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# Supporting the recovery, transforming the economy

- The watershed events of the past 14 months provide a timely reminder that economics is ultimately about lives and livelihoods, and the choices that people make. Throughout South Africa nearly half a million people have lost their jobs. Hundreds of thousands of families have been affected by retrenchments. Businesses and households are struggling to adjust to declining incomes and precarious levels of debt.
- South Africa is beginning to emerge from its first recession in 17 years, but the recovery is likely to be slow and uneven, with job creation lagging the return to growth and many households continuing to face hardship. Healthy public finances, and strong partnerships with business and labour, have enabled government to reduce the impact of the crisis.
- This *Medium Term Budget Policy Statement* presents the outlook for economic recovery and discusses government's three-year spending priorities. It also addresses two key policy challenges. The first is to transform our economy to enable a massive expansion of employment alongside faster growth. The second is to create a culture of responsible stewardship and reform the public service, which does not yet meet the legitimate expectations of South Africans. In these circumstances, our social and economic transformation challenge has to be addressed with renewed urgency.

## From recovery to inclusive growth

*South Africa needs an economy in which more people can find work*

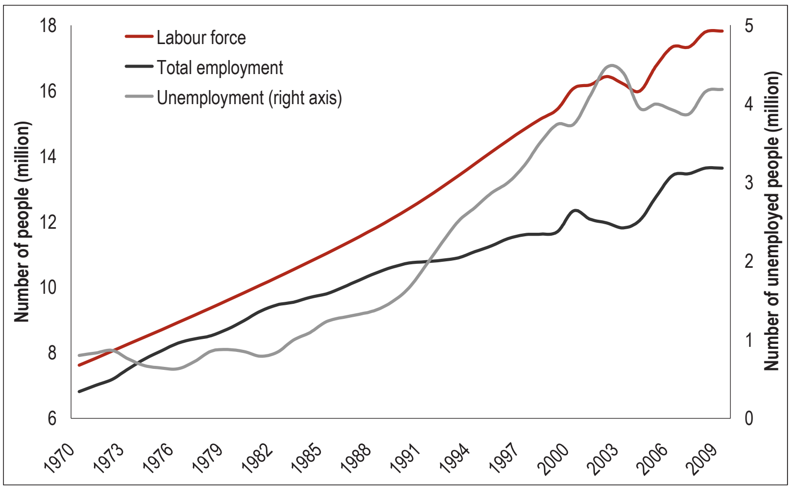
Over the next few years, South Africa faces the related challenges of supporting the nascent economic recovery while transforming the economy so that more people are able to find work. The 2009 *Medium Term Budget Policy Statement* is tabled in a period of opportunity, at the intersection of an economic crisis and a change of administration, to reshape our economy, public finances and the state more generally – and to improve the lives of all South Africans.

## Key challenges over the medium term

*From the mid-1980s to 2002, South Africa experienced rising unemployment*

Too few people in South Africa work, with the result that for millions of citizens, daily life is a struggle with poverty, hunger, frustration and marginalisation. Figure 1.1 shows that unemployment rose rapidly from the mid-1980s to 2002.

**Figure 1.1 Labour force, employment and unemployment, 1970 – 2009**




*The quality of public services, especially in poor communities, is often inadequate*

While government has made good progress in increasing access to public services and to household infrastructure, the quality of public services, especially in poor communities, is often inadequate. Too many children cannot read and count, too many women die giving birth, too many people fear for their safety and too many South Africans stand in long queues to receive basic public services. Tackling the twin challenges of employment creation and efficient service delivery is essential to building a cohesive and prosperous nation.

These policy imperatives must be addressed in an international and domestic environment characterised by much lower economic growth rates than those preceding the financial crisis.

*A new, sustainable and equitable growth path is needed for South Africa and the world*

In recent months the world economy has benefited from a coordinated policy response to the economic crisis. A series of extraordinary fiscal and monetary measures has helped to stabilise the global economy, but the road back to higher employment and rising living standards is likely to be long and bumpy. While some causes of the crisis are being addressed, others merely fester. The challenge remains to find a new, more sustainable and equitable growth path – both for the world economy and for South Africa.

The Group of 20 (G20),[1] of which South Africa is a member, is coordinating the response to the global downturn. The G20 has sought to identify and address causes of the crisis, and has put forward a *Framework for Strong, Sustainable and Balanced Growth*. Our policies are broadly in line with this framework. Yet as a developing country with its own unique challenges, South Africa has an obligation to learn its own lessons from the crisis and address the country's main economic weakness: that too few people work and benefit from economic activity.

*The Group of 20 is coordinating the international response*

In line with international forecasts, South Africa expects a gradual economic recovery. Gross domestic product (GDP) growth of 1.5 per cent is projected for 2010, with growth only expected to breach the 3 per cent level in 2012. Job creation is likely to be slow, and many households will be forced to get by on reduced incomes, even as the economy recovers. This underlines the need for government to maintain public spending, especially expenditure that assists poor communities, and to accelerate efforts to create jobs.

*Job creation is likely to lag return to economic growth*

A sound fiscal position has enabled government to sustain public services, and to increase spending on investment that will raise our future growth potential. This has required a higher level of borrowing. As the economy recovers, government will act to reduce the budget deficit from a projected 7.6 per cent of GDP this year, so that the economy is not left with an unsustainable debt burden. Over the next three years, revenue growth is projected to recover gradually, and spending growth will have to moderate to return the public finances to a sustainable trajectory.

*As the economy recovers, the budget deficit will gradually reduce*

In this challenging fiscal environment, government must shift resources away from lower priorities to higher priorities: job creation, education, health, rural development, and fighting crime and corruption.

The functioning of the public service requires fundamental reform to obtain better value for public money, to do more with less, and to build a culture of responsible stewardship so that citizens trust the institutions of service delivery. The fight against corruption in government, and to prevent the resources of the state from being captured by various interest groups, must be given priority. Corruption hurts the poor most and damages the ability of government to deliver services to the country as a whole. Combating corruption requires steps to improve financial management and to reform state procurement. It also requires greater accountability in the way in which public resources are handled.

*To fight corruption, financial management will have to be improved and procurement reformed*

[1] The G20 members, representing about 90 per cent of global gross national product, 80 per cent of world trade and two-thirds of the world's population, are: Argentina, Australia, Brazil, Canada, China, the European Union, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States.

## Learning from the global crisis

*Failure to prevent a new crisis would have devastating consequences*

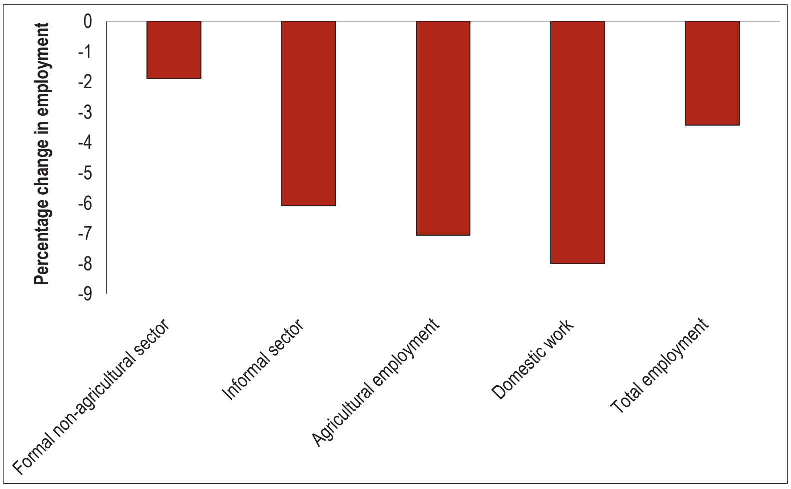
Like the rest of the world, South Africa has to address boom-bust cycles and their effects on the lives of ordinary people. Nouriel Roubini, the New York University economist who warned of the threat posed by the US housing market bubble, states: "The financial, fiscal and economic costs of this crisis are so severe that failing to prevent the next virulent one will lead to a severe backlash against globalisation, free trade and free capital flows." The collapse of global trade that would follow would have devastating consequences, particularly for Africa and the rest of the developing world.

To prevent such an outcome, policy-makers have begun drawing lessons from the most serious economic crisis in more than seven decades.

*Macroeconomic stability is required, particularly to reduce the impact of boom-bust cycles on the poor*

The first lesson is that boom-bust cycles hurt low-income workers, the poor and the vulnerable more than other sectors of society. This is as true of a developing country like South Africa as it is of major economies. Figure 1.2 shows that aggregate employment fell by 3.4 per cent in the first half of 2009, with the highest ratios of jobs lost in agriculture, domestic work and the informal sector. Government has to act in ways that reduce economic volatility while strengthening job creation and providing adequate social security.

**Figure 1.2 Percentage change in employment, first half 2009**




*Source: Labour Force Survey*

*Vast economic imbalances are not sustainable*

Second, the 21st-century global economy cannot sustain vast imbalances between savings and investment, between earnings and consumption, and between rich and poor:

- Countries cannot invest at a much higher rate than their savings can support on a sustainable basis. For South Africa, this means that savings have to rise to be able to fund a higher level of investment.
- Neither countries nor households can consume more than they earn for prolonged periods of time, because unsupportable debt eventually leads to lower living standards.

- Rising income inequality – both internationally and in South Africa – has negative social effects and leads to economic instability. Policy must focus on reducing inequality by creating more jobs, combating abuse of market power and broadening income security.

*Appropriate financial sector regulation is a necessity*

Third, appropriate regulation of the financial services sector – the unbridled excesses of which led to the present crisis – is required. Financial services play a vital role in the economy, moving resources from savers to investors. But when financial institutions fail, there are negative consequences, and when such failures take place on a global scale, the consequences threaten the world economy. Sound regulatory frameworks are needed to ensure that the financial sector can continue to play its important intermediary role while minimising the potential for harm to companies, households and economies.

*An effective state is needed to support growth and protect the poor*

Fourth, government intervention is essential to protect the poor and vulnerable, to help prevent boom-bust cycles, to regulate financial markets and to support growth when demand falls. An effective and capable state is required to achieve these objectives.

While the global crisis precipitated South Africa's recession, domestic factors also played a role. Our economy experienced rapid economic growth between 2003 and 2007, accompanied by rising employment. During this period, however, several imbalances emerged that put the economy on a weaker footing.

*A range of factors contributed to overheating the domestic economy*

Rising commodity prices, in combination with low interest rates, fed a consumer boom and rising house and asset prices. Business responded by increasing investment, mainly in construction, financial services, telecommunications and transport, contributing to higher employment. However, rising food prices, pressure on wages for skilled employees and rising import costs pushed up inflation. Infrastructure bottlenecks, most notably the lack of adequate capacity to generate electricity, served as visible signs of these imbalances.

Recent experience has reinforced several aspects of policy:

- Fiscal and monetary policy should be used to "lean against the wind", countering cyclical trends when there are signs that the economy is overheating or slowing below potential
- Infrastructure investment is required to sustain high rates of growth over the long term
- Keeping inflation low contributes to both growth and job creation
- Cooperation between the Reserve Bank and the fiscal authorities is essential to counter the effects of asset price bubbles on inflation, and to accumulate reserves to reduce exchange rate volatility.

## Supporting the recovery

### *Striking a balance*

*Government supports the recovery while avoiding the build-up of unsustainable debt*

Over the medium term, economic policy must strike a delicate balance, supporting the recovery through appropriate fiscal and monetary measures while avoiding the build-up of unsustainable debt that will impose costs on future generations. By providing appropriate support to key sectors while enabling economic adjustment to occur – allowing resources to move from industries that can no longer compete to newer, globally competitive ones – government supports a resumption of faster growth and job creation.

Achieving this balance requires sound economic policy, better coordination of policy between departments and well-functioning economic institutions.

### *The fiscal response*

*Public-sector borrowing is likely to reach 11.8 per cent of GDP this year*

The magnitude of South Africa's fiscal adjustment to the crisis has been among the biggest in the world, with the budget balance shifting from a deficit of 1 per cent in 2008/09 to an expected deficit of about 7.6 per cent in 2009/10. Taking into account the state-owned enterprises, public-sector borrowing is likely to reach 11.8 per cent of GDP this year.

*Government will gradually bring the budget back towards a balanced position*

South Africa has the fiscal space to be able to run a significant deficit to support the economic recovery. However, over the medium term, a phased moderation of the borrowing requirement will be required.

Low levels of public debt have also enabled a rapid increase in infrastructure spending, much of it supported by government-guaranteed borrowing by state-owned enterprises. Gross fixed capital formation by the public sector increased from 5.9 per cent of GDP in the second quarter of 2007 to 9.4 per cent in the same period of 2009. The public-sector infrastructure programme has helped to sustain investment and employment during a time of declining demand. Higher public-sector investment crowds in private investment.

*Private sector and government have developed partnerships to support employment*

Public employment has increased during the recession, though the sustainability of this is in question given high real wage increases. The expanded public works programme has accelerated, drawing more people into employment for longer periods. Government has provided support to several sectors through the development finance institutions.[2] Lending by these entities has also helped to boost public investment. Innovative partnerships have been developed between government and the private sector, including the training layoff scheme in which workers agree to forego their normal wage and receive training and an allowance instead of being retrenched. We have been able to take these steps while sustaining public spending on core services, including social security.

[2] The four major development finance institutions are the Development Bank of Southern Africa, the Industrial Development Corporation, the Land Bank and the National Housing Finance Corporation.

In summary, the steps that South Africa is taking to support the recovery include:

- Sustaining public spending and expanding public employment programmes
- Supporting state-owned enterprises to raise their investment levels
- Assisting sectors affected by the cyclical slowdown and bolstering municipal capital spending through the development finance institutions
- Maintaining expansionary fiscal and monetary policies only as long as is necessary
- Reinforcing the social safety net.

**Framework for South Africa's response to the international economic crisis**

In February of this year, government, business, labour and community representatives concluded an agreement addressing the impact of the world economic crisis on the real economy. Key elements of this framework, concluded under the auspices of the National Economic Development and Labour Council, include:

- A combination of countercyclical fiscal and monetary policy measures to support economic activity.
- An undertaking to maintain and to expand South Africa's public investment programme, to boost growth and employment, and to crowd in private-sector investment.
- Strategies to help vulnerable sectors, such as clothing and textiles and motor manufacturing, to weather the storm. A national jobs initiative will combine various state resources to finance industrial and special employment measures. As part of this initiative, the Industrial Development Corporation plans to lend more than R6 billion to distressed companies by March 2011.
- Development of investment incentives to create "green" jobs in industries and facilities that will mitigate the effect of climate change.
- Encouraging local procurement of supplies and services to support employment levels.
- Stepping up measures to combat customs fraud and illegal imports.
- Encouraging the financial sector to maintain credit and investment flows to the real economy.
- A pledge by companies to try to avoid retrenchments, and to invest in people and productive capacity. A key agreement in this regard is the training layoff scheme.
- Scaling up the expanded public works programme.

## Looking beyond the crisis

*South Africa's growth path must become more inclusive*

South Africa has to look beyond the present crisis and the short-term recovery. For some years, government and broader society have recognised that if we are to emerge as a prosperous and successful nation, the country's growth path must become more inclusive. While we have made good progress in stabilising the economy since 1994, in putting the macroeconomic and public finance foundations in place for higher growth, and in broadening access to public services and infrastructure, we must address longstanding structural limitations to more rapid and equitable growth.

*Informed by active consultation, government will work towards an alternative growth path*

Over the period ahead, policy development – informed by active engagement within government and in consultation with business, labour and civil society – will focus on charting an alternative growth path. As a contribution to this process, the *Medium Term Budget Policy Statement* identifies elements required for more rapid and shared growth in the years ahead. The policy statement also recognises that South Africa's peers in the developing world are expected to sustain their focus on economic growth, improving their competitiveness and drawing in investment. Unless we are able to make similar progress, South Africa will be left behind.

For more than a century, South Africa's economic growth has been characterised by heavy reliance on mining exports on the one hand, and a sophisticated but skills-intensive services sector on the other. As a result, too few people work, and too many lack the skills required for the sophisticated services economy.

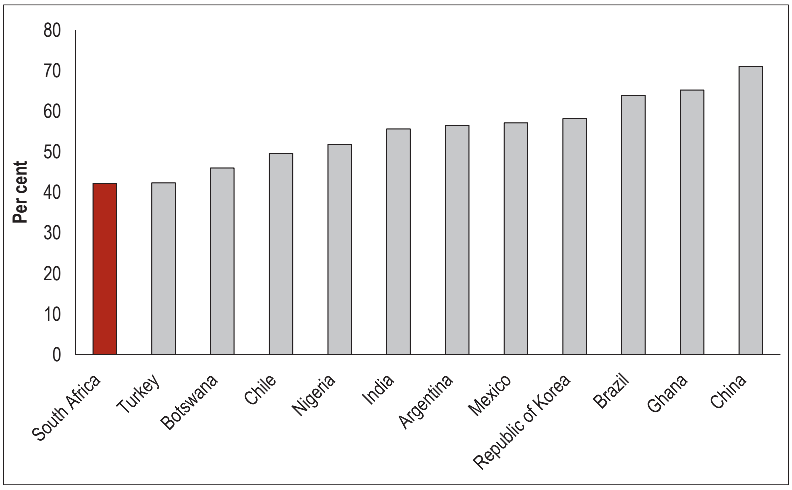
### *Boosting job creation*

*All policy choices must be informed by the need to create more jobs*

Creating jobs, particularly among millions of relatively unskilled South Africans, is the country's greatest economic challenge. Low employment is the direct cause of our high levels of inequality and marginalisation. Only 42 per cent of the population aged between 15 and 64 are in some form of employment. This compares unfavourably with countries such as Brazil and China, where about two-thirds of the adult population work. In the former homelands, the picture is even bleaker, with fewer than 30 per cent of the adult population working. According to the Labour Force Survey, almost half of young Africans have never worked.

If the country does not find a way to resolve this problem, there will be catastrophic implications for social stability and future growth.

**Figure 1.3 Labour-force absorption rates in selected countries, 2008**




The jobs crisis has wide-ranging significance for economic and social policy initiatives. Current policy options available to government to boost employment include:

- Expanding services that are labour intensive, such as home-based care, refuse removal, building maintenance, grass-cutting, rural road construction, securing government buildings such as schools, and cleaning up environmentally sensitive areas such as rivers, lakes and wetlands.

- Changing the orientation of industrial incentives to focus on labour-intensive industries.
- Using the tax system to encourage employment. Government can consider using the income tax system to provide incentives to employers to hire staff, lowering the cost of employment without affecting wages. Similarly, government can subsidise social security contributions (such as unemployment insurance) for low-income workers.
- Making greater use of research and development capacity and innovation to support job creation by the private sector. Similarly, responding to the climate-change challenge provides the opportunity to increase investment and employment in "green" technologies.
- Introducing a targeted voucher to help matriculants enter the workforce. Such a voucher could either be used for further education and training, or be presented to an employer willing to hire the school leaver, helping young workers to gain skills and experience.
- Implementing a coherent rural development programme, including support for access to agricultural markets, training and assistance to small farmers. Rural infrastructure projects tend to be labour-intensive, with positive effects for community livelihoods.

### *Pursuing a competitive real exchange rate and low inflation*

The volatility and level of the rand also require attention, particularly because they affect investment in export-led industries. Since 1994, the nominal and real effective exchange rates have depreciated by 60 per cent and 15 per cent respectively, making the rand more competitive today than it was 15 years ago. This long-term trend has supported growth in manufacturing, mining and goods production.

*The fiscal and monetary authorities will work to support a more competitive real exchange rate*

Mindful of the appreciation of the currency in recent months, the National Treasury and the Reserve Bank will enhance coordination of fiscal and monetary policy to support low inflation and a more stable and competitive real exchange rate. A relaxation of exchange controls is announced (see Chapter 2) to lower the cost of doing business and promote investment. The development of asset prices and their impact on inflation will be the focus of future analytical work.

Inflation rates that are higher than those of our trading partners imply decreasing competitiveness, something that needs to be countered more strongly in the period ahead through various economic policies, not only monetary policy.

### *The role of countercyclical fiscal policy*

*Fiscal policy helps to counter the effect of boom-bust cycles*

Fiscal policy can play an important role in reducing the occurrence of boom-bust cycles and in supporting a competitive exchange rate. Government has adopted a countercyclical fiscal policy. In practice, this means that spending and tax decisions made when the economy is strong will still be affordable when the economy weakens. In times of economic stress, government is able to borrow to compensate for temporary revenue losses.

### *Supporting competitiveness, creating jobs through trade policy*

*South Africa requires higher productivity and greater competitiveness*

South Africa's productivity, compared with that of our key emerging-market peers, has deteriorated. Low productivity has contributed to our poor export performance in goods and services – apart from those products, like minerals, which other countries do not have. South Africa needs higher levels of productivity and competitiveness for our economy to grow and employ a greater number of workers. Improving the quality of education, increasing the skills base and raising levels of fixed investment will contribute to higher productivity.

Trade policy is another instrument that can be used to bolster competitiveness and to promote exports. On the basis of specific evidence, government will take steps aimed at raising employment and lowering the costs of products to boost competitiveness.

### *Tough choices ahead*

*Funding some priorities means reducing expenditure elsewhere*

Transforming the economy and restructuring the public service will require some difficult adjustments. Government, business, labour and civil society will need to give due consideration to these trade-offs and reach consensus on the best way forward.

For example, increasing budgets for labour-intensive public services could mean reducing expenditure elsewhere. Funding a wage subsidy might require higher taxes. Channelling incentives to labour-intensive sectors is likely to take resources away from other sectors of the economy. Such measures imply some discomfort for people and communities, because the options that governments have to reallocate resources are limited. Moreover, the benefits of such resource shifts can be blunted by bureaucratic inefficiency or captured by vested interests.

In summary, key elements of government's strategy to drive more inclusive growth could include:

- Shifting resources to labour-intensive sectors of the economy, helping young workers enter the economy and reducing the barriers to creating jobs
- Trade, industrial and competition policy that contributes to creating jobs through increasing competitiveness, raising productivity and lowering costs for both businesses and households
- Fiscal and monetary policies that promote balanced, sustainable and stable growth, lower inflation, a competitive exchange rate, and higher savings and investment
- Improving the performance of the state, especially in the quality of services it delivers to the poor.

*Partnerships are essential to promote better economic outcomes*

The budget framework set out in this *Medium Term Budget Policy Statement* balances investment in public services capacity with support for broader development and inclusive growth. While public expenditure plays a key role, partnerships are essential. All actors in the economy, and all those with responsibility for policy, need to pull together to achieve better economic outcomes – a more fair and prosperous society with opportunities for all.

### Transforming the public sector

There is public dissatisfaction with the poor quality of service delivery, and high levels of wasteful expenditure and inefficiency in government.

**Figure 1.4 Percentage of people satisfied with public services, 2000 – 2009**


*Source: Development Indicators 2009, The Presidency*

To contribute to higher and more inclusive growth, we must also transform the performance of the public sector, which accounts for about one-fifth of consumption and one-third of investment. An efficient public sector means effective resource allocation, better development of human capital and lower costs for business in its interactions with the state.

*Government will reprioritise all aspects of public spending over the next three years*

Over the next three years government will conduct a phased reprioritisation of public spending. In phase one, the emphasis is on reducing unnecessary and wasteful expenditure. In phase two we will consider rationalising public entities and agencies, shift resources from back-office operations to frontline services, and reform the procurement process to reduce unit costs and corruption. Phase three will include a comprehensive expenditure review. During this phase, government will look at reshaping the way in which public services are delivered and resources are allocated.

*The culture of the public service must change*

These reforms, as important as they are, cannot substitute for a much-needed change in culture in the public service – one that is premised on respect for citizens, due care and thrift in the management of public funds, and greater accountability. Cabinet oversight of public-sector reform initiatives, planning, and performance monitoring and evaluation will support this process.

# Overview of the 2009 policy statement

## Economic policy and outlook

Chapter 2 discusses the macroeconomic outlook and provides a perspective on the changes required for higher growth and employment in the context of a much weaker global economy.

*Global recovery is likely to be gradual, with job creation lagging growth*

A coordinated effort by the major economies to apply large-scale fiscal and monetary stimuli appears to have stabilised the world economy, with tentative signs that output and confidence are beginning to recover. Nevertheless, this recovery is likely to be gradual, with job creation lagging output growth. While some aspects of the systems of economic management, such as the regulation of the financial sector, have received considerable attention, many of the weaknesses that gave rise to the crisis have yet to be addressed. The International Monetary Fund expects the world economy to grow by 3.1 per cent next year, following an estimated output decline of 1.1 per cent this year, driven mainly by growth in emerging markets and a gradual recovery of global trade.

The global crisis led to South Africa's first recession in 17 years. Demand for key exports has fallen. The prices of most commodities, while recovering strongly in recent months, remain below their pre-crisis levels. Employment has fallen, private-sector investment has been curtailed, and industrial and mining output have declined sharply.

*Growth of 1.5 per cent expected for South Africa in 2010, rising to 3.2 per cent in 2012*

While GDP is expected to decline by 1.9 per cent in 2009, there are signs that the economy is now recovering. Positive GDP growth is anticipated in the fourth quarter of 2009, with growth of about 1.5 per cent projected for 2010, reaching 3.2 per cent in 2012. While public-sector investment will be robust, household consumption, the largest component of GDP, is likely to remain weak as households reduce their considerable debts. Private-sector investment is only likely to recover in 2011. Higher commodity prices should contribute to the recovery.

*African prospects buoyed by investment in mining, chemicals, tourism and transport infrastructure*

Growth prospects in Southern Africa and Africa in general remain relatively healthy, with growth of 4.1 per cent projected for 2010 due to a recovery in investment in mining, petrochemicals, tourism and transport infrastructure. South Africa is one of the largest investors on the continent and benefits from growing intra-African trade.

Consumer price inflation has fallen from a peak of 13.6 per cent in August 2008 to 6.4 per cent in August 2009, largely as a result of moderating food and oil prices and a stronger rand. However, higher nominal salary increases and rising electricity prices will put upward pressure on inflation.

Table 1.1 summarises the key macroeconomic projections.

**Table 1.1 Macroeconomic projections, 2009 – 2012**

| Calendar year | 2008<br>Actual | 2009<br>Estimate | 2010 | 2011<br>Forecast | 2012 |
|---|---|---|---|---|---|
| *Percentage change unless otherwise indicated* | | | | | |
| Final household consumption | 2.3 | -3.1 | 0.9 | 2.3 | 2.5 |
| Gross fixed capital formation | 10.2 | 3.5 | 4.4 | 7.1 | 6.6 |
| **Real GDP growth** | **3.1** | **-1.9** | **1.5** | **2.7** | **3.2** |
| **GDP at current prices (R billion)** | **2 283.8** | **2 373.8** | **2 560.5** | **2 798.9** | **3 050.0** |
| CPI inflation | 9.9 | 7.1 | 6.3 | 6.0 | 5.7 |
| Current account balance (% of GDP) | -7.4 | -4.9 | -5.7 | -6.1 | -6.9 |

A key focus of economic policy is to support the recovery. In addition, South Africa's high unemployment rate calls for a bolder response to the jobs crisis. In this regard, Chapter 2 summarises the key findings of several reviews of the South African economy focused on higher employment and faster growth.

## Fiscal policy and trends

*Sound fiscal policy has prepared South Africa for the global storm*

Chapter 3 discusses fiscal policy and revenue trends. South Africa entered the recession in good fiscal health. Low budget deficits and small surpluses during the boom years reduced public debt to about 23 per cent of GDP at the end of 2008/09. Efficient tax administration and sound debt management contributed to a steady reduction in liabilities, reflected in a falling share of spending on debt service.

*Strong fiscal response has included rising capital infrastructure investment*

A strong fiscal response, complemented by monetary easing, has supported economic growth and prevented further deterioration in consumption, investment and employment. The fiscal stance enabled government to sustain strong growth in public spending during the recession. In particular, rising investment spending by general government and state-owned enterprises helped stimulate short-term activity and raise future potential growth. These investments also have considerable social benefits for the poorest South Africans.

Public-sector employment growth has also increased strongly, especially in services such as education, health and policing. Government has been able to increase borrowing in the face of lower revenue to sustain public spending and investment. A deficit of 7.6 per cent is expected in 2009/10.

As the economy recovers over the next few years, government will act to reduce borrowing gradually as the present deficit level is unsustainable.

*Tax revenue is down sharply as a result of the recession*

Tax revenue has fallen by about 3.2 per cent of GDP since peaking in 2007/08, with the greatest declines in VAT receipts, company taxes and trade taxes. As the economy recovers tax revenues will rise automatically. However, this will not be sufficient to reduce the deficit to sustainable levels. Other means of increasing revenue, such as broadening the tax base, improving tax compliance and introducing new taxes (such as environmental levies) may have to be considered.

*Growth in public expenditure needs to slow given pressure on the fiscus*

Over the next several years the rate of growth in public spending needs to moderate. Given the considerable pressures for delivery of more and better public services, the constrained fiscal environment places an obligation on government to do more with less. This implies the need for a new approach to the management of public resources and for spending to be reprioritised towards key areas such as education, health and job creation. Chapter 4 provides a more detailed discussion of efforts to reduce waste and inefficiency in public spending.

Table 1.2 summarises the fiscal framework of consolidated government, taking account of the spending and revenue of national and provincial government, the social security funds and public entities. A consolidated government budget deficit of 7.6 per cent is forecast for 2009/10, declining to 4.2 per cent by the end of the forecast period.

**Table 1.2 Consolidated government fiscal framework, 2008/09 – 2012/13**

| | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 |
|---|---|---|---|---|---|
| R billion | Outcome | Estimate | Medium-term estimates | | |
| **Revenue** | **692.0** | **657.5** | **743.5** | **833.4** | **921.3** |
| *Percentage of GDP* | *29.8%* | *27.3%* | *28.4%* | *29.1%* | *29.6%* |
| **Expenditure** | **715.4** | **841.4** | **905.6** | **975.6** | **1 052.8** |
| *Percentage of GDP* | *30.8%* | *35.0%* | *34.6%* | *34.0%* | *33.8%* |
| **Budget balance** | **-23.4** | **-183.8** | **-162.1** | **-142.1** | **-131.5** |
| *Percentage of GDP* | *-1.0%* | *-7.6%* | *-6.2%* | *-5.0%* | *-4.2%* |
| *Gross domestic product* | *2 321.2* | *2 405.1* | *2 620.1* | *2 868.7* | *3 111.3* |

## Medium-term budget priorities and the division of revenue

Following several years of buoyant public expenditure, the medium-term expenditure framework reflects a moderation in spending growth, accompanied by significant reprioritisation of spending.

*Procurement reforms are under consideration*

Table 1.3 shows consolidated government by function. A deep savings exercise is underway to reduce spending on lower priorities and non-core services, moving resources towards frontline services and higher priorities to enhance the effectiveness of public spending. Reforms to financial management and procurement policy are under consideration.

The main budget priorities, informed by the medium-term strategic framework, are:

- Supporting job-creation initiatives and realigning support to business to enhance employment opportunities
- Enhancing the quality of education and skills development
- Improving the provision of quality health care
- Driving a more comprehensive rural development strategy
- Intensifying the fight against crime and corruption.

These priorities are discussed in more detail in Chapter 4.

**Table 1.3 Consolidated expenditure, 2009/10 – 2012/13**

| R billion | 2009/10 Revised estimate | 2010/11 | 2011/12 | 2012/13 | % Average growth 2009/10–2012/13 |
|---|---|---|---|---|---|
| | | Budget estimate | | | |
| General public services | 49.2 | 52.8 | 55.8 | 55.8 | 4.3% |
| Defence | 34.1 | 36.5 | 39.3 | 41.9 | 7.2% |
| Public order and safety | 77.7 | 85.9 | 96.2 | 101.6 | 9.3% |
| Economic affairs | 182.9 | 169.4 | 155.6 | 162.8 | -3.8% |
| Environmental protection | 5.5 | 6.4 | 6.9 | 7.4 | 10.4% |
| Housing and community amenities | 69.4 | 78.9 | 89.7 | 98.5 | 12.3% |
| Health | 89.8 | 100.8 | 109.2 | 115.2 | 8.6% |
| Recreation and culture | 7.6 | 5.8 | 5.4 | 5.6 | -9.5% |
| Education | 144.0 | 160.2 | 174.8 | 184.6 | 8.6% |
| Social protection | 121.1 | 132.2 | 145.2 | 156.6 | 8.9% |
| Contingency reserve | – | 6.0 | 12.0 | 24.0 | |
| **Non-interest expenditure** | **781.4** | **834.9** | **890.1** | **954.0** | **6.9%** |
| State debt cost | 60.0 | 70.7 | 85.4 | 98.7 | 18.1% |
| **Total expenditure** | **841.4** | **905.6** | **975.6** | **1 052.8** | **7.8%** |

Table 1.4 summarises the division of nationally raised revenue. The fiscal framework makes available an additional R78 billion for allocation to spending programmes. In addition, savings of about R14.5 billion at national level and R12.6 billion at provincial level contribute to financing new priorities. Just over half of the additional amount goes to provinces, mainly for education and health, in part to finance general salary increases and occupation-specific salary dispensations aimed at attracting and retaining skilled professionals.

*Further resources for health, education and housing programmes*

Resources are also provided to accommodate a higher take-up of antiretroviral treatment, for the rollout of workbooks for the early phases of schooling, and for the housing programme.

About R12.4 billion is added to the local government share, mainly to compensate municipalities for the higher costs of providing free basic services (principally to take account of more expensive electricity). The *municipal infrastructure grant* and other infrastructure programmes also receive additional resources.

**Table 1.4 Division of revenue, 2009/10 – 2012/13**

| R billion | 2009/10 | 2010/11 | 2011/12 | 2012/13 |
|---|---|---|---|---|
| National allocations | 346.6 | 356.3 | 369.0 | 390.5 |
| Provincial allocations | 295.4 | 321.4 | 348.7 | 367.0 |
| *Equitable share* | *236.9* | *260.6* | *280.3* | *294.4* |
| *Conditional grants* | *58.5* | *60.7* | *68.4* | *72.6* |
| Local government allocations | 50.5 | 59.3 | 68.0 | 75.7 |
| **Total allocations** | **692.5** | **737.0** | **785.7** | **833.2** |
| **Changes to baseline** | | | | |
| National allocations | 3.6 | 3.7 | 8.2 | 13.8 |
| Provincial allocations | 10.8 | 11.7 | 12.8 | 15.4 |
| *Equitable share* | *9.0* | *10.3* | *10.9* | *11.5* |
| *Conditional grants* | *1.8* | *1.3* | *1.9* | *3.9* |
| Local government allocations | 0.8 | 1.6 | 3.0 | 7.8 |
| **Total** | **15.2** | **17.0** | **24.0** | **37.0** |

*The additions factor in the cost of establishing new government departments*

Additions to the national share provide for the phased extension of the child support grant, greater investment in rural development, continued growth in spending on the criminal justice sector, and support for industrial development and job creation. The additions also accommodate the cost of establishing new departments.