerated to 24.6 per cent in the first half of 2007 compared with 19.4 per cent during 2006.

Trade reform and productivity

International trade is a key determinant of economic growth and employment. The simplification and reduction of tariffs has stalled in recent years, following a period of rapid reform in tariff and trade policy in the 1990s. Significant tariff peaks still exist and effective rates of protection have increased in some sectors despite considerable tariff reductions. This is because duties on intermediate goods and final products are higher than the duties on raw materials, which leads to tariff escalation. High rates of protection reduce the profitability of exports relative to domestic sales. In South Africa high protection rates are found in textiles, leather, footwear, clothing, motor vehicles, parts and accessories and in food processing.

Trade reform increases productivity by encouraging businesses to become more efficient. Higher productivity growth improves the competitiveness of import-competing firms and exporters. Investment in trade-related infrastructure such as transport and telecommunications and in effective skills development programmes helps to make the boost in economic growth more inclusive. To take better advantage of strong economic growth in the rest of the world and with the continuing impasse in the World Trade Organisation's Doha round, a more unilateral approach to capturing the economic gains of lower tariffs may be appropriate.

Less restricted operating environment is needed in telecommunications sector

It is also recognised that a less restricted operating environment in the telecommunications sector would have strong positive economic effects and raise growth beyond the 5.4 per cent achieved in this sector in the first half of 2007.

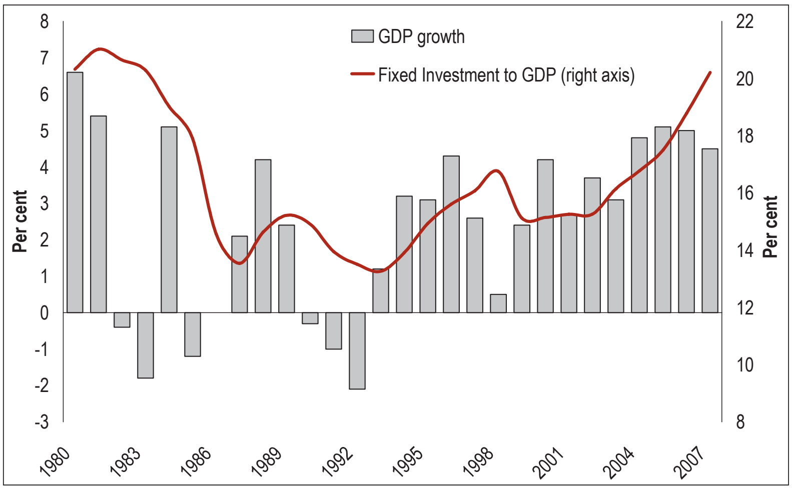
Sustaining growth with lower inflation

Energy and food price spike have driven inflation

In South Africa, as with any small and open economy, rapid increases in investment spending put pressure on domestic capacity, raise imports and push up prices. Over the past year, a spike in energy and food prices has added to inflationary pressures. The policy challenge is to maintain robust investment and economic growth while keeping inflation from rising, undermining competitiveness of the economy and pushing up the cost of capital.

Investment has played a major role in strong economic growth, rising from about 15 per cent of GDP in 2002 to nearly 21 per cent in the first half of 2007. The ratio of fixed investment to GDP of 25 per cent by 2014 should be achieved ahead of schedule, helping to reduce capacity constraints and supporting sustained higher growth.

Figure 2.8 Gross fixed capital formation and GDP growth, 1980 – 2007



Household consumption should moderate in response to rate hikes and National Credit Act

Household consumption expenditure continued to expand at the brisk pace of 7.4 per cent in the first half of 2007. Rising interest rates and the effects of the National Credit Act will help to slow excess growth in spending. Spending on interest-sensitive durable goods has already slowed. Over time, the ratio of household debt to disposable income, which had reached a high level of 76.6 per cent in June this year, will return to more sustainable levels.

Overall growth in the broad measure of money supply (M3) and private-sector credit is expected to remain strong given robust demand from the corporate sector to finance investment and the general rise in income across the economy.

CPIX inflation above the target band

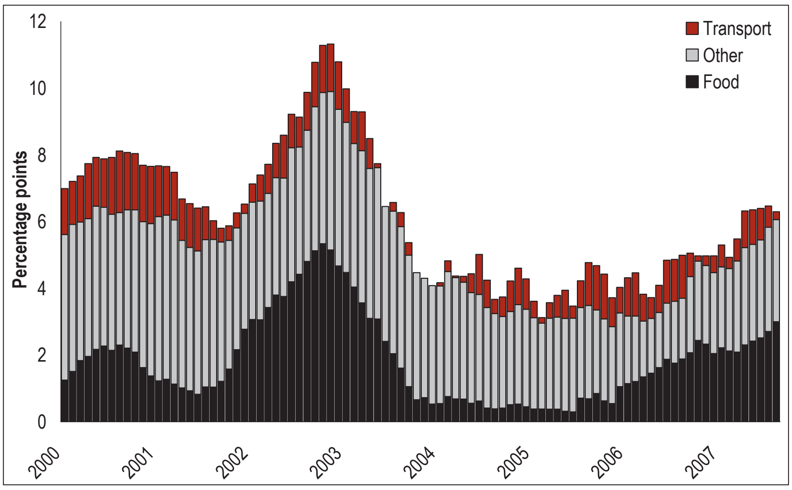
After remaining between 3 and 6 per cent for 43 months, CPIX inflation breached the upper end of the target band in April 2007 and remained above target through September. External shocks to food and oil prices have been the primary drivers of inflation over the past year, but inflation pressures have broadened recently due to the weaker rand, buoyant demand and capacity limits in domestic industry.

Inflation expectations on the rise

Sharp upward adjustments in homeowners' costs in July – assessment rates, refuse removal, water and electricity – have added to pressure on service price inflation, which rose by 5.8 per cent year on year in September. Inflation expectations and wage settlements have also moved higher after a period of relative stability.

There is significant wage pressure in the economy following a series of strikes in the first nine months of the year. Average wage settlements are expected to be in the range of 7 to 8 per cent in 2007 from 6.5 per cent in 2006. Real wage settlements have averaged about 2 per cent since 2003 and will remain close to that level this year.

Figure 2.9 Contributions to CPIX inflation, 2000-2007



Upward pressure on wage settlements poses a risk to the inflation outlook if productivity growth does not keep pace. Productivity grew by 2.4 per cent in the first quarter of this year, which was roughly the same pace as in 2006, but lower than the rate of 4 per cent achieved in 2005. Unit labour costs increased by 3 per cent and 5 per cent respectively in 2005 and 2006.

Greater investment in skills and education required

Low and stable inflation promotes economic growth and helps to keep the economy internationally competitive. Rising inflation over the past year highlights the need for more balanced growth, which can be achieved as household consumption moderates, and as capacity constraints ease as a result of sustained investment. Greater investment in education and skills development is also necessary to reduce wage pressures in key sectors where skilled labour is in short supply and for employment generally.

Conclusion

South Africans are on average considerably better off today than they were in 1999 as a result of more rapid increases in real income, lower borrowing costs and more widely available public services. These achievements have been supported by growing public sector investment in infrastructure, a stable financial environment and significantly improved terms of trade in an expanding world economy.

South Africa needs to expand both exports and production

Future growth needs to reflect a much stronger expansion in South African exports and production. Improved export growth alongside the accumulation of foreign reserves will help to reduce the economy's exposure to international financial risks.

A more explicit focus on export capacity also supports government's efforts to broaden participation, reduce poverty, and make more meaningful the idea of shared growth through more rapid job creation and small enterprise development.

3

Fiscal policy

- The 2008 budget framework reinforces government's commitment to sustainable growth and development, providing strong real growth in expenditure while steadily reducing the debt burden on future generations.
- Tax revenue remains buoyant and is expected to exceed expenditure over the next three years. Improved budget balances provide for increased government savings in response to greater risk to the economic outlook over the medium term. The budget position enables government to contribute to containing inflation and current account pressures, and creates the fiscal space required to continue to invest in infrastructure and better public service delivery. The main budget surplus of 0.6 per cent of GDP – or 0.9 per cent including the social security funds – also creates room for anticipated growth in borrowing for capital projects by state-owned enterprises, municipalities and the private sector.
- The improved sustainability of the fiscus is reflected in the structural budget balance. As an estimate of what the budget balance would be if temporary tax revenues were removed, the structural budget balance averages a deficit of 0.6 per cent of GDP over the period ahead.

Overview of medium-term fiscal policy

Fiscal policy has enabled the public sector to make a major contribution to improved welfare

Robust economic growth over the past five years has provided greater fiscal resources to support growth in government expenditure. Average annual real growth in central government non-interest spending of more than 9 per cent a year since 2003/04 has allowed the public sector to make a substantial contribution to the welfare of all South Africans by expanding the social wage, increasing transfers to households, and accelerating infrastructure investment and service provision.

South Africa's economic outlook is positive. GDP growth is expected to remain healthy, averaging about 5 per cent over the medium term. However, the global economic environment is marked by greater uncertainty today than in recent years. In the event of sharply slower world growth or a reversal of capital inflows to emerging markets, South Africa's high current account deficit and inflationary pressures could expose the domestic economy to heightened risk, putting pressure on the fiscus and government's development programme.

Framework takes account of risks by improving government savings

The 2007 *Medium Term Budget Policy Statement* (MTBPS) takes account of these risks by setting out a fiscal framework that provides for a moderation in government expenditure growth, while further improving government savings and investment.

Table 3.1 Fiscal trends and projections

Calendar year	2002 – 2006		2006 – 2010
Average annual real growth			
Gross fixed capital formation			
General government[1]	7.0%		12.2%
Public corporations	14.8%		19.4%
Government consumption expenditure			
Compensation of employees	1.8%		4.5%
Non-wage	9.3%		7.0%
Government transfers to households	21.7%		9.4%
Fiscal year	**2002/03**	**2006/07**	**2010/11**
Percentage of GDP			
Interest on public debt	4.4%	3.4%	3.2%
General government savings	-1.0%	0.6%	1.0%
Public sector borrowing requirement	1.4%	-0.2%	1.2%
General government tax revenue	25.3%	29.5%	29.4%

1. General government refers to the accounts of national government, provincial government and local government, the social security funds, extra-budgetary institutions, adjusted to net out flows between government institutions.

Expenditure and revenue

Government expenditure continues to grow strongly

In line with government's commitment to poverty reduction and development, expenditure continues to grow in real terms over the medium term.

Higher spending over the medium-term expenditure framework (MTEF) will continue to be financed mainly by tax revenue. Despite a steady reduction in personal and corporate income tax rates over the past 10 years, tax revenue has grown from 25.2 per cent of GDP in 2000/01 to an estimated 29.5 per cent of GDP in 2006/07. The buoyancy in revenue has been supported by sustained economic growth, high commodity prices and relatively low interest rates. Growth in tax revenue is expected to moderate over the medium term as a result of higher business investment allowances and a slower rate of consumption growth.

Compensation of public sector employees accounts for the greatest share of government consumption expenditure and is expected to grow by about 4.5 per cent a year in real terms.

Three elements account for growth in the government wage bill. Firstly, higher-than-expected inflation for 2007/08 has been taken into account in the recently negotiated salary agreement. Secondly, in support of improved career progression and to retain high-quality personnel, occupation-specific remuneration dispensations have been developed. Finally, government employment is expected to continue to grow in support of broader access to and quality of public services.

Cost-of-living adjustments driven by higher inflation push up wage bill

Improvements in conditions of service for public-sector employees

The 2007 wage agreement takes account of higher-than-expected inflation by providing for salary adjustments of 7.5 per cent in 2007/08 and inflation plus 1 per cent for 2008/09. Employees at the lower end of the wage scale with long periods of service receive a larger once-off increase.

The payment of the non-pensionable housing allowance for permanent employees is fast-tracked, and the medical aid subsidy for employees on the Government Employees Medical Scheme has been adjusted. Outstanding issues related to overtime pay and Sunday work have also been resolved.

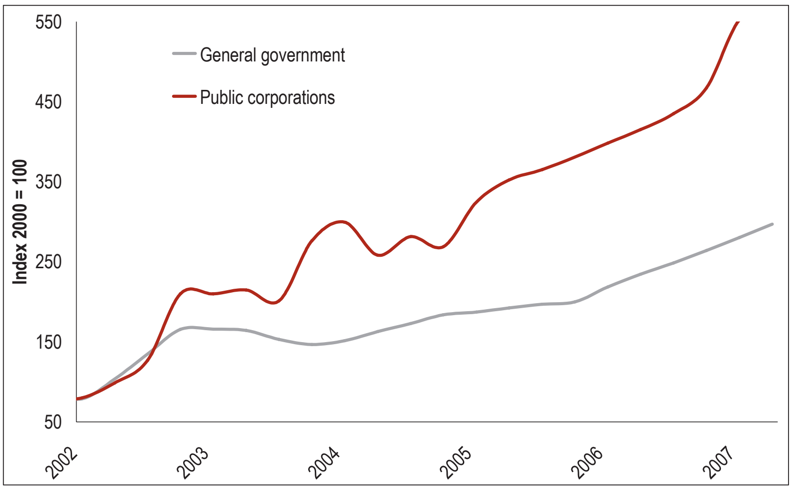
Occupation-specific dispensations

Occupation-specific dispensations aim to improve government's ability to attract and retain skilled employees, in part by allowing for diversified remuneration and career progression for a range of occupational categories previously grouped under a single salary structure.

Occupational groupings to be phased in over the next two years include health professionals (specifically nurses), educators, correctional services employees and legally qualified personnel in the justice system. The new dispensations will be implemented over the next three years, with priorities to be determined by agreement within sector bargaining councils. Career-pathing opportunities based on competencies, experience and performance are taken into account. Government seeks to attract and retain professional staff through improved recognition of career progression in the salary structure. A similar dispensation was put in place for police in 2005.

Fixed investment expenditure has grown strongly across all sectors of the economy. Government capital investment has increased at an average annual real rate of 7 per cent over the past five years. The pace of capital outlays by public corporations has also grown, with average annual real growth of 14 per cent for the past two years.

Figure 3.1 Real gross fixed capital formation by sector, 2002 - 2007



Source: SARB data

Investment in economic and social infrastructure remains a core government priority, with the goal of enhancing economic efficiency and broadening development. Continued growth in expenditure baselines reflects additional allocations to public transport, education, health, social development, justice and protection services, housing and land reform.

Public sector borrowing to increase to fund infrastructure investment

The public sector borrowing requirement is forecast to increase significantly over the next three years to about 1.2 per cent of GDP. This increase is driven by the accelerating capital investment programmes at all levels of the public sector, in particular the non-financial enterprises. The improved fiscal position of national government creates the space for the state-owned enterprises, municipalities and the private sector to increase their borrowing for capital purposes, without placing undue pressure on capital markets and interest rates.

Table 3.2 shows that over the medium term, public sector infrastructure expenditure plans total R482.4 billion. Public sector infrastructure plans account for about 6.5 per cent of GDP over the period ahead, up from 5.4 per cent in 2006/07. After several years in which actual spending has lagged behind budget allocations, infrastructure programmes are now well under way.

Support for school buildings, public transport, housing water and sanitation

Major funding proposals over the next three years include additions to the school building programme, public transport, housing, water and sanitation. In addition, non-financial public enterprises continue to invest in power generation, transmission, distribution, airports, ports, freight rail and pipelines.

Table 3.2 Infrastructure expenditure estimates, 2006/07 – 2010/11

	2006/07	2007/08	2008/09	2009/10	2010/11
R million		**Estimate**	**Medium-term estimate**		
National departments [1, 2]	4 626	4 810	5 601	6 367	8 899
Provincial departments [2]	26 731	32 709	34 432	42 481	44 502
Municipalities	21 441	28 768	30 663	33 871	36 773
Public private partnerships [3]	2 443	4 050	7 886	9 288	11 367
Extra-budgetary public entities	3 999	4 747	4 950	5 323	7 814
Non-financial public enterprises	37 176	53 165	64 570	63 956	63 687
Total	**96 416**	**128 249**	**148 102**	**161 286**	**173 042**
percentage of GDP	*5.4%*	*6.4%*	*6.6%*	*6.6%*	*6.4%*
GDP	1 787 311	2 019 148	2 230 281	2 458 882	2 723 837

1. *Transfers between spheres have been netted out.*
2. *Includes maintenance of infrastructure assets.*
3. *Infrastructure expenditure on PPPs overseen by the Treasury PPP Unit, South African National Roads Agency, Department of Public Works and at municipal level.*

Fiscal sustainability

Economy is receiving a cyclical boost

The South African economy, is subject to temporary global and domestic cyclical factors. In recent years, high commodity prices and relatively low real interest rates have had a large impact on the pattern of growth. High investment and low savings have resulted in a large increase in the current account deficit and higher inflation.

Fiscal policy plays a role in supporting an orderly correction of these economic and financial imbalances, and smoothing volatility in expenditure over the cycle. In the context of current macroeconomic pressures and extraordinary buoyancy in revenue, it is recognised that government should contribute positively to national savings. By not spending the full value of buoyant tax revenues, government helps to limit current account and inflationary pressures, and takes some pressure off domestic interest rates, contributing to the sustainability of economic growth.

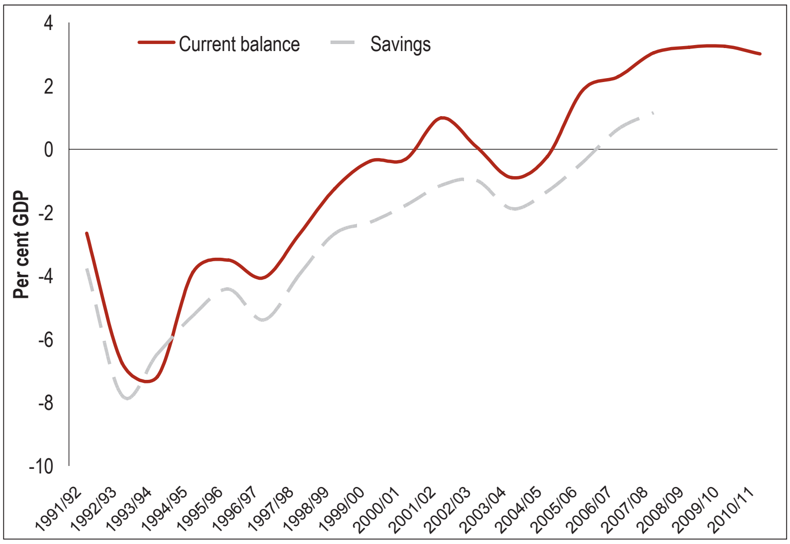
Government saves a share of tax revenue to offset economic risk

Figure 3.2 shows the current balance (measured on the consolidated government level as current income less current expenditure) and general government savings. The current balance is a useful proxy for government savings, with consumption of capital stock and local government savings accounting for the difference between the two.

In 2006, for the first time since 1981, government savings moved into a positive position. Given their relationship to investment levels and the current account balance, savings are an important indicator of economic stability. As household and corporate savings continue to indicate a decline, improved government savings are an important contribution to strengthening the macroeconomic outlook. In combination with lower debt levels, these savings also provide a buffer against future cyclical revenue reductions. This allows government to continue to meet its expenditure priorities without negatively affecting welfare by cutting other expenditure, raising taxes or borrowing excessively.

Improved government savings provide a buffer against a decline in cyclical revenue

Figure 3.2 General government savings and current balance, 1991/92 – 2010/11



The budget framework

The budget framework presented in the 2007 MTBPS takes into account the consolidated revenue and expenditure of the social security funds in addition to the main budget. This provides for a more

Social security funds' revenue and expenditure shown in main budget complete view of the revenue and expenditure activities of government and their effects on the economy.

Tax revenue as percentage of GDP moderates over the medium term

Growth in gross tax revenue is expected to continue to increase as a percentage of GDP next year, before moderating over the medium term in response to higher business investment and the lagged effects of lower consumption expenditure. The movement in gross tax revenue is the main factor driving consolidated national revenue from 28.5 per cent in 2007/08 to 28.8 per cent in 2009/10, before declining to 28.3 per cent in 2010/11.

Table 3.3 Consolidated national government, 2006/07 – 2010/11

R billion / *per cent*	2006/07	2007/08 Estimate	2008/09	2009/10 Projections	2010/11
Main budget revenue					
Gross tax revenue	495.5	566.1	632.4	699.3	764.0
percentage of GDP	*27.7%*	*28.0%*	*28.4%*	*28.4%*	*28.0%*
plus: other non-tax receipts and payments	10.9	11.8	11.9	12.5	13.3
less: SACU transfers	-25.2	-24.7	-28.4	-32.1	-36.8
Total Revenue	**481.2**	**553.1**	**616.0**	**679.6**	**740.5**
Main budget expenditure					
State debt cost	52.2	52.9	51.2	51.0	50.4
percentage of GDP	*2.9%*	*2.6%*	*2.3%*	*2.1%*	*1.9%*
Non-interest expenditure[1]	418.0	489.4	548.7	614.6	675.8
percentage of GDP	*23.4%*	*24.2%*	*24.6%*	*25.0%*	*24.8%*
per cent real growth	*9.0%*	*9.8%*	*6.9%*	*7.2%*	*5.2%*
Of which:					
Increases over 2007 Budget		11.5	14.4	21.2	45.8
Unallocated		–	4.0	8.0	16.0
Total Expenditure	**470.2**	**542.4**	**599.9**	**665.6**	**726.2**
Main budget balance[2]	**11.0**	**10.8**	**16.2**	**14.0**	**14.3**
percentage of GDP	*0.6%*	*0.5%*	*0.7%*	*0.6%*	*0.5%*
Social security funds					
Revenue	20.6	22.9	25.6	28.5	30.3
Expenditure	14.0	17.4	19.1	21.2	23.3
Of which:					
Unemployment Insurance Fund	3.6	5.5	6.1	6.7	8.0
Compensation funds	2.9	3.2	3.5	3.7	3.9
Road Accident Fund	7.5	8.7	9.6	10.9	11.4
Consolidated national budget[3]					
Revenue	**501.6**	**575.6**	**641.1**	**707.6**	**770.3**
percentage of GDP	*28.1%*	*28.5%*	*28.7%*	*28.8%*	*28.3%*
Expenditure	**484.0**	**559.4**	**618.5**	**686.3**	**749.0**
percentage of GDP	*27.1%*	*27.7%*	*27.7%*	*27.9%*	*27.5%*
Consolidated national budget balance[2]	**17.6**	**16.2**	**22.6**	**21.3**	**21.3**
percentage of GDP	*1.0%*	*0.8%*	*1.0%*	*0.9%*	*0.8%*
Gross domestic product	1 787.3	2 019.1	2 230.3	2 458.9	2 723.8

1. Includes transfers to provinces and local government, the National Skills Fund and sectoral skills development funds.

2. A positive number reflects a surplus.

3. Flows between funds are netted out.

Main budget expenditure allows for 6.4 per cent real growth in non-interest expenditure over the 2008 MTEF, with R81.4 billion being added to the main budget framework. Of this, R20 billion is made available to compensate social grant recipients and government employees for higher-than-anticipated inflation, leaving R61.4 billion for allocation to new projects and enhanced service delivery. Because new policy initiatives often have long lead times, and given already strong expenditure growth in 2008/09 and 2009/10, the additional resources are mainly allocated in the final year of the MTEF. Including inflation adjustments, total new allocations are R14.4 billion in 2008/09, R21.2 billion in 2009/10, and R45.8 billion in 2010/11.

6.4 per cent real growth in non-interest expenditure over the 2008 MTEF

Including the expenditure of the social security funds, total consolidated national expenditure grows from 27.7 per cent of GDP in 2007/08 to 27.9 per cent of GDP in 2009/10, before declining marginally to 27.5 per cent of GDP in 2010/11.

Since peaking at 5.6 per cent of GDP in 1998/99, debt service costs have shown a steadily declining trend, and move further down from 2.9 per cent of GDP in 2006/07 to 1.9 per cent of GDP by 2010/11. The decline in debt service costs underscores the sustainability of the framework by providing fiscal space to accommodate cyclical volatility or to finance new priorities in the years ahead.

Debt service costs continue to fall as percentage of GDP

Table 3.4 Total government debt, 2004/05 – 2010/11

As at 31 March	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
R billion		**Outcome**		**Estimate**		**Medium-term estimates**	
Domestic debt	432.4	461.8	469.5	474.5	488.3	488.6	492.2
Foreign debt[1]	69.4	66.8	82.6	78.8	80.7	77.1	79.1
Gross loan debt	**501.8**	**528.6**	**552.1**	**553.2**	**568.9**	**565.7**	**571.3**
Less: National Revenue Fund bank balances	-30.9	-58.2	-75.3	-89.4	-116.8	-125.1	-141.9
Net loan debt[2]	**470.9**	**470.4**	**476.8**	**463.8**	**452.1**	**440.6**	**429.5**
As percentage of GDP :							
Net loan debt	*32.9*	*29.8*	*26.7*	*23.0*	*20.3*	*17.9*	*15.8*
Foreign debt	*4.9*	*4.2*	*4.6*	*3.9*	*3.6*	*3.1*	*2.9*
As percentage of gross loan debt:							
Foreign debt	*13.8*	*12.6*	*15.0*	*14.2*	*14.2*	*13.6*	*13.8*

1. Forward estimates are based on National Treasury's projections of exchange rates.
2. Net loan debt is calculated with due account of the bank balances of the National Revenue Fund (balances of government's accounts with the Reserve Bank and the tax and loans accounts with commercial banks).

Table 3.4 reflects the net and gross debt of national government. As a consequence of budget surpluses the debt burden on future generations continues to fall, with net loan debt reaching a low of 15.8 per cent of GDP by 2010/11. Over the forecast period cash balances of the National Revenue Fund are estimated to increase by R53 billion to R142 billion. The higher cash balances will be used to build reserves and manage the foreign debt.

Debt burden on future generations continues to fall

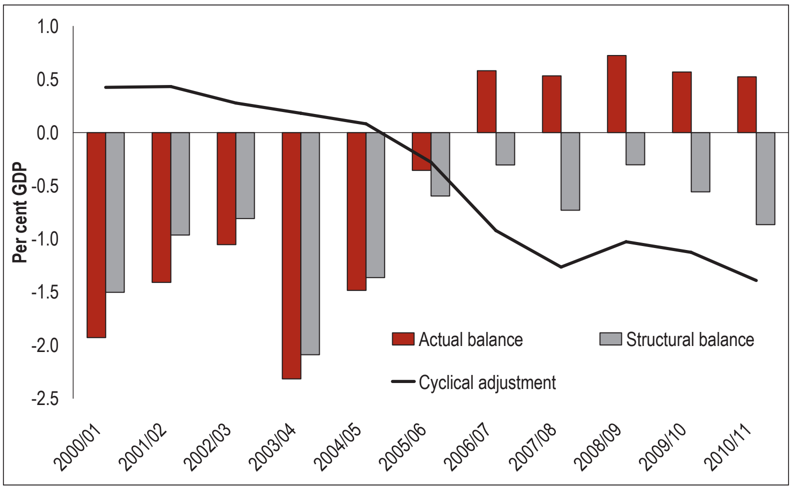
Budget balances

Structural budget balance estimates the budget balance excluding cyclical factors

The structural budget balance (also known as the cyclically adjusted budget balance) is an estimate of the budget balance after adjustment for cyclical revenue and spending. In arriving at the structural budget balance, the main budget balance is adjusted to take into account the cyclical under- or overperformance of revenue and cyclical deviations in spending trends. The resulting structural budget balance provides a useful indicator of the sustainability of the fiscal stance.

South Africa's economic cycle responds to the performance of its major trading partners, commodity prices, domestic and foreign interest rates, inflation trends and business profitability. Over the past five years, many of these factors have favoured domestic economic growth, resulting in generally positive cyclical factors, including commodity price strength and high levels of global liquidity. While commodity prices are expected to remain firm over the medium term, emerging weaknesses related to US economic growth and increased global inflation pressures may threaten this forecast.

Figure 3.3 Main budget and structural budget balances, 2000/01 – 2010/11



High commodity prices, low interest rates have fuelled strong revenue growth

The strong revenue performance of recent years has a cyclical component. High commodity prices have boosted mining profits, while low interest rates have spurred profitability in the retail, banking and construction sectors. High consumption spending has also contributed to higher VAT receipts. Where companies have used cyclical profitability to employ workers, the positive effects of the economic cycle will have also boosted personal income tax receipts.

Cyclical value of revenue must be factored into framework

To the extent that part of the present tax revenue trend can be attributed to the economic cycle, the main budget and consolidated budget surpluses of about 0.6 per cent over the medium term overstate the fiscal position. By running a moderate budget surplus, government has the fiscal space to increase borrowing to finance expenditure priorities when the cycle turns without placing an excessive financing burden on the economy.

Preliminary National Treasury calculations estimate that the value of revenue derived from cyclical activity will remain in excess of the main budget surplus over the MTEF. As a result, a share of the cyclical revenue is not saved and is allocated to expenditure. To maintain fiscal sustainability and avoid excessive volatility in the financing of government expenditure over the economic cycle, it is necessary that these amounts not saved be invested in physical and human capital development that serves to lift the potential growth rate of the economy.

Cyclical revenue not saved should be invested to lift potential growth rate of the economy

The structural budget balance

An economy has a "potential" or 'trend' level of GDP growth determined by its state of development and utilisation of capital and labour. Economies may perform better or worse than their potential level for a period of time. These periods of over- or underperformance are cyclical, because the economy tends to return to its potential level. Sustainable growth is about expanding this output potential over time. Determining the extent of the cycle is extremely complex; however, rising inflation and a burgeoning current account deficit are signals that an economy is performing above potential.

Generally, when an economy is in the positive phase of the business cycle, tax revenue will over-perform. The resulting improvement in the budget balance is temporary, and an economy seems "richer" than it really is. The structural budget balance adjusts by subtracting this revenue in the positive phase of the business cycle, and making the opposite adjustment in a downturn. These calculations provide a more accurate picture of the real budget balance, allowing for informed policy decisions that avoid permanent expenditure or tax decisions based on temporary revenue events.

The structural budget balance (also known as the cyclically adjusted balance) is calculated by estimating the cyclical components of revenue and expenditure. This is done by considering differences between potential and actual GDP growth, shifts in the composition of tax revenue, and cyclical estimates of key commodity export prices. The actual budget balance is adjusted by this amount to arrive at a structural budget balance. A more detailed discussion of the cyclical revenue estimate is available on the National Treasury website at *www.treasury.gov.za*.

Public sector borrowing requirement

Table 3.5 shows the anticipated public sector borrowing requirement for the period ahead, taking into account the current capital spending plans of state-owned enterprises, municipalities and other public entities.

Borrowing requirement widens over medium term

Table 3.5 Public sector borrowing requirement, 2006/07 – 2010/11

	2006/07	2007/08		2008/09	2009/10	2010/11
R billion	Outcome	Budget	Revised	Medium-term estimates		
Main budget balance[1]	**-11.0**	**-10.7**	**-10.8**	**-16.2**	**-14.0**	**-14.3**
Extraordinary payments	4.2	0.4	0.8	–	–	–
Extraordinary receipts	-3.4	-1.3	-2.6	-1.3	-1.3	-1.0
Financing requirement	**-10.2**	**-11.6**	**-12.6**	**-17.4**	**-15.3**	**-15.3**
Other government borrowing[2]	-2.3	3.1	-1.8	3.8	5.6	5.7
General government borrowing	**-12.5**	**-8.5**	**-14.4**	**-13.6**	**-9.7**	**-9.6**
Percentage of GDP	*-0.7%*	*-0.4%*	*-0.7%*	*-0.6%*	*-0.4%*	*-0.4%*
Plus: Non-financial public enterprises	8.1	13.6	19.9	32.1	36.4	41.5
Public sector borrowing requirement	**-4.4**	**5.1**	**5.5**	**18.5**	**26.8**	**31.9**
Percentage of GDP	*-0.2%*	*0.3%*	*0.3%*	*0.8%*	*1.1%*	*1.2%*
Gross domestic product	*1 787.3*	*1 938.9*	*2 019.1*	*2 230.3*	*2 458.9*	*2 723.8*

1. A negative number reflects a surplus and a positive number a deficit.

2. Includes social security funds, provinces, extra-budgetary institutions and local government.

Since 2002, buoyant economic conditions have boosted revenue receipts for all levels of the public sector. While capital expenditure plans have grown significantly, the implementation of these plans tends to lag behind revenue growth, resulting in significant public sector cash surpluses between 2002/03 and 2005/06.

The marked reduction of the public sector cash surplus over the past two years is largely the result of increased capital expenditure by local government and the public enterprises. Strong growth in capital expenditure plans by all levels of government is expected to lead to an increasing public sector borrowing requirement over the longer term.

Over the past three years, capital spending by non-financial public enterprises has been financed through operational revenue. As their infrastructure programmes have accelerated, the public enterprises have gone from a cash surplus of R10 billion in 2005/06 to a borrowing requirement of R8.1 billion in 2006/07. In raising finances from capital markets, public enterprises will generally be expected to borrow based on their own balance sheets. Both Eskom and Transnet have taken steps in this direction.

4

Tax policy

- Government continues to broaden the tax base, simplify the tax system and, where appropriate, reduce tax rates. The abolition of the retirement fund tax and reforms to the secondary tax on companies, including the proposed move to a dividend tax in the hands of shareholders in 2008 or 2009, are the latest major tax reforms.
- Revenue growth remains buoyant, reflecting continued increases in business profitability, high commodity prices, strong household spending, employment growth and higher salary increases. Due to a rebalancing of the economy away from consumption towards investment, revenue growth is slowing slightly and is expected to moderate further over the medium term. Over the past four years, government has learnt more about the cyclicality of revenue sources, and factors this information into analysis and forecasts.
- It is estimated that tax revenue collections during 2007/08 will exceed the budgeted amount by R9.5 billion, mainly as a result of higher inflation and higher wage settlements, which are reflected in rising personal income tax yields.
- Continued improvements in tax administration and a greater service-oriented approach from the South African Revenue Service (SARS) contribute to rising tax compliance and broader improvements in business accountability and transparency.

Introduction

Collection trends during the first half of the fiscal year suggest a tax revenue overrun of R9.5 billion for 2007/08. This healthy revenue performance is primarily the result of above-inflation wage settlements, increasing employment and sustained levels of profitability in the corporate sector.

Revenue continues to exceed estimates as a result of inflation and cyclical factors

A more modest tax overrun for 2007/08

Although the revised tax revenue estimates for 2007/08 will exceed the February 2007 budgeted figures, the anticipated overrun is more modest than those of the previous three fiscal years. This trend is reflected in consumption-related revenue instruments, such as VAT and the fuel levy, which are expected to be below budget estimates.

Factors contributing to moderation in consumption expenditure include rising interest rates and the implementation of the National Credit Act (2005). As the pattern of economic growth shifts towards higher levels of investment, revenue buoyancy is likely to decline marginally. However, strong commodity prices and higher-than-normal consumption spending imply that some of the revenue growth over the past three years, particularly in company taxes, is probably of a cyclical nature.

Cyclical revenue should either be invested in infrastructure or saved

Sound fiscal policy suggests that cyclical revenue overruns should either be invested in long-term economic or social infrastructure, or saved so that public expenditure growth remains sustainable. It is not prudent to spend cyclical tax revenues on recurrent expenditure or use it to provide tax relief given present conditions of buoyant demand.

Final draft Royalty Bill to be released

One tax policy matter that warrants specific mention is the Mineral and Petroleum Royalty Bill. A third and final draft of the bill will be released by mid-November 2007 for consideration by Parliament's Portfolio Committee on Finance. The new royalty regime is scheduled to start on 1 May 2009 to coincide with the conversion to the new mineral rights regime as required by the Mineral and Petroleum Resources Development Act (2002).

National budget revenue 2006/07

Audited main budget revenue for 2006/07 was R34.8 billion higher than the budget estimate

The audited main budget revenue outcome of R481.2 billion for 2006/07 was R34.8 billion higher than the original budget estimate of R446.4 billion and R5.4 billion higher than the revised estimate of R475.8 billion published in the 2007 *Budget Review*. The main variances in revenue were higher-than-budgeted:

- Income tax of R23.8 billion from the corporate sector
- Personal income tax revenues of R8.1 billion
- VAT collection of R3.3 billion.

The audited main budget revenue outcome for 2006/07 is presented in Table 4.1.

Medium-term revenue estimates

Gross tax revenue for 2007/08 is revised upwards by R9.5 billion

Based on revised macroeconomic projections set out in Chapter 2 and the revenue trends for the first six months of this fiscal year, expected gross tax revenue for 2007/08 is revised upwards by R9.5 billion to R566.1 billion. This is mainly due to extra revenues from personal income tax (R11.7 billion), secondary tax on companies (R2.0 billion) and corporate income tax (R1.6 billion).

Table 4.1 National budget revenue, 2006/07 estimates and audited outcome

R billion	Budget estimate	Revised estimate	Audited outcome	Deviation from Budget estimate	Deviation from Revised estimate
Taxes on income and profits	**245.8**	**274.3**	**280.0**	**34.2**	**5.7**
Persons and individuals	132.5	139.0	140.6	8.1	1.6
Companies	95.2	114.8	119.0	23.8	4.2
Secondary tax on companies	13.9	15.7	15.3	1.4	-0.4
Other[1]	4.3	4.8	5.1	0.8	0.3
Taxes on payroll and workforce	**5.6**	**5.9**	**5.6**	**–**	**-0.3**
Taxes on property	**8.9**	**10.3**	**10.3**	**1.4**	**–**
Domestic taxes on goods and services	**171.9**	**174.7**	**174.6**	**2.7**	**–**
Value-added tax	131.2	134.6	134.5	3.3	-0.1
Specific excise duties	16.6	16.1	16.4	-0.2	0.3
General fuel levy	21.8	21.8	21.8	–	0.1
Other	2.3	2.3	2.0	-0.3	-0.3
Taxes on international trade and transactions	**23.6**	**23.9**	**24.0**	**0.4**	**0.1**
Stamp duties and fees	**1.0**	**0.6**	**0.6**	**-0.3**	**–**
State miscellaneous revenue[2]	**–**	**–**	**0.3**	**0.3**	**0.3**
Total tax revenue	**456.8**	**489.7**	**495.5**	**38.7**	**5.9**
Non-tax revenue and repayments[3]	9.3	11.3	10.9	1.6	-0.5
Less: Estimate of SACU payments	-19.7	-25.2	-25.2	-5.5	–
Main budget revenue	**446.4**	**475.8**	**481.2**	**34.8**	**5.4**

1. Includes tax on retirement funds and interest on overdue income tax.

2. Revenue received by SARS in respect of taxation which could not be allocated to a specific tax instrument.

3. Preliminary outcome.

Revenues from VAT and general fuel levy expected to be below budget estimates

However, revenues from VAT and the general fuel levy are expected to be R8.1 billion and R0.7 billion respectively below budget estimates. The lower VAT collections result from larger VAT refunds due to higher non-wage input costs, higher levels of fixed investment, and inventory accumulation caused by a moderation in household consumption expenditure.

Additional adjustment payments to Southern African Customs Union (SACU) member countries of R1.7 billion in terms of the preliminary outcome of the common revenue pool for 2006/07 raises SACU payments for 2007/08 to R24.7 billion.

Main budget revenue for 2007/08 is expected to increase by R8.5 billion to R553.1 billion. Revised revenue projections for 2007/08 are set out in Table 4.2, along with medium-term projections.

Longer-term tax revenue trends

Nominal gross tax revenue was buoyant during the three fiscal years from 2004/05 to 2006/07. This buoyancy was reflected in strong nominal growth in VAT, corporate income tax and customs revenues.

Table 4.2 National budget revenue, 2006/07 – 2010/11

R billion	2006/07 Audited outcome	2007/08 Budget estimate	2007/08 Revised estimate	2007/08 Deviation	2008/09 Medium-term estimates	2009/10 Medium-term estimates	2010/11 Medium-term estimates
Taxes on income and profits	**280.0**	**312.2**	**327.3**	**15.1**	**368.1**	**406.5**	**445.5**
Persons and individuals	140.6	155.3	167.0	11.7	192.1	210.3	230.7
Companies	119.0	138.5	140.1	1.6	157.8	176.0	193.6
Secondary tax on companies	15.3	16.0	18.0	2.0	16.0	17.8	18.5
Other[1]	5.1	2.3	2.2	-0.1	2.2	2.4	2.7
Taxes on payroll and workforce	**5.6**	**6.5**	**6.8**	**0.3**	**7.5**	**8.2**	**9.0**
Taxes on property	**10.3**	**11.0**	**12.1**	**1.1**	**13.5**	**14.9**	**16.4**
Domestic taxes on goods and services	**174.6**	**199.2**	**191.1**	**-8.1**	**211.0**	**232.9**	**254.4**
Value-added tax	134.5	155.1	147.0	-8.1	162.4	179.5	195.6
Specific excise duties	16.4	17.8	18.5	0.7	20.4	22.5	25.0
General fuel levy	21.8	23.9	23.2	-0.7	25.6	28.3	31.0
Other	2.0	2.4	2.4	–	2.5	2.7	2.8
Taxes on international trade and transactions	**24.0**	**27.5**	**28.0**	**0.5**	**31.7**	**36.1**	**38.1**
Stamp duties and fees	**0.6**	**0.2**	**0.8**	**0.6**	**0.7**	**0.6**	**0.5**
State miscellaneous revenue[2]	**0.3**	**–**	**–**	**–**	**–**	**–**	**–**
Total tax revenue	**495.5**	**556.6**	**566.1**	**9.5**	**632.4**	**699.3**	**764.0**
Non-tax revenue and repayments[3]	10.9	11.1	11.8	0.7	11.9	12.5	13.3
Less: Estimate of SACU payments[4]	-25.2	-23.1	-24.7	-1.7	-28.4	-32.1	-36.8
Main budget revenue	**481.2**	**544.6**	**553.1**	**8.5**	**616.0**	**679.6**	**740.5**
Percentage of GDP	*26.9%*	*28.1%*	*27.4%*		*27.6%*	*27.6%*	*27.2%*
Changes from 2007 Budget							
Total tax revenue			9.5		25.5	39.5	
Main budget revenue			8.5		24.8	38.1	

1. Includes tax on retirement funds, interest on overdue income tax and small business tax amnesty.

2. Revenue received by SARS in respect of taxation which could not be allocated to a specific tax instrument.

3. Preliminary outcome.

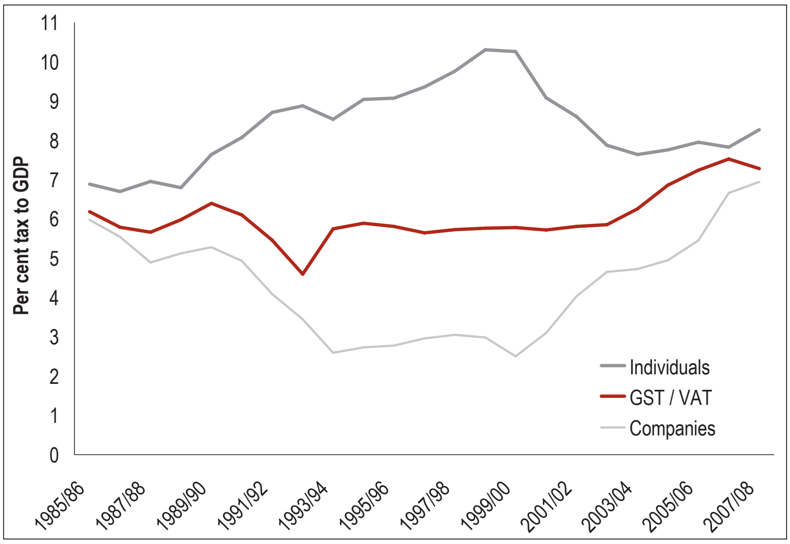
4. The revised estimate for 2007/08 includes adjustment payments to SACU member countries.

The three main tax instruments – personal income tax (individuals and unincorporated businesses), VAT and corporate income tax – account for nearly 80 per cent of total budget revenue. The next three important sources of tax revenues are the general fuel levy, excise duties and customs duties, which together make up between 12 and 14 per cent of budget revenue.

Corporate tax as a share of GDP is trending upward

The ratio of corporate income tax revenues to GDP decreased from 6 per cent in 1985/86 to a low of 2.5 per cent in 1999/00, and has since increased to nearly 7 per cent. Tax reforms accompanied by substantial improvements in tax administration and robust economic growth have supported this rise in the share of corporate taxes.

Figure 4.1 Tax to GDP ratio, 1985/86 – 2007/08



The improved corporate revenue performance was accompanied by a gradual reduction in the headline corporate tax rate, from 48 per cent in 1993/94 to 30 per cent in 2000/01 and to 29 per cent in 2005/06.

Ratio of tax from individuals has been declining, but may rise in 2007/08

The ratio of tax revenues from individuals (including unincorporated businesses) to GDP increased from 6.9 per cent in 1985/86 to a high of 10.3 per cent in 1999/00, and subsequently decreased to 7.8 per cent in 2006/07. The decrease in this ratio is the result of substantial tax relief provided to individuals over the past seven years. However, this ratio is expected to increase to 8.3 per cent in 2007/08, largely due to above-inflation wage settlements and improved tax compliance.

The ratio of VAT revenue to GDP was relatively stable at about 5.8 per cent during the decade between 1993/94 and 2002/03. This ratio increased to a high of 7.5 per cent in 2006/07, despite the fact that the standard VAT rate remained unchanged at 14 per cent.

VAT revenue robust, but likely to moderate

Factors contributing to this improved VAT revenue performance include improved efficiency at SARS, robust growth in consumption expenditure, and a shift in consumption expenditure towards non-zero rated non-zero-rated goods and services such as cellphones. Given that some of the increased consumption expenditure over the past three years should be ascribed to cyclical factors, it is expected that the increase in VAT revenues will moderate over the near term.

Over the period ahead VAT as a share of GDP is likely to stabilise. It is also expected that corporate income tax will slow over the short term in certain sectors, such as mining, where investment is rising. These trends are not likely to affect the sustainability of the fiscal position. They do, however, strengthen the case for taking greater account of the cyclicality in revenue in the fiscal stance.

Outcome of the small business tax amnesty

The small business tax amnesty announced in the 2006 Budget provided small businesses with a turnover of R10 million or less in 2006 with an opportunity to regularise their tax affairs. The amnesty process was also aimed at broadening the tax base, improving the culture of tax compliance and facilitating the entry of small businesses into the formal economy.

The application period opened on 1 August 2006 and closed on 30 June 2007. SARS received a total of 353 388 applications, of which 298 814 were for amnesty and 54 574 were for the waiver of additional taxes, penalties and interest. The taxi industry contributed 24 174 applications. Initial analysis of the amnesty applications indicates that about 22 per cent of the applicants are new registrants.

Subsequent to the amnesty, SARS stepped up its enforcement efforts. Targeted enforcement resulted in the issue of more than 200 arrest warrants, nearly 1 000 summonses and the collection of more than R70 million through writs of execution.

Conclusion

South Africa is on the road to improved tax morality and compliance

South Africa's tax policy continues to emphasise the need for a broader tax base, simplicity in the tax system and high service levels in tax administration. This combination is the most likely route to improved tax morality and compliance.

We are also ever mindful of the role that tax administration can play to support small businesses and, ultimately, more rapid economic growth.

Where base-broadening efforts and improved efficiency lead to higher revenue, government will endeavour to continue to lower tax rates. However, revenue growth that results from cyclical factors should neither be spent on recurrent items nor provided in tax relief given the present buoyant demand conditions.

Government is obtaining a greater understanding of the relationship between a host of economic variables and revenue collection. This growing understanding will inform both fiscal policy and tax policy in the years ahead.

5

Public spending priorities and budget policy

- Accelerating economic growth, broadening access to services and improving community infrastructure are the core priorities of the medium-term expenditure framework (MTEF).
- Public spending will continue to expand strongly over the next three years. About R81 billion is proposed to be added to government expenditure over the period, bringing spending growth to 6.4 per cent a year in real terms. While providing for steady improvements in public services, the budget framework recognises that the present macroeconomic context calls for some moderation in government expenditure. The emphasis is therefore on investment that supports growth and employment creation, and strengthening critical social and human development programmes.
- Budget priorities include further investments in infrastructure, with emphasis on broadening access to basic household services, public transport, education, health, labour-intensive employment initiatives, industrial policy initiatives that raise productivity and employment, fighting crime and improving service delivery.
- In keeping with the government-wide challenge of improving service delivery within affordable spending limits, national and provincial departments and public entities will be expected to include specific efficiency improvements and cost-saving initiatives in their strategic plans for the 2008 Budget and beyond.

Improved service delivery and the MTEF

Giving greater impetus to AsgiSA

The 2008 budget framework aims to give greater impetus to the Accelerated and Shared Growth Initiative (AsgiSA) and the priorities set in government's Programme of Action. Transforming public service delivery in keeping with the country's reconstruction and development challenges remains the central organising principle of public expenditure planning.

Public spending needs to support long-term economic performance

Over the next three years, government's spending plans will focus on investment in human resources and physical infrastructure, geared towards sustainable long-term social and economic development.

There has been marked progress in meeting service delivery targets and broadening social development since the advent of democracy 13 years ago.

Across a wide range of social measures, government is making demonstrable progress

The Community Survey released by Statistics South Africa in October 2007 records the advances made in several areas, while signalling also the scope of the challenges ahead. The proportion of South Africans living in informal settlements has declined from 16 per cent to 14.5 per cent since 1996. The number of households with access to electricity, sanitation and water has increased significantly. The proportion of South Africans who indicate that they have not been to school continues to decline. The proportion of people who have completed tertiary education rose from 7.1 per cent in 1996 to 9.1 per cent in 2006.

Employment trends continue to improve, but youth unemployment remains too high

The latest Labour Force Survey shows a continuing improvement in the employment trend, although youth unemployment in particular remains too high. Strong economic growth has enabled the fiscus to expand social security transfers to vulnerable households and to accelerate investment in services and infrastructure.

A central aim of government's policy framework is to broaden participation in a more rapidly growing economy, while progressively extending and improving public service delivery. The 2008 Budget will accelerate investment in both people and infrastructure, and strengthen capacity across national, provincial and local government.

Accountability in service delivery, however, continues to be a weakness in certain areas of the public sector. A government-wide monitoring and evaluation framework has been introduced under the auspices of the Presidency, strengthening oversight of the delivery of key policy outcomes. The National Treasury's guidelines for performance information aim to develop better measures of value for money in government expenditure, in alignment with the monitoring and evaluation framework.

A focus on controlling costs and better value for money in government departments

Recognising that sustained improvements in service delivery depend on efficient use of resources, the 2008 Budget will also put the spotlight on controlling costs. Government departments and public entities will be expected to include explicit efficiency savings and cost-containment initiatives in their strategic plans. Targeted expenditure includes unnecessary travel and subsistence costs, entertainment, poorly managed consultancy services, outdated administrative systems, misplaced marketing and communication initiatives, and weaknesses in supply-chain management. Through efficiency savings measures, R2.3 billion will be redirected to new and expanded frontline services over the next three years.

This chapter sets out broad proposals for the 2008 MTEF, within which departmental and programme allocations have to be determined during the remaining months of the budget process. It outlines some of the policy considerations and implementation challenges ahead and also discusses specific changes to the 2007/08 budget estimates. As always, the budget process confronts a wide range of pressing claims on public resources, not all of which can be accommodated given the resources available. Further details on the division of revenue and major changes to provincial and local government allocations are discussed in Chapter 6.

Revised expenditure estimates for 2007/08

A special adjustments budget tabled in September 2007

This year government tabled a special adjustments appropriation in September. The normal adjustments bill is published alongside this statement. The Adjusted Estimates of National Expenditure sets out detailed changes to the 2007/08 allocations proposed in both adjustments appropriation bills.

The special adjustments appropriation of R5.2 billion provides for:

- R1.9 billion brought forward from the 2008/09 estimate to accommodate accelerated spending on stadium construction
- A R222 million transfer to Denel to meet a guarantee claim relating to its Airbus supply commitments
- Recapitalisation of R700 million to the Land Bank
- R1.8 billion for the Pebble Bed Modular Reactor project
- R500 million to contribute to Sentech's wholesale wireless broadband network
- R44.7 million to support the Alexkor diamond mining company.

Changes proposed to normal adjustments appropriation bill

The main adjustments appropriation bill for 2007/08 proposes the following changes:

- R654 million for unforeseen and unavoidable expenditure associated with fire, floods, drought and other adverse weather conditions
- R400 million for treatment and prevention of multidrug-resistant tuberculosis
- R300 million for bus subsidies
- Approved rollovers of R4.0 billion arising from unspent balances in 2006/07
- R181 million of self-financed expenditure
- R1.9 billion to accommodate the higher-than-budgeted cost of the 2007 salary agreement
- Supplementary allocations of R707 million.

Revised estimate for National Revenue Fund expenditure is R542.4 billion

Taking into account projected underspending, declared savings and the adjusted state debt cost estimate, the revised estimate of total expenditure from the National Revenue Fund in 2007/08 is R542.4 billion, or 15.4 per cent more than 2006/07 expenditure. A summary of mid-year spending estimates for 2007/08 for both national departments and provinces is included in Annexure A.

Medium-term budget policy

Budget priorities for the next three years

Spending priorities are informed by government's Programme of Action, which in turn reflects the annually updated medium-term strategic framework overseen by the Policy Coordination and Advisory Service in the Presidency. In reviewing plans for the next three years, attention has focused on identified priority programmes associated with AsgiSA, the Joint Initiative for Priority Skills Acquisition (Jipsa) and requirements for a successful 2010 FIFA World Cup. Continuing cross-cutting priorities include:

- Investing in both economic and social infrastructure so that the economy can grow faster, and access to basic social and household services can be assured.
- Improving the quality of education, health and other social services, and stepping up targeted anti-poverty initiatives.
- Enhancing job creation associated with growth by supporting labour-absorbing industries and active labour market initiatives, and expanding employment-intensive government programmes.
- Improving the efficacy of police services and the justice system to make further progress in reducing crime.
- Enhancing the effectiveness of economic and sectoral interventions through appropriate regulation of and support for business to expand the productive side of the economy, and through regional and international partnerships.

An additional R81.4 billion to be added to the R1.7 trillion baseline

The proposed framework for the 2008 Budget makes available an additional R81.4 billion over the next three years, in addition to more than R1.7 trillion already included in departmental and provincial baseline allocations. About R50 billion of the available additional funds will go to municipalities and provincial governments.

The 2007 public service salary settlement results in additional personnel costs over the next three years, for which R15 billion is included in the additions to baseline allocations of national departments and provinces.

Inflation-related increases protect value of social grants

Inflation-related adjustments to the value of social grants are also provided for, and are expected to take up R4.3 billion of the available additional funding over the MTEF.

Medium-term budget priorities and key policy considerations relating to public spending are summarised below.

Investing in infrastructure

Public infrastructure investment has risen strongly for three years

Since 2004, public infrastructure investment has risen strongly. Some of these investments are financed from resources allocated through the budget process; others are financed directly by state-owned enterprises through their own revenue or financing sources. These include the sale of non-core assets, retained earnings, borrowing from capital markets and public-private partnerships.

Table 5.1 shows projected consolidated national and provincial government expenditure by type of service.

Table 5.1 Consolidated government expenditure by type of service, 2006/07 – 2010/11

R billion	2006/07 Outcome	2007/08 Revised	2008/09 Medium-term estimates	2009/10	2010/11	Average annual growth 2007/08 – 2010/11
Social services	**270.7**	**305.4**	**347.7**	**388.8**	**424.1**	**11.6%**
Education	92.3	106.4	120.8	135.6	148.6	11.8%
Health	57.3	63.1	71.0	79.5	87.3	11.4%
Welfare and social security	84.1	89.0	100.5	110.7	117.5	9.7%
Housing and community development	37.1	47.0	55.4	63.0	70.7	14.6%
Protection services	**78.9**	**89.2**	**96.8**	**105.0**	**114.2**	**8.6%**
Defence and intelligence	27.8	30.6	32.5	33.6	36.1	5.6%
Justice, police and prisons	51.1	58.6	64.3	71.4	78.1	10.1%
Economic services and infrastructure	**89.6**	**114.4**	**127.6**	**142.0**	**159.6**	**11.7%**
Water and related services	15.0	17.4	18.3	20.6	22.2	8.5%
Agriculture, forestry and fishing	10.7	13.2	14.1	14.6	15.4	5.3%
Transport and communication	34.7	46.1	57.4	64.9	76.3	18.3%
Other economic services	29.2	37.7	37.8	41.9	45.7	6.6%
Administration	**33.6**	**39.6**	**41.2**	**47.3**	**50.6**	**8.5%**
Total	**472.8**	**548.7**	**613.3**	**683.0**	**748.5**	**10.9%**
Interest	55.3	56.1	55.4	56.0	55.6	-0.3%
Contingency reserve	–	–	4.0	8.0	16.0	
Consolidated expenditure	**528.1**	**604.8**	**672.7**	**747.0**	**820.1**	**10.7%**

General government investment is mainly focused on the built environment, which covers housing, water, sanitation, electrification, schools, health facilities, police stations, roads and public transport investment – investments designed to create sustainable and viable communities. This category of public spending has been the single fastest-growing area of government expenditure, rising by 19.2 per cent a year in real terms since 2004.

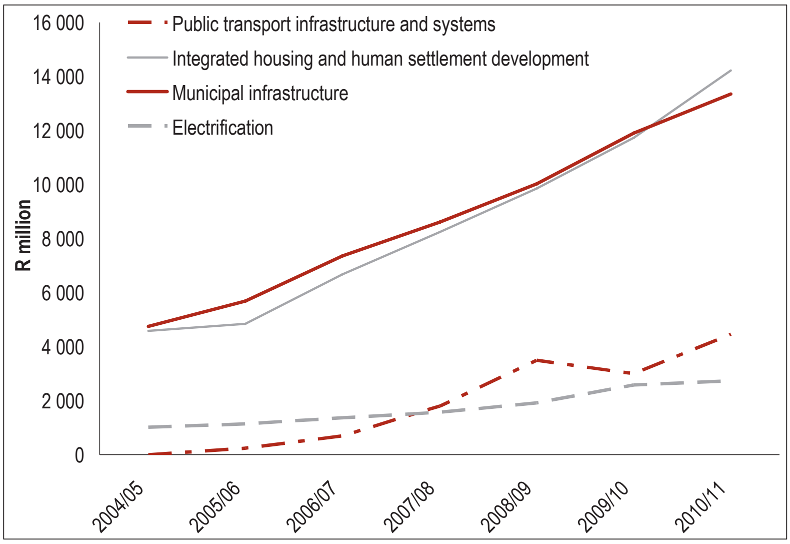
Government targets universal access to water, sanitation and electricity

Government investment in the built environment is aimed at achieving universal household access to water, sanitation and electricity, and the elimination of informal settlements. These are ambitious targets, and substantial additional allocations are proposed for local and provincial government to expand the pace of delivery, and to contribute to the costs of providing free basic services at local level.

Economic growth, improved revenue performance and the fiscal space created by sound policies make possible continued strong growth in physical capital formation. Progress in industrial and trade policies and performance are necessary complements to these investments. South Africa's plans for power plants, rail lines, bus lanes and routes, dams, water purification plants, roads, ports and office accommodation are likely to see public sector gross fixed capital formation grow rapidly for well over a decade.

Figure 5.1 below shows the strong investment growth trends in the principal built environment spending streams.

Figure 5.1 Built environment grants and subsidies, 2004/05 – 2010/11



Two critical social sector infrastructure programmes – the hospital revitalisation grant and the school building programme – will be significantly boosted over the period ahead to contribute to improving health services and eliminating unsatisfactory school environments.

A temporary operating grant to help host cities prepare for 2010

Considerable infrastructure spending related to the 2010 FIFA World Cup is in progress. Stadium construction projects are on track or ahead of schedule. A World Cup host city operating grant is proposed for the 2008 Budget to help municipalities commission new stadiums, prepare training facilities, improve signage and develop fan parks.

Public transport infrastructure and systems related to the World Cup have been prioritised for the 2007-2010 period. Planning is under way for several public transport projects beyond 2010, mainly to link residential areas with places of economic activity.

Proposed public transport allocations over the MTEF will help to develop core economic infrastructure for the long term, and build up an integrated bus, rail and taxi system.

Capital markets fund the bulk of state-owned enterprises' infrastructure projects

In recent years financial assistance has been provided to state-owned enterprises – including South African Airways, Denel, Sentech, the Pebble Bed Modular Reactor and Infraco – to support their role in underpinning economic growth. Although the bulk of capital required by state-owned enterprises is sourced from debt markets and from own revenue sources, restructuring initiatives and further investment in transport and communications infrastructure will continue to be supported by the fiscus.

Improving the quality of public services

Targeted interventions to improve the quality of services and reinforce other programmes

In many areas, progress in improving public services has failed to keep pace with increased financial resources. The 2008 Budget will prioritise public services in under-served areas that improve the likelihood of success of other programmes. For example:

- In education, improved early learning opportunities increase success rates in later years, and collective purchasing of textbooks can reduce costs and allow for greater access to appropriate learning materials.
- Improved traffic enforcement and removing unroadworthy vehicles leads to fewer road accidents, alleviating pressure on the health and emergency services.
- Better agricultural extension services and post-settlement support to new farmers increases the likelihood that the land reform programme will meet its objectives. Further support for land restitution is envisaged, along with a step-up in spending on provincial agricultural support programmes.

Support for departments with an economic regulatory role

Targeted allocations will support service delivery improvements in the Department of Home Affairs, and communication and IT network infrastructure in the criminal justice sector. Improved capacity in departments that fulfil an economic regulatory role is also prioritised.

The 2007 Public Sector Coordinating Bargaining Council resolution announced occupation-specific salary dispensations for teachers, nurses and legally qualified personnel. A new dispensation for social workers is also envisaged. These grading systems provide differentiated pay based on performance, seniority and qualifications, and are aimed at raising productivity, and recruiting and retraining skilled personnel.

Jipsa partners with private sector to strengthen skills training

Through Jipsa, government intends to work with the private sector to identify skills gaps, refocus training initiatives and attract skills from abroad. The intention is also to place 2 000 young South Africans abroad to gain international work experience.

As part of strengthening the professionalism and technical competence of the civil service, the South African Management Development Institute will receive further support over the MTEF period.

Turning around Home Affairs

The Department of Home Affairs turnaround programme includes various short-term interventions focused on improved service delivery. These include:

- A tracking system enabling South Africans to chart the progress of their ID document applications without having to queue at an office
- A streamlined ID production process that is fast, efficient, customer friendly and reliable
- Clearing backlogs and upgrading facilities, and improving the application process for refugee and immigrant permits
- A new call centre service and IT systems upgrades
- Financial improvements and addressing audit concerns, including the identification of risk areas.

Supporting employment growth and poverty reduction

Through expanded public works the budget supports direct job creation

Raising the level of employment is a critical economic policy objective. Initiatives grouped under the expanded public works programme receive further support over the medium term. Over the past three years, more than 300 000 short-term work opportunities have been created through these programmes. While some initiatives have shown good results, such as those in the environmental sector, there has not been sufficient progress in increasing the labour intensity in other critical sectors.

Government seeks to raise the labour-intensity of municipal infrastructure projects. The 2008 Division of Revenue Bill will emphasise the degree to which government expects municipal and provincial government to use labour, where feasible, to deliver community infrastructure and services.

Employment creation is also an objective of industrial and trade reform, through initiatives supporting labour-intensive sectors such as business process outsourcing (including call centres), small-scale agriculture and small business support. A new incentive programme for small business, to be introduced by the Department of Trade and Industry, will also be supported over the period ahead.

School nutrition programme to be expanded

Social assistance grant programmes play an important role in reducing poverty and vulnerability. Social grants are increased annually to maintain their purchasing power, and provision must also be made for rising beneficiary numbers. Expanding the school nutrition programme to cover more children for the full school year will also be provided for in the 2008 Budget.

Work in progress on social security proposals

Following the announcement of proposed reforms to the architecture of social security and retirement funding, government is assessing the viability of a wage subsidy to underpin job creation and income security of the poor. Work is still in progress on this and related regulatory, tax and social security reform options, and as a result their fiscal and financial implications are not taken into account in the present framework.

A more efficient criminal justice sector

Support for improved police IT and communications infrastructure

Crime levels remain unacceptably high, though progress has been made in stabilising and in some instances reducing incidence rates. This remains an area where public expectations are a long way from being met. Over the past five years, police personnel numbers and remuneration have grown. However, there has been underinvestment in improving IT systems and bringing forensic capability up to a level commensurate with the high level of contact crime. We also need more detective training. Over the MTEF period the budget for the police will prioritise improved IT and communications infrastructure, and forensic laboratories. Budgetary provision will also be made to secure both citizens and visitors during the 2010 FIFA World Cup.

Improving court efficiency and sharply reducing longstanding case backlogs are key priorities for the criminal justice system. The assignment of more public defenders and two prosecutors to each court is continuing, and provision is made for the appointment of more judges and magistrates. Further allocations are required for the implementation of an electronic case flow management system in the National Prosecuting Authority.

Support for reorientation of Correctional Services towards offender rehabilitation

Correctional Services is taking steps to emphasise rehabilitation, which should reduce repeat offences. This strategy requires more social workers, psychologists, training capacity and critically, less overcrowding. Five new prisons, to house 15 000 offenders, are to be procured through partnerships with private contractors.

Raising the productive capacity of the economy

This year government announced a National Industrial Policy Framework and the Industrial Policy Action Plan. The policy framework entails a closer partnership between government and the private sector to facilitate business expansion, diversify the economy and increase its ability to absorb labour. To sustain the current growth trajectory it is critical to raise the level of exports. The 2008 Budget will support targeted industrial policy, trade and sectoral strategy initiatives. Consultations between government and business on several sector support programmes are under way.

Support for increased research and development

Research and development (R&D) encourages innovation, helping the economy to introduce and adapt to technological change, and raising productivity in the process. The next budget will continue to provide support to R&D through the statutory science councils, universities and partnerships with the private sector. Infrastructure investment, education, skills development and reduction of the bureaucratic burdens facing business are all essential to strengthening the economy. These measures provide generalised support to all businesses, levelling the playing field for higher productivity.

Higher education funding

Government funding for universities falls into three main categories. The main institutional subsidy is a formula-based block grant that takes into account student enrolment, graduate rates and research outputs. It is complemented by earmarked grants, such as allocations to expand engineering studies and foundation programmes for disadvantaged learners. A separate allocation is also made for each institution's share of the National Student Financial Aid Scheme, which provides loans and bursary funding to cover fees of students who would otherwise not be able to afford higher education.

Additional amounts proposed increase allocations to higher education from R13.3 billion in 2007/08 to R19.1 billion in 2010/11, an average annual growth of 11.5 per cent over the MTEF.

Higher education funding, 2004/5 – 2010/11

R million	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	Average annual growth
Institutional subsidy grants	8 798.5	9 190.3	10 260.6	11 344.2	13 309.7	14 667.0	16 133.7	10.6%
Restructuring Grants[1]	502.0	550.0	568.0	600.0	–	–	–	
NSFAS[2]	578.2	864.1	926.4	1 112.7	1 175.3	1 258.7	1 334.2	15.0%
Sub-Total	**9 878.7**	**10 604.4**	**11 755.0**	**13 056.8**	**14 485.0**	**15 925.7**	**17 467.9**	**10.0%**
Higher Education Programme[3]	9 911.4	10 646.8	11 967.6	13 330.9	15 068.2	16 830.9	19 066.4	11.5%

1. Included in Institutional subsidy grant from 2008/09.

2. Excludes teacher and FET College bursaries.

3. Includes departmental management costs and proposed additional allocations.

Utility regulators and competition authorities likely to receive further support

Competition policy can also serve as an instrument to raise productivity, since economic theory suggests that monopolies, either state or private, are likely to under-produce and overprice. Utility regulators and the competition authorities will be strengthened during the period ahead.

Government moves to strengthen its diplomatic ties with Asia

South Africa's foreign relations agenda, particularly initiatives aimed at regional peace and stability, have facilitated greater trade and investment opportunities with developing nations. Government will continue to support development initiatives in Africa, expand diplomatic capacity on the continent and simultaneously strengthen diplomatic ties with Asia, given improved trade and economic links with the East.

Consolidated government expenditure

An economic classification of projected government expenditure is set out in Table 5.2. These estimates indicate that the fastest-growing categories of spending are transfers to municipalities and investments in physical infrastructure.

Table 5.2 Consolidated government expenditure by economic classification, 2006/07 – 2010/11

R billion	2006/07	2007/08	2008/09	2009/10	2010/11	Average annual growth
	Outcome	Revised	Medium-term estimates			2007/08–2010/11
Current payments	**316.3**	**351.5**	**386.0**	**426.6**	**460.8**	**9.5%**
Compensation of employees	169.7	191.9	215.7	237.1	257.8	10.3%
Goods and services	91.4	103.4	114.9	133.6	147.4	12.6%
Interest and rent on land	55.3	56.1	55.4	56.0	55.6	-0.3%
of which: State debt cost	*52.2*	*52.9*	*51.2*	*51.0*	*50.4*	*-1.6%*
Transfers and subsidies	**180.5**	**212.2**	**235.1**	**256.8**	**277.8**	**9.4%**
Municipalities	30.6	39.5	47.4	52.0	60.3	15.2%
Departmental agencies and accounts	22.0	24.5	24.8	25.2	27.3	3.7%
Universities and technikons	12.6	13.7	15.2	16.6	18.0	9.7%
Public corporations and private enterprises	19.6	26.1	23.6	27.4	27.9	2.3%
Foreign governments and international organisations	0.9	1.0	0.8	1.0	1.1	0.6%
Non-profit institutions	10.6	12.8	16.3	17.9	20.3	16.7%
Households	84.3	94.7	107.1	116.8	123.0	9.1%
Payments for capital assets	**31.2**	**41.2**	**47.6**	**55.6**	**65.5**	**16.7%**
Buildings and other capital assets	22.5	31.5	36.6	43.6	51.9	18.1%
Machinery and equipment	8.7	9.7	11.0	11.9	13.6	11.9%
Total	**528.1**	**604.8**	**668.7**	**739.0**	**804.1**	**10.0%**
Contingency reserve	–	–	4.0	8.0	16.0	
Consolidated expenditure	**528.1**	**604.8**	**672.7**	**747.0**	**820.1**	**10.7%**

6

Division of revenue and medium-term expenditure estimates

- The division of revenue reflects a strong bias towards local government to support universal access to basic services and built environment initiatives. In addition, significant increases are recommended for provincial governments, mainly for specific programmes in education, health, welfare services, agriculture and housing.
- Collectively, local and provincial government receive R48.6 billion or just under 60 per cent of additional resources. National government receives R32.7 billion of additional resources for initiatives that will raise productivity and employment, fight crime and improve service delivery.
- Including the additional R81.4 billion, total non-interest expenditure rises by 6.4 per cent a year in real terms, focusing on infrastructure delivery and improving the reach and quality of public services, particularly in poor communities.

Division of revenue overview

Further acceleration in spending and delivery of priority social programmes

The proposed 2008 medium-term expenditure framework (MTEF) builds on the momentum created by rising government spending in recent budgets.

Baseline allocations to national departments are revised upwards by R7.0 billion in 2008/09, R9.3 billion in 2009/10 and R16.4 billion in 2010/11, with additions focusing on:

- Raising the productive capacity of the economy through investing in infrastructure and supporting industrial development

- Fighting crime through higher investment in communications and network infrastructure, forensic capacity and more prison capacity
- Protecting the real value of social grants from higher inflation and rising food prices
- Improving administrative services, including support to the Department of Home Affairs.

Provincial baseline allocations are increased by R36.1 billion over the next three years to reinforce interventions in education, health and social development with the aim of extending the reach and quality of these services, especially for poor communities.

Support for expanded access to potable water, sanitation and electricity

Additional allocations to local government baselines of R12.6 billion are proposed over the MTEF to support expanded community access to potable water, sanitation and electricity. Of this amount, R5.8 billion will be added to the local government equitable share to help municipalities meet the costs of providing free basic services to poor households. The balance is earmarked for municipal infrastructure and programmes to boost planning, budgeting and management capacity in local government.

Table 6.1 shows the division of revenue over the MTEF.

Table 6.1 Medium-term expenditure framework and the division of revenue, 2007/08 – 2010/11

R million	2007/08 Revised	2008/09	2009/10	2010/11	2008 MTEF	Growth
		Medium-term estimates				
National	**246 331**	**269 011**	**295 389**	**316 683**		**8.7%**
Provincial	**205 537**	**235 110**	**264 069**	**288 160**		**11.9%**
Equitable share	172 862	197 688	222 589	242 100		11.9%
Conditional grants	32 676	37 422	41 480	46 060		12.1%
Local	**37 569**	**40 538**	**47 108**	**54 970**		**13.5%**
Equitable share	20 676	24 711	29 936	35 565		19.8%
Conditional grants	16 893	15 828	17 172	19 406		4.7%
Total	**489 437**	**544 659**	**606 566**	**659 813**		**10.5%**
Percentage shares						
National	*50.3%*	*49.4%*	*48.7%*	*48.0%*		
Provincial	*42.0%*	*43.2%*	*43.5%*	*43.7%*		
Local	*7.7%*	*7.4%*	*7.8%*	*8.3%*		
Changes to baseline						
National	**5 450**	**7 019**	**9 279**	**16 415**	**32 713**	
Provincial	**2 772**	**5 814**	**9 625**	**20 659**	**36 098**	
Equitable share	1 590	4 214	6 805	13 369	24 388	
Conditional grants	1 182	1 600	2 820	7 290	11 710	
Local	**3 257**	**1 570**	**2 280**	**8 700**	**12 550**	
Equitable share	–	936	492	4 354	5 782	
Conditional grants	3 257	634	1 788	4 346	6 768	
Total	**11 479**	**14 403**	**21 184**	**45 774**	**81 361**	

Funding provincial government

Of the R36.1 billion added to the provincial share over the next three years, R24.4 billion is proposed for the provincial equitable share and

R11.7 billion for conditional grants. These additions result in transfers to provinces growing by 11.9 per cent per year, from R205.5 billion in 2007/08 to R288.2 billion in 2010/11.

Provincial equitable share

Programmes that have a greater impact on human development and quality of life to be strengthened

The provincial equitable share is budgeted to grow by 11.9 per cent annually from a revised R172.9 billion in 2007/08 to R242.1 billion in 2010/11. Robust growth in these allocations provides for the strengthening of social services programmes, especially those likely to have a high impact on human development and the quality of life.

In addition to the R8.0 billion added to education budgets and R4.2 billion added to health budgets over the 2007 MTEF, a further R11.7 billion is proposed to fund the implementation of the recently concluded public sector salary agreement, and to finalise an occupation-specific dispensation for educators and social workers. An agreement on a separate salary scale for nurses was signed in September 2007.

Increased resources for grade R and learners with disabilities

In education, government intends to allocate increased resources through provincial budgets to cater for the scaling up of grade R, including training more practitioners. Over the next three years the education sector is also going to devote resources to making public ordinary schools more inclusive.

In particular, facilities will be modified to make them more accessible to learners with disabilities. For learners with special needs who cannot be accommodated in public schools, new facilities will be built where needed. To implement the new curriculum statement, funds are provided to assist provinces to procure textbooks for all learners in grades 10, 11 and 12. Government is exploring innovative approaches to procuring these materials in a more cost-effective way.

A focus on early childhood development

A portion of the additional equitable share allocation aims to ensure that social welfare services are accelerated to meet the growing welfare needs of communities. The focus over the medium term is on bolstering early childhood development, catering for those aged 0-4 years (in collaboration with the education sector), expanding secure care services to children in conflict with the law, and strengthening access to home- and community-based care.

Boosting provincial economic development and expanded public works

The equitable share also provides for investment in provincial economic sectors (roads, agriculture, economic affairs and tourism) to boost economic development, including programmes that contribute to rural development. Furthermore, programmes falling under the umbrella of the expanded public works programme will be accelerated.

In health, the equitable share provides resources to tackle the challenge of multidrug-resistant tuberculosis (TB) and extreme drug-resistant TB, and for a general increase in health spending.

A battle plan for multidrug-resistant TB and extreme drug-resistant TB

A major cause of mortality and morbidity in its own right, TB is also the most important opportunistic infection arising from HIV and Aids. The MTEF will make provision for a scaled-up response to multidrug-resistant TB and extreme drug-resistant TB, with improved systems of detection and surveillance, and development of specialised inpatient treatment hospitals in all provinces. Facilities will be provided to isolate and treat these patients for a period of six months in hospital, with 18 months of follow-up treatment, including regular laboratory testing.

Table 6.2 Provincial equitable share allocations, 2007/08 – 2010/11

R million	2007/08 Revised	2008/09	2009/10 Medium-term estimates	2010/11
Eastern Cape	27 381	31 094	34 841	37 705
Free State	10 835	12 301	13 738	14 820
Gauteng	28 464	32 895	37 408	41 086
KwaZulu-Natal	37 425	42 849	48 329	52 651
Limpopo	22 498	25 696	28 836	31 255
Mpumalanga	14 253	16 285	18 300	19 862
Northern Cape	4 638	5 293	5 945	6 449
North West	12 087	13 696	15 284	16 474
Western Cape	15 282	17 579	19 909	21 798
Total	**172 862**	**197 688**	**222 589**	**242 100**

Table 6.2 shows the proposed equitable share allocations to each province over the MTEF. The calculation of the equitable share is determined by an objective redistributive formula published annually in the *Budget Review*. Revisions to the formula this year take into account the results of the 2007 Community Survey, with the adjustments phased in over three years.

Conditional grants to provinces

About half of all additional conditional allocations are for infrastructure grants

Conditional grant spending is expected to grow from a revised R32.7 billion in 2007/08 to R46.1 billion in 2010/11. About R6.5 billion or 56 per cent of additional conditional allocations are proposed for infrastructure-related grants.

School infrastructure report card

Findings released by the Department of Education in September 2007 highlight both the progress and challenges in providing school infrastructure. The figures show that:

- The number of overcrowded schools has fallen from 51 per cent in 1996 to 24 per cent in 2006, leaving nearly a quarter of schools with more than 45 learners per classroom.
- The number of schools without electricity decreased by 9 539 between 1996 and 2006, leaving 4 297 schools without electricity.
- The number of schools without water has decreased by 5 671 between 1996 and 2006, leaving 3 152 schools without water.
- The number of schools without toilets has decreased by 1 733 between 1996 and 2006, leaving 1 532 schools without toilets.
- 17 065 schools (68 per cent) have no computers.

The MTEF will provide an additional R2.7 billion to address these infrastructure needs, bringing education capital spending to a total of R17 billion over the next three years.

The *infrastructure grant to provinces* is revised upwards by R2.7 billion to address school infrastructure needs, including replacing unsafe and inappropriate school structures. Job creation in communities is an expected spin-off. Government plans to spend over R17.8 billion to build schools over the next three years.

National school nutrition programme is enhanced

The *national school nutrition programme* is allocated a further R1.5 billion over the MTEF to expand the programme in the primary school phase by extending coverage to more learners, improving the quality of meals and providing meals on more school days.

Hospital revitalisation programme receives additional R1.6 billion

An additional R1.6 billion is recommended for the *hospital revitalisation programme* to assist provinces to equip and modernise their hospital facilities. Government plans to spend R9.2 billion on this programme over the next three years.

Table 6.3 shows the revisions to provincial conditional grant allocations.

Table 6.3 Revision to provincial conditional grant allocations, 2007/08 – 2010/11

R million	2007/08	2008/09	2009/10	2010/11	2008 MTEF Total revisions
Agriculture	**300**	**100**	**150**	**250**	**500**
Agricultural disaster management grant	300	–	–	–	–
Comprehensive agriculture support programme grant	–	100	150	250	500
Education	**111**	**300**	**400**	**800**	**1 500**
Further education and training college sector recapitalisation grant	36	–	–	–	–
HIV and Aids (life skills education) grant	9	–	–	–	–
National school nutrition programme grant	66	300	400	800	1 500
Health	**416**	**800**	**1 270**	**2 740**	**4 810**
Comprehensive HIV and Aids grant	61	350	600	1 150	2 100
Forensic pathology services grant	121	–	70	110	180
Hospital revitalisation grant	234	300	400	900	1 600
National tertiary services grant	–	150	200	580	930
Housing	**105**	**–**	**200**	**2 000**	**2 200**
Integrated housing and human settlement development grant	105	–	200	2 000	2 200
National Treasury	**250**	**400**	**800**	**1 500**	**2 700**
Infrastructure grant to provinces	–	400	800	1 500	2 700
Transitional grant: North West	250	–	–	–	–
Total	**1 182**	**1 600**	**2 820**	**7 290**	**11 710**

Further allocations for comprehensive HIV and Aids programme

A further R2.1 billion is added to the *comprehensive HIV and Aids grant*, resulting in planned spending of R9.8 billion on the programme over the MTEF period.

The *national tertiary service grant* is allocated an additional R930 million to increase spending on tertiary hospitals and, more specifically, to fund diagnostic radiology, telemedicine and oncology.

The *integrated housing and human settlements grant*, which finances government's flagship housing subsidy programme, is allocated an additional R2.2 billion to speed up housing delivery. Government plans to spend R35.8 billion on this programme over the medium term.

A boost for agricultural support services, with a focus on emerging farmers

To expand the provision of agriculture support services, particularly extension and advisory services to emerging farmers, R500 million is added to the *comprehensive agricultural support programme.*

Table 6.4 shows conditional grants to provinces over the MTEF.

Table 6.4 Conditional grants to provinces, 2007/08 – 2010/11

	2007/08	2008/09	2009/10	2010/11
R million	Revised	Medium-term estimates		
Agriculture	**762**	**584**	**680**	**812**
Agriculture disaster management grant	300	–	–	–
Comprehensive agriculture support programme grant	415	535	628	757
Land care programme grant: poverty relief and infrastructure development	47	49	51	55
Arts and Culture	**180**	**338**	**466**	**494**
Community library services grant	180	338	466	494
Education	**2 017**	**2 501**	**1 901**	**2 418**
Further education and training college sector recapitalisation grant	631	795	–	–
HIV and Aids (life skills education) grant	166	168	177	188
National school nutrition programme grant	1 219	1 538	1 724	2 230
Health	**11 737**	**13 343**	**14 996**	**17 289**
Comprehensive HIV and Aids grant	2 006	2 585	3 276	3 987
Forensic pathology services grant	672	467	492	557
Health professions training and development grant	1 596	1 676	1 760	1 865
Hospital revitalisation grant	2 141	2 583	2 982	3 637
National tertiary services grant	5 321	6 032	6 486	7 244
Housing	**8 343**	**9 853**	**11 731**	**14 223**
Integrated housing and human settlement development grant	8 343	9 853	11 731	14 223
National Treasury	**6 414**	**7 247**	**8 797**	**10 080**
Infrastructure grant to provinces	6 164	7 247	8 797	10 080
Transitional grant: North West	250	–	–	–
Sport and Recreation South Africa	**194**	**290**	**402**	**426**
Mass sport and recreation participation	194	290	402	426
Transport	**3 029**	**3 266**	**2 507**	**318**
Gautrain rapid rail link	3 029	3 266	2 507	318
Total	**32 676**	**37 422**	**41 480**	**46 060**

Funding local government

Policy priorities and fiscal framework

Considerable success in provision of municipal services to the poor

Local government has had considerable success in expanding access to basic services to the poor. The recently released Community Survey shows that by February 2007:

- 89 per cent of households had access to water compared to 62 per cent in 1994
- 89 per cent of households had access to sanitation compared to 50 per cent in 1994
- 80 per cent of households had access to electricity compared to 51 per cent in 1995.

Through the *municipal infrastructure grant*, 610 293 household connections have been made for water and 324 071 for sanitation since 2004. Through the *integrated national electrification programme*, 550 247 households have been connected to the national electricity grid since 2004.

Municipalities receive a further R12.6 billion to expand free basic services and prepare for 2010

An additional R12.6 billion is allocated to municipalities to expand the provision of free basic services and to enhance the country's readiness for the 2010 FIFA World Cup. Of this amount:

- R5.8 billion is allocated to the local government equitable share for the rollout of free basic services and to step up institutional support for weaker municipalities in poorer areas.
- R4.1 billion is earmarked for municipal infrastructure and programmes to boost planning, budgeting and management capacity in local government.
- R2.0 billion is proposed for the *public transport infrastructure and systems grant* to finance an integrated public transport network in large municipalities, including 2010 FIFA World Cup host cities.
- R684 million is allocated for a *World Cup host cities operating grant* to provide the relevant municipalities with funding needed to ensure their readiness for the 2010 FIFA World Cup.

Funding of poorer, smaller municipalities to increase

The 2008 MTEF seeks to assist poorer municipalities by allocating them a proportionally larger share of the local government equitable share and the *municipal infrastructure grant.*

Transfers to local government

The additional R12.6 billion allocated to local government over the next three years results in its share of nationally raised revenue growing from a revised R38.2 billion in 2007/08 to R57.6 billion in 2010/11. This includes R9.0 billion in 2008/09, R10.1 billion in 2009/10 and R10.7 billion in 2010/11 in compensation for Regional Services Council (RSC) levies until a suitable replacement is announced.

Table 6.5 Revision to local government allocations, 2007/08 – 2010/11

R million	2007/08 Revised	2008/09	2009/10 Medium-term estimates	2010/11
Total local government allocation	**38 183**	**43 020**	**50 072**	**57 583**
Equitable share and related[1]	21 226	25 311	30 398	36 209
Infrastructure[2]	16 208	17 279	19 174	20 797
Capacity building and restructuring	749	430	500	577
Changes to baseline				
Equitable share and related	–	936	492	4 354
Infrastructure	3 257	604	1 688	4 196
Capacity building and restructuring	–	30	100	150
Total	**3 257**	**1 570**	**2 280**	**8 700**

1. *Includes water services operating subsidy grant.*
2. *Includes indirect transfers to municipalities.*

Local government equitable share grows 12.3 per cent in real terms per year

The local government equitable share continues to be an integral funding instrument to supplement municipal own revenues for the provision of free basic services to poor households and to fund institutional capacity. Excluding the replacement grant for RSC levies, the local government equitable share is budgeted to grow 12.3 per cent a year in real terms from R12.6 billion in 2007/08 to R20.5 billion in 2010/11.

National transfers for municipal infrastructure investment amount to R57.3 billion over the next three years

Infrastructure transfers to local government amount to R57.3 billion over the next three years. This includes:

- R30.7 billion for the rollout of basic infrastructure and to provide for a reasonable minimum allocation for every municipality under the *municipal infrastructure grant.*
- R6.5 billion for the electrification of poor households.
- R13.8 billion to enable the host cities to meet the challenges of the 2010 FIFA World Cup – R3.8 billion for stadium refurbishment and construction, and R10 billion for the development of public transport infrastructure and systems.
- R2.5 billion for the neighbourhood development partnership grant.
- R1.8 billion for bulk water infrastructure to enable municipalities to connect more households to water and sanitation systems.
- R800 million to alleviate backlogs in electrification, water and sanitation at schools and clinics.
- R1.2 billion for the water services operating subsidy.

The *capacity-building and restructuring grant* helps municipalities to develop planning, budgeting, financial management and technical skills. The *financial management grant* and the *municipal systems improvement grant* receive total funding of R1.5 billion.

Annexure A

2006/07 outcome and half-year spending estimates for 2007/08

Table A.1 Expenditure by vote, 2006/07 and 2007/08 financial year

	2006/07				2007/08		
R million	Main budget	Adjusted budget	Audited outcome	Over(-)/ Under(+)	Main budget	Adjusted budget[1]	Actual spending April to September
CENTRAL GOVERNMENT ADMINISTRATION							
1 The Presidency	256	239	236	3	255	272	110
2 Parliament	782	782	755	27	836	836	326
3 Foreign Affairs	3 042	3 042	2 945	97	3 856	4 119	1 543
4 Home Affairs	2 800	2 800	2 547	253	3 315	3 521	1 168
5 Provincial and Local Government	24 903	25 392	24 576	817	28 844	30 037	10 702
6 Public Works	3 080	3 117	3 026	91	3 693	3 759	1 970
FINANCIAL AND ADMINISTRATIVE SERVICES							
7 Government Communication and Information System	288	295	293	1	376	384	186
8 National Treasury	15 571	16 753	16 171	582	19 708	19 748	8 957
9 Public Service and Administration	326	442	429	13	357	384	161
10 Public Service Commission	96	97	96	1	105	108	49
11 SA Management Development Institute	59	59	58	1	71	131	37
12 Statistics South Africa	1 074	1 162	1 060	101	1 100	1 157	419
SOCIAL SERVICES							
13 Arts and Culture	1 318	1 330	1 330	0	1 608	1 608	831
14 Education	14 129	14 299	14 250	49	16 001	16 387	11 671
15 Health	11 270	11 454	11 338	116	12 655	13 091	6 187
16 Labour	1 513	1 493	1 454	40	2 033	2 038	876
17 Social Development	62 005	62 382	61 676	706	67 232	67 229	35 083
18 Sport and Recreation South Africa	352	960	887	73	3 157	5 067	1 581
JUSTICE AND PROTECTION SERVICES							
19 Correctional Services	10 631	9 832	9 251	580	10 742	11 384	4 856
20 Defence	23 830	23 903	23 818	85	25 922	26 292	10 456
21 Independent Complaints Directorate	66	66	65	1	81	81	35
22 Justice and Constitutional Development	6 270	6 479	6 005	473	7 278	7 539	3 085
23 Safety and Security	32 558	32 521	32 521	0	35 917	36 386	16 584
ECONOMIC SERVICES AND INFRASTRUCTURE							
24 Agriculture	1 958	2 368	2 219	149	2 281	3 470	968
25 Communications	1 280	1 322	1 320	3	1 424	1 924	625
26 Environmental Affairs and Tourism	2 018	2 062	2 060	2	2 591	2 791	1 571
27 Housing	6 861	7 334	7 166	168	8 878	8 982	3 815
28 Land Affairs	4 852	3 730	3 726	5	5 679	5 928	2 780
29 Minerals and Energy	2 548	2 635	2 608	27	2 966	2 975	1 522
30 Public Enterprises	683	2 870	2 590	280	1 064	4 605	985
31 Science and Technology	2 614	2 617	2 613	4	3 142	3 144	1 531
32 Trade and Industry	3 666	3 942	3 805	137	4 846	5 479	2 467
33 Transport	12 870	13 747	13 360	386	15 858	16 544	6 660
34 Water Affairs and Forestry	4 477	4 660	4 306	355	5 306	5 863	2 174
	260 049	**266 186**	**260 558**	**5 628**	**299 178**	**313 264**	**141 972**
State debt cost	52 049	52 588	52 192	396	52 916	52 937	26 723
Equitable share	150 753	150 753	150 753	–	171 271	172 862	89 061
Other direct charges against the National Revenue Fund	6 774	6 802	6 653	149	7 508	8 311	3 390
Unallocated and contingency reserve	3 100	–	–	–	3 000	–	–
Less: Projected underspending	–	–	–	–	–	-5 000	–
Total	**472 725**	**476 330**	**470 156**	**6 174**	**533 873**	**542 374**	**261 146**

1. Includes Special Adjusted Appropriation Act.

Table A.2 Expenditure by province, 2006/07 and 2007/08 financial year

	2006/07					2007/08	
R million	Main budget	Adjusted budget	Preliminary outcome	Over(-)/ Under(+)	Deviation from adjusted budget	Main budget	Actual spending April to September
Eastern Cape	**26 827**	**27 530**	**26 923**	**607**	**2.2%**	**31 009**	**13 615**
Education	13 065	13 122	12 873	249	1.9%	14 726	6 515
Health	6 893	7 337	7 257	80	1.1%	8 143	3 721
Social Development	763	741	750	-10	-1.3%	952	382
Other functions	6 107	6 330	6 043	287	4.5%	7 188	2 996
Free State	**11 626**	**11 883**	**12 297**	**-414**	**-3.5%**	**13 309**	**6 241**
Education	5 272	5 333	5 346	-12	-0.2%	5 692	2 721
Health	3 250	3 369	3 461	-92	-2.7%	3 643	1 848
Social Development	418	446	443	3	0.6%	453	191
Other functions	2 686	2 734	3 047	-313	-11.4%	3 520	1 481
Gauteng	**34 500**	**35 136**	**34 748**	**388**	**1.1%**	**40 312**	**17 652**
Education	12 282	12 262	11 623	639	5.2%	14 543	6 746
Health	10 404	10 748	11 115	-366	-3.4%	12 052	5 596
Social Development	982	1 006	1 012	-6	-0.6%	1 404	535
Other functions	10 832	11 120	10 998	121	1.1%	12 312	4 775
KwaZulu-Natal	**37 192**	**37 429**	**36 955**	**474**	**1.3%**	**43 515**	**21 022**
Education	16 209	16 136	16 234	-98	-0.6%	18 577	9 228
Health	11 737	11 819	11 664	155	1.3%	13 413	6 894
Social Development	895	1 000	942	59	5.9%	1 000	444
Other functions	8 351	8 473	8 116	358	4.2%	10 525	4 455
Limpopo	**22 899**	**23 722**	**23 908**	**-186**	**-0.8%**	**25 312**	**11 777**
Education	11 067	11 399	11 367	32	0.3%	11 948	5 938
Health	5 448	5 554	5 832	-278	-5.0%	6 096	2 924
Social Development	432	395	401	-6	-1.5%	439	200
Other functions	5 953	6 374	6 308	66	1.0%	6 829	2 715
Mpumalanga	**12 805**	**12 832**	**12 690**	**142**	**1.1%**	**16 211**	**7 250**
Education	6 218	6 326	6 273	53	0.8%	7 956	3 731
Health	2 912	3 032	3 013	19	0.6%	3 595	1 583
Social Development	430	334	319	15	4.5%	498	218
Other functions	3 244	3 140	3 085	55	1.7%	4 163	1 718
Northern Cape	**4 395**	**4 510**	**4 569**	**-59**	**-1.3%**	**5 663**	**2 668**
Education	1 644	1 648	1 643	5	0.3%	2 267	1 114
Health	1 291	1 316	1 407	-91	-6.9%	1 460	745
Social Development	215	223	218	5	2.3%	304	132
Other functions	1 245	1 323	1 301	21	1.6%	1 632	677
North West	**14 400**	**15 532**	**15 017**	**515**	**3.3%**	**14 412**	**6 893**
Education	6 305	6 780	6 686	94	1.4%	5 324	2 984
Health	3 428	3 616	3 479	137	3.8%	3 755	1 641
Social Development	428	420	368	51	12.2%	608	170
Other functions	4 240	4 717	4 484	233	4.9%	4 726	2 098
Western Cape	**18 376**	**19 458**	**18 850**	**608**	**3.1%**	**20 717**	**9 745**
Education	6 988	7 116	6 920	195	2.7%	7 685	3 546
Health	6 323	6 476	6 420	57	0.9%	7 095	3 449
Social Development	727	728	720	8	1.2%	892	409
Other functions	4 337	5 138	4 790	347	6.8%	5 045	2 341
Total	**183 020**	**188 031**	**185 956**	**2 075**	**1.1%**	**210 460**	**96 863**
Education	79 051	80 122	78 963	1 158	1.4%	88 719	42 523
Health	51 686	53 269	53 648	-379	-0.7%	59 252	28 401
Social Development	5 289	5 293	5 173	120	2.3%	6 550	2 682
Other functions	46 994	49 347	48 171	1 176	2.4%	55 940	23 256

Glossary

Adjustments estimate	Presentation to Parliament of the amendments to be made to the appropriations voted in the main budget for the year.
Appropriation	The approval by Parliament of spending from the National Revenue Fund, or by a provincial legislature from the Provincial Revenue Fund.
Balance of payments	A summary statement of all the international transactions of the residents of a country with the rest of the world over a particular time period.
Baseline	The initial allocations used during the budget process, derived from the previous year's forward estimates.
Budget balance	The difference between budgeted expenditure and budgeted revenue. If expenditure exceeds revenue, the budget is in deficit – or, if the reverse is true, it is in surplus.
Capital gains tax	Tax levied on the profits realised from the disposal of capital assets or investments by a taxpayer. A capital gain is the excess of the selling price over the original purchase price of a capital asset.
Capital flow	A flow of investments in and out of the country.
Conditional grants	Allocations of money from one sphere of government to another, conditional on certain services being delivered or on compliance with specified requirements.
Consolidated expenditure	Total expenditure by national and provincial government, social security funds and selected public entities, including transfers and subsidies to municipalities, businesses or other entities.
Consumption expenditure	Expenditure on goods and services, including salaries, which are used up within a short period of time, usually a year.
Contingency reserve	An amount set aside, but not allocated in advance, to accommodate changes to the economic environment and to meet unforeseen spending pressures.
CPIX inflation	A measurement of the price increases of a basket of consumer goods and services. This measure differs from the consumer price index in that it excludes mortgage costs. See also *inflation.*
Current account (of the balance of payments)	The difference between total exports and total imports, also taking into account service payments and receipts, interest, dividends and transfers. The current account can be in deficit or surplus. See also *trade balance.*

Debt service costs	The cost of interest on government debt.
Depreciation (capital)	A reduction in the value of fixed capital as a result of wear and tear or redundancy.
Depreciation (exchange rate)	A reduction in the external value of a currency.
Division of revenue	The allocation of funds between the spheres of government as required by the Constitution. See also *equitable share.*
Economic cost	The cost of an alternative that must be forgone to pursue a certain action. Put another way, the benefits that could have been received by taking an alternative action.
Equitable share	The allocation of revenue to the national, provincial and local spheres of government as required by the Constitution. See also *division of revenue.*
FIFA	The Fédération Internationale de Football Association – the international governing body of football.
Financial and Fiscal Commission (FFC)	An independent body established by the Constitution to make recommendations to Parliament and provincial legislatures about financial issues affecting the three spheres of government.
Financial account (of the balance of payments)	A statement of all financial transactions between a country and the rest of the world, including portfolio and fixed investment flows and movements in foreign reserves.
Financial year	The 12 months according to which companies and organisations budget and account.
Fiscal policy	Policy on taxation, public spending and borrowing by government.
Fiscal space	The ability of a government's budget to provide additional resources for a desired programme without jeopardising fiscal or debt sustainability.
Foreign direct investment (FDI)	The acquisition of controlling interest by governments, institutions or individuals of a business in another country.
GDP inflation	A measure of the total increase in prices in the whole economy. Unlike CPI inflation, GDP inflation includes price increases in goods that are exported and intermediate goods such as machines, but excludes imported goods.
Gross domestic product (GDP)	A measure of the total national output, income and expenditure in the economy. GDP per head is the simplest overall measure of welfare, although it does not take account of the distribution of income, nor of goods and services that are produced outside the market economy.
Gross fixed capital formation	The addition to a country's fixed capital stock over a specific period, before provision for depreciation. See also *capital formation.*

Inflation	An increase in the general level of prices.
Inflation targeting	A monetary policy framework intended to achieve price stability over a certain period of time. The Reserve Bank and government agree on a target rate or range of inflation to be maintained over a stipulated period.
Medium-term Expenditure Committee (MTEC)	The technical committee responsible for evaluating the MTEF budget submissions of national departments and recommending allocations.
Medium-term expenditure framework (MTEF)	The three-year spending plans of national and provincial governments published at the time of the Budget.
Money supply	The total stock of money in an economy.
National budget	The projected revenue and expenditures that flow through the National Revenue Fund. It does not include spending by provinces or local government from their own revenues.
National Revenue Fund	The consolidated account of national government into which all taxes, fees and charges collected by SARS and departmental revenue must be paid.
Nominal exchange rates	The current rate of exchange between the rand and foreign currencies. The "effective" exchange rate is a trade-weighted average of the rates of exchange with other currencies.
Non-interest expenditure	Total expenditure by government less debt service costs.
Primary sector	The agricultural and mining sectors of the economy.
Private sector credit extension	Credit provided to the private sector by banks. This includes all loans, credit card balances and leases.
Public private partnership (PPP)	A contractual arrangement in which a private party performs part of a government function and assumes the associated risks. In return, the private party receives a fee according to predefined performance criteria.
Public sector borrowing requirement	The consolidated cash borrowing requirement of general government and public enterprises.
Real effective exchange rate	A measure of the rate of exchange of the rand relative to a trade-weighted average of South Africa's trading partners' currencies, adjusted for price trends in South Africa and the countries included.
Real expenditure	Expenditure measured in constant prices, i.e. after taking account of inflation.
Repurchase (repo) rate	The rate at which the Reserve Bank lends to commercial banks.
Reserves (foreign exchange)	Holdings of foreign exchange, either by the Reserve Bank only, or by the Reserve Bank and domestic banking institutions.

Seasonally adjusted and annualised	The process of removing the seasonal volatility (monthly or quarterly) from a time series. This provides a measure of the underlying trend in the data.
Southern African Customs Union (SACU) Agreement	An agreement that allows for the unrestricted flow of goods and services, and a sharing of customs and excise revenue, between South Africa, Botswana, Namibia, Lesotho and Swaziland.
Southern African Development Community (SADC)	A regional governmental organisation that promotes collaboration, economic integration and technical cooperation throughout Southern Africa.
Terms of trade	An index measuring the ratio of export prices to import prices.
Trade balance	The monetary record of a country's net imports and exports of physical merchandise. See also *current account.*
Unit labour costs	The cost of labour per unit of output. Calculated by dividing average wages by productivity (output per worker per hour).