Medium Term
Budget Policy Statement
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Trevor A Manuel, MP
Minister of Finance

2 November 1998

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FOREWORD

by Trevor A. Manuel, MP
Minister of Finance

We present South Africa's second Medium Term Budget Policy Statement against the background of a world economy which has been rocked by a financial crisis, a slowdown in world trade, and financial disinvestment from emerging market economies. It is an uncertain environment in which to frame medium term policies.

South Africa has weathered the storm remarkably well, compared to many of our middle-income and developing country peers. We benefit from a sound balance of payments, moderate external liabilities, a well-regulated and well-developed financial system, open and transparent public finances and, above all, sound, coherent and sustainable macroeconomic and fiscal policies. These strengths have protected us from the worst effects of the crisis.

But however strong our economic position, the slowdown in the world economy and in world trade must inevitably have an adverse impact on our economy. As a result we have had to lower our forecasts of growth over the coming three years.

The change to economic conditions has meant that we have had to re-examine our projections of spending, tax revenue and borrowing. We will continue to focus on our reconstruction and development objectives, protecting spending on social services and grants to the poor, despite the traumatic events that have shaken the world economy since the last Budget. At the same time, we will continue on our path of deficit reduction, delayed a year in order to maintain stability in the real level of government spending. The deficit will continue to be reduced, year by year, and will reach 3 per cent of GDP in 2000/01.

We are therefore maintaining our economic policies, but making a measured adjustment to the profile of our economic and fiscal projections. We remain committed to creating jobs and growth, and increasing spending on new priorities, within a sound and sustainable economic framework.

Within this revised budget framework, we are continuing to improve the efficiency with which we use money to deliver services. We are redirecting resources to our reconstruction and development objectives. Spending on the social services and on infrastructure is expected to rise as a share of total spending over the coming three years. The formula which allocates funds to provinces will continue to redistribute funds to the previously disadvantaged provinces – and we have added a new component to address backlogs in infrastructure and services.

This Medium Term Budget Policy Statement sets out the total levels of spending, borrowing and tax, and the division of revenue between the spheres of government, that we expect to publish in the Budget in February. This provides provincial and municipal governments with the information they need to frame their budgets; and it enables Parliament and the public to engage in the dialogue about budget priorities with a shared understanding of the resources available.

The Medium Term Budget Policy Statement is a further step forward in the openness of the budget process, part of our reforms aimed at enhancing the amount of information available and improving the predictability and transparency of the public finances.

This policy statement encapsulates our approach to financing reconstruction and development. It demonstrates clearly the benefits of the sound foundations our economic policies have laid. It sets out our budgetary goals and priorities, and shows how they can be delivered.

We can, and we will, go on working to deliver a better life for all.

Trevor Manuel
Minister of Finance

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What is the Budget Policy Statement?

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Spending projections

The Medium Term Budget Policy Statement sets out the equitable division of nationally raised revenue between the three spheres of government. The Budget Policy Statement explains the rationale underlying the division of revenue and projects spending for the next three years for the main components of government's social, economic, protection and administrative functions.

Relationship with the budget

The Budget Policy Statement provides a point of departure for Government's medium term spending plans, which give practical expression and substance to the nation's shared reconstruction and development commitments. The detailed spending plans for the next three years will be published in the Budget on 17 February 1999.

Advantages of fiscal targets

Setting fiscal policy targets over the medium term – for the coming three years – has a number of advantages:

- policy credibility is enhanced, contributing to economic confidence and a more stable financial environment;
- a transparent fiscal policy encourages investment by enhancing the predictability of taxes, interest rates and government spending;

- a medium term fiscal framework facilitates transformation by creating an integrated planning framework, indicating broad dimensions of budget reprioritisation and providing a baseline against which policy changes can be assessed;
- by planning spending over the medium term, government improves the allocation and efficiency of public spending; and
- the medium term framework encourages public discussion and debate of policy priorities within the context of consistent macroeconomic and budget projections.

Budget reform

The Medium Term Expenditure Framework

The Medium Term Expenditure Framework is one of three broad reforms to the budget process. The 1999 Budget will be the second to include spending projections for the next three fiscal years. The key features of the Medium Term Expenditure Framework are:

- publication of three-year forward estimates when the Budget is tabled in Parliament;
- a focus on outputs and outcomes of government spending programmes as part of the budget review process;
- a cooperative approach to expenditure analysis and planning, involving national and provincial treasuries and spending departments;
- more detailed budget information to promote understanding and debate in Parliament and civil society; and
- a budget process aimed at informed political responsibility for budget priorities and spending plans.

Adjustments to forward estimates

The three-year projections of expenditure introduced in the 1998 Budget provide the baseline estimates for planning the 1999 Budget, and allow spending implications to be properly assessed when policy options come under consideration. Reviews of expenditure during the course of the budget process or shifts in priorities may lead political office-bearers to consider changes in the forward estimates. Policy changes will thus typically lead to specific adjustments to the baseline spending plan.

This three-year rolling budget framework means that departments can plan and reprioritise with greater certainty about future resource allocations than in the past. It also provides Parliament and civil society with clear signals of Government's spending intentions.

Evaluation of spending plans

On Budget Day, Parliament is presented with a set of three-year spending plans, but is only asked to vote on the budget for the coming year. The three-year spending projections allow Parliament, institutions of civil society and particular interest groups to evaluate Government's reconstruction and development goals and objectives in relation to envisaged spending plans. While the vigour of public debate will no doubt remain undiminished, its substance and quality are enhanced by the transparency and extent of information Government provides in the new approach to expenditure planning.

The Treasury Control Bill

The second key component of the budget reform process is the Treasury Control Bill. This gives effect to the Constitutional requirement for national legislation to:

- establish a National Treasury;
- introduce generally recognised accounting practices;
- introduce uniform norms and standards;
- prescribe expenditure control in all spheres of government; and
- set the operational procedures for borrowing, procurement and oversight over the various National and Provincial Revenue Funds.

The Treasury Control Bill sets the stage for the introduction of further budget reforms by introducing an approach to the management of public finances that focuses on outputs and responsibilities. The shift in emphasis toward outputs rather than expenditure regulations will be taken further in the Budget Reform White Paper to be published early next year.

Responsibilities of office-bearers

The Treasury Control Bill clarifies the respective responsibilities of the political head and the official head of a department or agency.

In broad terms, the political head is responsible for policy matters, including the preparation of the Budget and ensuring that the administrative head is implementing the budget in line with policy objectives.

The administrative head is accountable to the political head for the implementation of the budget, and accountable to Parliament for financial management. The Bill includes provision for penalties or sanctions in the event of failure of accounting officers to discharge their responsibilities.

Accounting officers

Four specific areas of responsibility of accounting officers are set out:

- operation of basic financial systems;
- ensuring that departments do not overspend their budgets;
- regular financial reporting; and
- publication of reports covering outputs and performance, in a prescribed format.

Overhaul of financial management

The Treasury Control Bill lays the basis for phasing in a major overhaul of financial management. This will include, amongst other things, the introduction of appropriation control and accountability arrangements for the management of budgets. As these principles take root, the emphasis will increasingly turn to oversight of the efficiency and effectiveness of programmes and qualitative improvements in financial management practice.

The Budget Reform White Paper

As noted in last year's Medium Term Budget Policy Statement, a longer term budget reform strategy is to be published in the form of a White Paper. This sets out proposals for more effective budgeting and financial management, aimed at strengthening the links between resource allocation and the delivery of services consistent with social and development priorities.

Budget reform challenges

The budget reform process must deal in practical ways with the challenges of South Africa's fiscal environment:

- a cooperative governance framework, in which key policies and their implementation are managed jointly by national and provincial governments;
- the translation of agreed policy goals into delivery of public services;
- the need to make choices so that resources are used to maximise Government's reconstruction and development aims, meet basic needs and ensure redistribution;
- the promotion of democratic accountability and greater transparency and understanding of the nation's budget; and
- greater effectiveness in the management of public resources to deliver services more efficiently and fairly.

Devolution of decision-making

These challenges underscore the need for a coherent vision of the budgeting system. The White Paper will set out proposals for greater devolution of powers of decision-making, empowering departments to allocate resources and manage their personnel and other inputs to improve service delivery. It will provide a clearer role for accounting officers in linking responsibility for resources to identified services, outputs and outcomes. It will outline tougher enforcement of controls, including improved financial accounting systems, more rapid audit and tougher penalties for over-spending or inappropriate use of funds.

These are inter-dependent reforms. If decision-makers are to be accountable for their actions, management responsibilities must be devolved to them. By the same token, devolution of decision-making requires a framework of accountability, and information systems to support decision-makers.

Medium term fiscal policy

The budget reform initiatives discussed above are aimed at fostering a sound allocation of resources through the budget process. At the same time, Government remains committed to a sustainable overall fiscal stance, consistent with a stable macroeconomic environment that promotes investment, supports job creation and improves the standard of living for all.

What is fiscal policy?

Fiscal policy deals with the levels and composition of taxation, spending and borrowing by government. Fiscal policy encompasses several fundamental policy issues, including the proper role and size of the state, the role of government in promoting growth, job creation, social development and redistribution, the nature and extent of public services and fairness between the present and future generations of South Africans. Government's fiscal policy has both microeconomic and macroeconomic objectives.

Improved distribution and economic efficiency

Microeconomic objectives include an improved distribution of income and wealth, equitable access to social services, meeting the basic needs of the poor, promoting investment in public goods, and enhancing the efficiency with which the public and private sectors produce goods and services and their responsiveness to the needs of consumers.

Promoting growth and development

Macroeconomic objectives relate to evolution of the economy as a whole – national income and output, jobs, inflation and the balance of payments.

Microeconomic objectives of fiscal policy

Government's fiscal policy seeks to invest in public services that contribute to future productivity, employment creation and improved living standards. The reprioritisation of government spending aims to redirect public resources to spending areas that promote sustainable growth, while also providing safety and security and promoting the efficient administration of justice.

Investing in people

The budget includes provision for social grants targeted to protect the incomes of the poor, equitable access to schooling, support for training and higher education and an extensive public health system. By investing in people, Government seeks to extend opportunities to all and promote productivity and social well-being.

Tax fairness

Fiscal policy must also ensure that the level and structure of taxes promote equity and redistribution, and do not interfere unduly in people's investment and consumption decisions.

Encouraging investment

Government promotes a financial environment in which the nation's savings are directed towards productive investments, both in business enterprises and public infrastructure. By moderating the claims of the public sector on available savings, fiscal policy contributes to lower real interest rates, which in turn encourages investment, productivity and growth.

Macroeconomic objectives of fiscal policy

Government's fiscal policy is aimed at promoting stability, jobs and growth. A sound macroeconomic environment encourages investment in the economy, both domestically and from abroad, to create more jobs and a higher standard of living. Fiscal policy also seeks to create a climate conducive to increased domestic saving, to limit the extent to which South Africa is dependent on foreign savings and investment.

Affordable spending targets

In addition, Government recognises that public expenditure must be kept at an affordable level, and that spending must be matched by revenue – either currently or when debt obligations fall due. By keeping spending commitments in line with current and future revenue trends, fiscal policy contributes to low inflation and a sustainable balance of payments.

Debt and interest

Against the background of relatively high public sector borrowing requirements in the past, a rising ratio of debt to national income and an excessive interest burden on the budget, Government aims to lower the annual budget deficit to 3 per cent of GDP within the next two years. This will ensure that government debt does not grow faster than government's ability to meet debt service payments.

Government also aims to strengthen public sector investment spending as part of a broader commitment to building the productive capacity of the economy.

These fiscal objectives are part of an integrated macroeconomic strategy, aimed at more growth and jobs, and sustainable improvements in the standard of living of all South Africans.

A revised budget framework

Adaptation to changed economic environment

This Statement explains several significant shifts in the macroeconomic and fiscal environment since the publication of the 1998 Budget. The revised budget framework set out in chapter 3 is part of Government's response to the dramatic changes of the last six months in the international financial context. A slowdown in economic growth has led to adjustments in spending and tax plans. Higher interest rates have impacted sharply on resources available for service delivery.

Budget priorities

At the same time, chapter 4 of this Statement indicates several shifts in spending priorities in support of employment creation and stronger public investment. Government's commitment to effective policing and a revitalised justice system is outlined. Reforms aimed at better management of education, health and welfare services provided by provinces are noted.

Revised division of revenue

Shifts in priorities are also reflected in the allocation of resources between the spheres of government. Chapter 5 details a revised division of revenue between national, provincial and local government. Chapter 6 outlines likely spending trends over the next three years.

In setting out these policy considerations, Government invites Parliament, citizens and the institutions of civil society to contribute to the making of sound budgets, honest evaluation of policies and programmes and steady progress in implementing improved public services.

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BUDGET REFORM AND MEDIUM TERM FISCAL POLICY

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2

MACROECONOMIC SLOWDOWN AND PROSPECTS FOR RECOVERY

Introduction

Growth anticipated at time of Budget

At the time of the Budget in March this year, South Africa appeared set to avoid the financial distress and economic reversal that was then confined to Japan and East Asian economies. Lower interest rates, a strengthening of confidence and an acceleration of growth were widely anticipated. The economy was expected to record growth of 3 per cent in 1998/99.

Global financial crisis

Since April, the world economy has been rocked by a deepening banking crisis in Asian economies, a marked slowdown in global trade and massive financial disinvestment from emerging markets.

By some calculations, exchange rate and asset price declines have destroyed more than US$1,5 trillion of financial wealth in the affected Asian countries alone. About the same loss of value has been suffered on the New York Stock Exchange. The Russian economy is in a deep structural crisis, resulting in a debt standstill declaration. Latin American economies are being drawn into the crisis.

Impact on South Africa

South Africa has also been affected. The exchange value of the rand depreciated steeply between May and August this year and the Johannesburg Stock Exchange all-share index lost a third of its value over the same period. Foreign sales of bonds in the third quarter of the year rapidly reversed the net inflows recorded for the first half of the year. Having fallen to below 13 per cent in March 1998, the yield on government stock averaged nearly 20 per cent in August. Money market rates, prime interest rates and home loan rates were six percentage points higher in September than in May, and an unprecedented 16 percentage points higher than consumer price inflation.

Private consumption and retail sales have stagnated, export growth has slowed and business confidence has been severely dented. Although gross domestic product continued to record slight positive growth in the first two quarters of 1998, the economic outlook has weakened. An economic recovery comparable with the growth rates recorded over the 1994-1996 period is now not expected until the second half of 1999.

These developments inevitably impact on the budget for the 1999/00-2001/02 medium term planning period. This chapter provides a brief account of recent international financial developments and the revised macroeconomic outlook for the South African economy. Implications for the budget and fiscal framework are set out in chapter 3.

Background to the Asian crisis

Asian contagion

During the last decade the world has witnessed very strong growth in world trade and international capital flows. These flows contributed to the high rates of growth in many Asian economies, but also to a rapid extension of financial intermediation in an environment in which banking supervision was under-developed. Poor investments, fuelled in part by speculative finance and spiraling asset prices, eventually led to dramatic reversals in several prominent East Asian economies. Private capital outflows in the second half of 1997 resulted in sharp currency devaluations, increases in interest rates and severe declines in stock and other asset markets.

The crisis was sparked by the decline in asset values in Thailand, and pressure on the Thai baht which had become overvalued against the yen. The crisis spread between countries in the region because of trade linkages, the weakness of the Japanese economy and contagion effects operating through capital market sentiment. Having grown by over 5 per cent a year for over a decade, these economies are now shrinking at about the same rate.

Financial vulnerability

The East Asian crisis countries were vulnerable to sudden swings in international capital market sentiment because of the scale of short term foreign currency debt incurred by the private sector. Incentives for foreign borrowing arose from the fixed exchange rate policies adopted by most of these countries as well as from the structure of the financial system and weaknesses in financial regulation. Poor governance structures in the corporate sector also contributed to excessive corporate leveraging, which, together with a deterioration in returns, rendered firms highly vulnerable to interest and exchange rate shocks.

Burden of adjustment

The reversal of high rates of growth in East Asian economies and the impact of economic decline on government services and on employment and earnings of the poor raise important questions about development policies, international finance and the distribution of the burden of adjustment. In responding to these concerns in the Southern African context, the emphasis must fall strongly on protecting services and opportunities for the poor and ensuring that financial contagion does not destroy the livelihoods of working people.

Impact on the world economy

Slowdown in trade and financial flows

The slowdown in the Asian economies, the deepening recession in Japan and a slowdown in China affect growth prospects for the world economy. Commodity prices are low and growth in trade volumes has slowed. Banking failures in Asian economies impact both on fiscal balances in these countries and on international capital flows. Losses made by several prominent investment funds in emerging markets have both raised awareness of financial risks and sharply reversed sentiment towards investment in middle-income economies.

Protracted adjustment

Affected countries have had to implement tighter monetary and fiscal policies, in turn impacting on consumption and trade. It is increasingly apparent that the scale of the non-performing loan problem in the banking systems of East Asian economies is historically unprecedented. A protracted period of financial restructuring and negative or slow economic growth seems likely.

The Asian financial crisis and weakening of stock markets worldwide have increased international concern regarding the transparency of financial markets and the potentially destabilising impact of unchecked financial flows. There are efforts to increase the provision of financial support to countries in difficulties. Improved surveillance and reporting requirements in international capital markets are also under investigation.

Impact on industrial economies

Although moderate growth is expected to continue in the United States and Europe, slower import volume growth is putting pressure on the balance of payments of commodity exporting countries. Recognising the global nature of the economic slowdown, industrial countries are now expected to ease interest rates and cooperate to some extent in seeking greater stability on financial markets.

Initiatives of international financial institutions and the industrial economies may ease the adjustment somewhat, but the global outlook for trade and capital flows remains depressed. Slower world growth will impact on South Africa through both weaker export prices and volumes and a more cautious international investment environment.

Implications for the South African economy

Lower export earnings

About 65 per cent of South Africa's exports are commodities (including gold) or commodity-related. The deterioration in the demand for commodities thus affects export earnings significantly, weakening both national income and the balance of payments.

Lower oil prices and the currently depressed prices of goods imported from Asia are offsetting pressures on the balance of payments and will contribute to moderating the inflationary impact of the recent depreciation of the rand. However, South Africa's manufacturing exporters now face more difficult international trading conditions and tough competition from Asian and other countries. The contribution of exports to South Africa's economic growth is likely to be constrained over the next year or so.

Slower capital flows

South Africa remains heavily dependent on foreign investment as a result of the low level of domestic savings. Between 1994 and the first quarter of 1998, a total net inflow of capital of R57,4 billion was realised. Since then, long term capital flows have slowed and short term capital has flowed out of the economy, contributing to the depreciation of the rand from an average of R5,05 to the US dollar in April to R6,32 in August and R5,86 at the end of September.

Higher interest rates

High interest rates have contributed to stabilising the rand in September and October, and a recovery of international capital flows in the fourth quarter of the year is possible.

Protecting basic services

South Africa's social service sectors are well-developed and largely financed through the fiscus. Although government finances have come under pressure in the current financial environment, services remain securely funded and largely unaffected by the downturns in trade and finance. Government recognises that for both long term growth and broad stability of service delivery, basic social services should continue to enjoy sound and stable funding.

South Africa: comparative perspective

Although growth has slowed in the South African economy and foreign portfolio investment has been sluggish, the impact of the changed international environment has been moderate by comparison with many other economies. In East Asian emerging economies growth is now sharply negative, massive outflows of capital have occurred and systemic banking failure remains a serious risk. In Russia, debt obligations have had to be unilaterally set aside and government is unable to meet its pension and other payment commitments.

Underlying strengths

The success of the South African economy in coping with adverse international pressures is partly a consequence of underlying financial strengths:

- The financing requirement on the balance of payments is at present less than 2 per cent of GDP;
- External debt obligations of the private and public sectors are lower relative to GDP than in most developing countries;
- South Africa attracts foreign investment into rand-denominated instruments, which reduces the risk to the economy of adverse exchange rate movements;
- The banking system is sound and well-regulated and has a low level of non-performing loans;
- Well-developed financial markets permit participants to hedge currency exposures and other risks effectively; and
- Company balance sheets are strong and do not show excessive gearing.

Policy stability and growth

These factors enhance South Africa's standing as an emerging economy and underpin longer term growth prospects. However, the risks inherent in the present international context remain considerable. Foreign fund managers are likely to adopt a cautious stance, seeking assurance of a stable policy environment and signs of a recovery of growth before committing to significant levels of reinvestment.

A sound response to currency pressures

Maintenance of sound monetary and fiscal policies has contributed to the adjustment of the South African economy to international pressures.

Monetary & exchange rate policy

In responding to the weakness of the currency, the South African Reserve Bank has provided liquidity to the foreign exchange market from time to time without attempting to defend any particular level of the currency. Interest rates have been raised to encourage foreign investors not to liquidate their holdings, to offset the inflationary impact of the depreciation and to ensure a sustainable position on the current account.

By pursuing fixed nominal exchange rates in a context of capital account liberalisation, many emerging market economies encouraged banks and companies to ignore exchange rate risk, leaving them highly exposed when currencies collapsed.

South Africa has allowed the rand to fluctuate in response to market conditions. This has ensured that companies and banks are very aware of the need to manage exchange rate risk.

Capital market controls

Since 1994 South Africa has progressively lifted restrictions on foreign exchange transactions, thereby contributing to the openness and competitiveness of the capital market.

In the current context of international financial volatility, several countries have attempted to protect their currencies from speculative flows, with varying success. Measures to check capital mobility are difficult to implement and potentially damaging. This is a policy arena in which greater international cooperation is required.

South Africa requires foreign investment to supplement the limited supply of domestic savings. While recognising the importance of extending financial prudential regulations and reporting requirements to foreign exchange transactions, Government remains committed to an open capital market and to the gradual elimination of restrictive exchange controls.

Fiscal policy

South Africa needs to raise domestic savings, while creating further opportunities for foreign investment. Sound fiscal policies will continue to be pursued, aimed at sustaining a moderate and affordable public sector borrowing requirement and encouraging broad-based economic growth.

Investment grade rating

Against the run of expectation, South Africa's investment grade sovereign credit rating was affirmed by Moody's Investment Services in October this year.

This reflects a recognition that South Africa's sound combination of financial and economic policies is a firm foundation for long term growth and development. Amongst emerging markets, South Africa has particular strengths:

- a modern and well-regulated banking and corporate governance environment;
- a healthy fiscal stance and steady improvements in financial management; and
- a moderate and sustainable external debt position.

Assurance of financial standards

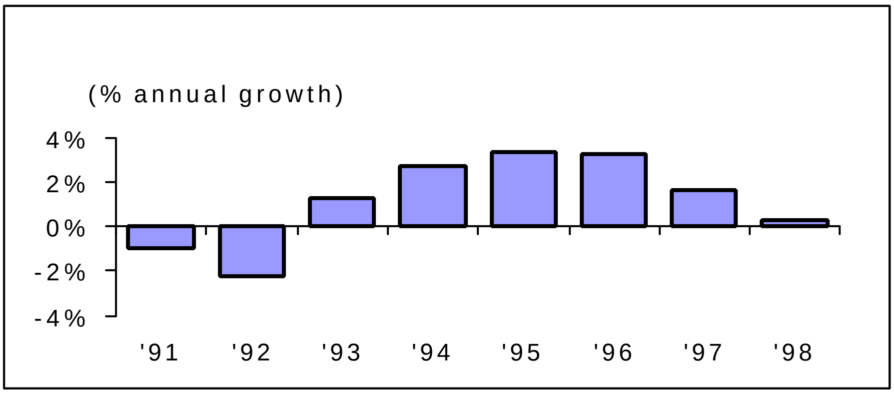
Government will continue to ensure that South Africa maintains the highest standards of regulation, transparency and disclosure in the financial services offered to its people, foreign investors and business enterprises. This assurance underpins the capacity of the economy to respond to the volatility that has proved so destabilising in less developed financial systems.

Real output and expenditure trends

Gross domestic product

Economic growth slowed to just over 1 per cent a year in mid-1997, after three years of GDP growth of about 3 per cent a year. For the first two quarters of 1998, GDP growth was 0,5 per cent and 0,2 per cent annualised.

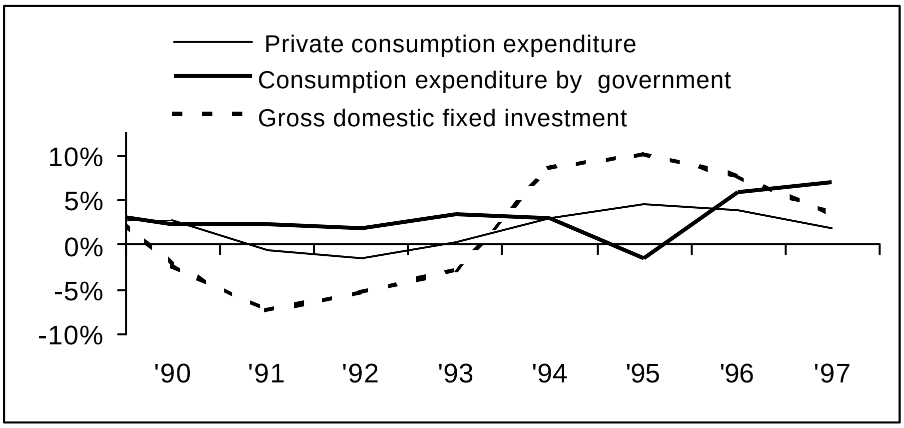
Figure 2.1: GDP growth



Private consumption expenditure

Growth in real private consumption expenditure slowed down from 3,9 per cent in 1996 to 2 per cent in 1997. In the first half of 1998 real private consumption expenditure slowed further, reflecting high interest rates, growing levels of personal debt and weaker growth in the real disposable income of private households. Strong real wage growth was offset by continued declines in employment in the formal sectors of the economy and an increase in the tax burden of households.

Figure 2.2: Growth in expenditure



General government consumption spending

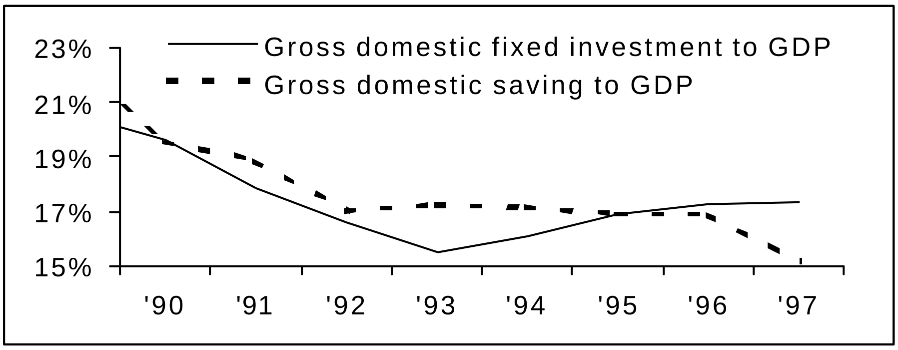
Real consumption expenditure by general government, comprising personnel remuneration and purchases of goods and services, increased by 6 per cent in 1996 and an estimated 7 per cent in 1997. Government consumption spending has slowed in 1998 and is expected to be about 2 per cent over the year.

Investment

Investment has contributed strongly to expenditure growth in recent years, growing by 7,8 per cent in 1996, 3,5 per cent in 1997 and 7,4 per cent (annualised) in the first half of 1998. The improvement in investment spending in 1998 mainly reflects the expansion of Telkom's infrastructure investment, facilitated by the enterprise restructuring effected in 1997.

As a percentage of GDP, fixed investment spending increased from 15,5 per cent in 1993 to an average of 17,4 per cent in 1997 and the first quarter of 1998.

Figure 2.3: Investment and savings



Saving

Inadequate saving remains a structural weakness of the economy. Gross domestic saving declined from 17 per cent of GDP in 1996 to about 15 per cent in 1997 and the first half of 1998. Coupled with the withdrawal of foreign investors from emerging markets over the past year, this keeps interest rates high in real terms and inhibits investment and growth.

Changes in inventories

During 1997 and the first half of 1998 expenditure on GDP has increased faster than output, reflected in steady reductions in the levels of commercial and industrial inventories. The decline in real inventory levels may be explained by several factors:

- a slowdown in the growth of final domestic demand;
- deteriorating expectations of overall economic growth; and
- high real interest rates and the attendant high cost of carrying inventories.

Once prospects for the economy improve, re-stocking should contribute strongly to a recovery of GDP growth.

International trade and finance

Export and import trends

Export growth has provided an important boost to demand since 1994 and has served to stimulate substantial industrial restructuring. Buoyant demand and industrial investment have fueled strong import growth, however, resulting in a deficit on the current account of the balance of payments. The current account deficit was about 1,5 per cent of GDP in 1997, and is again expected to be between 1,0 and 2,0 per cent of GDP this year.

Figure 2.4: Merchandise imports and exports

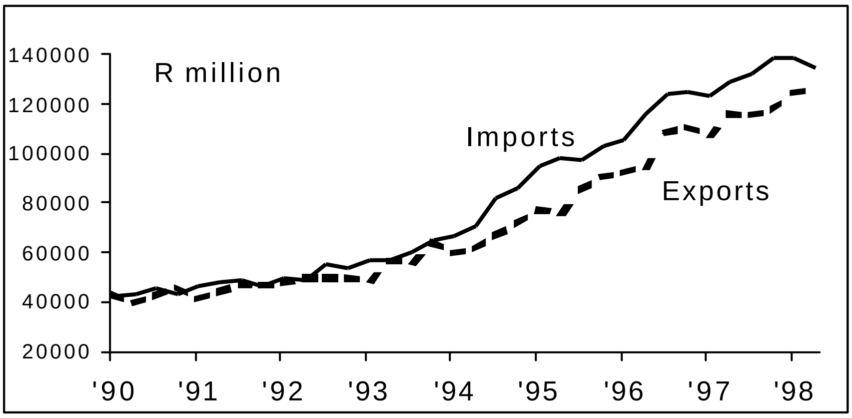
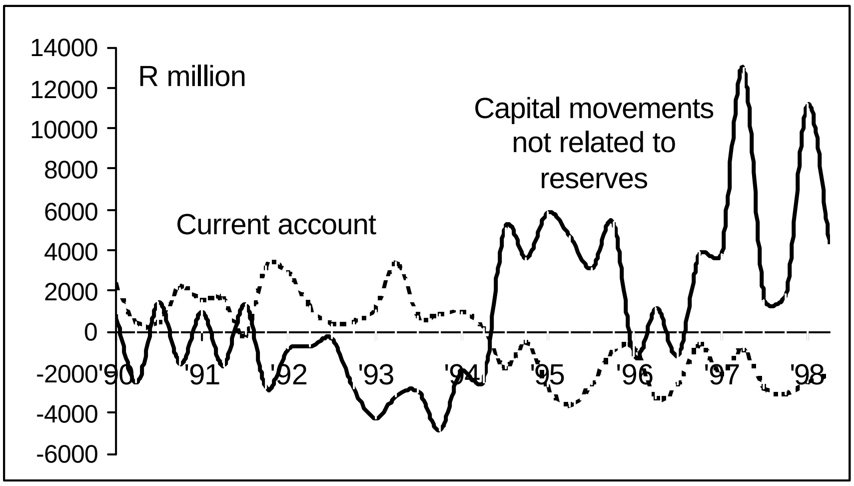


Figure 2.5: Balance of payments



Capital account

Flows on the capital account have been extremely volatile over the last year. In 1997, South Africa experienced a net inflow of capital of R20 billion, considerably exceeding the current account financing requirement. This was followed by a substantial net inflow of capital amounting to R11 billion in the first quarter of 1998 and R4 billion during the second quarter. Since then, a marked outflow of capital has occurred, reflecting the changed investor sentiment to emerging markets.

Foreign reserves

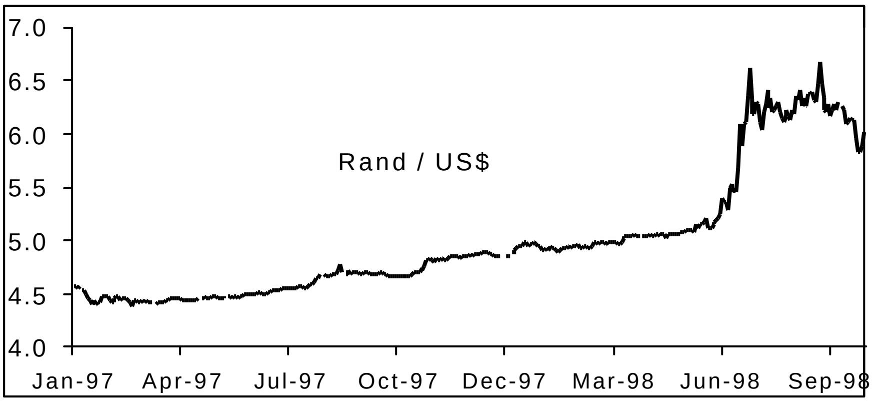
The country's gross foreign reserves rose substantially in the first half of 1998 as a result of capital inflows and the use of foreign credit lines by the Reserve Bank. The level of net reserves however remains a cause for concern, as foreign investors have become more concerned over the risk of currency depreciation.

In responding to the increased uncertainty on foreign exchange markets this year, the Reserve Bank has continued to meet shortfalls between the supply and demand of foreign currency in the forward market, thereby reversing the considerable decline in its net open forward position recording during 1997 and early 1998. Once stability returns to the foreign exchange market, it is expected that the forward book will return to its longer term downward trend.

Exchange rates

The real effective exchange rate – taking account of the difference between South African inflation and price trends in trading partner countries – depreciated by 8 per cent in 1996 and then appreciated during 1997. Between April and August 1998 the currency came under massive pressure, depreciating by some 20 per cent in real terms before recovering part of its value in September and October. However, exchange rate volatility remains a serious risk in the current distressed international financial environment.

Figure 2.6: Rand-US$ exchange rate



Inflation and money supply

Inflation trend

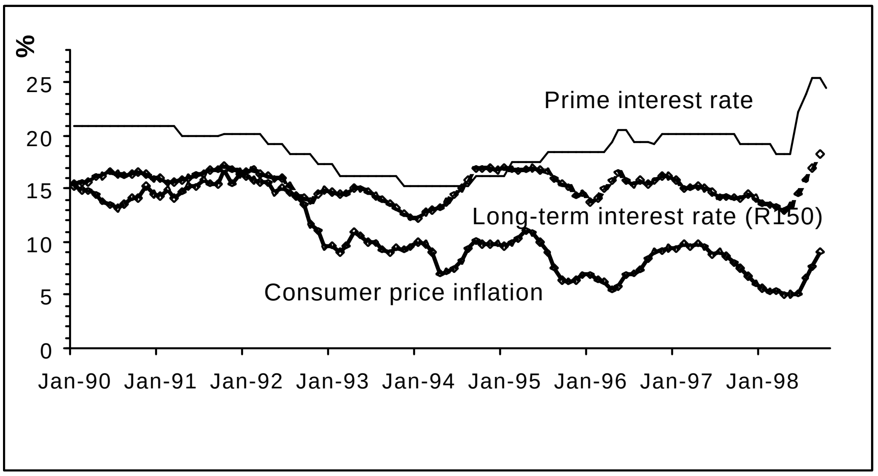
Inflation in South Africa has been on a declining trend since 1993. Tight monetary policy has ensured that exchange rate depreciation has only had a passing impact on inflation.

Consumer price inflation averaged 5,7 per cent for the first eight months of 1998, after averaging 8,6 per cent in 1997. Consumer price inflation rose to 9,1 per cent in September, mainly due to the combined impact of the depreciation of the rand and the increase in interest rates on mortgage bonds.

Interest rates

Consistent with the lower inflation environment, interest rates declined during 1997. However, capital outflows, exchange rate depreciation and financial uncertainty put strong upward pressure on money and capital markets in 1998, resulting in unusually high real interest rates. Following improved stability in the exchange rate, interest rates began to decline in October 1998 and are expected to continue to ease during the remainder of the year and in 1999.

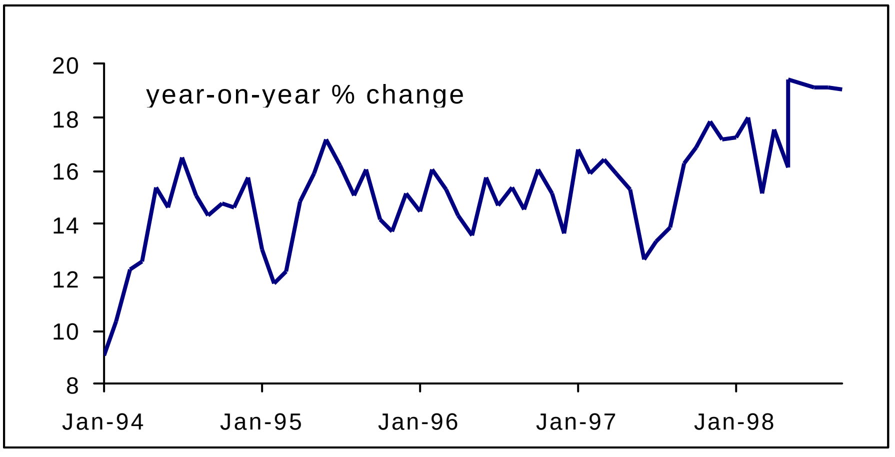
Figure 2.7: Inflation and interest rates



Money supply and credit

Having declined significantly in the early 1990s, the growth rate of broad money (M3) increased rapidly after 1993 and has averaged 15 per cent for the last three years, primarily as a result of private credit growth. This has contributed to the need for a cautious monetary stance.

Figure 2.8: Growth in money supply (M3)



The rate of increase in total domestic credit extension accelerated from 17 per cent in December 1997 to 20 per cent in June 1998 and 22 per cent in August. It is expected that money supply growth and credit extension will slow during the fourth quarter of the year.

Employment and remuneration trends

Employment

Measured formal non-agricultural employment has continued to decline over the past year, decreasing by 1,8 per cent in 1997 and falling further in the first quarter of 1998.

Total employment of 9,1 million recorded in the 1996 census is 75 per cent higher than the recorded non-agricultural aggregate, which leaves considerable scope for uncertainty regarding the overall employment trend. Nonetheless, the deterioration of employment in manufacturing, mining and construction in recent years is a clear sign that structural barriers to job creation remain a serious policy challenge.

Wage trends

Positive real remuneration trends and improved productivity have been marked features of the performance of the economy in recent years. Average real wages have increased by about 2 per cent a year since 1994, both in the public and the private sectors.

Economic outlook

GDP growth

Economic growth is expected to remain subdued in the second half of 1998, before recovering in 1999. As external conditions stabilise, economic growth will strengthen in response to renewed demand and the structural transformation of the economy that is in progress.

Demand

Domestic demand is projected to be weak until the second half of 1999 as private consumption expenditure and private investment are affected by higher interest rates. As inflation and interest rates resume their downward trend, investment and consumption expenditure will strengthen, supported by the impact of demutualisation and increased export competitiveness and renewed foreign inflows.

After a slowdown in 1999, private consumption is expected to grow by 2 to 4 per cent in subsequent years. Gross domestic fixed investment is not expected to grow in 1999, before expanding by 6 to 9 per cent in the following two years.

Balance of payments

Slower growth in domestic expenditure and a depressed rand should in due course lead to a decline in the volume of imports. Whereas commodity export volumes may suffer during the remainder of 1998 in the weak international trading environment, the more competitive rand will provide some relief. Exports of manufactured goods should benefit from improved competitiveness following the depreciation. Overall the current account deficit is anticipated to remain between 1 and 2 per cent of GDP in 1998, rising moderately over the following years.

Exchange rate

The nominal average effective exchange rate is expected to recover somewhat over the coming year before resuming its long run average trend and depreciating by approximately 3 per cent per year.

Large and unpredictable capital movements are likely to be a feature of the global economy in coming months. Sound monetary and fiscal policies should, however, ensure that net capital inflows will continue to exceed the current account deficit over the 1998-2002 period.

Inflation

Consumer price inflation is projected to peak at 9,8 per cent by the end of the year and then decline rapidly towards its 5 per cent trend level during 1999.

Financial stability

Domestic savings will come under pressure in the coming year as households face historically high debt burdens. For this reason, the realisation of a sustained net capital inflow, in the form of both direct investment and portfolio flows, is an increasingly important factor in supporting economic performance. Capital flows not only raise the level of investment, but also provide the liquidity needed in money and capital markets in order for market interest rates to decline.

Risk factors

Although there is every indication that the global financial environment will soon stabilise, the enormous volatility in global markets makes it unusually difficult to predict the outlook for the economy over the next three years.

Several risks to the foregoing outlook should be noted: investment confidence may remain poor; the international financial environment may worsen; and exporters may face increasingly depressed commodity markets.

South Africa's strengths

However, the underlying strengths of South Africa's financial structure, moderate debt levels and a sound policy framework are grounds for confidence that the economy will recover strongly in the course of the new year.

Macroeconomic projections

Real GDP growth is expected to improve from about 0,2 per cent in 1998/99 to reach 2 per cent, 3 per cent and 4 per cent over the 1999/00 to 2001/02 period. GDP inflation is expected to fall to 4 per cent in 2001/02 from about 8 per cent in 1998/99.

Table 2.1: Macroeconomic projections: 1998/99 – 2001/02

Fiscal year:	1998/99	1999/00	2000/01	2001/02
Gross domestic product (R billion)	**656,9**	**710,2**	**768,1**	**830,8**
Real GDP growth	0,2%	2,0%	3,0%	4,0%
Real private consumption growth	-1,0%	2,0%	2,6%	3,8%
Real gross domestic fixed investment growth	0,4%	-2,0%	6,8%	9,0%
GDP inflation	8,0%	6,0%	5,0%	4,0%
CPI inflation	7,5%	6,0%	5,0%	4,0%

For comparative purposes the above fiscal year projections are converted below into calendar years.

Table 2.2: Macroeconomic projections: 1998 - 2000

Calendar year:	1998	1999	2000	2001
Gross domestic product (R billion)	**645,0**	**693,2**	**751,1**	**814,0**
Real GDP growth	0,3%	1,2%	3,1%	4,0%
Real private consumption growth	-0,1%	0,4%	2,6%	3,7%
Real gross domestic fixed investment growth	2,3%	-4,3%	4,9%	9,0%
GDP inflation	8,1%	6,2%	5,1%	4,2%
CPI inflation	8,0%	7,0%	5,0%	4,3%

3

FISCAL POLICY AND THE BUDGET FRAMEWORK

The fiscal policy framework

Government's fiscal policy seeks to support structural reforms of the South African economy consistent with long run growth, employment creation and an equitable distribution of income. It aims to promote investment and export expansion while enabling Government to finance public services, redistribution and development in an affordable and sustainable budget framework.

Fiscal policy aims

Fiscal policy seeks to:

- ensure a sound and sustainable balance between Government's spending, tax and borrowing requirements;
- improve domestic savings to support a higher level of investment and reduce the need to borrow abroad;
- keep government consumption spending at an affordable level, contributing to lower inflation and a sustainable balance of payments;
- support an export-friendly trade and industrial strategy to improve South Africa's competitiveness; and
- ensure that pay increases within the public sector are market and productivity related, and are fiscally sustainable.

Medium term fiscal objectives

Within the current medium term planning horizon, Government aims to:

- reduce the level of borrowing used to finance current spending;
- reduce the overall tax burden as a share of GDP over time; and

- reduce government consumption spending as a share of national income.

Commitment to sound public finances

Government remains committed to a sound and stable fiscal policy, aimed at ensuring the sustainability of South Africa's economic transformation, promoting jobs and investment, and ensuring that public services reflect Government's priorities.

The Government's commitment to sound public finances and a sustainable deficit has protected South Africa from the worst of the current international financial crisis, and has contributed to the structural changes needed to strengthen the long run performance of the economy.

Government revenue, expenditure and borrowing

Recent trends in the broader public finances, including the national and provincial authorities, extra-budgetary accounts and funds, social security funds and local government, are summarised below.

Consolidated general government revenue

Tax revenue, including social security contributions and local rates and taxes, has risen steadily from 25,6 per cent of GDP in 1992/93 to an estimated 28,5 per cent in 1997/98. Non-tax revenue of the general government has remained at about 4,0 per cent of GDP over this period.

Current non-interest expenditure

Consumption expenditure by general government grew strongly in real terms in 1997/98, amounting to an estimated 21,7 per cent of GDP, compared to 20,6 per cent recorded in the previous fiscal year. Personnel remuneration accounts for 58,8 per cent of government consumption expenditure. Transfers and subsidies amounted to about 5,1 per cent of GDP in 1997/98, mainly comprising social grants and unemployment benefits.

Interest on public debt

Interest on debt absorbed 6,7 per cent of GDP in 1997/98, compared to about 3,6 per cent five years ago.

Dissaving

Government dissaving (that is, current expenditure on interest, consumption, subsidies and transfers in excess of revenue) has fallen significantly from a peak of 6,4 per cent of GDP in 1993. After adjustments for depreciation and inventory valuation, Government dissaving in 1997 amounted to 3,7 per cent of GDP.

Investment

Capital expenditure by the general government increased by 12,4 per cent in 1997/98, reflecting a real growth rate of 5 per cent. This reflects a significant improvement in the contribution of government to infrastructure investment.

Public sector borrowing requirement

Taking into account the overall general government accounts, and the surpluses or deficits of public enterprises, the public sector borrowing requirement has been reduced from 10,4 per cent of GDP in 1993/94, to 5,2 per cent in 1997/98. In nominal terms, the public sector borrowing requirement declined by 7 per cent in 1997/98 to an estimated R31,3 billion.

Government's medium term fiscal strategy envisages further steady reductions in the borrowing requirement over the next three years, in line with the projected reduction in the national budget deficit.

Revised fiscal projections

Lower growth reduces available resources

International developments and the extended slowdown in the South African economy this year have led to downward adjustments in expected growth for the next three years. Lower growth reduces government revenue and constrains the resources available to the fiscus and the broader economy.

Adjustments to baseline projections

Within the context of the fiscal policy framework outlined above, Government has made the following revisions to the baseline medium term fiscal projections set out in the March 1998 Budget:

- a budget deficit for 1998/99 of 3,9 per cent of GDP is now expected (compared to a March estimate of 3,5 per cent);
- debt interest costs will be R1,2 billion more in 1998/99 than originally budgeted and a projected R3,0 billion more in subsequent years;
- revenue of 27,1 per cent of GDP is expected in 1998/99, falling to 26,5 per cent in 2001/02 – about 0,7 per cent of GDP higher each year than in the baseline projections; and
- a budget deficit of 3,5 per cent of GDP is projected in 1999/00 (compared to a baseline 3,0 per cent), falling to 3,0 per cent in subsequent years.

These adjustments to the baseline medium term budget framework are summarised below and discussed in more detail in the paragraphs that follow.

Table 3.1: Baseline and revised medium term budget framework

	1998/99		1999/00		2000/01		2001/02
R billion	Baseline	Revised	Baseline	Revised	Baseline	Revised	
Revenue	**177,6**	**178,0**	**193,4**	**191,3**	**210,5**	**206,2**	**220,1**
as per cent of GDP	*26,5%*	*27,1%*	*26,3%*	*26,9%*	*26,0%*	*26,8%*	*26,5%*
Expenditure	**201,3**	**203,9**	**215,7**	**216,5**	**235,0**	**229,6**	**245,0**
Interest on debt	42,5	43,7	45,0	48,0	48,0	51,0	54,0
Non-interest spending	158,8	160,2	170,7	168,5	187,0	178,6	191,0
Deficit	**23,7**	**25,9**	**22,3**	**25,2**	**24,5**	**23,4**	**24,9**
as per cent of GDP	*3,5%*	*3,9%*	*3,0%*	*3,5%*	*3,0%*	*3,0%*	*3,0%*
GDP	669,0	656,9	734,3	710,2	809,6	768,1	830,8

Note: Repayments and recoveries of loans and advances are included in revenue in these estimates.

Robust tax performance

Total national budget revenue amounted to 27,2 per cent of GDP in 1997/98. Despite the slower economic growth recorded in the first half of 1998/99, revenue collection remains buoyant. Combined Customs and Excise and Inland Revenue collections increased by 9,3 per cent up to September 1998, compared to the same period of 1997/98.

Revised revenue projections

Revenue in 1998/99 is expected to exceed the budget target slightly, and will amount to 27,1 per cent of the revised GDP estimate. The revised budget framework allows for a phased reduction in the national revenue aggregate to 26,5 per cent of GDP in 2001/02.

Higher debt service cost

Higher interest rates than anticipated this year have sharply increased debt service costs, highlighting the importance of Government's commitment to reducing the annual borrowing requirement. The reduction in the budget deficit as a share of GDP since 1994 has already released about R4 billion in interest costs that would otherwise have had to be found in the 1998/99 budget.

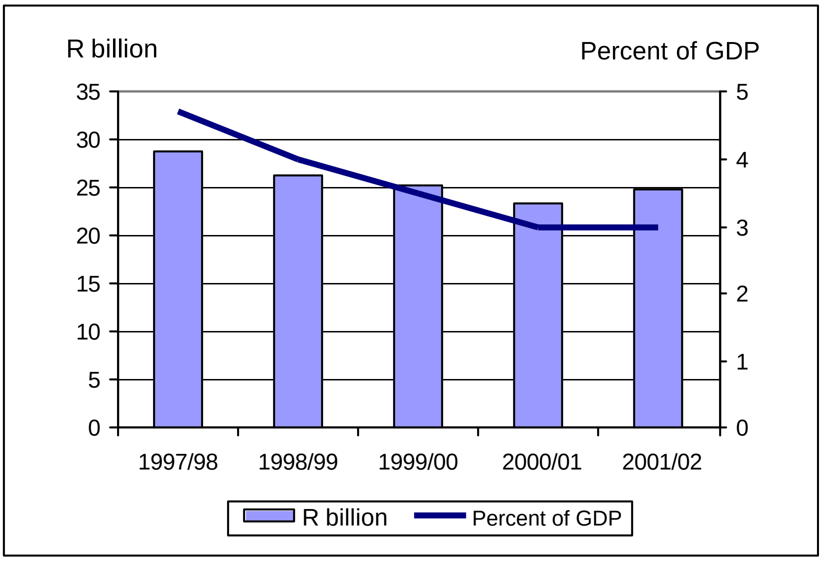
The higher debt service costs reflected in the revised budget framework are mainly the consequence of adverse financial market conditions this year. Higher capital market rates have significantly raised the costs of financing this year's deficit and refinancing maturing government stock. In addition, the revised framework projects higher deficits in 1998/99 and 1999/00, in turn leading to increased interest costs in subsequent years.

Adjusted deficit targets

Revised budget deficit projections of 3,9 per cent in 1998/99 and 3,5 per cent in 1999/00 reflect the impact on the fiscus of lower GDP growth and unusually high interest costs, together with a consideration of social and developmental spending priorities.

Adverse economic conditions have necessitated substantial downward adjustments in non-interest spending over the 1999/00-2001/02 period. In addition, the revenue and deficit targets have been reviewed. In adjusting the budget framework consideration has been given to the overall balance of spending, revenue and borrowing in a context of an unanticipated slowdown in the economy. Government has been mindful also of the need for stability in funding basic services and for a realistic phasing in of fiscal adjustments. While retaining Government's commitment to a sustainable fiscal policy, the deficit reduction target has accordingly been postponed by a year. The budget deficit is still expected to reach 3,0 per cent of GDP in 2000/01 and beyond.

Figure 3.1: Budget deficit – 1997/98-2001/02



Spending objectives

Within the projected spending totals, Government is committed to reprioritising spending to meet reconstruction and development objectives, with additional emphasis in the revised medium term expenditure framework on job creation, infrastructure investment, strengthening the integrated justice system and the consolidation of education, health and welfare services. Chapter 4 provides more details.

Changes to the medium term budget framework

1998/99 adjustments

The Adjustments Estimate reflects the following additions to the 1998/99 expenditure estimates:

- R1,2 billion in additional debt interest costs;

- R1,0 billion in additional expenditure for national government departments;
- R1,2 billion in additional expenditure for the provinces, of which R200 million is to supplement provision for textbook supplies;
- R300 million in additional expenditure for the improvement in conditions of service of both national and provincial government employees; and
- R2,0 billion of expenditure rolled over from 1997/98, offset by expected savings and allocations to be rolled forward to 1999/00 amounting to R2,1 billion.

At this stage additional revenue of R384 million is anticipated, including a R350 million receipt to the Exchequer following the closing of the Post Office Fund.

After taking into account the contingency reserve of R1,0 billion set aside in the 1998/99 Budget, the overall impact is an increase of R2,2 billion in the projected deficit to R25,9 billion, or 3,9 per cent of revised GDP.

Donor funding expenditure

The Adjustments Estimate also shows R651 million of additional spending financed from foreign grants or international cooperation agreements. International budgetary support is expected to continue to grow over coming years, in keeping with various sectoral agreements with partner countries. This spending and revenue is excluded from the budget framework set out in this Statement.

Revenue estimates

National budget revenue is expected to grow by an annual average rate of 7,3 per cent over the next three years. In real terms, this amounts to an annual average growth rate of 2,3 per cent over the MTEF period.

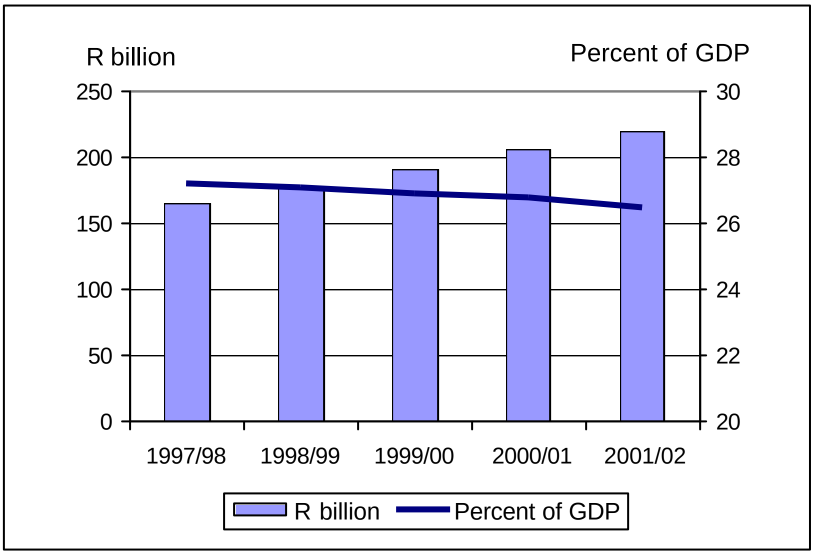
Table 3.2: Growth of budget revenue

	1997/98	1998/99		1999/00	2000/01	2001/02
R billion	Outcome	Budget	Revised	Medium term estimates		
Revenue	**165,3**	**177,6**	**178,0**	**191,3**	**206,2**	**220,1**
as per cent of GDP	*27,2%*	*26,5%*	*27,1%*	*26,9%*	*26,8%*	*26,5%*
nominal growth		*7,4%*	*7,7%*	*7,5%*	*7,8%*	*6,7%*
real growth		*1,4%*	*-0,3%*	*1,5%*	*2,8%*	*2,7%*
Change from baseline			**0,4**	**-2,1**	**-4,3**	

Table 3.2 shows the envisaged decline in revenue as a share of GDP from 27,2 per cent to 26,5 per cent in 2001/02. The table also

indicates the changes in budget revenue relative to baseline projections.

Figure 3.2: Budget revenue – 1997/98-2001/02



Budget expenditure

Budget expenditure is expected to grow by an annual average rate of 6,3 per cent over the next three years. In real terms, this amounts to an average annual growth rate of 1,3 per cent over the MTEF period. Table 3.3 shows the changes in expenditure estimates relative to the March 1998 baseline projections.

Figure 3.3: Budget expenditure – 1997/98-2001/02

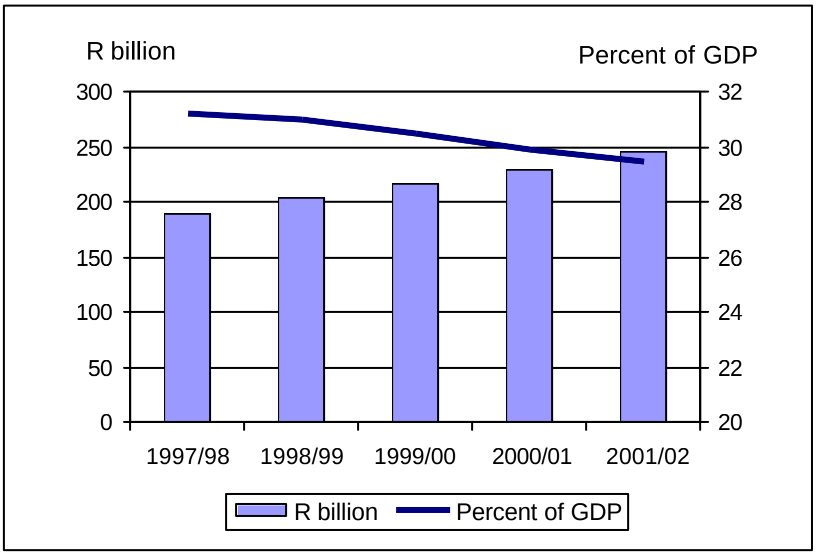


Table 3.3: Growth of budget expenditure

R billion	1997/98 Outcome	1998/99 Budget	1998/99 Revised	1999/00	2000/01	2001/02
				Medium term estimates		
Expenditure	**190,2**	**201,3**	**203,9**	**216,5**	**229,6**	**245,0**
as per cent of GDP	*31,3%*	*30,1%*	*31,0%*	*30,5%*	*29,9%*	*29,5%*
nominal growth		*5,8%*	*7,2%*	*6,2%*	*6,1%*	*6,7%*
real growth		*-0,2%*	*-0,8%*	*0,2%*	*1,1%*	*2,7%*
Change from baseline			**2,6**	**0,8**	**-5,4**	

The available expenditure level

The expenditure level in the MTEF refers to the total nationally-financed spending to be shared between the national, provincial and local spheres of government, as described in more detail in chapter 5 of this Statement.

Amounts set aside

Before expenditure is equitably divided among the three spheres of government, two items are set aside from the total. These are:

- *debt service costs* – the nation's obligations to pay debt service costs represent a first claim against expenditure; and
- *the contingency reserve* – a proportion of the total available resources is not allocated at this stage.

Debt service costs

Provision is made for debt service costs on the following assumptions:

- a budget deficit of 3,5 per cent of GDP in 1999/00, falling to 3,0 per cent in the subsequent two years;
- refinancing of all domestic and foreign loans as they mature;
- continued borrowing mainly in long-dated domestic securities, supplemented by limited foreign bond issues and domestic short-term securities; and
- gradual declines in capital market rates and inflation from 1998/99 onwards.

Interest as % of GDP

It is projected that interest on debt will be reduced from 6,8 per cent of GDP in 1999/00 to 6,5 per cent by 2001/02.

The impact of higher interest rates on debt service cost projections is illustrated in table 3.4.

Table 3.4: Debt service costs

R billion	1997/98 Outcome	1998/99 Budget	Revised	1999/00 Medium term estimates	2000/01	2001/02
Debt service costs	**39,4**	**42,5**	**43,7**	**48,0**	**51,0**	**54,0**
as per cent of expenditure	*20,7%*	*21,1%*	*21,4%*	*22,2%*	*22,2%*	*22,0%*
as per cent of GDP	*6,5%*	*6,4%*	*6,7%*	*6,8%*	*6,6%*	*6,5%*
average bond rate assumed		13%	16%	14%	13%	12%
Change from baseline			**1,2**	**3,0**	**3,0**	

The contingency reserve

The contingency reserve is set aside within the expenditure total to deal with unforeseen circumstances. This ensures that Government can adjust to adverse macroeconomic developments, or make funds available for natural or other disasters, without breaking the overall expenditure ceiling.

Table 3.5: The contingency reserve

R billion	1998/99 Budget	Revised	1999/00 Medium term estimates	2000/01	2001/02
Contingency reserve	**1,0**	**-**	**1,5**	**3,0**	**7,0**
as per cent of expenditure	*0,5%*	*-*	*0,7%*	*1,3%*	*2,9%*
Change from baseline		**-1,0**	**-1,5**	**-4,0**	

Provision for macroeconomic uncertainty

The revised macroeconomic projections and higher interest costs are the first claims against the contingency reserve. The contingency reserve has consequently served a useful purpose in the current medium term budget framework in providing a cushion to reduce the impact of lower-than-expected GDP growth.

Changes in priorities

A component of the contingency reserve, in the second and third years of the projections, will be allocated as part of the 2000/01 and 2001/02 budget processes. This part of the reserve may be used to address emerging policy priorities or changes in economic circumstances. This enables Government to address its priorities in future budgets without having to disrupt the expenditure plans of other services.

Total available spending

Growth in available expenditure

Total budget expenditure, less debt interest and the contingency reserve, is expected to grow by an annual average rate of 4,6 per cent over the next three years, which is broadly unchanged in real terms. The growth in total available spending accelerates through the latter two years of the MTEF period.

Recovery from pension funds

As set out in the 1998 *Budget Review*, Government proposes to lower the employer's contribution to pension funds from 17 per cent to 15 per cent this year, in keeping with actuarial advice. This has yet to be finalised in negotiations with employee representatives. At this stage, for comparability and consistency, the budget is prepared inclusive of a 17 per cent employer's contribution and a recovery from pension funds corresponding to the reduction in the contribution rate is shown as a deduction from the spending aggregate.

Division of resources

Table 3.5 summarises the total expenditure available over the MTEF period. While the 1998/99 Adjustments Budget provides for an additional R2,5 billion in non-interest allocations, the available expenditure level is reduced by R0,7 billion in 1999/00 and by R4,4 billion in 2000/01. The division of the available expenditure between the national, provincial and local shares is explained in chapter 5 of this Statement.

Table 3.6: Growth in total available spending

	1997/98	1998/99		1999/00	2000/01	2001/02
R billion	Outcome	Budget	Revised	Medium term estimates		
National budget expenditure	**190,2**	**201,3**	**203,9**	**216,5**	**229,6**	**245,0**
Less amounts set aside						
Debt service costs	*39,4*	*42,5*	*43,7*	*48,0*	*51,0*	*54,0*
Reserve	-	*1,0*	-	*1,5*	*3,0*	*7,0*
Recovery from pension funds	-	0,9	0,9	0,9	1,0	1,0
Total expenditure to be shared	**150,9**	**158,6**	**161,1**	**167,9**	**176,6**	**185,0**
Change from baseline			**2,4**	**-0,7**	**-4,4**	

Consolidated revenue and expenditure

Table 3.7 shows the projected consolidated national and provincial revenue and expenditure, taking into account provincial own revenue and overall spending projections.

Table 3.7: Consolidated revenue and expenditure

	1998/99		1999/00	2000/01	2001/02
R billion	**Budget**	**Revised**	**Medium term estimates**		
National budget revenue	177,6	178,0	191,3	206,2	220,1
Provincial own revenue	3,9	3,3	3,8	4,1	4,4
Consolidated revenue	**181,5**	**181,3**	**195,1**	**210,3**	**224,5**
National budget expenditure	201,3	203,9	216,5	229,6	245,0
Provincial self-funded expenditure	3,9	3,3	3,8	4,1	4,4
Consolidated expenditure	**205,2**	**207,2**	**220,3**	**233,7**	**249,4**
National budget deficit	23,7	25,9	25,2	23,4	24,9
Consolidated deficit	**23,7**	**25,9**	**25,2**	**23,4**	**24,9**
as per cent of GDP	*3,5%*	*3,9%*	*3,5%*	*3,0%*	*3,0%*

Conclusion

Government remains committed to sound and sustainable fiscal policies. Budget projections have been revised to reflect changed economic circumstances and to ensure realistic and deliverable spending totals. Within a framework in which the budget deficit is reduced to 3,0 per cent of GDP and revenue falls moderately as a share of GDP, overall expenditure is projected to increase by an annual average of 6,3 per cent over the next three years. The expenditure level includes provision for debt service costs, a rising contingency reserve and a stable level of real expenditure available to be allocated to the three spheres of Government over the MTEF period.

4

RECONSTRUCTION, DEVELOPMENT AND THE BUDGET

Reconstruction and development priorities

Shared commitments

Reconstruction and development are aimed at a better life for all South Africans. This is the foundation of the partnership between government and the people that underpins our medium term policies and priorities. The Foreword to the 1997 *Medium Term Budget Policy Statement* summarised our shared commitments as:

- meeting the basic needs of the people;
- accelerating the basis for sustained economic growth, development and job creation;
- development of our human resources;
- ensuring the safety and security of the citizen and the state; and
- transforming the organs of government to reflect the developmental and people-centred nature of our democratic state.

Social and development policies and the budget

This chapter reviews key social and developmental policies reflected in South Africa's medium term budget trends. It reflects the contribution of the fiscus to Government's reconstruction and development initiatives, and highlights the impact of new policies and programmes on the structure and distribution of government spending.

Since 1994, the policies and programmes of Government have been subject to extensive consultation, publication of discussion documents, White Papers and wide-ranging legislative or regulatory reforms. The medium term expenditure framework reflects the spending implications of these transformation initiatives, within a sustainable overall budget framework.

MTEF reviews

Focused reviews of six spending functions – education, health, welfare and social security, infrastructure investment, the integrated justice sector and personnel spending – were conducted as part of this year's budget programme. The discussion below summarises many of the findings and recommendations of these reviews.

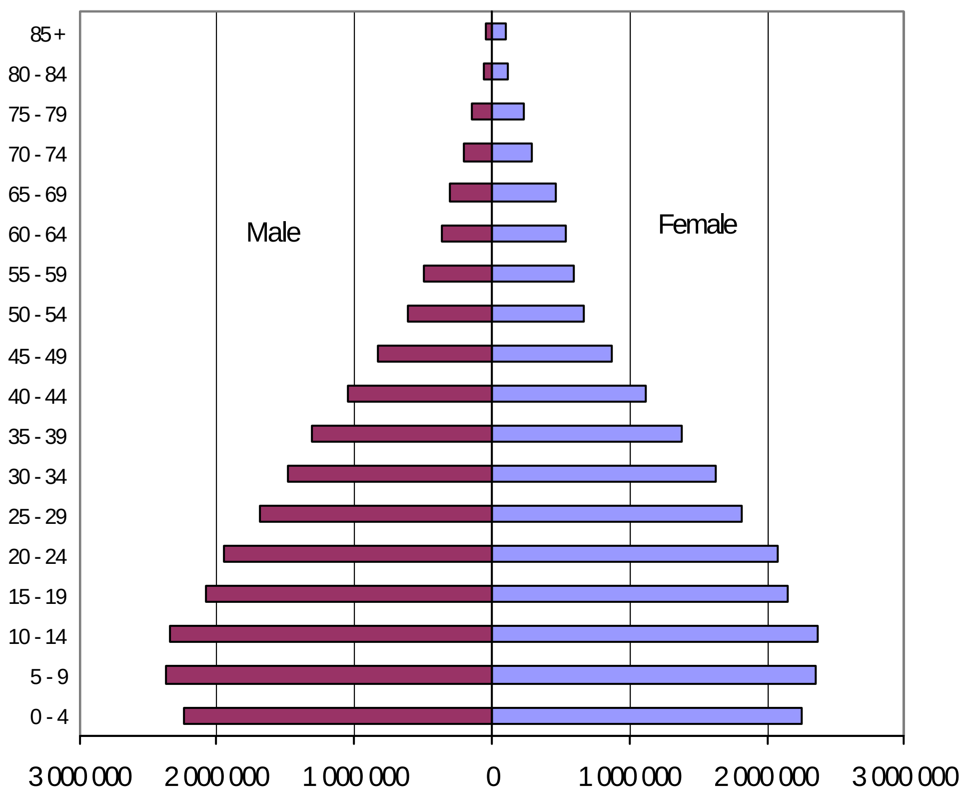
Demographic trends

1996 census results

The final results of the 1996 census have now been published. The estimated age distribution reflected in the 1996 census is illustrated below and the population distribution by province is set out in table 4.1.

Although the revised estimates reflect a larger total population than the preliminary census results published last year, they confirm that fertility rates have declined over the past two decades and migration from rural to urban areas is proceeding steadily.

Figure 4.1: Age distribution of the 1996 population



Population growth trends

Population trends with implications for longer term budgetary planning include the following:

- population growth has slowed from 2½ per cent in the 1980s to perhaps 2 per cent a year;

- the age 6 population entering school each year is now about 940 000, set to decline to about 800 000 a year by 2005;
- the number of young people entering the labour market is about 450 000 a year – this flow will increase to over 600 000 a year in the early 21st century; and
- the elderly population (men and women over 65) is about 1 960 000 and is growing by about 3 per cent a year.

Table 4.1: Population by province – 1996 census estimates

	Male	Female	Urban	Rural	Provincial population	
	Percentage of provincial population					% of total
Eastern Cape	46,1%	53,9%	36,6%	63,4%	6 303 000	15,5%
Free State	49,3%	50,7%	68,6%	31,4%	2 634 000	6,5%
Gauteng	51,0%	49,0%	97,0%	3,0%	7 348 000	18,1%
KwaZulu-Natal	46,9%	53,1%	43,1%	56,9%	8 417 000	20,7%
Mpumalanga	48,6%	51,4%	39,1%	60,9%	2 801 000	6,9%
Northern Cape	49,1%	50,9%	70,1%	29,9%	840 000	2,1%
Northern Province	45,7%	54,3%	11,0%	89,0%	4 929 000	12,1%
North West	49,2%	50,8%	34,9%	65,1%	3 355 000	8,3%
Western Cape	48,9%	51,1%	88,9%	11,1%	3 957 000	9,7%
Total ('000s)	**19 521**	**21 063**	**21 782**	**18 802**	**40 584 000**	**100,0%**
Percentage	48,1%	51,9%	53,7%	46,3%	100,0%	

Employment and unemployment

The census results indicate that total employment in the economy is 9 114 000, of which about 1 800 000 are informal job opportunities. About 22 per cent of the economically active population is unemployed, numbering some 2000 000 work seekers. A further 2 200 000 people would like to work but no longer actively seek employment.

Growing youth unemployment remains a major challenge, impacting on crime trends and threatening the integrity of family and community structures. The census confirms that the unemployment burden falls disproportionately on black men and women under the age of 35, and is particularly severe in rural areas.

The employment challenge has been the focus of concerted deliberations of government, business, labour and community representatives over the past months. Key elements of Government's contribution to meeting this challenge are summarised below.

Creating jobs

A joint, broad-based approach

Government and the constituencies of civil society represented in NEDLAC have agreed to act in concert to create jobs and stable employment, as part of our broader strategy for providing a better life, with improvement over time, for all our people.

The understanding reached between participants in the Presidential Jobs Summit held on 30 October 1998 recognises that we will have to combine our efforts, in new and innovative ways, to increase the number of jobs created in the South African economy. The Jobs Summit process has focused on a broad range of policy commitments:

- sustainable and stable macroeconomic and fiscal policies;
- industry policy measures and programmes that will directly address employment and encourage investment;
- new programmes to strengthen further the small, medium and micro enterprises sectors;
- tourism promotion and enhancement of tourism capacity;
- enhanced delivery of housing and new initiatives to expand the stock of rental housing;
- human resource development, support for education and broader access to training; and
- labour market policies dealing with job security, productivity and employment of youth, woman and the disabled.

Special employment programmes

The national budget includes about R5 billion allocated to special employment projects and labour-intensive infrastructure programmes. These exclude ongoing capital and maintenance expenditure by government and public corporations on roads, telecommunications, regional water networks and electrification, several of which are expanding and have significant employment impacts.

Employment-intensive programmes include:

- the *consolidated municipal infrastructure programme*, comprising grants to local authorities for bulk infrastructure works in low-income neighbourhoods and housing projects;
- the *community based public works programme*, largely focused on rural road maintenance and other local infrastructure needs;

- *working for water*, which clears alien vegetation in water catchment areas;
- *rural water supply and sanitation*, bringing water services to formerly un-served communities;
- the *housing subsidy programme*, comprising standard capital subsidies for low-income housing development projects; and
- support for *social development and income-generating projects* of non-governmental organisations.

Focus on women and children

Several of these programmes focus on infrastructural services that strongly benefit women and children – rural water supplies and social development projects targeted at unemployed women with dependent children, for example. Rural projects provide jobs for women without other sources of income.

Cost per job opportunity

Special employment programmes create a "person-year" of work at a cost of about R15 000. These initiatives currently account for about 300 000 jobs, and will add another 100 000 jobs over the next three years.

Government recognises that public spending channelled to employment-intensive activities can contribute to job creation, although this cannot address the entire shortfall in the labour market. Policies aimed at strengthening job creation in the private sector take time to bear fruit, but market-related employment has the advantage of being self-sustaining.

Employment and development

Government has adopted a mix of special employment initiatives that are integrally bound up with key development initiatives. These may involve temporary or short-term projects, but they are elements of a broad-based sustainable reconstruction of the South African economy. Further programmes under consideration include targeted investment in tourism-related infrastructure and a "clean cities" campaign. It is recognised that more work is required to ensure that job creation and training opportunities are maximised in these programmes and progress in this regard will be closely monitored.

Government's employment creation projects have explicit training components, are aimed at strengthening small businesses and community organisations and will make lasting contributions to local infrastructure. This is a strategy for employment linked to local economic development.

Infrastructure investment

Benefits of infrastructure

Government recognises the importance of strengthening infrastructure investment over the medium term. Energy, transport, communications and social infrastructure bring significant benefits to poor people, and underpin an improved performance of the economy.

Expansion of public sector investment spending

Electrification, investment in airports, construction of toll roads and more recently the investment of Telkom in expanding telecommunication infrastructure have contributed to the recovery of public sector investment spending in recent years. The tariff policies set out in the National Water Policy will over time strengthen the financing of water resource maintenance and construction. The Development Bank of Southern Africa is playing an expanding role in financing infrastructure.

The 1999 Budget and medium term spending projections will give added impetus to Government's contribution to infrastructure investment. Planned capital spending includes:

- a hospital rehabilitation programme initiated in 1998 that will accelerate over the next three years;
- a steady increase in the contribution of the fiscus to national roads maintenance; and
- several major water projects, including the ongoing Komati River project, a joint undertaking with Swaziland, and a new regional water project in the Northern Province.

MTEF infrastructure investment review

The 1998 MTEF review of infrastructure investment draws two main conclusions:

- South Africa lags behind comparable countries in investing in household infrastructure, while economic infrastructure is broadly in line with the level of development of the economy; and
- inadequate maintenance of existing infrastructure is weakening the asset base of the country.

Maintenance and rehabilitation backlogs

Economic infrastructure spending is about 20 per cent of gross domestic fixed investment (GDFI) and has increased since 1994, mainly because of the electrification programme. The infrastructure report notes the projected strengthening of telecommunications spending in coming years, which will have wide-ranging benefits for the operational efficiency of the economy. South Africa has about 9 telephone lines per 100 people, compared with 30 for East Asian middle-income economies. The report notes the growing maintenance and rehabilitation backlog of the roads system and railways rolling stock. Inadequate maintenance of infrastructure is currently depleting the nation's national water supply capacity.

Low social infrastructure spending

Social infrastructure spending is now little more than 2 per cent of GDFI. Although audits of backlogs in the hospital and college sectors have been undertaken, rehabilitation programmes are not yet in progress.

Housing delivery has gathered considerable momentum. It is recognised that infrastructure spending has to maintain an appropriate balance between the housing strategy and municipal infrastructure provision, water services, schools and other facilities.

Key policy issues

The report identifies several key policy issues:

- clarity is required as to the future fiscal responsibility for supporting the electrification programme, in the context of the envisaged corporitisation of Eskom;
- a phased increase in support for housing, municipal infrastructure and the rural water and sanitation programmes needs to be considered;
- consolidated government spending needs to reflect the infrastructure maintenance and rehabilitation responsibilities of local and provincial government;
- a coherent policy on public-private financing partnerships is needed, bringing together existing initiatives and strengthening the share of infrastructure spending sourced from outside the budget, within a sound financial framework; and
- further scope appears to exist for accelerating infrastructure investment and maintenance through public enterprise restructuring and equity partnerships, particularly in the Transnet group.

Integrated justice sector

Increased spending on the justice sector

Justice, Police and Correctional Services have increased their share of the national budget from 7 per cent in 1986/87 to nearly 10 per cent today. Nonetheless, the three departments have frequently exceeded their budgeted allocations. Personnel spending has grown particularly rapidly.

Adjusted allocations to these budget votes in recent years now put the integrated justice sector on a sound footing. Projects are underway to update the information technology in use in the justice system and to enhance the efficiency of the courts. High risk prisoners are being held in more secure facilities and substantial improvements have been effected in 18 prisons. Modernisation and streamlining of the SA Police Service has been identified as a critical priority.

Performance of the justice system

The 1998 MTEF review team on the integrated justice sector devoted considerable effort to analysing relevant indicators of performance in control of crime and prosecution of justice. In recent years the proportion of cases successfully completed by the police and in turn taken through the justice system has declined. One outcome is that the prisons now house 43 103 awaiting trial prisoners, up from 24 265 in 1995. More effective and more streamlined administration of justice needs to be sought.

Cost pressures in the justice system

The MTEF review notes that average real remuneration has increased sharply in the justice sector since 1994, taking up the available increases in resources. Other sources of increased spending include the provision for legal aid, commissions and other rights-related agencies on the Justice budget and the phasing in of higher standards of accommodation and rehabilitation in prisons.

Government recognises that to improve performance in controlling crime, several key choices have to be made:

- reorientation of expenditure from real wage increases towards investment in capital, equipment and training;
- moderation of expenditure on legal aid and rights commissions in favour of improved court management and prosecutorial efficiency; and
- limiting the standards at which prisoners are accommodated to current Correctional Services norms, with a view to reducing overcrowding within an affordable accommodation plan.

Education

Focus on enhancing quality

Following last year's emphasis on improved financial management and quality enhancement, the 1998 education review team focused on a range of possible solutions geared towards improving quality in the classroom.

This year’s national Education budget includes R200 million set aside for supporting provincial education. The greater part of the funds are assigned to strengthening district management of the school system and teacher development programmes. This will continue to be a priority allocation in the national budget.

Reforming provincial education spending

Against the background of significant budget over-runs in provincial education departments, the 1998 MTEF review explored several options for reforming provincial education spending. With overall spending already some R40 billion a year, this is a function in which improved and extended services have largely to be achieved within the present real resource limits. To achieve the desired redistribution and quality enhancement in schooling, the review proposes that Government:

- keep average salary growth below inflation;
- allow average learner : educator ratios to increase from 34 to 37;
- manage the required reduction in the employment of teachers so far as practical through natural attrition and redeployment;
- increase non-personnel spending to 15 per cent of education expenditure;
- increase efficiency measures across a broad front, including increased teacher workloads, lower teacher substitution, curriculum development and quality enhancement programmes; and
- decrease the incidence of out-of-age enrolment.

The Minister of Education has recently published policy to regulate admissions and repetition in public schools.

Skills development and further education

Legislation giving effect to Government’s skills development strategy was introduced to Parliament in 1998. The strategy envisages the introduction of a wide range of “learnerships” within the context of the South African Qualifications Framework, providing a bridge between formal education and the workplace, strengthening industrial training and creating learning opportunities for the unemployed. Consistent with the broadening of the overall tax base, the skills development strategy will be financed by levies on payroll at a rate of 1 per cent.

A White Paper and Bill on further education have been introduced this year. In line with the new policies the 1998 MTEF education report proposes a “fast-track” approach to introducing innovative vocationally oriented projects in colleges or senior secondary schools, in association with industry training bodies, employers and employees. In the longer term, a new funding framework is needed for further education and training institutions, comprising formula funding of programmes, earmarked funding for specified priorities and capacity building, student financial aid and greater recovery of income from students and employers.

Higher education

Government funding of higher education has increased strongly in recent years, accommodating both rising student numbers and a new student financial assistance programme. Work is in progress on a new approach to subsidising universities and technikons. A key step in the new approach was taken this year as all higher education institutions have been required to submit three-year plans to the national Department.

Health services

MTEF review of health

This year's review of health expenditure included an evaluation of provincial health spending trends, a discussion of revenue retention, cross boundary billing and hospital rehabilitation, an assessment of the health conditional grants and a review of personnel issues.

Hospital construction and maintenance

The construction of a new academic hospital at Cato Manor to relieve pressure on existing Durban hospitals is progressing well. Following the nationwide health facilities audit, funds have been set aside in the national Health vote for a nationwide hospital rehabilitation programme. This will gather momentum over the next three years. Government recognises the importance of strengthening hospital administration along with improved maintenance of facilities.

Hospital revenue

The 1998 review included an examination of options for improving revenue collection by public hospitals and updating tariff levels. The report includes several specific recommendations on cross-border billing where patients are officially referred for services other than central hospital services, and where provincial health departments provide services on behalf of other departments.

Health conditional grants

It was agreed that the conditional grants for health services should be retained for the 1999/00 to 2001/02 years, and that an expert group should be formed to explore further refinement of the grants.

Consideration should also be given to integrating the primary school nutrition grant into a broader nutrition programme in future.

Welfare and social security

Broad range of support for the poor

South Africa provides social grants to over 3 million beneficiaries, representing income support to a large proportion of poor households. Welfare services comprise a wide range of developmental and community-based functions, including support for the non-governmental welfare sector.

The key challenge for the welfare sector is to manage growth of expenditure on social security entitlement programmes while strengthening the funding of discretionary and developmental welfare services. The aim is to increase the share of spending allocated to developmental welfare services, currently less than 10 per cent of welfare and social security expenditure. A critical focus is ensuring an efficient management and delivery of social assistance grants, thereby contributing savings within the welfare budget.

Refocusing of programmes

Refocusing of financial and programme resources is in progress, including support for developmental income-generating programmes, re-prioritising towards more effective programmes, an emphasis on early intervention and prevention rather than residential care and promotion of family-centred and community-based programmes for children, youth and people with disabilities.

Further savings in welfare will result from integrating targeted welfare services with aspects of social security.

Improved financial management

This year's budget includes R100 million to improve financial management. There have already been significant gains from improved data management and other measures aimed at countering fraud and abuse of the social security system.

MTEF review of welfare

The 1998 MTEF review of welfare recommended that the Department of Welfare should investigate a more integrated and comprehensive social security policy, in collaboration with other role-players. The report recommends that provinces should have separate health and welfare departments.

It is noted that Welfare departments support several other departments' activities. This needs to be examined further with a view to possible budgeting reforms, focusing on developmental needs and integrated service delivery.

Personnel spending

Personnel expenditure trends

Personnel spending fell as a share of the budget in 1995/96, and has increased in subsequent years. A marked increase in average remuneration levels in 1996 has contributed to spending over-runs and pressure on budgets, particularly in provinces.

It appears that budgets for personnel expenditure frequently do not adequately take into account:

- the full carry-through cost of annual salary increases;
- the effect of agreements about rank and leg promotion; and
- the cost of other agreements reached in past years and inflation-related adjustments in benefits and allowances.

Personnel budgeting

The 1998 personnel spending review drew attention to the importance of budgeting procedures in the more decentralised personnel management system that is evolving. The Department of Public Service and Administration is responsible for taking the lead in developing a new remuneration policy, including:

- appropriate minimum and maximum salaries for the public service;
- guidelines for annual improvements;
- more equitable and affordable methods of pay progression; and
- more appropriate incentives for employees in rural areas or with scarce skills.

Personnel policy will also need to create the flexibility needed to enable departments to introduce new policies without incurring undue personnel costs. This will require fair and affordable redundancy and redeployment instruments and less reliance on traditional approaches such as freezes on recruitment or cuts in funded vacancies.

The budget process will need to adapt to the new policy framework, including greater transparency and clearer reporting of personnel spending and appropriate controls over pay progression.

Redundancy management

The report makes several proposals relating to redundancy management, aimed at assisting the downsizing of some government activities while minimising the negative impact on employees affected. It is noted that medium term planning and budgeting can assist in managing staffing levels without undue disruption and that more effective redeployment procedures need to be developed.

Financing development

Public-private partnerships

The Government aims to extend the range of infrastructure projects and services that make use of private sector participation. Programmes such as electrification and telecommunications are self-financing, recovering costs from users and able to draw on capital market finance. Private finance and management have been brought into airports and roads. A unit has been established to support the development of business partnerships between municipalities and private service providers. Pilot projects include water, sanitation, refuse collection and transport initiatives.

Innovative projects bringing private support to local police services have recently been developed. Hospital construction and management, further education and welfare services are other areas in which productive opportunities for cooperation between government and the private sector exist.

Umsobomvu Trust

The Umsobomvu Trust will shortly come into being, as announced in the March 1998 budget speech. This fund will receive the proceeds of a charge levied on the demutualisation of Sanlam this year and Old Mutual in early 1999. A Board of Trustees will be established with responsibility for the fund’s management and the disbursement of project funding to support the stimulation of employment creation and skills upgrading amongst young people.

National Development Agency

Following extensive consultation and the passage of enabling legislation, the National Development Agency will be established shortly to support developmental civil society organisations, building on the work of the Transitional National Development Trust.

The Agency will channel government funds to organisations for programmes aimed at meeting the development needs of the poor and to strengthen their institutional capacity. It will also serve to facilitate the flow of donor funding set aside for development agencies. This initiative represents an important bridge between Government and civil society partners in meeting our shared reconstruction and development challenges.

5

DIVISION OF REVENUE

The intergovernmental budget process

Introduction

The 1998 Budget tabled by the Minister of Finance included three-year allocations for the national government, the nine provinces and local government. These allocations reflected the outcome of a lengthy consultative process among stakeholders and the application of an objective, demographically based formula in determining the provincial equitable shares.

The revised allocations set out here are lower than those originally announced in March 1998. The decreases are largely due to changes in the economic outlook, explained in chapter 2. The allocations to each of the nine provinces also reflect the impact of using the final, rather than the preliminary, results of the 1996 census in the provincial equitable shares formula.

Intergovernmental Fiscal Relations Act

The intergovernmental budget process is guided by the Intergovernmental Fiscal Relations Act, which took effect on 1 January 1998. The Act establishes a formal process for considering intergovernmental budget issues and is designed to facilitate consultation and promote a budget-making process that is fair and equitable. It provides a legislative basis for co-operative governance through the Budget Council, which brings together the Finance Minister and provincial Finance MECs, and the Budget Forum, which, in addition includes organised local government.

Co-operative governance

During 1998, the Budget Council met regularly to discuss budget issues and co-ordinate the budget preparation process. In addition, the Budget Council met with its counterpart intergovernmental bodies in Education, Health and Welfare. These joint meetings of national Ministers and provincial MECs gave important direction to the formulation and content of the budgets of the three social services that make up about 85 per cent of provincial expenditure.

Division of revenue

The Minister of Finance is required to table a Division of Revenue Bill alongside the national Budget. It must be accompanied by a memorandum linking the allocations to relevant Constitutional requirements and the recommendations of the Financial and Fiscal Commission.

The introduction of the MTEF process has improved intergovernmental coordination and led to several new initiatives in the budget process. National departments, provinces and local governments came together to play a much more crucial role in the development of sectoral policy, particularly in the areas of education, health, welfare and personnel expenditure.

Improved financial planning

These developments will further improve the link between policy planning and financial planning, which has been lacking in government programmes in the past. The co-operative governance framework that is evolving signals a more mature approach to governance, integrating both national priorities and provincial and local autonomy.

The focus of intergovernmental relations now extends beyond financial co-ordination, towards a greater role for various spheres of government in the policy arena. This will help bring funding and policy considerations in line with the new intergovernmental framework and the Constitution.

Resources available

Equitable shares

The Constitution provides that each sphere of government - national, provincial and local - is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it. The equitable division of revenue takes into account the functions assigned to each sphere and the capacity of each government to pay for these functions through own receipts and revenues.

The equitable share is an unconditional allocation. Provincial and local governments, being distinct spheres of government, determine the priorities for these funds and are directly accountable for how they are spent. However, provincial and local government spending is largely assigned to functions in which national legislation sets norms and standards.

Conditional grants

In addition to their equitable share, provinces and local governments may also receive other allocations from the national share to which the national government may attach conditions. In the 1998 Budget, provinces and local governments received approximately R9,0 billion in conditional allocations from the national share of revenue. A further R4,2 billion was assigned to provincial agencies responsible for implementing specific policies and programmes on behalf of national departments.

Resources to share

In addition to collecting revenue, government currently borrows to meet its expenditure requirements. It is the balance of national revenue plus borrowing, less debt obligations, which represents the total pool of resources available for sharing. Government has also set aside a contingency reserve for each of the MTEF years. The purpose of this reserve is to cushion public expenditure from unforeseen events, such as a deterioration of economic performance or a natural disaster.

Own revenues

Provincial and local government own-revenues are not included in the calculation of equitable shares. The Constitution places limitations on the types of own revenue that provincial and local government have access to, and indicates that any additional revenue raised by a province or municipality cannot be deducted from its equitable share.

Borrowing powers

The Constitution provides for national legislation to govern the power of provinces and local government to borrow. Subject to national oversight, loans may be raised for capital expenditure and to bridge temporary revenue shortfalls. At present, none of the provinces has borrowed on the capital market. Their borrowing has been confined to overdrafts to cover short-term shortfalls.

The vertical division

A choice based on priorities

Government does not use a formula to divide the funds between the spheres of government. The so-called vertical division is done by considering the factors listed in Section 214 of the Constitution and in consultation with the FFC and provincial governments. The vertical division is a policy judgement that reflects the relative priority of functions assigned to each sphere of government. It is a judgement that cannot be captured in a formula.

In considering this division, Government takes into account the economic and social impact of services; the effectiveness with which extra funds can be spent; the scope for savings within budgets; and the short-term impact of fluctuations in allocations.

The division of functions

National government is largely responsible for economic services, the criminal justice system, defence, infrastructure investment and public administration. Both the criminal justice system and infrastructure are priorities for government. At the provincial level, the main services delivered are education, health and welfare, together with provincial roads and regional development. Government has clearly identified the three social service functions as key priorities.

Protection of social services

Government recognises that in times of economic slowdown, its spending priorities should be protected. In arriving at the vertical division for the coming year, Government sought to protect the delivery of social services. All three spheres will receive allocations less than initially expected over the MTEF period, but the burden of the adjustment is placed more on national departments in 1999/00. Thereafter, the reductions are shared in proportion to each sphere's allocation.

Table 5.1: The vertical division

R million	1998/99	1999/00	2000/01	2001/02
National share	**77 176**	**79 608**	**81 338**	**84 898**
Conditional grants to provinces[1]	*7 891*	*7 671*	*7 529*	*7 324*
Grants for local government	*1 132*	*950*[2]	*0*	*0*
Provincial share	**82 862**	**86 946**	**92 743**	**97 522**
Local government share	**1 024**	**1 366**	**2 480**[3]	**2 580**[3]
Total expenditure to be shared	**161 062**	**167 920**	**176 560**	**185 000**
National share (excluding conditional grants)	*42, 3%*	*42, 3%*	*41, 8%*	*41, 9%*
Provincial share (including conditional grants)	*56, 3%*	*56, 3%*	*56, 8%*	*56, 7%*
Local share	*1, 3%*	*1, 4%*	*1, 4%*	*1, 4%*

1. Excludes agency payments and other grants from national departments to provinces that are not yet allocated.
2. Includes R359 million for R293 personnel currently carried on provincial budgets and transfers of R591 million for R293 town functions.
3. The local government equitable share for 2000/01 and 2001/02 includes R591 million for R293 functions.

National government spending over the next three years amounts to approximately 42 per cent of the total, while provinces will receive around 57 per cent. Part of the provincial and local government allocations are assigned on the national budget as conditional grants. These are included in the national share for the purposes of the Division of Revenue Act.

Improvements in remuneration

Improvements in conditions of service are distributed to provinces as conditional grants from national revenue after the division of revenue is done. The amounts depend on the outcome of the annual salary negotiations conducted in the Public Sector Consolidated Bargaining Chamber. The table above includes preliminary allocations for improvement in conditions of service distributed between the national and provincial shares in proportion to the current distribution of personnel spending.

Horizontal division – equity between provinces

Definition

An explicit revenue sharing formula is used to divide the provincial equitable share between the nine provinces – this is called the *horizontal division*. It directs funds to provinces based on their demographic and economic profiles, as these provide an indication of the demand for basic services within the provinces.

The equitable share formula was introduced in the 1997 Medium Term Budget Policy Statement and explained in detail in the 1998 Budget Review. The formula used the preliminary 1996 census results. It was noted then that allocations might be adjusted once the final census results became available.

Increase in population estimates

The final census results will have a significant impact on the allocations to provinces since the distribution of the population (shown in table 4.1) diverges from the preliminary distribution. Although a majority of the country's population live in urban areas, poorer provinces emerged with both a larger population and a larger share of the total population than was originally estimated.

The final census results gives the Free State, Gauteng, Western Cape and Mpumalanga smaller shares of the population than preliminary census, while the other five provinces increase their shares. The provinces with smaller shares of the population will receive smaller shares of the provincial equitable share than originally announced in the 1998 Budget.

Formula elements

Following deliberation in the Budget Council and consultations with the Financial and Fiscal Commission and relevant national departments, a number of refinements to the formula are introduced this year. The formula will be updated each year as new data becomes available. Refinements of the formula will in due course become infrequent. There is a growing understanding of how to measure the service needs of each province.

A notable change to the formula this year is the introduction of a backlog component. Several provinces and national departments have indicated an interest in highlighting backlogs within the equitable share formula.

The equitable share formula is comprised of the following seven components:

- *an education share*, based on the size of the school-age population (ages 6-17) and the number of learners enrolled in public ordinary schools – school-age children are given twice the weight as the number of enrolled, reflecting Government's intention to reduce under-age and over-age enrolment;

- *a health share*, based on the differential use of the public health system by people with and without medical aid or health insurance – the formula weights those without health insurance more heavily, reflecting the fact that they use public health facilities far more frequently than those with insurance;

- *a social security component*, based on the target population for social security grants - the elderly, disabled and children - weighted using a poverty index derived from the 1995 income and expenditure survey;

- *a basic share*, based on each province’s share of the total population of the country;

- *a backlog component*, based on the distribution of capital needs as captured in the schools register of needs, the audit of hospital facilities and the share of rural population in each province;

- *an economic output share*, based on the distribution of total remuneration in the country; and

- *an institutional component*, equally divided among the provinces.

Components of the equitable division

Table 5.2 sets out the contributions of the components of the formula to each province’s equitable share of revenue.

Table 5.2: Components of the equitable shares formula

	Education	Health	Social security	Basic share	Backlogs	Economic output	Institu-tional	Weighted average
Weight	***40%***	***18%***	***17%***	***9%***	***3%***	***8%***	***5%***	***100%***
Eastern Cape	18,5	17,0	19,6	15,5	20.7	5,9	11,1	16,8
Free State	6,3	6,5	7,1	6,5	5.6	5,1	11,1	6,6
Gauteng	12,3	14,7	13,9	18,1	5.0	43,2	11,1	15,7
Kwazulu-Natal	22,1	21,7	19,6	20,7	23.0	18,9	11,1	20,7
Mpumalanga	7,3	7,2	6,5	6,9	8.5	4,7	11,1	7,1
Northern Cape	1,9	2,0	2,2	2,1	1.3	1,6	11,1	2,4
Northern Province	15,7	13,3	13,7	12,1	22.9	1,7	11,1	13,5
North West	8,0	8,6	8,7	8,3	9.5	5,1	11,1	8,2
Western Cape	7,9	8,9	8,8	9,7	3.6	13,7	11,1	8,9
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

The elements of the equitable division formula are not indicative budgets. The education, health or social security shares are unconditional allocations. Provinces budget for these functions within their overall resource constraints, informed by their own processes of prioritising spending within the context of national policies.

Phasing

Government policy reflects the Financial and Fiscal Commission recommendation that the equitable shares be phased in over time to allow provinces to adjust to changes in their relative funding levels. The changes to the allocations brought about by the new census and other amendments to the formula will accordingly be phased in over five years. This will consolidate the progress already made in moving towards a more equitable division of resources.

Redistribution of resources

By relying on provinces' demographic and economic profiles, the revenue sharing formula represents a sharp break from historical funding patterns. The result is a significant redistribution of resources to reflect an equitable provision for services provided by provinces.

The 1996 census results suggest that the distribution of people between provinces is shifting in favour of the Western Cape and Gauteng. Elderly people, women and children are still disproportionately resident in provinces with large rural populations, such as the Eastern Cape, the Northern Province and KwaZulu-Natal. These are factors that impact directly on the provincial revenue shares.

Table 5.3: Impact of equitable shares formula

	1998/99 Base shares	2003/04 Target shares	Percent change
Eastern Cape	17,8%	16,8%	-5,5%
Free State	6,9%	6,6%	-3,6%
Gauteng	14,8%	15,7%	6,4%
KwaZulu-Natal	19,6%	20,7%	5,6%
Mpumalanga	6,6%	7,1%	8,2%
Northern Cape	2,5%	2,4%	-2,0%
Northern Province	13,2%	13,5%	1,9%
North-West	8,6%	8,2%	-4,6%
Western Cape	10,1%	8,9%	-11,4%
Total	**100,0%**	**100,0%**	

Formula to be phased-in over five years. The "equitable shares" exclude other unconditional and conditional grants to the provinces from the national share.

Table 5.3 illustrates the impact on provincial equitable allocations of the revenue sharing formula. Shifts between provinces reflect:

- new census data;
- the poverty-related aspect of the welfare component;
- the bias in favour of the school-going population and education enrolment in the education component;
- the bias in favour of people without private medical insurance in the health component; and
- the weighting in favour of poor women, children and the elderly in the health and social welfare shares.

Table 5.4: Provincial equitable shares

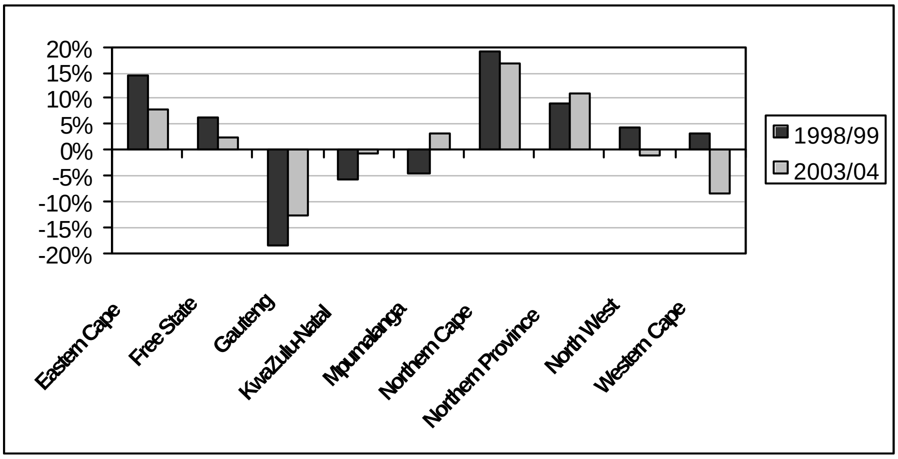
R million	1999/00	2000/01	2001/02
Eastern Cape	15 292	16 131	16 773
Free State	5 942	6 291	6 567
Gauteng	13 008	14 049	14 956
KwaZulu-Natal	17 238	18 591	19 764
Mpumalanga	5 820	6 308	6 738
Northern Cape	2 136	2 269	2 377
Northern Province	11 538	12 353	13 038
North West	7 433	7 854	8 181
Western Cape	8 539	8 895	9 129
Total	**86 946**	**92 743**	**97 522**

Note: These equitable share allocations exclude all conditional grants but include preliminary improvements in conditions of service.

Per capita shares

Deviations above or below the national average in per capita allocations of the equitable shares are illustrated in figure 5.1 for both 1998/99 and the target year 2003/04.

Figure 5.1: Deviation of equitable share per capita from national average



Conditional grants

Principal grant programmes

The 1998 Budget included several conditional grants for provinces and local government. Preliminary allocations for 1999/00-2001/02 of the conditional grants assigned to provincial revenue are set out in table 5.5. These exclude various agency payments and certain other transfers from national departments to provinces that remain unallocated at this stage.

Table 5.5: Conditional grants to provinces

R million	1999/00	2000/01	2001/02
Health			
Central hospitals	3 075	3 112	3 221
Training and research	1 118	1 174	1 215
Redistribution of specialised services	112	176	182
Durban Academic Hospital	247	273	103
Umtata Regional Hospital	64	-	-
Primary school nutrition programme	555	582	603
Finance supplementary allocations	2 500	2 212	2 000
Total	**7 671**	**7 529**	**7 324**

Other programmes on national votes that involve conditional transfers or agency payments to provinces include:

- the housing subsidies and other housing support programmes;
- subsidisation of commuter bus services;
- financial and personnel management systems support;
- education management and planning support; and
- the hospital rehabilitation programme.

The amounts and allocation of these conditional grants and agency payments are determined along with other budget decisions relating to national departments, in consultation with the provincial authorities.

Local government share

Transfers to local Government

Total intergovernmental transfers to local governments in 1997/98 exceeded R5,9 billion. During 1998/99, based on recommendations of the Financial and Fiscal Commission, a new local government funding system was introduced.

A formula-based equitable allocation of operating grants to local government was set out in the 1997 framework document 'An Equitable Share of Nationally Collected Revenue for Local Government'. Capital transfers to local government, such as the consolidated municipal infrastructure programme and the rural water supply and sanitation programme, will continue to be financed from the national share.

Equitable share

During 1999/00, R1 366 million will be allocated to local governments via the new equitable share formula (R342 million more than the 1998/99 year). The horizontal division of the equitable share between local governments using the formula system is managed by the Department of Constitutional Development. The local government equitable share is projected to grow to R2 580 million in 2001/02.

Transitional measures

Six provincial governments continue to provide personnel and services in R293 towns of the former homelands. In 1998/99 provincial governments received a conditional grant of R951 million to provide both personnel and services in R293 towns. In 1998, Parliament passed the Transfer of Municipal Staff Act to allow provincial governments to transfer staff who perform municipal functions to municipalities. This process is at this stage incomplete. In 1999/00, therefore, provinces will continue to receive a conditional grant to cover the R293 staff currently employed. For the next three years, grants for R293 non-personnel service functions will be allocated directly to the appropriate municipalities. Once this transition is complete, all allocations will be made through the equitable share formula.

Table 5.6: Allocations to local government

R million	1999/00	2000/01	2001/02
Equitable share (excluding R293 transfers)	1 366	1 889	1 989
R293 towns staff	359	0	0
R293 towns functions	591	591	591
Total	**2 316**	**2 480**	**2 580**
Other grants			
Municipal infrastructure programme	701	793	780
Other grants	626	542	544

Capital transfers

The main capital transfer to local governments is the consolidated municipal infrastructure programme. In 1999/00, the allocation to the programme is expected to be R701 million (R117 million more than in 1998/99). Other implicit capital transfers include allocations for community water services made by the Department of Water Affairs and Forestry.

Other allocations

In addition to their equitable share allocation, R293 transfers and the municipal infrastructure programme, local governments will receive other allocations amounting to a projected R626 million in 1999/00. These include special Presidential projects and operating subsidies for water services. Local governments also receive allocations for commuter bus subsidies. Operating subsidies for local government services managed by the Departments of Water Affairs and Forestry and Land Affairs will be incorporated into the local government equitable share over an agreed four-year phasing-in period.

Growth limits

For macroeconomic and fiscal reasons, local governments must ensure that their budgets fall within the limits set by the Minister of Finance. For the 1998/99 fiscal year, a growth rate of 6 per cent was determined for both the operating and capital expenditure. The Department projects that the growth rate for both these components for the 1999/00 fiscal year will be 5 per cent. Capital expenditure funded by grants and subsidies from the municipal infrastructure programme and other national government programmes are excluded from this limit.

Uniform standards

The Department of Finance has initiated a project to develop uniform standards, formats and classifications for local government budgets. Uniform budgeting will bring local governments in line with international reporting standards and will facilitate easier comparison of data across different-sized local governments, and with provincial and national governments. Multi-year budgeting for local governments will also be introduced.

Municipal borrowing

The Department of Finance commissioned an investigation into the borrowing powers of local governments and their relationship with creditors. The draft policy framework will be completed in 1998, and legislation relating to this will be tabled during 1999.

Further consultation

Details of the horizontal division of the local government equitable share between municipalities are currently being finalised by the Department of Constitutional Development in consultation with the Department of Finance, using the latest census results. The horizontal division will be made public early in 1999.

6

THE MEDIUM TERM EXPENDITURE FRAMEWORK

Projected expenditure trends

This chapter projects expenditure over the next three years. It looks at trends in spending on the main services, and the trends in capital and personnel spending.

Coverage

The classification of spending set out below includes consolidated national and provincial expenditure. The local government equitable share in the medium term expenditure plans, and the equivalent grants in the earlier years, are excluded from tables 6.3 to 6.6.

Some provincial spending is financed by own-revenues, which does not form part of the national budget. Thus consolidated national and provincial spending as projected in this chapter exceeds spending in the national budget shown in previous chapters.

Basis of projections

The projections are based on preliminary indications of national and provincial budgets. Actual budgets for the next three years will be announced in February 1999. These figures will therefore change between now and the budget.

Spending by sphere of government

Table 6.1 shows spending by the three spheres of government, and compares the projections to the 1998 Budget.

Table 6.1: Consolidated expenditure by sphere of government

R billion	Outcome 97/98	Revised 98/99	Medium term estimates 99/00	00/01	01/02	Changes since Budget 98 98/99	99/00	00/01
National spending (excl. conditional grants)	64,8	68,2	71,0	73,8	77,6	1,0	-0,6	-2,1
Provincial spending	93,4	94,0	98,4	104,4	109,3	0,8	-0,4	-2,7
Total national & provincial spending	**158,2**	**162,2**	**169,4**	**178,2**	**186,9**	**1,8**	**-1,0**	**-4,8**
Local government spending	2,0	2,2	2,3	2,5	2,6	0,0	0,0	-0,1
Debt service costs	39,4	43,7	48,0	51,0	54,0	1,2	3,0	3,0
Contingency reserve	0,0	0,0	1,5	3,0	7,0	-1,0	-1,5	-4,0
Recovery from pension fund	0,0	-0,9	-0,9	-1,0	-1,0	0,0	0,0	0,0
Total	**199,5**	**207,2**	**220,3**	**233,7**	**249,4**	**2,0**	**0,5**	**-5,9**

The lower projected level of GDP and rising debt interest costs have reduced funds available to each of the spheres of government compared to the projections at Budget time.

Shares of spending

Table 6.2 shows the shares of spending, and projected growth rates over the MTEF period for the three spheres of government.

Table 6.2: Consolidated expenditure shares and projected growth

per cent	Outcome 97/98	Revised 98/99	Medium term estimates 99/00	00/01	01/02	Average annual growth 98/99 –01/02
National spending	40,5%	41,5%	41,3%	40,8%	40,9%	4,4%
Provincial spending (inc conditional grants)	58,3%	57,2%	57,3%	57,8%	57,7%	5,1%
Local government spending	1,2%	1,3%	1,3%	1,4%	1,4%	6,2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**4,9%**

Provincial spending

Provincial spending benefits from a rising equitable share, but own-revenues have not been buoyant, resulting in moderate growth in total spending.

Growth rates

Total non-interest expenditure by national and provincial governments, excluding the contingency reserve, is expected to grow by some 4,8 per cent a year over the next three years.

Expenditure by type of service

Basis of projections

Table 6.3 presents a projected breakdown of expenditure over the new MTEF period classified by type of service. These estimates, based on preliminary departmental allocations, are subject to possible changes, as budgets are finalised by the national government and provincial governments.

Table 6.3: Expenditure by type of service

R billion	Outcome	Revised	Medium term estimates			Changes since Budget 98		
	97/98	98/99	99/00	00/01	01/02	98/99	99/00	00/01
Social services	**85,3**	**87,8**	**92,9**	**98,7**	**103,7**	**0,6**	**-0,5**	**-2,1**
Education	44,6	45,3	48,5	51,2	53,7	0,0	-0,3	-1,2
Health	22,9	23,6	24,6	26,4	28,1	0,7	-0,1	-0,7
Welfare	17,8	18,9	19,8	21,1	21,9	-0,1	-0,1	-0,2
Protection services	**30,5**	**31,7**	**33,4**	**35,1**	**36,6**	**1,1**	**0,8**	**0,6**
Defence & intelligence	11,9	11,2	11,3	11,8	12,4	1,2	0,8	0,8
Justice, police & prisons	18,5	20,6	22,2	23,3	24,2	-0,1	0,0	-0,2
Economic services	**10,4**	**9,7**	**9,4**	**9,6**	**10,1**	**0,0**	**-0,9**	**-1,6**
Infrastructure	**23,1**	**22,4**	**23,3**	**24,7**	**26,1**	**0,3**	**0,1**	**-0,3**
Administration	**8,9**	**10,6**	**10,4**	**10,2**	**10,3**	**-0,2**	**-0,6**	**-1,4**
Total	**158,2**	**162,2**	**169,4**	**178,2**	**186,9**	**1,8**	**-1,0**	**-4,8**
Contingency reserve	*0,0*	*0,0*	*1,5*	*3,0*	*7,0*	*-1,0*	*-1,5*	*-4,0*

This classification does not fully correspond with the more detailed functional breakdown of expenditure that is published in the Budget Review and in the official general government statistics.

In addition, the amounts exclude the contingency reserve, part of which is likely to be allocated to services.

Service shares

The table below shows spending in each service as a share of non-interest spending, and projected growth rates over the MTEF period.

Table 6.4: Service shares and growth

per cent	Shares of non-interest spending 97/98	98/99	99/00	00/01	01/02	Average annual growth 1998/99 to 2001/02
Social services	**53,9%**	**54,2%**	**54,8%**	**55,4%**	**55,5%**	**5,7%**
Education	28,2%	28,0%	28,6%	28,7%	28,7%	5,8%
Health	14,4%	14,6%	14,5%	14,8%	15,0%	6,0%
Welfare	11,3%	11,6%	11,7%	11,8%	11,7%	5,0%
Protection services	**19,3%**	**19,6%**	**19,7%**	**19,7%**	**19,6%**	**4,9%**
Defence & intelligence	7,5%	6,9%	6,7%	6,6%	6,6%	3,5%
Justice, police & prisons	11,7%	12,7%	13,1%	13,1%	13,0%	5,5%
Economic services	**6,6%**	**5,9%**	**5,5%**	**5,4%**	**5,4%**	**1,7%**
Infrastructure	**14,6%**	**13,8%**	**13,8%**	**13,9%**	**14,0%**	**5,3%**
Administration	**5,6%**	**6,5%**	**6,1%**	**5,7%**	**5,5%**	**-1,0%**
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**4,8%**

Social services

The projections demonstrate Government's commitment to protecting social services from the effect of slower economic growth.

Social services are mainly delivered at the provincial level. Education, health and welfare spending by the provinces is expected to grow as a share of total spending and somewhat faster than inflation. In addition, spending on these services at a national level is expected to increase. This reflects continued growth in the budget for higher and further education, and increased spending on social service management systems.

Protection services

Protection services are largely delivered by national government. Total expenditure on protection services is expected to increase in line with inflation, though somewhat slower than social services.

Within this total, the integrated justice system - comprising of justice, police and correctional services - takes up an increased share. This reflects both increased allocations to policing, the courts and prisons and continued spending on civil justice and human rights functions. The projected level of defence spending recognises the importance of diplomatic, intelligence and defence capabilities in meeting South Africa's security requirements.

Economic services

Economic services – such as trade, industrial and agricultural services – are projected to grow more slowly than inflation, and fall as a share of total non-interest spending. These functions are complemented by the activities of various public sector corporations and extra-budgetary government agencies.

Infrastructure

These projections show infrastructure spending increasing moderately in real terms and as a share of total spending over the MTEF period. This includes government spending on housing, municipal infrastructure development and investment in water resources. Budgetary allocations for infrastructure are supplemented by accelerating capital spending by parastatals.

Administration

Spending on administration services is expected to fall over the MTEF period, reflecting increased efficiencies and rationalisation.

Capital and current spending

Table 6.5 below shows projected personnel, other current and capital spending, broken down between national and provincial governments.

Table 6.5: Capital and current spending

	Outcome	Revised	Medium term estimates		
R billion	97/98	98/99	99/00	00/01	01/02
Personnel expenditure	**78,1**	**83,7**	**87,3**	**91,2**	**95,7**
National	24,4	27,2	27,6	28,2	29,3
Provincial	53,6	56,6	59,7	63,1	66,4
Other current spending	**69,8**	**66,5**	**69,5**	**73,9**	**77,6**
National	33,6	33,3	34,9	37,4	39,7
Provincial	36,3	33,2	34,6	36,5	37,9
Capital spending	**10,3**	**11,9**	**12,6**	**13,1**	**13,6**
National	6,8	7,6	8,5	8,2	8,7
Provincial	3,5	4,3	4,2	4,8	4,9
Total	**158,2**	**162,2**	**169,4**	**178,2**	**186,9**

Public sector investment

Public sector spending on infrastructure development is largely the responsibility of public utilities and corporations and municipalities, which are not included in these figures. There is nonetheless an important role for spending from the budget, including support for housing development, road construction and water schemes.

Public-private partnerships

Some investment in public services, such as roads and prisons, is now made by the private sector as a result of public-private partnerships. This investment does not appear as part of government capital spending. Increasing use of private finance may therefore result in lower recorded government capital spending figures, giving a misleading impression that investment in public services and infrastructure are being reduced.

Table 6.6 shows the projected shares of capital and current spending in the total, and average annual growth over the 1998/99 to 2001/02 period.

Table 6.6: Capital and current spending shares and growth

	Outcome	Revised	Medium term estimates			Average annual growth 1998/99 to 2001/02
per cent	97/98	98/99	99/00	00/01	01/02	
Personnel expenditure	**49,4%**	**51,6%**	**51,5%**	**51,2%**	**51,2%**	**4,6%**
National	37,7%	39,9%	38,9%	38,2%	37,7%	2,5%
Provincial	57,4%	60,2%	60,6%	60,4%	60,8%	5,5%
Other current spending	**44,2%**	**41,0%**	**41,0%**	**41,5%**	**41,5%**	**5,3%**
National	51,8%	48,9%	49,2%	50,7%	51,1%	6,0%
Provincial	38,8%	35,3%	35,1%	35,0%	34,7%	4,5%
Capital spending	**6,5%**	**7,3%**	**7,4%**	**7,4%**	**7,3%**	**4,5%**
National	10,5%	11,2%	11,9%	11,2%	11,2%	4,2%
Provincial	3,7%	4,5%	4,2%	4,6%	4,5%	4,9%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**4,8%**

Personnel

Personnel expenditure is projected to fall slightly as a share of total spending over the MTEF period, mainly as a consequence of slower personnel spending growth in national departments.

Other current spending is expected to increase as a share of spending, reflecting a strengthening of operating and maintenance outlays and steady growth in social grants and other transfers.

Conclusion

The projections in this chapter are based on indicative budgets, and are likely to be revised before the Budget in February.

The projections indicate:

- the priority of social services and the justice cluster in Government's spending plans;
- moderate real growth in infrastructure spending;
- relative declines in economic and administrative services;
- a shift in favour of non-personnel current spending; and
- a broadly stable share of spending on capital outlays.

GLOSSARY

Accounting officer	The civil servant in a department who is accountable to Parliament for financial management. The accounting officer is usually the Director-General or the head of the department.
Adjustments estimate	Presentation to Parliament of the amendments to be made to the appropriations voted in the main budget for the year.
Agency payments	Payments made by one government department to another in the same or in a different sphere of government to pay for services administered by the department receiving the payments. Agency payments do not form part of the budget of the department receiving the payment. (See also *conditional grants*)
Appropriation	The approval by Parliament of spending from the National Revenue Fund, or by the provincial legislature from the Provincial Revenue Account.
Available expenditure	That part of the national budget which can be divided between the national, provincial and local spheres of government, after debt interest and the contingency reserve have been taken into account.
Balance of payments	A summary statement of all the international transactions of the residents of the nation with the rest of the world during a particular period of time.
Baseline estimates	The initial allocations used during the budget process, derived from the previous year's forward estimates.
Budget Council	A body established to co-ordinate financial relations between national and provincial government, comprising the Minister and Deputy Minister of Finance and the nine provincial MECs for finance.
Budget deficit	The difference between budgeted spending and budgeted revenues.
Capital inflow	An increase of foreign assets in the country or a reduction in the country's assets abroad.

Conditional grants Allocations of money from one sphere of government to another, conditional on certain services being delivered or on compliance with specified requirements. Conditional grants appear as expenditure in the budget of the department making the grant and as revenue of the province or municipality receiving the grant. (See also a*gency payments)*

Consolidated expenditure Total expenditure by national and provincial government, including transfers to municipalities and other extra-budgetary agencies. Consolidated expenditure includes spending by provinces financed from own revenues. Consolidated spending is therefore the sum of national and provincial spending, excluding the double counting of transfers from national to provincial government.

Consumer price inflation Price increases as measured by the consumer price index (CPI), which reflects the prices of a representative basket of consumer goods and services. (See also *inflation; GDP inflation*)

Contingency reserve The portion of the spending total which is set aside and not allocated in advance, in order to accommodate changes to the economic environment and to meet unforeseen spending pressures.

Current account deficit The difference between total imports and total exports, also taking into account service payments and receipts, interest, dividends and transfers. A current account deficit means that South African residents consume more than they produce, which must be financed by capital inflows from abroad.

Debt interest The cost of interest on government debt.

Depreciation (capital) A reduction in the value of fixed capital as a result of wear and tear as well as redundancy.

Depreciation (exchange rates) A reduction in the external value of the rand. A depreciation makes South African goods cheaper to foreign purchasers, and imported goods more expensive to South African buyers.

Devaluation A deliberate change in the exchange rate by a nation's monetary authorities from one fixed level to another.

Direct investment Investment from abroad in physical assets such as factories. (See also *portfolio investment*)

Dissaving The difference between current income and current expenditure.

Division of revenue The allocation of funds between the spheres of government as required by the Constitution.

Domestic demand	The total level of spending in an economy, including imports but excluding exports.
Economically active population	That part of the population of working age which is employed, or seeking work in the market economy.
Economic growth	An increase in the total amount of output, income and spending in the economy.
Emerging markets	A name given by international investors to middle income economies.
Equitable shares	The allocation of revenue to the national, provincial and local spheres of government as required by the Constitution.
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.
Fiscal policy	Policy on tax, spending and borrowing by government.
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, excludes imported goods, and includes intermediate goods such as machines. (See also *consumer price inflation; inflation*)
Generally recognised accounting practice (GRAP)	Accounting standards for government as required by the Constitution. The public sector equivalent of generally accepted accounting practice (GAAP) which sets out private sector accounting standards.
Government debt	The total amount of money owed by government as a consequence of Government's borrowing in the past.
Gross domestic fixed investment (GDFI)	The addition to a country's fixed capital stock during a specific period, before provision for depreciation.
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, such as work within the household.
Hedging	Reducing risk in financial markets by insuring against movements in exchange rates or interest rates.

Improvements in conditions of service (ICS)	The sum set aside to meet the costs of pay increases for public servants. The distribution of improvements in conditions of service depends on the agreements between the government as employer and the public service unions.
Inflation	The rate of increase of prices. (See also *consumer price inflation; GDP inflation*)
Inventories	Stocks of goods held by firms. An increase in inventories reflects an excess of output relative to spending over a period.
Investment	The flow of expenditure on new capital goods.
Macroeconomics	The branch of economics dealing with the whole economy – for example, growth, inflation, unemployment and the balance of payments.
Medium term expenditure framework (MTEF)	The three-year spending plans of national and provincial governments published at the time of the budget.
Merchandise exports	Exports of goods, but not services. In the South African accounts this usually excludes exports of gold.
Microeconomics	The branch of economics dealing with the behaviour of individuals and firms – for example, relative prices and changes in demand or supply of particular goods and services.
Monetary policy	Policy in relation to interest rates, the exchange rate and the supply of money in the economy. Monetary policy is usually focused mainly on keeping control of inflation.
National Budget	The projected revenue and expenditures which flow through the national Exchequer Account. Does not include spending by provinces or local government from their own revenues.
Net open forward position	The difference between aggregate future commitments of purchases and sales of foreign exchange by the South African Reserve Bank.
Nominal exchange rates	The current rate of exchange between the rand and foreign currencies.
Non-tax revenue	Income received by the government as a result of administrative charges, licences, fees, sales of goods and services, etc.
Outcomes	The effect on individuals and communities as a result of the activities of government.

Outputs	Goods and services delivered by government.
Portfolio investment	Investment in financial assets such as stocks and shares or government bonds.
Public sector borrowing requirement (PSBR)	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 exchange rate	The level of the exchange rate taking account of inflation differences.
Real expenditure	The level of expenditure after taking account of inflation.
Recession	A period in which national output and income declines. A recession is usually defined as two consecutive quarters of negative growth.
Remuneration	The costs of personnel including salaries, housing allowances, car allowances, and other benefits received by personnel.
Reserves	Holdings of foreign exchange, either of the Reserve Bank only, or of the Reserve Bank and domestic banking institutions.
Rolling budgets	A budget system in which three year forward projections are revised each year.
Saving	The difference between income and spending.
Treasury committee	Committee that evaluates all requests for additional funds during a financial year for unavoidable and unforeseen expenditure.
Vertical division	The division of revenue between spheres of government. (See also *horizontal division*)

SPEECH BY TREVOR MANUEL, MINISTER OF FINANCE

THE 1998 MEDIUM TERM BUDGET POLICY STATEMENT AND ADJUSTMENTS ESTIMATE

Introduction

Today represents another milestone in the budget reform process. I rise before this Parliament to table formally, for the first time, the Medium Term Budget Policy Statement (MTBPS). In this statement we set out a three year projection for the economy. We explain how much money will be available from taxes and borrowing to pay for social goods and services over the period to March 2002. We also table the Adjustments Estimate for 1998/99, which seeks Parliament's approval to revise the budgets for the current year.

Madam Speaker, when we tabled the Budget on 11 March we expected the economy to grow robustly, interest rates to fall, lower inflation and stronger investment growth. Much has changed since then.

The pain of the changes we are having to live through is felt most acutely by working people and the poor. Over this past weekend, being month-end, working families across the length and breadth of our country will have spent time working through their household budgets, struggling to make ends meet. High interest rates have pushed up repayments on home loans and other debt, reducing the amount of cash available for essentials such as food. In many cases, people run the risk of losing their homes and other possessions.

The change in economic circumstances has also put pressure on investment and job creation.

It has been a difficult and challenging time for all of us. But despite the downturn of the economy we have not cut back on social welfare spending. We have not cut back spending on education and health. We have not cut back on any of the spending on special poverty alleviation and employment programmes. This distinguishes South Africa from all other countries which have been affected by the global crisis.

The developments of the past year have been a real test of our resolve and commitment to the vision and objectives we set out in the Reconstruction and Development Programme (RDP). We believe that we have remained true to these ideals. We continue to deliver on them. We have done this in the most difficult of times. But we have done this without jeopardising the potential of our economy for sustainable growth and development.

It is important to acknowledge that we have been assisted in our task by the fact that our economy has been undergoing major structural reform, which has made it stronger, more resilient and better able to withstand external shocks.

Last December we published (but did not formally table) our first Medium Term Budget Policy Statement, which set out a three-year projection of the economy. In the Budget in March this year those economic projections were updated, and our spending plans were translated into detailed Budget allocations for departments and provinces.

But, as I have already mentioned the world has changed since our first Policy Statement.

The world economy

The global economy is in the midst of a serious financial and economic crisis. We have witnessed a deepening of the financial crisis in the Asian economies. We saw investors respond by withdrawing their money from these economies in the second half of 1997, leading to currency devaluations, increases in interest rates and precipitous declines in stock and other asset markets. Countries were made more vulnerable by the fact that they had very high levels of short term foreign debt.

Since April the global economy has been rocked again and again. The speed at which this crisis has spread from East Asia through Russia and into Latin America, and in particular Brazil, is alarming.

We have watched financial investors flee from emerging markets to relative security, without at times, any semblance of rationality. And, investors have often failed to differentiate between good and bad policies. It has become difficult, if not impossible, for any developing country to access the international capital markets, a fact, which has served only to deepen the crisis.

It is of course true that the world has benefited over the last decade from very strong growth in trade and flows of capital.

There is no question that these flows have contributed to the high rates of growth in many Asian and other developing economies, and have financed investment, growth and jobs in many developing countries.

But these flows have also been accompanied by rapid development of new financial instruments in an environment of poorly regulated banking systems and financial markets. Speculative finance and spiraling stock market prices - and yes, greed - have fuelled poor investments.

Today large parts of the world economy are near or in recession. Sadly most of the countries in recession are in the developing world. The pain and suffering of the poor in these countries is immeasurable. In Indonesia alone, six to eight million more people will join the ranks of the unemployed; in the other economies of East Asia the adjustment has seen large cuts in education and health spending, children are being taken out of school, reversing decades of investment in social development. In our continent lower commodity prices are having a significant impact on growth and creating even greater hardships for the poor. Sadly the burden of adjustment to the global crisis has fallen disproportionately on the poor.

The facts speak for themselves:

- About 1½ trillion dollars – that is almost ten thousand billion rand – of financial wealth has been destroyed in the affected Asian economies.

- About the same amount has been wiped off the New York Stock

Exchange.

- The Russian economy has collapsed and the country is facing a debt standstill.

- Latin America has been drawn into the crisis, and Brazil is at the edge of the precipice. The adjustments its government has to make require large cuts in social spending, significant increases in taxes and interest rates which are now at around fifty per cent.

The consequence is that world trade and global growth has fallen sharply. The consensus at the recent Annual Meeting of the IMF was that world economic growth for 1999 was projected to slowdown very significantly. Recognising the global nature of the crisis, industrial countries are expected to ease their interest rates to prevent a global recession. However, slow growth for a number of years seems inevitable.

Impact on South Africa

Inevitably, we have not been immune to these shocks.

The rand plummeted between May and August, and our stock market lost nearly a third of its value. Capital outflows reversed the net inflows of the first half of the year. The interest rate on government bonds rose from below 13 per cent at Budget time to nearly 20 per cent in August, significantly increasing the government's interest burden. Money market rates, prime interest rates and home loan rates rose 6 percentage points from May to September, reaching an unprecedented 16 per cent above consumer price inflation.

As a result, private consumption and retail sales have stagnated, export growth has slowed and business confidence has been severely dented. Although the economy continued to grow in the first half of the year, all indications are that it has slowed down sharply in the second half.

We cannot avoid the impact of the changed outlook for the world economy. Two thirds of our exports are commodities, which means that the decline in commodity prices has impacted negatively on export earnings and our national income. Our manufacturers now face more difficult international trading conditions and tougher competition from Asian and other countries. And, we remain heavily dependent on foreign investment because we save too little ourselves.

The announcements we make today must not be seen as a mere revision of the numbers. They go to the heart of how this Government gives priority to reconstruction and development, to basic social services, to the poor and vulnerable and to job creation. They are our beacons and we reaffirm today that we will steer our course by them.

We do so cognisant of the fact that the course we are steering is a difficult one. We have said on many occasions that there are no shortcuts, and that we have a responsibility to our people to ensure that the gains we make are sustainable in the long run.

We want our children and grandchildren to enjoy greater prosperity; our mothers and fathers to enjoy peace of mind; and we want to restore the pride and dignity of our people and communities by eliminating the scourge of unemployment. The choices we have made and present to our people today are a testimony to our commitment to creating a better life for all.

Economic prospects

We have come through the worst of this storm and although we have suffered some damage we expect calmer waters for the remainder of this year. We are also projecting that the economy will begin to recover next year, albeit slowly.

The higher interest rates will dampen private consumption and investment until the second half of next year. But as inflation and interest rates come down, demand will strengthen, augmented by demutualisation, increased export competitiveness, and the resumption of foreign inflows. By 2000, we expect to see private consumption and investment growing by as much as 6 to 9 per cent.

Domestic savings are still too low, which means that we need to attract higher levels of foreign investment if the economy is to grow. Capital from abroad not only finances investment and growth, but also provides the liquidity in money and capital markets which we need to bring down our interest rates.

In our trade with the rest of the world, sluggish demand and the lower rand, will dampen import volumes. Although our exports may suffer from the slowdown in world growth, the lower level of the rand will provide some relief. Overall the current account deficit is anticipated to remain between 1 and 2 per cent of GDP in

1998, rising moderately over the following years as demand recovers.

Consumer price inflation is projected to peak below 10 per cent by the end of this year and then decline rapidly towards its 5 per cent trend level during next year.

On balance, we anticipate real growth in the economy of 2 per cent in the next financial year, rising to 3 per cent in 2000/01 and 4 per cent in 2001/02.

Economics is an uncertain science – and rarely is it more uncertain than now. This Medium Term Budget Policy Statement comes at a time when it is difficult to be sure what will happen in the next three weeks, let alone three years. Our forecasts are based on our best assessment of domestic and international conditions, but they are vulnerable to unexpected shocks.

Relatively strong performance

Although investment and growth have suffered, the impact on South Africa of the slowdown in the world economy has been moderate compared with a number of other middle-income countries.

There are several reasons why we have not been so hard hit;

- We have a sound balance of payments, with a deficit to be financed of less than 2 per cent of national income.

- We have moderate foreign debts – in both the public and the private sector.

- We have a well-regulated and well-developed financial system.

- We have made substantial investments in social development over the past four years, in social welfare, education, health, housing, water and sanitation, electrification and other social infrastructure.

- And above all, we have coherent and sustainable macroeconomic policies, and transparent and credible public finances.

These strengths protected us against the worst of the world financial crisis. Our performance has enhanced our standing as an emerging economy. This is also reflected in the fact that the credit rating agency Moodys confirmed South Africa's investment grade rating and changed its outlook from negative to stable. Our investment grade rating was also confirmed by Duff and Phelps, the other rating agency.

We will hold our nerve and walk the path to which we are committed. And, we will emerge stronger from this experience, enhancing our longer term prospects for sustainable growth, investment and above all jobs.

The Adjustments Estimate

We also table today the Adjustments Estimate, which seeks Parliament's approval to revise the budgets for the current year. In part, the changes in spending reflect our changed circumstances.

The Adjustments Estimate contain the following additions to the 1998/99 expenditure estimates:

- Like every other borrower government has had to live with the high interest rates. When we budgeted for debt service costs for 1998/99 we expected that government bonds would cost us an average interest rate of 13 per cent. To date it has cost us on average 15,9 per cent to finance our deficit and to re-finance maturing loans, while short-term loans have been obtained at an average rate of 17 per cent. What all this means is that the cost of servicing government debt has increased and we have had to set aside an amount of R1,18 billion in the Adjustments Estimate for this. This pushes the total interest bill up from R42,5 billion to R43,7 billion. The importance of government's commitment to reducing the deficit is underscored by the sheer magnitude of these numbers.

- Every parent will welcome the news that the Adjustments Estimate includes R200 million for new textbooks. Although the provision of new textbooks is a provincial function, the National government has decided to set aside R 200 million to assist provinces in meeting this commitment. It should now be possible for children to have schoolbooks in the first week of school.

- The Adjustments Estimate also provides an extra R1 billion for national government departments, to meet unforeseen and unavoidable expenditure. This includes commitments by the Special Defence Account, foreign currency losses incurred by SATOUR, the extension of the Truth and Reconciliation Commission, an additional allocation to the Rail Commuter Corporation, and construction contracts of Water Affairs.

- In addition, a billion rand will be provided for provinces. Provinces must use this money to pay off debt and pay their bills on time.

- The Adjustments Estimate also provides for R300 million in additional expenditure for the improvements in conditions of service of both national and provincial government employees.

- R2,0 billion of expenditure rolled over from 1997/98, offset by expected savings and allocations to be rolled forward to 1999/00 amounting to R2,1 billion.

At this stage additional revenue of R384 million is anticipated, including a R350 million receipt to the Exchequer following the closing of the Post Office Fund.

After taking into account the contingency reserve of R1 billion set aside in the 1998/99 Budget, the overall impact of the Adjustments Estimate is an increase of R2,2 billion in the projected deficit to R25,9 billion. This is 3,9 per cent of the revised GDP. The revised expenditure level is now R204,5 billion compared to R201,3 billion announced in the Budget.

The Adjustments Estimate also shows R651 million of additional spending financed from foreign grants or international cooperation agreements. International budgetary support is expected to continue to grow over the coming years, in keeping with various sectoral agreements with partner countries.

The details of the Adjustments Estimates are set out in the Explanatory Memorandum, which we table today. The proposals are a measured response to the changed economic outlook and its impact on the public finances. Government will live within this revised expenditure limits to the end of March 1999.

Revision to macroeconomic and fiscal projections

Madam Speaker, our commitment to economic growth built on investment in our people and the infrastructure of our nation remains unshakable. We believe that it has been our ability to stay the course that has protected us from the worst of this crisis.

The deterioration in the world economy has not led us to abandon our macroeconomic policy. On the contrary, our commitment is underscored by our belief that it has served us well as an anchor in recent storms. The experience of the last year has redoubled our determination to pursue the sustainable economic policies we need to underpin the reconstruction and development of our nation.

Our Growth Employment and Redistribution strategy (GEAR) has never been about specific numbers. It is about a set of policy choices designed to increase growth, employment and redistribution over the medium term. Sustainable growth and job creation are the goals. To achieve them we need to increase the levels of both private and public sector investment particularly in infrastructure; we need a strong export sector; we need to increase the potential of small and medium size enterprises; it also requires a labour market capable of encouraging enterprise while protecting workers. It requires sound public finances and the Budget needs to continue to give priority to spending on education, health, welfare, and social infrastructure.

This reprioritisation demands that we reduce our debt service costs and to do this we have to reduce the government deficit. It also means that we have to begin to address the ratio of current expenditure to capital expenditure, and to do this we have to halt the increase in the government wage bill. But we also have to improve the quality and efficiency of delivery of services. This is the logic that informs our macroeconomic policy.

Of course we must look again at the detailed projections, and adapt them in the light of the changed economic environment. We already know that growth is not as strong as we anticipated; that the exchange rate has been a little stronger; that interest rates have been much higher than we assumed and inflation more subdued. And, more importantly perhaps, the world economic outlook has changed fundamentally. In revising our projections we must be clear where we have fallen short of our goals, and understand why we have not succeeded. But we believe and state unequivocally that the coherence and strength of our policy framework remains.

Fiscal policy and projections

Madam Speaker, I want to deal now with our fiscal projections over the coming three years, on which the next Budget, which will be tabled in this Parliament on the 17 February, will be based.

Our projections in March this year assumed reasonably rapid economic growth over the coming three years, averaging 4 per cent a year. This would have allowed us to reduce the deficit whilst allowing for increases in spending in welfare, education and health. In turn taxes as a percentage of GDP were also projected to fall.

The economy will continue to grow, but more slowly than we anticipated in the Budget. To reduce spending as a share of GDP as fast as we had intended in our Budget projections would result in severe year-on-year real cuts in spending. That in turn would mean reductions in basic services and force Government to step aside from its policy commitments.

This Government does not intend to cut back on social services and infrastructure spending because of a temporary slowdown in growth. It would not be fair to shift the burden of adjustment on to those services that make up the backbone of social delivery. But it would also not be efficient or sustainable. We have therefore decided to protect the real level of public spending over the next three years.

This does not mean that we have abandoned our commitment to sound fiscal management. Quite the opposite. We are more conscious now than ever before that we cannot spend our way out of trouble. The more we borrow, the more we have to set aside to pay the interest on our debt and the less there is left to deliver on reconstruction and development.

It is important to note that the reduction in the deficit since 1994 has already saved about R 4 billion in interest costs that would not have been available in the 1998/99 budget.

Our commitment to reduce the deficit and overtime the debt burden remains firmly in place. We will be reducing the deficit to 3 per cent of GDP in 2000/01, a year later than we planned at the time of the budget. The deficit next year, 1998/99, will be R25,2 billion rand, which is 3½ per cent of GDP.

In other words, we have deferred by a single year our progress to a sustainable and affordable deficit target. We have done so in the face of changes to economic conditions, which make more rapid progress undesirable and unachievable. However, we are mindful of the higher interest costs, which arise from the higher deficit and it is for this reason that the deficit reduction programme is being deferred for only one year.

For the current fiscal year revenue is expected to exceed the Budget slightly and will amount to 27,1 per cent of the revised GDP estimate. In the revised budget framework we allow for a phased reduction in national revenue to 26,5 per cent of GDP in 2001/02.

As a result, budgeted public spending will grow by 20 per cent over the next three years – giving us an average growth of 6,2 per cent a year (or in real terms more than 1 per cent a year).

The new fiscal projections are set out in detail in today's Medium Term Budget Policy Statement. They reflect our commitment to protecting services and jobs in the face of the world economic downturn within a sound and sustainable macroeconomic framework.

The division of revenue

As well as the projections for total spending, tax and borrowing, the

Medium Term Budget Policy Statement sets out the proposed division of revenue among the three spheres of Government.

The proposed division is given effect by the Division of Revenue Bill, which is tabled along with the Budget. We now publish the proposed Division of Revenue some 3 months before the Budget. This will enable provinces to plan their budgets more effectively before February. It will enable analysts and the public to consider the implications of the division of revenue before the budget. Above all, it will enable Parliament to reflect on the proposed division of revenue before the Bill is tabled here in February. This is another step forward in transparency and predictability of the Budget.

The vertical division of revenue between the three spheres of government has been held broadly constant. Some 42 per cent of available revenue is allocated to national government, 57 per cent to provincial governments, and the rest makes up the local government equitable share that we introduced last year.

The division of the provincial share between the nine provinces is determined by a formula which takes account of the demographic profile of each province, in order to reflect the demand for basic social services.

We have updated the formula this year to take account of the final data from the 1996 Census, which we unveiled last month. In addition, we have introduced a new backlog component into the formula, to address backlogs in infrastructure and delivery. This component is distributed according to reported backlogs in health and education infrastructure, and represents an important further step in the redistribution of spending towards previously disadvantaged areas.

The proposed equitable shares to each province are set out in detail in the Medium Term Budget Policy Statement.

Financial management in provinces

Madam Speaker, we have heard much about provincial overspending and mismanagement. There undoubtedly have been problems, particularly in those provinces which inherited bantustan administrations, and there have been acute bottlenecks in financial management capacity.

However, there have been substantial changes over the last year. In March this year, national government intervened in both Eastern Cape and KwaZulu-Natal, using its powers under section 100(1)(a) of the Constitution, to ensure the continued delivery of services in the face of severe financial difficulties. Seven months later, both provinces are now projected to run surpluses this year and throughout the coming three years, to pay off the debt that they incurred. In the other provinces, less acutely burdened with poor capacity and backlogs to address, financial systems have been improved. The provinces are on immeasurably firmer ground today than they were a year ago.

I should like to pay tribute to all nine MECs for Finance. As “Team Finance” we have introduced a new system of financial relations between the spheres of government. We have grappled together with the problems of financial administration, and we have sought to persuade and cajole our colleagues to respect the budget law. We have learned together, and I am proud to call them friends as well as colleagues.

It is a result of their efforts personally that we have a sound system of intergovernmental financial relations which gives effect to our Constitution.

Conclusion

Over the coming weeks and months, Cabinet will finalise the allocation of the national budget, and each provincial Executive Council will do the same for provincial budgets. A new Medium Term Expenditure Framework, setting out spending plans for the next three years, will be announced in the budget in February.

In the meantime, projections based on preliminary budgets are set out in the Medium Term Budget Policy Statement. This enables all stakeholders to engage in a constructive dialogue about the nation’s priorities, to ensure that the widest possible cross-section of views are taken into account in the Budget. We invite this Parliament and our nation to actively engage with the policy proposals we have put forward today.

Madam Speaker, at the Presidential Jobs Summit on Friday, Government, business and labour recognised that we will have to combine our efforts, in new and innovative ways, to increase the number of jobs created in our economy.

The national budget already includes about R5 billion allocated to special employment projects and labour-intensive infrastructure programmes. In addition, there is considerable capital and maintenance expenditure by government and public corporations on roads, telecommunications, regional water networks and electrification, several of which are expanding and have significant employment impacts.

The Job Summit established a common purpose for our nation. It recognised that the only way to improve living standards on a sustained basis is to get people into work and earning a decent living wage.

Madam Speaker, in drawing up our budget we compile an operational plan which breathes life into our goals for the nation.

Our task is made more difficult by the turmoil in the world economy, which has resulted in an economic slowdown in South Africa as in the rest of the world.

But we face this challenge knowing that we have in place a sound economic framework, and steadfast in our commitment to our priorities. We will place job creation first. We will enhance our basic social services, to ensure that all our citizens have access to affordable, good quality health care and education. We will invest in our economic and social infrastructure. And we will wage war on crime.

But we will not do this by abandoning our commitment to sound and sustainable economic policies. We will not do this by throwing away the hard-won gains of the past four years. Instead we will redouble our efforts to deliver better services, more equitably and more efficiently, within the resources we have available. That is the stamp of a socially and economically responsible and committed government.

We have published today a Medium Term Budget Policy Statement which shows how we will meet these commitments within an economic framework which is sustainable and coherent. It shows how we will go on bringing down the burden of tax and the budget deficit, meeting our 3 per cent target in 2000/01. It reaffirms our belief in our macroeconomic policies to promote dynamic growth and job creation, which must underpin social and economic transformation.

Our policy framework has been tempered in the furnace of a global financial crisis. It has proven its worth, shielding us from the worst of the crisis. It is a firm foundation, to which we have made measured adjustments in the face of a changed economic environment. It is because of our responsible economic policies that we are able to affirm here today that we can, and we will, go on building a better life for all.

I thank you.

JOBS AND SOCIAL SERVICES PROTECTED DESPITE ECONOMIC SLOWDOWN

Trevor Manuel MP, the Minister of Finance, today tabled South Africa's second Medium Term Budget Policy Statement (MTBPS) and announced the Adjustments Estimate for 1998/99.

What's new?

- New economic projections show slower growth over the next three years than was anticipated at the time of the Budget;
- The deficit will fall to 3% of GDP in 2000/01, a year later than was projected in the Budget;
- Spending on job creation, social services and infrastructure is protected, despite overall reductions in resources available.
- Provincial allocations are announced for the coming three years, incorporating the effects of the new census results and the introduction of a component to address service and infrastructure backlogs.
- The 1998/99 Adjustments Estimate provides for an increase in the projected deficit of R2,2 billion to R25,9 billion, or 3,9 per cent of GDP.

New economic projections

The world economy has been rocked by a financial crisis, a slowdown in world trade, and financial disinvestment from emerging market economies.

South Africa has performed better than many middle-income economies. We benefit from a sound balance of payments, moderate external liabilities, a well-regulated and well-developed financial system, open and transparent public finances and, above all, coherent and sustainable macroeconomic and fiscal policies.

Nevertheless, the slowdown in the world economy and in world trade will inevitably have an adverse impact on the South African economy. As a result, forecasts of growth over the coming three years have been reduced compared to the Budget. In addition, the economic projections are now extended a year to 2001/02.

The new projections, and a comparison with the 1998 Budget, are set out below:

Table 1: Revised economic projections

	1998/99		1999/00		2000/01		2001/02
Fiscal year:	**Budget**	**MTBPS**	**Budget**	**MTBPS**	**Budget**	**MTBPS**	**MTBPS**
GDP (R billion)	**669,0**	**656,9**	**734,0**	**710,2**	**810,0**	**768,1**	**830,8**
Real GDP growth	3,0%	0,2%	4,0%	2,0%	5,0%	3,0%	4,0%
GDP inflation	6,0%	8,0%	5,5%	6,0%	5,0%	5,0%	4,0%
CPI inflation	5,5%	7,5%	5,5%	6,0%	5,0%	5,0%	4,0%

Source: Table 2.1 of MTBPS; 1998 Budget Review

Projections of spending, tax and borrowing

In the light of the economic background, Government has revised projections of spending, tax revenue and borrowing. Government will continue to focus on its reconstruction and development objectives, protecting spending on social services and grants to the poor, despite the deterioration in the economic outlook.

Government remains committed to reducing the budget deficit to 3% of GDP. This target will now be reached in 2000/01, a year later than planned in the Budget, in order to maintain stability in the real level of government spending.

The new projections, and a comparison with the Budget projections, are set out below:

Table 2: Projections of spending, tax and borrowing

	1998/99		1999/00		2000/01		2001/02
R billion	**Budget**	**MTBPS**	**Budget**	**MTBPS**	**Budget**	**MTBPS**	**MTBPS**
Revenue	**177,6**	**178,0**	**193,4**	**191,3**	**210,5**	**206,2**	**220,1**
as per cent of GDP	*26,5%*	*27,1%*	*26,3%*	*26,9%*	*26,0%*	*26,8%*	*26,5%*
Expenditure	**201,3**	**203,9**	**215,7**	**216,5**	**235,0**	**229,6**	**245,0**
Interest on debt	42,5	43,7	45,0	48,0	48,0	51,0	54,0
Non-interest spending	158,8	160,2	170,7	168,5	187,0	178,6	191,0
Deficit	**23,7**	**25,9**	**22,3**	**25,2**	**24,5**	**23,4**	**24,9**
as per cent of GDP	*3,5%*	*3,9%*	*3,0%*	*3,5%*	*3,0%*	*3,0%*	*3,0%*

Source: Table 3.1 of MTBPS

Within the spending total, debt interest costs have increased because of higher-than-expected interest rates and because of the slightly increased deficit.

Over the next three years, total spending is expected to grow by 20 per cent, and non-interest spending is expected to grow by 19 per cent, compared to an average increase in prices of 16 per cent. This extra spending is accommodated within the Government's goal of a declining deficit and lower tax burden.

Focusing on jobs, reconstruction & development

Government's spending plans include substantial measures to create jobs and invest in reconstruction and development.

Government will create jobs through sustainable and stable macroeconomic and fiscal policies; industry policies, programmes to strengthen further the small, medium and micro enterprises sectors; tourism promotion, new housing; support for education and training; and labour market policies dealing with job security, productivity and employment of youth, woman and the disabled.

Government's medium term spending projections include substantial real increases in infrastructure spending, such as public works and capital grants to municipalities.

Expanding social services and fighting crime

Social services continue to grow faster than other public spending programmes, reflecting the priority Government attaches to basic services.

In addition to job creation, infrastructure and social services, Government's spending plans also reflect the priority given to the fight against crime. Spending on the integrated justice sector is projected to grow by 18 per cent over the next three years.

The Division of Revenue

The Medium Term Budget Policy Statement sets out the proposed vertical division of revenue between the spheres of government, and of the horizontal division of revenue between the nine provinces.

The proposed equitable shares between provinces takes account of the latest census results and revisions to the revenue-sharing formula, including the introduction of a new component to take account of backlogs in infrastructure and services.

The advance publication of the proposed division of revenue provides national and provincial government with more certainty within which to plan. It enables Parliament and the public to engage in an informed debate about priorities, informed by the likely constraints on the overall level of spending.

The proposed division of revenue between the spheres of government is:

Table 3: The proposed division of revenue

R million	1998/99	1999/00	2000/01	2001/02
National share	**77 176**	**79 608**	**81 338**	**84 898**
Conditional grants to provinces	*7 891*	*7 671*	*7 529*	*7 324*
Grants for local government	*1 132*	*950*	*0*	*0*
Provincial share	**82 862**	**86 946**	**92 743**	**97 522**
Local government share	**1 024**	**1 366**	**2 480**	**2 580**
Total expenditure to be shared	**161 062**	**167 920**	**176 560**	**185 000**
National share (excluding conditional grants)	*42, 3%*	*42, 3%*	*41, 8%*	*41, 9%*
Provincial share (including conditional grants)	*56, 3%*	*56, 3%*	*56, 8%*	*56, 7%*
Local share (including conditional grants)	*1, 3%*	*1, 4%*	*1, 4%*	*1, 4%*

Source: MTBPS Table 5.1

Within the provincial share, a formula is used to allocate funds to provinces based on their demographic and economic profiles, since these are related to the level of demand for basic services.

Table 4: Provincial Equitable Shares

		1999/00	
	Shares	**Rand amount**	**Rand per head**
Eastern Cape	17,6%	15 292	2 426
Free State	6,8%	5 942	2 256
Gauteng	15,0%	13 008	1 770
KwaZulu-Natal	19,8%	17 238	2 048
Mpumalanga	6,7%	5 820	2 078
Northern Cape	2,5%	2 136	2 542
Northern Province	13,3%	11 538	2 341
North-West	8,5%	7 433	2 216
Western Cape	9,8%	8 539	2 158
Total	**100,0%**	**86 946**	**2 142**

Source: MTBPS Table 5.4; 1996 Census; Department of Finance calculations

This is the third year in which an equitable shares formula has been used, and the shares increasingly reflect the demographic profiles of provinces.

The Adjustments Estimate

The Adjustments Estimate provides for:

- R1,19 billion to meet higher debt interest payments;
- R1,0 billion for national government departments; this includes commitments by the Special Defence Account (R398m), foreign currency losses incurred by SATOUR (R5m), the impact of currency movements on Foreign Affairs (R50m), the Electoral Commission (R100m), winding down the SA Housing Trust (R20m), the new offices of the Director of Public Prosecutions (R4,5m), new equipment for the Government Communication and Information Service (R8,7m), the extension of the Truth and Reconciliation Commission (R30m), additional allocation to the Rail Commuter Corporation (R100m), SARS bonuses (R195m) and construction contracts of Water Affairs (R100m).
- R200 million for provinces to buy new textbooks; this should ensure that every pupil has textbooks on the first day of school next year;
- R1,0 billion for provinces, to enable them to pay off debt and pay their bills on time;
- R300 million for improvement of conditions of service of national and provincial government employees, including R200m to assist transformation.

The grant to provinces for textbooks is allocated according to the education component of the provincial equitable shares formula. The additional grant is allocated proportionately to the total equitable shares for 1998/99. The allocations are set out in the table below.

Table 5: Allocation of Provincial Adjustment

Rmillion	Textbook Grant	Additional Grant
Eastern Cape	37,1	177,4
Free State	12,7	69,0
Gauteng	27,6	148,6
KwaZulu-Natal	42,6	195,6
Mpumalanga	15,0	65,8
Northern Cape	3,6	24,7
Northern Province	28,5	131,7
North-West	15,9	86,1
Western Cape	17,0	101,1
Total	**200,0**	**1000,0**

After taking into account the contingency reserve of R1,0 billion set aside in the 1998/99 Budget, the overall impact of the Adjustments Estimate is an increase of R2,2 billion in the projected deficit to R25,9 billion, or 3,9 per cent of GDP.

The following table summarises the Adjustments Estimate.

Table 6: Summary of Adjustments Estimate

R million	Budget 98	Adjustments Estimate	Change
National departments	**66 104**	**67 672**	**1 568**
Of which:			
Additional allocations			*1 017*
Rollovers from 1998/99			*1 987*
Savings & rollovers to 1999/00			*-2 120*
Donor financed spending			*651*
Self financed expenditure			*34*
Provincial allocation including conditional grants	**87 008**	**88208**	**1 200**
Of which			
Textbooks			*200*
Additional allocations			*1 000*
Local government	2 156	2 156	0
Improvement of conditions of service	3 375	3 675	300
Debt interest	42 525	43 713	1 188
Reserve	1 000	0	-1 000
Recovery from pension funds	-870	-870	0
National Budget Expenditure	**201 299**	**204 554**	**3 255**
Memo: excluding donor financed	*201 299*	*203 903*	*2 604*
Repayments	**969**	**1 319**	**350**
Revenue	**176 631**	**177 316**	**685**
Memo: excluding donor funds	176 631	176 665	34
Deficit Rm	**23 698**	**25 920**	**2 222**
Deficit % GDP	*3,5%*	*3,9%*	*0.4%*
Memo: GDP	*669 000*	*656 900*	