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.