Medium Term Budget Policy Statement

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Foreword

Establishing a credible budget is not an event but a process. In just four short years, South Africa has transformed its budget process from a staid Westminster-styled bureaucratic cycle to a dynamic, interactive and policy-driven engagement with the issues by the Ministers' Committee on the Budget and Cabinet.

The Medium Term Budget Policy Statement draws on the debates on the February 2000 Budget that have taken place within Government, the legislatures and in the public domain, and frames the issues to be considered in the 2001 Budget. We provide information on the state of the economy, the public finances, revenue performance, spending plans and intergovernmental fiscal developments. We set out policy proposals and provide a platform from which to make informed input into the 2001 Budget.

In taking the 'surprise-factor' out of the annual budget speech, we are signaling a clear commitment to open, transparent and interactive policy-making. The Budget, as a statement of Government's operational plans, must be developed and informed by Government's policies and priorities. Only a policy-driven budget process can shift resources consistently to areas of need. This Statement provides the framework within which national, provincial and local governments will prepare their budgets for the three-year period beginning in April 2001.

The economic context within which the 2001 Budget will be compiled is marked by steady economic recovery following the economic slowdown of 1998, which resulted from global financial crises. Lower debt service costs and buoyant revenue projections allow for both strong real increases in spending on public services and further cuts in income taxes.

The floods that ravaged our sub-continent have left a lasting scar on the lives of many of our people. The people worst affected live in poor, rural areas. In the Adjustments Estimate, we were able to commit additional resources to post-flood reconstruction. Despite this, the fact remains that people in poor provinces with inadequate infrastructure are most vulnerable to the moods of nature. The redistribution of resources towards poor provinces, poor local authorities and ultimately poor households can only be achieved within a consistent intergovernmental system of grants, transfers, revenue powers and borrowing powers. This Statement outlines proposals for strengthening the quality of national, provincial and local government services over the next three years.

The 2001 Budget will signal the most significant shift towards infrastructure spending that Government has yet made. Infrastructure programmes targeted to the poor will contribute to job-creation and faster economic growth. Most importantly, they will offer more people the opportunity to live a better life.

Trevor A Manuel, MP
Minister of Finance

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Introduction

Role of the MTBPS

The Medium Term Expenditure Framework (MTEF), and the annual budgets which proceed from it, are among the most important statements of government policy every year.

The *2000 Medium Term Budget Policy Statement* (MTBPS) sets out Government's thinking on the appropriate macroeconomic and fiscal responses to current trends in the economy. It also sets out current thinking on the manner in which public resources will be deployed to tackle the country's social and economic challenges.

The annual MTBPS is the culmination of a rigorous and consultative process in which the resource needs of various spheres and functions of government are assessed and prioritised. The process is informed by an assessment of the overall state of the economy, as well as Government's macroeconomic policy imperatives.

Outline of policy options

The MTBPS is presented well in advance of the 2001 Budget in order to enhance transparency, facilitate public discussion, and create a common framework for assessing the choices made by government. It also serves to signal the manner in which government proposes to realise the vision set out by the President in his State of the Nation address to Parliament earlier this year.

The highlights of the *2000 MTBPS* are set out in this introduction, with more detail contained in the chapters which follow.

Overview of the MTBPS

Challenges of government

Government's overwhelming priority is to meet the socio-economic needs of all South Africans, and, in particular, to alleviate poverty. These needs arise from the challenges that we face as a developing country, and from the massive economic inequalities and social problems that result from the injustices of the past.

Affordable and sustainable development

In seeking to address these challenges, Government has to balance short- and long-term goals, and pursue its objectives in a sustainable manner. In this respect, economic policy and the use of resources must be affordable. Government cannot impose undue risks or burdens on future budgets and future generations.

Investing in human capital and infrastructure

The imperatives of policy sustainability are embodied in two of the key policy themes of the MTBPS:

- The focus of public spending on programmes that promote human development and broaden economic opportunities
- The targeting of additional expenditure on capital formation and maintenance of infrastructural assets.

If fiscal polices are to be sustainable they must be consistent with the state of the economy, and the associated constraints. Chapter 2 of the MTBPS sets out Government's assessment of the major issues and trends.

State of the economy

The South African economy has been buffeted by a number of external shocks over the past twelve months. These include a depressed gold price, soaring oil prices and the floods at the start of the year. In the face of these shocks the economy has shown resilience, has adjusted to these challenges, and is expected to resume more rapid growth next year.

Stronger economic growth projected

The prevailing lower interest rates, and the decline in debt service costs, together with the sound outlook for South Africa's export performance, are expected to result in increased investment growth, further strengthening the medium-term outlook. Although there remain some uncertainties about the trajectory of the global economy and the ultimate resolution of current imbalances in international trade and the flow of capital, economic growth is expected to average 3,5 per cent over the MTEF period.

Continued commitment to fiscal discipline

South Africa's fiscal policy has consistently sought to achieve stable, sustainable growth, while improving the efficiency of public spending and targeting the provision of services to the poor. Government's success in achieving fiscal sustainability underpins the policies set out in the 2001 MTEF. Government's fiscal framework is set out in Chapter 3.

Lower debt service costs

Fiscal policy over the past five years has resulted in lower debt levels and, hence, lower debt service costs. This has in turn reduced the public sector borrowing requirement, further reducing pressure on interest rates, and released significant funds for non-interest expenditure.

In addition, higher growth projections allow Government both to continue to lower the tax burden, and to increase expenditure. Real non-interest expenditure on public services will rise at an annual rate of over 3,7 per cent over the MTEF period.

Budget deficit to fall to 2,1 per cent of GDP

Disciplined expenditure growth will be accompanied by a reduction of both the proportion of national income devoted to tax, and the proportion of GDP spent by Government. In addition, the national budget deficit before borrowing will fall from a projected 2,6 per cent of GDP in 2000/1 to 2,1 per cent in 2003/4.

The increased resources available to the state will be spent on raising the quality and quantity of services provided. In this respect, Government is prioritising expenditure on capital formation in the public sector. This will raise the levels of sustainable long-term growth and enhance the state's capacity to deliver services.

Budget revenue trends

The success of Government in transforming the South African Revenue Service is reflected in the continued widening of the tax-base, improved tax compliance and strong growth in the collection of revenues. Chapter 4 sets out these achievements, and highlights the future course of South Africa's tax policies.

Revenue growth has helped Government to reduce the deficit on the national budget, while at the same time allowing for a reduction of the rate of tax on companies and individuals. In the medium-term, Government will continue to seek to reduce the income tax burden further.

Government's tax reform programme is informed by the need to enhance the efficiency and equity of South Africa's tax system, and takes into account the country's increasing integration in the global economy.

The 1999/00 fiscal year has also seen steps to enhance tax co-ordination in the region, with the formation of two SADC-based committees. The issue of tax co-ordination, and the role that it has to play in protecting the regional tax base and in contributing to the creation of an attractive regional investment environment, will continue to receive attention in the coming years.

Expenditure plans

The 2001 MTEF sets out a bold programme of public expenditure for the delivery of services and the improvement of public infrastructure. Overall expenditure is projected to grow at an average annual rate of 7,9 per cent over the course of the MTEF.

The allocation of the available resources between various elements of public expenditure reflects Government's commitment to:

- Stabilise personnel budgets across all spheres of government
- Maintain and rehabilitate public infrastructure and increase expenditure on capital goods
- Invest resources in human capital development
- Improve the efficiency and effectiveness of the criminal justice system
- Promote equality by targeting service delivery for the poor
- Provide resources for improving the capacity of Government to deal with the impact of HIV/Aids
- Accelerate employment creation.

These priorities are discussed further in Chapter 5.

The division of revenue

The allocation of public resources to the different spheres of government is regulated by legislation that seeks to ensure the most appropriate and equitable distribution, given the fiscal and functional competencies of each sphere.

Increasing allocation to provincial and local government

In general, the division of revenue over the MTEF sees a shift in the composition of expenditure towards provincial and local government. This is in recognition of the increasingly important role that these spheres of government play in delivering services and – in the case of local government – the costs imposed on municipalities by the process of restructuring.

The increase in the provincial share over the MTEF will assist provinces in accommodating the pressures imposed by the accelerating take-up the Child Support Grant, the pressures on health services resulting from HIV/Aids, and the costs associated with increased spending on infrastructure and poverty-alleviation.

Increased allocations to the local sphere seek to ensure that municipalities have the necessary resources to support the delivery of a basic package of services, including water, sanitation and municipal services, to the poorest communities.

The improved state of provincial finances raises the possibility of selected provincially imposed taxes, as is provided for by section 228 of the Constitution. Guidelines are currently under development to ensure that such taxes do not negatively affect the overall fiscal position of government or create unnecessary distortions in economic decision-making.

Chapter 6 discusses these issues at greater length.

Budget reform and the MTBPS

MTBPS and public debate

The release of the MTBPS is intended to facilitate debate on the economic policies and spending priorities of Government prior to the tabling of more detailed proposals on Budget Day. Such debate will enhance understanding of Government's spending decisions, the rationale underpinning them and the constraints in terms of which they are made.

Enhancing the budget process

This is a reflection of Government's general commitment to budget reform, the aims of which are to improve the quality of policy discussion, aid the management of scarce public resources, improve public accountability and, as a consequence, create the conditions for optimal decision-making and improved service delivery.

The implementation of a three-year budget cycle provides for both better debate on future budgets and improved planning in departments in all spheres of government. This strengthens the link between government policy-making and implementation, and enhances the responsiveness of Government to the needs of the people.

In line with this commitment, the release of the annual budget is now accompanied by detailed, performance-oriented assessments of the impact of government programmes on the lives of ordinary people. This information was captured last year in the *National Expenditure Review* (NES) and, for provincial spending, in the *Intergovernmental Fiscal Review*.

The National Medium Term Expenditure Estimates

The 2001 Budget will see the consolidation of the NES and the *Estimate of Expenditure* ("White Book") into the *National Medium Term Expenditure Estimates* (NMTEE). The NMTEE will bring expenditure and performance data together to show the impact of the services for which Parliament appropriates public funds.

Conclusion

The *2000 MTBPS* sets out Government's thinking on its priorities over the next three years. The information contained in this statement is part of Government's contribution to the national debate on appropriate social and economic policies. We invite as many people as possible – from policy- and decision-makers in the public and private sectors, to ordinary citizens and organs of civil society – to engage with it.

Public comment on the proposals and spending plans set out in the *2000 MTBPS* should reach the National Treasury before December 31 2000. They may be e-mailed to mtbps@finance.pwv.gov.za or posted to:

MTPBS
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National Treasury
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Pretoria 0001

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Macroeconomic challenges and adjustments

The South African economy is expected to grow more rapidly in the next three years than it has in the past two, driven by a strong export performance and accelerating investment.

Nonetheless, risks arising from the large economic and financial imbalances between the three main currency areas pose a threat to global and South African growth.

In the longer term, economic growth in South Africa depends on how well government policy contributes to the development of human capital – particularly through the provision of education and health services – and how state and society ensure that structural change benefits all.

Introduction

Medium term outlook

Improved outlook

In the face of adverse conditions – including floods, high oil prices, a depressed gold price, sluggish consumer demand and perceptions of regional instability – the economy has grown slower in the first half of the year than anticipated in the 2000 Budget. However, strong export performance, the favourable fiscal environment and accelerating investment are expected to contribute to growth of about 3,5 per cent a year over the next three years.

Encouraging current account performance

The balance of trade in goods and services has been positive this year, and despite rising income payments, the current account of the balance of payments is expected to record a deficit of less than 0,5 per cent of GDP.

Steady interest rates

Interest rates have declined from the high levels of 1998, while household consumption growth has been moderate and investment has improved.

Mixed employment performance

Despite these broader positive developments, employment in the formal sector has continued to decline, although overall employment has increased to an estimated 10 369 000 in October 1999.

Rising oil prices give rise to temporary inflationary pressures

Inflation rose this year due to flood-related increases in food prices and higher oil prices. The CPIX, which is used for the inflation target introduced in the Budget in February, rose from 6,8 per cent over the year to December 1999 to 8,1 per cent in September.

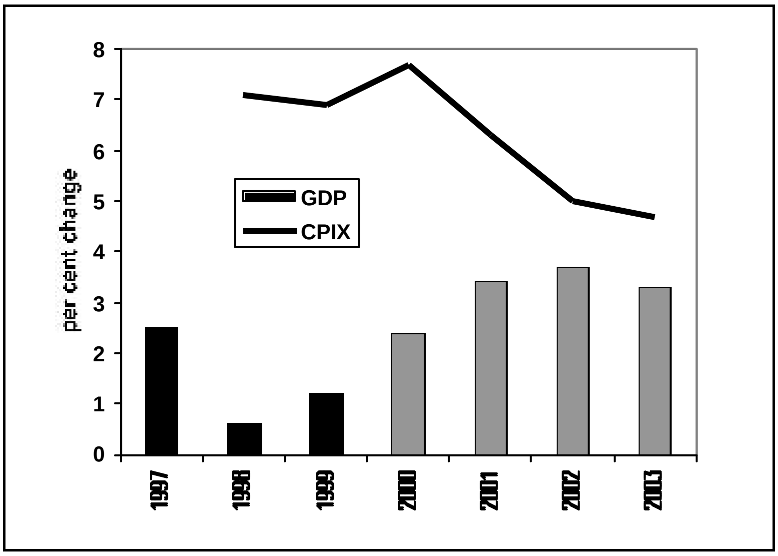
Recovery expected to accelerate

The high interest rates of 1998 and the consequent increase in household debt continue to affect household consumption spending. Debt levels have declined, however, from 59,6 per cent of disposable income at the beginning of 1999 to 56,8 per cent in the second quarter of 2000. The improvement in households' financial position will contribute to stronger consumer spending in due course.

Investment is forecast to accelerate in the second half of the year. Growth in real gross fixed capital formation is expected to average 6,7 per cent from 2001 to 2003.

Figure 2.1 shows GDP and CPIX from 1997 to 2003.

Figure 2.1: Change in GDP and CPIX, 1997 to 2003



Human development essential for future growth

The ultimate goals of South African economic policy are poverty reduction and human development. But human development also plays an important part in promoting further economic growth.

Embracing the knowledge economy

Social renewal and African renaissance will increasingly depend on Government's ability to enhance South Africa's knowledge and technological base, and by extension that of the continent.

Knowledge-driven economies are underpinned by human capital formation, lead by increased public and private sector engagement in research and development, both fundamental and applied, in critical sectors.

A country's level of innovation – defined as a combination of successful technology and conditions favouring business start-ups – provides an indicator of the degree to which a knowledge economy is being fostered. Measures of innovation, such as the World Economic Forum's Economic Creativity Index, indicate that South Africa ranks higher in providing the conditions that support innovation and growth of the knowledge economy than most other countries at similar levels of development.

Those countries that are most innovative tend to be among those that grew fastest over the past decade. This suggests that in order for South Africa to enhance, or even maintain, its competitive position, further steps will have to be taken to reduce impediments to innovation and knowledge diffusion. The report released by The National Research and Technology Foresight Project has unfolded a twenty-year vision for human resource and technology development.

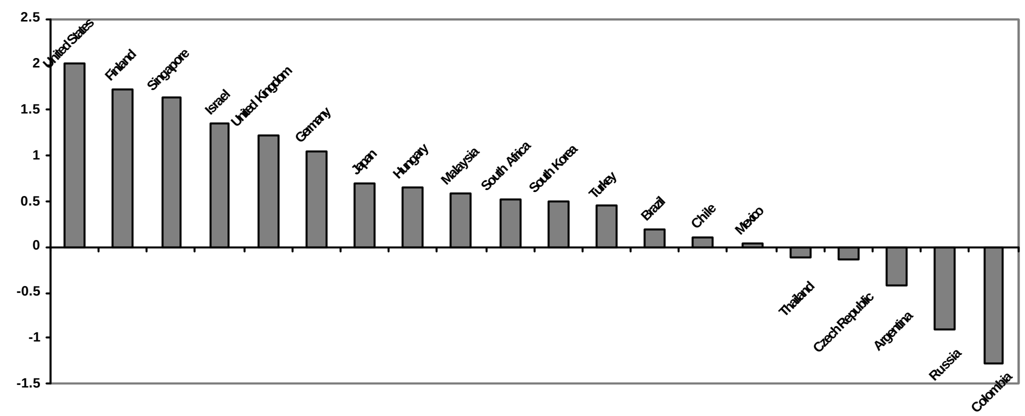
Various strategies can be adopted by the state and the private sector to take advantage of expected growth in areas such as health, clean energy, advanced information systems, genetic manipulation, new and 'smart' materials, bio-informatics, flexible production, and many others.

Infrastructure challenges include further enhancement of the telecommunications backbone and value-added services, an increased emphasis on computer literacy in schools, and a realignment of tertiary education to promote more science and technology graduates.

Regulatory challenges include addressing administrative and financial impediments to business start-ups and developing flexible regulatory regimes that can adapt to developments in fast-changing sectors such as e-commerce.

Institutional challenges include public-private initiatives to promote the spread of information and communication technologies, as well as research co-operation between higher education, industry and Government in focused areas of innovation. The Government's Innovation Fund is one mechanism designed to promote such networking.

Economic Creativity Index (World Economic Forum, Global Competitiveness Report)



Improved health and nutrition have direct effects on labour productivity. Additional education increases not only productivity, but also the ability to create, adopt and attract technology. Government's expenditure on health and education is high by international standards – the challenge

Health, education and productivity

of education and health policy must now be to improve the efficiency and effectiveness of spending. At the same time, Government's Foresight Project has focused on identifying specific areas in which progress in knowledge and human capital formation will reap the highest returns.

Income equality and growth

Human development – in particular improved education and knowledge diffusion – can play an important role in reversing income inequalities. A more equal distribution of wealth favours higher rates of growth.

Improved levels of human development, therefore, are a central link in a virtuous growth cycle, in which higher savings, stronger demand for education, strengthened social capital, greater political and economic stability and growth in output are all mutually reinforcing.

International outlook

South Africa in the global economy

Deeper global integration

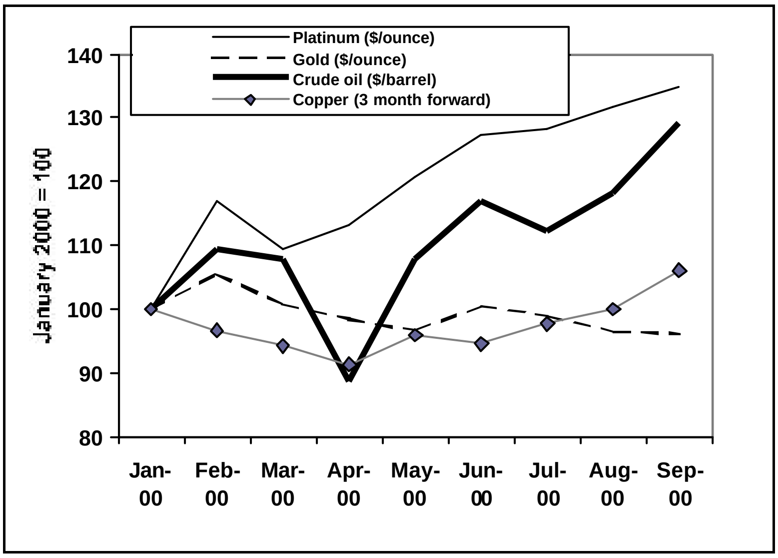
While the volatility that characterised the financial crises of the last two years has largely abated, the global environment continues to pose challenges.

Global growth – expected to exceed 4 per cent this year – has driven growth in South Africa's exports. But the economy has been constrained by the diminishing flow of private capital to emerging markets, rising oil prices, declining non-oil commodity prices, with the exception of platinum (as shown in figure 2.2), and perceptions of volatility in the region. These broader trends have significant effects on the real economy, primarily through domestic and international investor uncertainty.

Global structural imbalances

Among the most important risks to global and South African prosperity over the coming months are the large economic and financial imbalances between the three main currency areas. While the remarkable expansion of the US economy has continued to sustain world growth and trade, the current account deficit of the US balance of payments has become uncomfortably large. Furthermore, a potential correction in the prices of technology stocks remains a key concern of market participants. Uncertainty about the direction of interest rates has contributed to heightened volatility in US stock markets, with important knock-on effects for emerging markets and developing countries. The possibility that these imbalances might unwind in a disorderly fashion remains a risk to global growth.

Figure 2.2: Commodity prices in 2000



The recent increase in oil prices, if sustained, will hamper global growth, and will adversely affect oil-importing countries, particularly the poorest. By the beginning of September the oil price had soared to $35 a barrel, from about $10 a barrel in early 1999.

Reduced capital flows to emerging markets

While capital flows to emerging economies resumed in 1999, the scale of these flows has been smaller than before the crisis. Net private capital flows to emerging markets in 1999 amounted to $80,5 billion, just over a third of their pre-crisis level. Africa's share amounted to $14,8 billion.

Table 2.1 illustrates the divergent growth, inflation, balance of payments and fiscal positions of the three major global economies and a selection of developing countries in 1999.

Noteworthy are the large current account deficits of several faster growing counties, and the substantial fiscal shortfalls of many countries that experienced severe adjustments after the financial crises of the late 1990s.

Table 2.1: International comparison (figures are for calendar 1999)

	Real GDP growth (% increase)	Current account (% of GDP)	Consumer inflation (CPI) (% increase)	Fiscal balance (% of GDP)
United States	4,2	-3,7	2,2	0,7
Euroland	2,3	0,4	1,1	-1,2
Japan	0,3	2,5	-0,3	-7,6
Turkey	-6,3	-0,7	63,0	-11,6
South Africa	**1,2**	**-0,4**	**5,2**	**-2,4**
Mexico	3,7	-2,9	12,3	-1,1
Argentina	-3,0	-4,1	-1,8	-2,5
Brazil	0,8	-4,8	8,9	-10,0
Chile	-1,1	-3,0	3,3	-2,5
Indonesia	0,2	3,6	20,8	-3,8
Malaysia	5,4	-1,2	2,8	-5,5
Philippines	1,1	10,2	6,7	-4,5
Thailand	4,2	9,2	0,3	-7,5
Australia	4,4	-5,3	1,5	0,8
New Zealand	3,4	-8,0	-0,1	0,0

South Africa in the developing world

South Africa's growth prospects are closely tied to those of other middle income economies, and the rest of the continent. The economy will continue to be influenced by factors which impact on developing countries.

African vulnerability to commodity price fluctuations

Almost all of Africa remains vulnerable to fluctuations in commodity prices which force countries to adopt restrictive demand management policies and complicate the servicing of their external debt. Reducing domestic absorption exacerbates poverty by reducing growth rates. Countries most affected by falling commodity prices also suffered declines in average output growth from 1998 to 2000.

Political uncertainty in some countries has played a role in undermining regional growth prospects, highlighting the importance of stable political institutions for economic development.

Economic reforms in Africa

Diversification of output and ensuring macroeconomic stability have been part of the economic reform process throughout Africa:

- Fiscal deficits are on average far lower than they were a decade ago, falling from almost 7 per cent of GDP in 1992 to about 2,6 per cent in 2000

- Inflation has been significantly subdued, with the average inflation rate for sub-Saharan African countries forecast at about 6 per cent for the year
- Market-friendly investment environments have been established in more African economies than at any time in the past
- Trade liberalisation has progressed strongly in Africa and significant progress has been achieved in several key areas conducive to improved investment and trade, including tariff reduction, elimination of non-tariff barriers to trade, and improvement in the regulatory environment for foreign investors.

Debt and OECD protectionism

Unsustainable debt burdens and OECD protectionism continue to place constraints on the engagement of developing countries with the profound changes going on elsewhere in the world economy. OECD subsidies to agriculture in 1996 totalled about US$ 300 billion – roughly the total GDP of Africa. International debt relief initiatives have failed to make significant progress over the past year.

Global governance

Greater institutionalised participation in multilateral institutions – including the World Bank, IMF, and the World Trade Organisation – must be a key part of the strategy to increase developing country participation in the global economy. South Africa – in partnership with other middle income countries – is playing an increasingly prominent role in efforts to democratise these institutions of global governance.

Balance of payments

Healthy current account balances

International developments are reflected in the current and financial accounts of the balance of payments, illustrated in figure 2.3. The value of imports declined during 1999 due to the strengthened rand, and the current account deficit fell to R2,9 billion, or 0,4 per cent of GDP, compared with an average deficit of 1,5 per cent of GDP from 1995 to 1998. In the first half of 2000, the recovery in import demand was more than matched by strong export performance, resulting in a seasonally adjusted and annualised current account surplus of R0,5 billion (0,1 per cent of GDP).

Imports weak but rising

This surplus position is unlikely to be sustained over the second half of 2000, with rising import demand forecast to exceed export growth in both the third and fourth quarters. Imports in the first half of 2000 grew by 5 per cent, compared with a real decline of 8 per cent in 1999 as a whole.

Continued strength in exports

From mid-1999 South African exports responded well to higher world platinum prices and the depreciation of the rand. Despite lower agricultural output, merchandise export volumes grew by 6,8 per cent in the first half of 2000, compared with 2,5 per cent for 1999.

Booming platinum exports

Platinum exports performed particularly well, lifting the proportion of mining exports from 45 per cent of total merchandise exports in the first half of 1999, to 50 per cent in the first half of 2000. The platinum price has risen to above $600 an ounce, and the value of platinum exports in 1999 was equivalent to one-half of net gold export revenues, compared to around one-tenth in 1995.

Trade initiatives

The SADC Trade Protocol, the EU Free Trade Agreement and the United States AGOA initiative are expected to play an important part in enhancing South Africa's export performance.

Financial account weakens

Of the $14,8 billion net private capital flows to Africa in 1999, South Africa received a total of $4,1 billion. This was an increase of over $1 billion from 1998, and as a share of GDP (3,1 per cent), was significantly higher than the emerging market average of 1,1 per cent for 1999. However, this trend has been reversed in the first half of the year, with the capital account recording a net outflow of $1 billion, or 0,9 per cent of GDP.

Decrease in portfolio investment

This is a result primarily of decreases in portfolio investment into South Africa. After the surge in inward portfolio investment of R82,4 billion in 1999, these flows slowed to R1,9 billion for the first half of 2000.

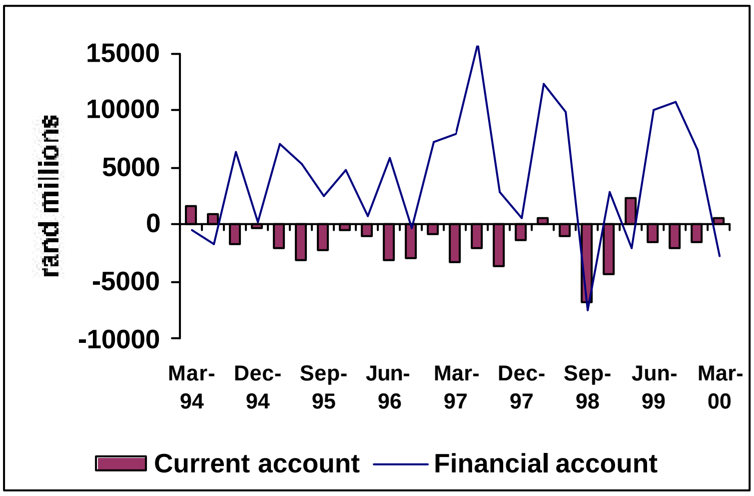
FDI and outward investment stable

Foreign direct investment into South Africa remained relatively stable, from a total of R8,4 billion in 1999 to R4,8 billion in the first half of 2000. Other foreign investment into South Africa, mainly in the form of bank deposits and foreign loans, totalled R7,4 billion in the first half of 2000.

Despite uncertainty in international financial markets, outward investment remained stable at R21 billion in the first half of 2000, compared with R46,3 billion in 1999.

The net deficit on the financial account was thus R6,8 billion in the first half of the year, compared to a net surplus of R25,1 billion in 1999.

Figure 2.3: Balance of payments



Foreign reserves

Total gross international reserves grew rapidly in the second half of 1999, to end the year at R45,4 billion. The overall surplus on South Africa's balance of payments in the first quarter of 2000 (R3,6 billion), resulted in a net increase in gross reserves, which rose to R51,7 billion by the end of September.

Expressed as the number of weeks of import payments, reserves increased to 15 weeks by the end of March, but declined to 14,6 weeks by the end of June 2000. This remains a marked improvement on the 12,6 weeks recorded at the same time last year.

Exchange rates

The real effective exchange rate of the rand appreciated by 3,0 percent from December 1998 to December 1999. The currency has since weakened against the dollar, but has held its ground against most other currencies. The real effective exchange rate depreciated by about 4,6 per cent between January and September.

Currency movements

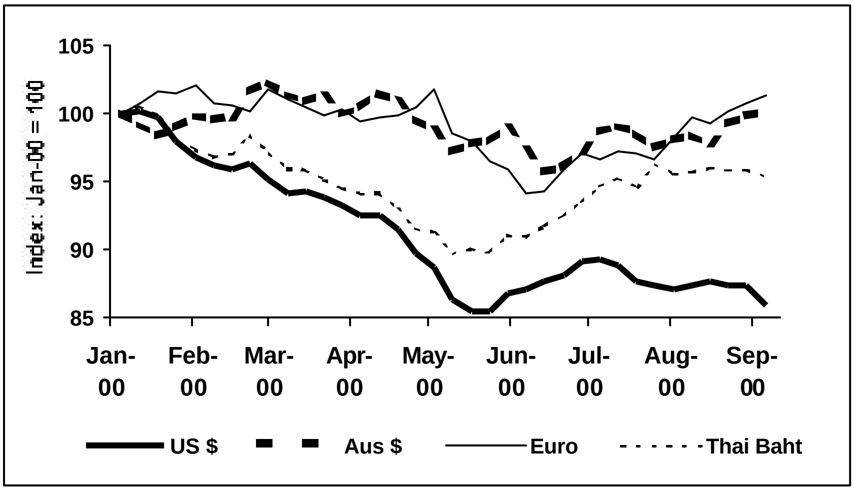
Although the rand fell by about 11,6 per cent against the US dollar over the first nine months of 2000, this was more a reflection of dollar strength than rand weakness, and was accompanied by significant volatility. The rand has strengthened marginally over this period against other major currencies, such as the euro and Australian dollar (see figure 2.4). The rand depreciated in real terms by about 4,6 per cent against a trade weighted basket of currencies.

Approximately 50 per cent of South Africa's exports are mining goods, most of which are priced in US dollar as are many of South Africa's agricultural exports and some manufacturing goods. Add to this that around 13 per cent of South Africa's total exports are destined for the US market, and it is clear that a large proportion of the country's exporters benefit from a depreciation of the rand against the US dollar.

On the other hand, most of South Africa's imports are manufactured capital goods, of which less than 15 per cent is sourced from the US, almost 50 per cent from Europe, and 20 per cent from East Asia. Currencies in these regions have remained relatively stable, or in some cases, weakened against the rand.

The net effect of all these factors on the South African current account and economy should be positive. Exports of dollar denominated goods should gain in terms of both competitiveness and rand income, generating additional export growth and foreign reserves. Moreover, except for rising oil costs, import prices should remain relatively stable and are unlikely to impact adversely on the balance of payments.

Figure 2.4: Exchange rates to the US dollar in 2000



Real output and expenditure trends

Output trends

The structure of the South African economy has changed significantly over the last ten years. This is a consequence of several trends and economic reforms, including industrial restructuring, public sector reform, the transformation of state enterprises, trade liberalisation and agricultural marketing reform.

Finance, transport and telecommunications underpin growth

Since 1995, the finance and telecommunications sectors have grown at annual average rates of 4,2 and 7,8 per cent respectively. This marked growth was associated with substantial investment, significant technology changes and a shift in consumption expenditure toward services.

Positive prospects for tourism

The tourism industry, which contributes to growth in the hospitality and transport sectors of the economy, has also performed well, growing significantly over the past 5 years, and creating an estimated 187 000 jobs. Foreign travel generated 51 per cent of total non-factor services income in 1999, up from 46 per cent in 1995.

Declines in primary sector

In the primary sector, by contrast, growth remains sluggish. Overall, the share of the primary sector in GDP decreased from 12,4 per cent in 1991 to 10,9 per cent in 1999. In the first half of 2000, it contracted further to 10,3 per cent.

From 1994 to 1997, agriculture growth was volatile, but grew by an annual average of 8,1 per cent. The agricultural sector grew by 4,3 per cent in 1999, and shrunk by 0,4 per cent in the first half of 2000.

Construction sector still recovering from high interest rates

The construction sector is recovering from the impact of high interest rates in 1998 and low demand from the public sector, with the rate of contraction of the industry slowing from a year-on-year decline of 1,6 per cent in 1999 to 0,1 per cent in the second quarter of 2000. Lower interest rates in the coming years should see a further improvement in the sector.

Manufacturing growth strengthens

The manufacturing sector has grown at an annual average rate of 1,7 per cent since 1995, with significant weakness in the first three quarters of 1999 followed by a strong rebound of 7,0 per cent in the fourth quarter. In the first two quarters of 2000, the manufacturing sector grew by year on year annualised rates of 3,3 and 2,9 per cent, respectively. This decline in manufacturing growth is due in part to knock-on effects of the floods on industry, in the form of severe disruptions in the supply of agricultural inputs. The contribution of the manufacturing sector to GDP has declined from 21,2 percent in 1995 to 19,9 percent in 1999.

Expenditure in the economy

Positive expenditure outlook

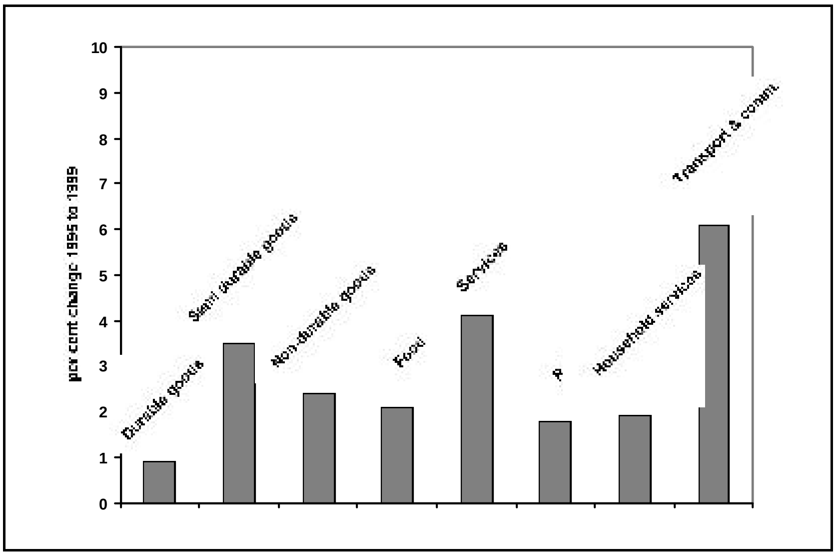
While expenditure growth by households, firms and government has been moderate, improved government savings and the declining public sector borrowing requirement bode well for sustainable increases in government expenditure over the MTEF period.

Household consumption moderate but increasing

Real expenditure by households in the first half of 2000 grew by 2,9 per cent compared with the first half of 1999. Household spending increased particularly strongly in the purchases of cars and furniture in the durable goods category. This was mainly the result of lower interest and personal income tax rates, and the consequent rise in household disposable income.

As figure 2.5 shows, final consumption of services has increased as a proportion of total consumption from 37 per cent in 1995 to 39,7 percent in 2000, and has grown by an annual average of 4,1 per cent since 1995.

Figure 2.5: Growth in consumption, 1995 to 1999



Turnaround in private investment spending

A decline in gross fixed capital formation in 1999 was followed by growth in the first and second quarters of 2000 of 1,6 per cent and 2,0 per cent, respectively. Private sector investment has grown strongly, except in the mining industry.

Investment by public corporations declined in the first and second quarters of 2000, reflecting a tapering off of the infrastructure rollout in the communications sector. However, a renewed upswing in public sector investment is expected as state asset restructuring picks up pace in 2001.

Inventories continue to rise

Inventories held by firms rose in the fourth quarter of 1999 and the first quarter of 2000, before weak demand induced business to reduce the rate of stock build-up in the second quarter. In the first half of 2000, inventories remained at 14,0 per cent of GDP compared with 13,3 per cent in 1999.

Government spending eases in the first half of 2000

Preliminary estimates indicate a continued easing in government consumption expenditure this year, reflecting restraint in expenditure on intermediate goods and in personnel remuneration.

The public sector borrowing requirement has declined from R29,5 billion in 1998 to R9,6 billion annualised in the first half of 2000.

Gross saving improves

Gross saving increased marginally in 1999 to 14,8 per cent of GDP, after declining from 19,1 per cent of GDP in 1990 to 14,3 per cent in 1998. In the first half of 2000, gross saving increased again to 15,3 per cent of GDP. This was due to improved saving performance by Government. Household saving as a percentage of disposable income continued to decline, reaching 0,4 per cent in the first half of 2000 from 0,8 per cent in 1999.

Employment and remuneration trends

Total employment increased from 1996 to 1999

The 1999 October Household Survey showed an increase in employment in the economy as a whole from 9 287 000 in 1996 to 10 369 000 in 1999. As illustrated in table 2.2, formal sector employment declined by 402 000, while informal employment increased by 911 000. The formal sector not covered by the Survey of Total Employment and Earnings increased by 174 000.

The 17 per cent increase in the economically active population (about 2 million people) indicates a large flow of people into the labour market between 1996 and 1999, swelling the numbers of young work-seekers without past work experience.

Table 2.2: Employment and unemployment, 1996 and 1999

	Thousands	**1996**	**1999**
A	**Total employed**	**9 287**	**10 369**
	Composition of the employed:		
	Employed in the formal sector STEE survey (excluding agriculture and certain formal sector activities not covered by the STEE)	5 242	4 840
	Employed in agriculture	759	1 099
	Employed in the formal sector in activities not covered by the STEE	1 550	1 724
	Employed in the informal sector	996	1 907
B	Total unemployed (official definition)	2 224	3 158
C	Total economically active (= A + B)	11 511	13 527
D	Total not economically active	13 146	12 753
E	Total working age population (= C + D)	24 657	26 280
F	Official unemployment rate (= B * 100/C)	19,3%	23,3%

Labour demand and skills

Increased capacity for skills development

Industrial restructuring and the changing nature of the work process have substantially raised the skills content of many jobs in the formal economy. Accelerated growth and job creation pose critical challenges for the education and training systems through which skills development and productivity enhancement are secured.

Shortages of professional skills

Private sector surveys of skills shortages routinely indicate the difficulties faced by firms (76 per cent of respondents in one study) in hiring qualified and experienced workers, especially in the information technology, medical and engineering fields. The skills shortage places a supply constraint on the rate of growth of the economy.

Skill shortages may become an even greater challenge than at present unless skills enhancement is increased, the education system responds adequately to the labour demands of the private sector and measures are taken to address the loss of skills through emigration. Government's skills development strategy, in co-operation with the private sector, will assist in adequately re-skilling the current labour force. More active linkages between the education system and industry can identify likely future skills requirements and pass them on to younger generations.

Wages and unit labour costs

Moderate growth in wages…

The skills shortage results in increasing wages and salaries for more highly-skilled workers, and contributes to wider income disparities. Nevertheless, wage growth has been moderate in 1999 and 2000. Following strong growth in 1998, the rate of growth of nominal remuneration in the formal sector continued to slow in 2000. Real wages increased by 0,4 per cent in the first quarter of 2000, after remaining stable in 1999.

…and unit labour costs

The rate of increase in nominal unit labour costs declined from 3,5 per cent in 1999 to 0,5 per cent in the first half of 2000. This improvement in the trend in unit labour costs is a result of a favourable combination of moderate nominal wage growth and strong labour productivity increases in 1999 and the first half of 2000.

Money supply and inflation

Stable monetary growth

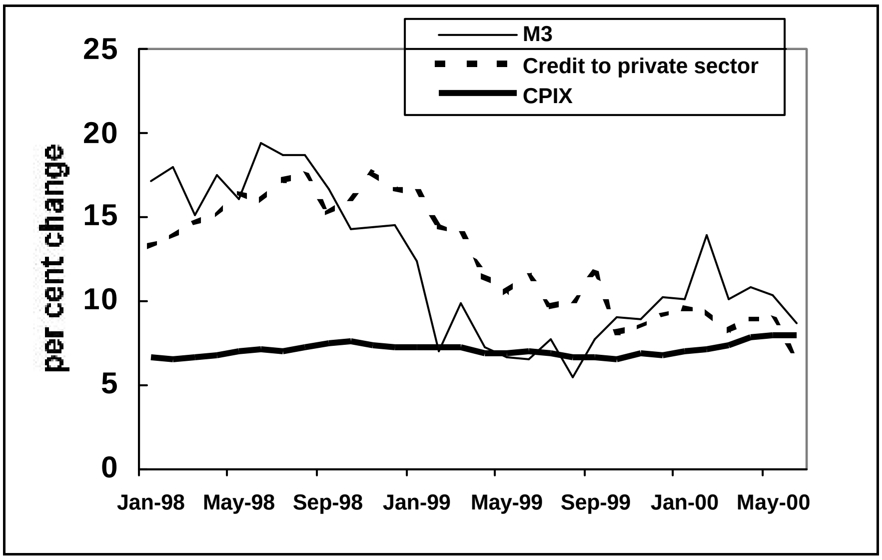
Despite stable trends in the growth rates of the money supply and of private sector credit extension, inflation has risen through the year. This is shown in figure 2.6.

This can be attributed primarily to cost-push factors, especially the increase of the price of crude oil and the impact of floods on agricultural production.

M3 – the broad money supply – increased by 8,7 per cent in the year to August 2000, compared with 10,2 per cent in calendar year 1999.

Private sector credit extension, which remained strong in 1998, weakened significantly in 1999 and into the first quarter of 2000. In the second quarter of 2000, private credit demand increased due to rising demand for mortgages and 'other loans,' accelerating from 7,1 per cent growth in the year to June, to 8,6 per cent in August.

Figure 2.6: Growth in the money supply, credit to the private sector and inflation, 1996 to 2000



Oil and agriculture drive prices in 2000

The rise in oil prices has had a marked impact on producer price inflation, which rose from 8,2 per cent over the year to January 2000 to 9,3 per cent in August. Consumer price inflation (measured by CPIX, the consumer price index excluding mortgage interest) increased from 7,7 per cent in the year to January 2000 to 8,1 per cent in September. The oil price increases will continue to filter through the economy in the second half of 2000 and first half of 2001.

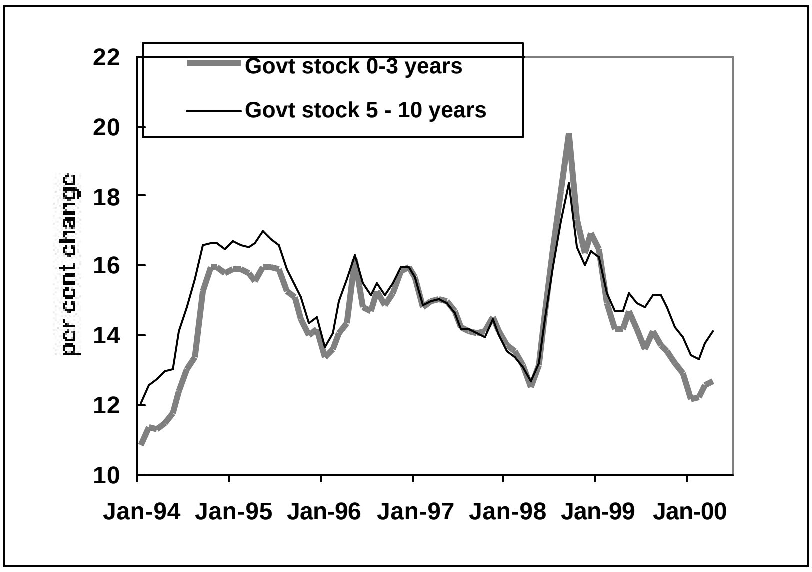
Interest rates remain steady

Reflecting the cost-push nature of the increases in the rate of inflation, nominal interest rates have remained steady in

2000. The repo rate remained stable at 11,75 per cent for most of this year, increasing to 12,0 per cent in October, while nominal yields on government bonds reached their lowest level since July 1994 – fluctuating around 12,8 per cent. This is illustrated in figure 2.7.

The predominant prime interest rate charged by commercial banks decreased from 18,0 per cent in 1999 to 14,5 per cent in 2000, year to date. The real cost of borrowing – measured by the prime rate minus CPIX – declined from 11,1 per cent in 1999 to 6,8 per cent in the year to August 2000.

Figure 2.7: Nominal bond yields, 1994 to 1999 (monthly data)



Domestic economic outlook

Improved GDP growth over MTEF period

Sound structural fundamentals, a continued strong export performance, accelerating investment spending, complemented by buoyant domestic consumption should underpin strong GDP growth through to 2003. The economic forecast is summarised in tables 2.4 and 2.5.

Employment forecast remains mixed

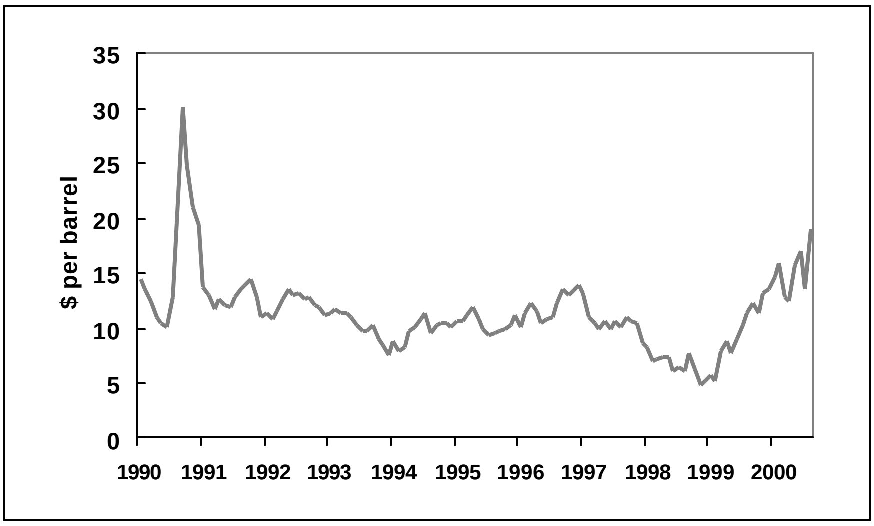
Employment is expected to increase in new formal sector industries, especially services, and in the informal sectors. Although job losses are likely to continue in mining and manufacturing as industrial restructuring proceeds, positive growth in overall formal employment should emerge as economic growth strengthens.

Oil prices and domestic inflation

Crude oil prices rose from a low of US$9,68 in February 1999 to levels above US$35 in early September. The domestic price of petrol increased from R2,29/litre to R3,66/litre over the same period. Measured in constant dollars, current oil prices are substantially above their ten-year average level, with the only comparable prices experienced during the Gulf war in 1990/91 (see figure 2.8).

The weight of fuel and power in the CPI is 4,0 per cent, while transport has a weighting of 15,4 per cent. However, the increase in international crude oil prices also impacts on inflation through the indirect cost increases in other goods and services.

Figure 2.8: Real oil prices, 1990 to 2000 (US dollars per barrel)



Inflation to decline

The upturn in inflation caused by the increase in international crude oil prices and the disruption to agricultural production caused by the floods earlier in the year, is expected to be reversed by the end of this year. Modest growth in money supply, excess production capacity and slower growth in labour costs will contribute to an easing of inflation in 2001 and beyond.

Consequently, CPIX inflation is expected to decline to 6,3 per cent in 2001 and to 5,0 per cent in 2002. Headline inflation is expected to follow more or less the same trend, with both CPIX and headline inflation falling to about 4,5 per cent by 2003.

Positive export growth

The real depreciation in the value of the rand, upward momentum in the commodity cycle, a relatively strong global economic environment and a further liberalised world trade environment are likely to provide a further impetus for strong export growth over the forecast period, albeit at slightly lower rates. Exports are set to rise by nearly 9 per cent this year and are expected to grow by about 7 per cent per year from 2001 to 2003.

Imports attuned to demand

Growth in merchandise import volumes slowed down in the second quarter of the year, largely owing to relatively weak domestic demand conditions. This trend is expected to turn around as domestic economic activity gains momentum and the demand for imported goods accelerates.

Minimal current account constraints

In light of the favourable first half current account data and the downward revision to domestic demand for this year, the projected deficit on the current account has been revised downwards to 0,4 per cent of GDP for this year. Although the deficit on the current account is expected to increase again as demand picks up, it is not expected to rise much above 1,5 per cent of GDP over the forecast period.

Consumption expected to rise

Higher disposable incomes due to the 2000 Budget tax changes should underpin renewed growth in consumption expenditure. Final consumption expenditure by households is expected to grow by 2,9 per cent in 2000 and 3,0 per cent in 2001.

Solid private sector investment growth

Private sector investment is expected to gain momentum in the forecast period as growth picks up and the benefits of lower interest rates filter through. Consequently, total private sector fixed capital formation will be the driving force of gross capital formation throughout the forecast period with an average growth rate of 6,3 per cent over the period 2000-2003.

Government consumption increasing

Government consumption expenditure is expected to grow by an average of 2,7 per cent over the next three years, following several years of restraint.

Fiscal year projections adjusted

Compared to the figures published in February’s Budget Review, the new fiscal year projections for 2000/01 show a downward adjustment in GDP growth and higher inflation.

Growth is expected to increase more rapidly in 2001/02 and 2002/03 than was previously anticipated, while inflation will decelerate somewhat more slowly, due to the oil price increases.

Table 2.3: Macroeconomic indicators: 1997 to 2003

Calendar year:	1997	1998	1999	2000	2001	2002	2003
		Outcome			Projected		
Real growth in demand:							
Final household consumption	2,7%	1,3%	0,7%	2,9%	3,0%	3,3%	2,9%
Final government consumption	4,5%	-0,5%	-1,9%	-1,7%	2,4%	2,9%	2,7%
Gross fixed capital formation	5,2%	4,8%	-6,9%	0,9%	6,3%	7,4%	6,5%
Gross domestic expenditure	2,5%	0,6%	-0,5%	2,1%	3,6%	3,9%	3,4%
Exports	5,5%	2,3%	0,0%	8,9%	6,8%	7,1%	6,7%
Imports	5,4%	2,1%	-7,0%	8,0%	8,0%	8,5%	7,2%
Real GDP growth	**2,5%**	**0,6%**	**1,2%**	**2,4%**	**3,4%**	**3,7%**	**3,3%**
GDP inflation	7,8%	7,7%	6,8%	6,2%	6,1%	5,0%	4,7%
Gross domestic product at market prices (R billion)	**683,7**	**740,6**	**801,1**	**871,8**	**956,9**	**1 041,0**	**1 126,8**
Consumer price inflation:							
Headline CPI	8,6%	6,9%	5,2%	5,2%	6,4%	5,2%	4,8%
CPIX (Metropolitan and urban areas)		7,1%	6,9%	7,7%	6,3%	5,0%	4,7%
Balance of payments:							
Current account balance (% of GDP)	-1,5%	-1,6%	-0,4%	-0,4%	-1,1%	-1,5%	-1,2%

Table 2.4: Macroeconomic projections: 1999/00 to 2003/04

	1999/00	2000/01		2001/02		2002/03		2003/04
Fiscal year:	**Outcome**	**February 2000 projection**	**Revised projection**	**February 2000 projection**	**Revised projection**	**February 2000 projection**	**Revised projection**	
Gross domestic product (R bn)	**816,7**	**885,2**	**892,5**	**958,2**	**976,7**	**1 036,7**	**1063,3**	**1148,7**
Real GDP growth	1,8%	3,6%	2,6%	3,2%	3,7%	3,3%	3,5%	3,3%
GDP inflation	6,1%	5,5%	6,5%	4,9%	5,6%	4,8%	5,2%	4,6%
CPI inflation:								
Headline	3,8%	5,5%	6,3%	5,2%	5,7%	4,7%	5,5%	4,5%
CPIX	6,9%	6,6%	7,6%	5,3%	5,8%	4,5%	5,0%	4,6%

3

Fiscal policy and the 2001 Budget

Against the background of robust revenue performance and the reduction in the budget deficit achieved since 1995, Government's fiscal policy stance is now decidedly growth-oriented. Over the next three years:

- *Interest rates and inflation should continue to fall in response to the moderation of the public sector borrowing requirement*
- *The burden of income tax on the economy will be reduced, accompanied by further broadening of the tax base and improvements in revenue administration*
- *Non-interest expenditure on public services is expected to grow by more than 3 per cent a year in real terms.*

Introduction

Fiscal policy creates platform for growth

Sound fiscal policies have successfully lowered the budget deficit and reversed the rising trend in interest costs relative to GDP. This creates a platform for both sustainable real growth and for quality improvements in service delivery by the state.

Key fiscal trends are outlined in this chapter, together with a summary of the proposed framework for the 2001 Budget.

Benefits of lower budget deficit

By reducing its borrowing requirement, Government has contributed to lowering the cost of capital. The reduction of the budget deficit from over 5 per cent in 1995/96 to 2 per cent in 1999/00 is one of the main factors driving the reduction of real interest rates. Over time, the reduced budget deficit has lead to lower interest on debt and accordingly to the expanded capacity of the fiscus to sustain real growth in expenditure on goods and services.

Robust spending growth

As a result of the healthier fiscal position and a projected recovery in economic growth, Government is able to increase the estimate of spending on public services by R7,8 billion in 2001/02 and R13,2 billion in 2002/03 above the level anticipated in the 2000 Budget forward estimates. Infrastructure spending will be a key focus of Government's budgetary priorities over the 2001 MTEF.

Lower tax burden

Government's tax policy aims to broaden the revenue base and improve collection efficiency, thereby creating room for lower tax rates and reducing the economic distortions associated with the tax structure. Reductions in both personal and corporate tax rates will lower the costs of investment and job creation, and release household spending power.

Renewed emphasis on spending responsibilities

The overarching objective of fiscal policy is to contribute to long-term growth, employment creation and an equitable distribution of income, in the context of an affordable and sustainable budget framework. In reviewing options for the 2001 Budget, Government has been mindful of the considerable progress made in consolidating revenue and reducing the budget deficit. This allows the emphasis to shift more strongly towards providing for the social, developmental and infrastructural expenditure responsibilities of the state.

Government's fiscal record

Fiscal policy, growth and investment

Table 3.1 summarises Government's fiscal performance over the last five years. It shows:

- A reversal of the upward trend in consumption expenditure
- Growth in capital spending up to 1998
- A decline in government dissaving and interest on debt, and
- A rising trend in the tax to GDP ratio.

The table shows a breakdown of government current expenditure between interest on debt, subsidies and transfers, individual services (such as education and health) and collective services (such as justice, defence and trade promotion).

Table 3.1: Key fiscal trends (national accounts estimates)

	1995	1996	1997	1998	1999	2000[1]
Government consumption expenditure (% of GDP)	18,3%	19,4%	19,8%	19,8%	19,2%	18,5%
Gross fixed capital formation (real growth)						
General government	6,0%	5,3%	4,4%	2,5%	-5,4%	-0,9%
Public corporations	15,8%	10,6%	9,7%	51,4%	-17,2%	-19,9%
General government saving (% of GDP)	-4,2%	-4,9%	-4,9%	-3,9%	-2,6%	-1,8%
Interest on public debt of general government (% of GDP)	5,9%	6,4%	6,1%	6,3%	6,1%	5,6%
Yield on long-term government stock at period end	14,6%	16,2%	14,1%	16,4%	14,0%	13,9%
General government tax revenue (% of GDP)	24,1%	24,7%	24,9%	26,0%	26,3%	26,0%
Distribution of general government expenditure (% of current expenditure):						
Interest on public debt	20,0%	20,5%	19,7%	20,3%	20,2%	
Subsidies and transfers	18,2%	17,2%	16,3%	15,5%	14,9%	
Final consumption expenditure						
Individual services	27,9%	26,5%	30,0%	30,1%	29,1%	
Collective services	33,8%	35,9%	34,0%	34,7%	34,8%	

1. 2000 figures based on data to end June; yield on long-term debt at end July 2000.

Reduction in government consumption expenditure as share of GDP

Between 1995 and 1997 final consumption expenditure by government increased relative to GDP, partly reflecting the impact of public service remuneration trends since 1996. This trend has now been reversed as a result of more effective efforts to align salary increases with inflation.

Strong capital spending

Over the past five years, gross fixed capital expenditure by general government and public corporations grew by an annual average rate of 6,1 per cent. 1998 saw a peak in fixed capital expenditure growth by public corporations of 51,4 per cent in real terms, with substantial investment by Telkom and SAA. The decline in 1999 and 2000 must be seen against the background of the large increase in 1998.

The contribution of the public sector to capital formation is projected to improve in 2000/01 and over the MTEF period, due to increased government investment in infrastructure and higher investment by public corporations as a result of the restructuring of state assets.

Declining government dissaving

Government dissaving – which is calculated after taking into account government consumption of fixed capital (depreciation) – has fallen from 5,9 per cent of GDP in 1994 to 2,6 per cent in 1999. This has been brought about largely by the reduction in the national budget deficit. As Government increases efforts to shift the balance of spending towards capital expenditure, government dissaving is projected to decline to zero by 2002.

Interest on debt to decline by over1 per cent of GDP

The reduction of the budget deficit has meant that for the first time in over twenty years, debt service costs as a percentage of GDP are declining. Had the deficit remained at the same levels as in 1995/96, South Africans would be paying at least R5 billion a year more in debt service costs. By the end of this MTEF period, debt service costs on the main budget will have declined from 5,6 per cent in 1998/99 to 4,5 per cent, thus releasing over 1 per cent of GDP a year for additional spending, or for tax cuts.

Tax to GDP ratio to decline

Tax revenue reflected in table 3.1 includes taxes collected by the South African Revenue Service as part of the national budget, provincial and local government taxes, unemployment insurance contributions and South African tax revenue diverted to other countries in terms of the Southern African Customs Union agreement. While general government tax revenue has increased from 24,4 per cent of GDP in 1994 to 26 per cent in 1998, it is projected to decline somewhat as a share of GDP over the next three years.

Distribution of government spending

The distribution of general government current expenditure shows a stable level of interest on public debt since 1995 and a fall in the level of subsidies and transfers (partly as a result of the phasing out of the general export incentive scheme and early retirement and voluntary severance offers). Over the next three years, interest on debt will take up a decreasing share, allowing expenditure on public services to rise.

Government's key fiscal policy aims are set out in table 3.2.

Table 3.2: Key fiscal policy aims

Percentage of GDP	1994	1999	2003
Government consumption expenditure	20,0	19,2	18,5
General government saving	-5,9	-2,6	0,0
Interest on general government public debt	5,5	6,1	5,4
General government tax revenue	24,4	26,3	25,0
	1994/95	**1999/00**	**2003/04**
Public sector borrowing requirement	5,7	1,3	2,0
	1994–1999		**1999–2003**
Gross fixed capital formation by general government (average annual real growth)	2,5%		5,0%

1999/00 Budget outcome

Strong growth in revenue

The preliminary outcome for revenue collected in 1999/00 is R198,2 billion. National budget revenue has increased by an annual average of 10,6 per cent between 1996/97 and 1999/00, while total expenditure has grown by 7,0 per cent a year

Table 3.3: National budget outcome: 1996/97 – 1999/00

	1996/97	1997/98	1998/99	1999/00	
R billion				**2000 Budget estimate**	**Preliminary outcome**
Total revenue	**146,5**	**163,5**	**184,3**	**196,3**	**198,2**
per cent of GDP	*23,2%*	*23,5%*	*24,4%*	*24,0%*	*24,3%*
per cent increase	*16,2%*	*11,6%*	*12,7%*	*6,5%*	*7,5%*
Total expenditure	**175,3**	**189,9**	**201,5**	**216,0**	**214,6**
per cent increase	*15,5%*	*8,3%*	*6,1%*	*7,2%*	*6,5%*
Budget deficit (-)	**-28,8**	**-26,5**	**-17,2**	**-19,7**	**-16,4**
per cent of GDP (-)	*-4,6%*	*-3,8%*	*-2,3%*	*-2,4%*	*-2,0%*

Preliminary expenditure outcome

Estimated actual expenditure in 1999/00 was R214,6 billion. This is 6,5 per cent more than in 1998/99 and R1,4 billion less than the February 2000 estimate. Preliminary indications are that some underspending occurred in new conditional grants and poverty relief programmes, in which spending has been slow to gather momentum.

Current budget deficit 2 per cent of GDP

The budget deficit in 1999/00 is estimated at 2,0 per cent of GDP, down from 4,6 per cent in 1996/97, as shown in table 3.3.

Revised framework

Overview

The revised framework for the 2001 National Budget is set out in table 3.4. These estimate take into account the adjustments to the 2000/01 budget tabled in Parliament on 12 October and revised projections for the economy outlined in Chapter 2.

Inflation increases nominal GDP

Higher inflation and real growth over the MTEF period lead to upward adjustments in expected nominal GDP compared with the forward estimate projected in the 2000 Budget. This accounts for higher revenue over the MTEF period and contributes to the upward adjustments in expenditure estimates.

Lower debt service costs

Lower debt service costs – a result of the declining budget deficit and proceeds of state asset restructuring – release further funds for spending on public services. Estimates of the cost of servicing debt have been revised downward by R831 million in 2001/02 and R1 billion in 2002/03.

The revised budget framework provides for real growth in non-interest spending of 3,7 per cent a year over the MTEF period, including provision for contingencies

Table 3.4: Revised national budget framework 2000/01 to 2003/04

R billion	2000/01 2000 Budget	2000/01 Revised	2001/02 2000 Budget	2001/02 Revised	2002/03 2000 Budget	2002/03 Revised	2003/04
Revenue	**210,4**	**212,2**	**227,4**	**232,2**	**243,6**	**251,5**	**271,0**
Per cent of GDP	*23,8%*	*23,8%*	*23,7%*	*23,8%*	*23,5%*	*23,7%*	*23,6%*
Expenditure	**233,5**	**235,3**	**251,5**	**257,1**	**266,7**	**275,5**	**295,4**
Per cent increase	*8,1%*	*8,9%*	*7,7%*	*9,2%*	*6,0%*	*7,2%*	*7,2%*
Interest on debt	46,5	46,3	49,5	48,7	51,0	50,0	51,5
Contingency reserve	2,0	-	4,0	2,0	8,0	4,0	8,0
Non-interest available expenditure	**185,0**	**189,0**	**197,9**	**206,4**	**207,7**	**221,5**	**235,9**
Deficit (-)	**-23,1**	**-23,1**	**-24,1**	**-24,9**	**-23,1**	**-24,0**	**-24,4**
Per cent of GDP (-)	*-2,6%*	*-2,6%*	*-2,5%*	*-2,5%*	*-2,2%*	*-2,3%*	*-2,1%*
GDP	**885,2**	**892,5**	**958,2**	**976,7**	**1 036,7**	**1 063,3**	**1 148,7**

Increased spending allocations

Allocations for spending on public services increase by R7,8 billion in 2001/02 and R13,2 billion in 2002/03 over the baseline estimates published in the 2000 Budget. An additional R18,3 billion has been made available for spending in 2003/04 over and above the baselines budgeted for by departments.

Budget deficit to fall to 2,1 per cent of GDP

Reflecting improved revenue trends, Government's improved expenditure management and the recovery of GDP growth, the national budget deficit is projected to fall from 2,6 per cent of GDP in 2000/01 to 2,1 per cent in 2003/04.

Declining public sector borrowing requirement

After taking into account the projected proceeds from the sale of state assets and a moderate rise in borrowing by public enterprises and local government, the public sector borrowing requirement is projected to reach about 2,0 per cent of GDP over the next three years.

Medium term national budget projections

National budget revenue

Growth in revenue

National budget revenue is projected to grow at an annual average rate of 8,5 per cent over the next three years, an upward revision from the 7,9 per cent rate projected in the 2000 Budget. This growth in revenue is illustrated in figure 3.1, together with projected national revenue as a share of GDP.

Revenue revisions

Table 3.5 sets out the revised revenue estimates alongside those of the 2000 Budget. Further details are provided in Chapter 4.

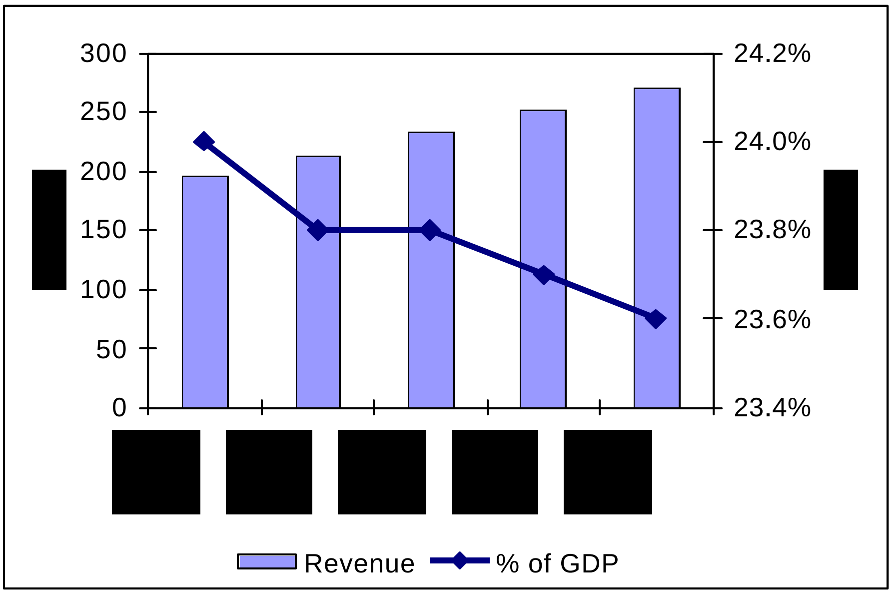
Table 3.5: Medium term revenue projections

	1999/00	2000/01		2001/02	2002/03	2003/04
R billion	**Outcome**	**Budget**	**Revised**	**Medium term estimates**		
National budget revenue	**198,2**	**210,4**	**212,2**	**232,2**	**251,5**	**271,0**
Per cent of GDP	*24,3%*	*23,8%*	*23,8%*	*23,8%*	*23,7%*	*23,6%*
Per cent increase	*7,5%*	*7,2%*	*7,1%*	*9,4%*	*8,3%*	*7,8%*
Real growth	*1,3%*	*0,6%*	*0,5%*	*3,6%*	*3,0%*	*3,0%*
Change from 2000 Budget			**1,8**	**4,8**	**7,9**	

Donor funded expenditure

Receipts of the RDP Fund for 2000/01 are expected to amount to R800 million. The estimates for subsequent years stand at R700 million a year. These receipts and the associated expenditure are not voted by Parliament in the departmental appropriations and are reported separately in the budget documentation.

Figure 3.1: National budget revenue



Skills Development Levy

The national budget includes the continued phasing in of the Skills Development Levy, introduced in the 2000/01 fiscal year, at 0,5 per cent of payroll. The levy will increase to 1 per cent in 2001/02 and beyond. These funds flow directly to Sectoral Education and Training Authorities and the National Skills Fund and are not appropriated by Parliamentary vote.

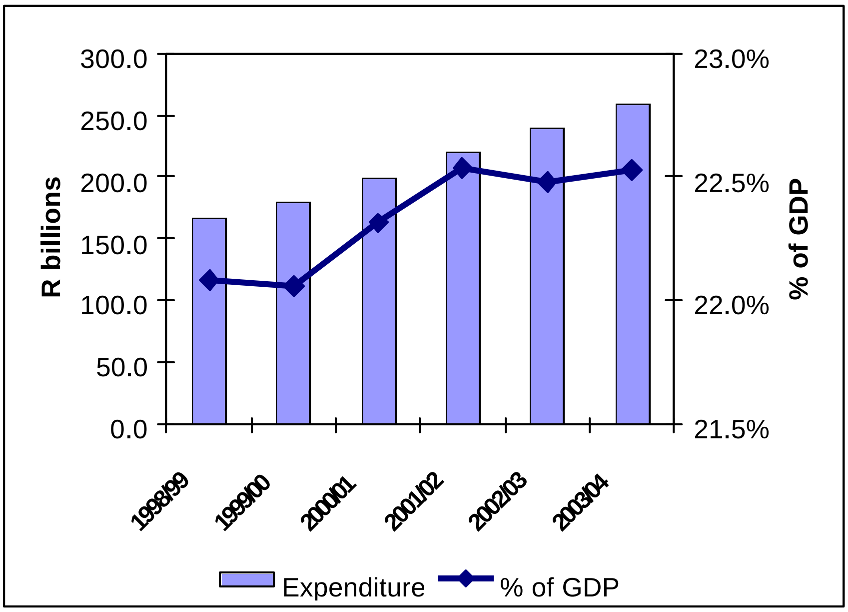
National budget expenditure

Robust expenditure growth

National budget expenditure is expected to grow at an annual rate of 7,9 per cent over the next three years, an upward revision from the 7,4 per cent rate set out in the 2000 Budget. Figure 3.2 illustrates the rising levels of consolidated national and provincial non-interest expenditure over the MTEF period.

In real terms, these increases represent an average annual growth rate of 3,7 per cent in non-interest expenditure – significantly higher than the growth rates of 1998/99 and 1999/00. This faster increase in expenditure reflects both improved fiscal performance and an increased capacity to spend.

Figure 3.2: Consolidated national and provincial non-interest expenditure – medium term projections



Revised expenditure estimates

Table 3.6 sets out the revised expenditure estimates alongside those of the 2000 Budget.

Lower debt service costs

Debt service costs are projected to fall from 5,5 per cent of GDP in 1999/00 to 4,5 per cent in 2003/04, a downward revision of the 2000 Budget estimates. This is shown in figure 3.3. This trend reflects a number of factors, including:

- The lower budget deficit, which has in turn reduced the net borrowing requirement of the past two years
- Lower long-term interest rates, partly as a result of lower government borrowing
- Lower borrowing associated with proceeds from state asset restructuring.

Figure 3.3: Debt service costs – medium term projections

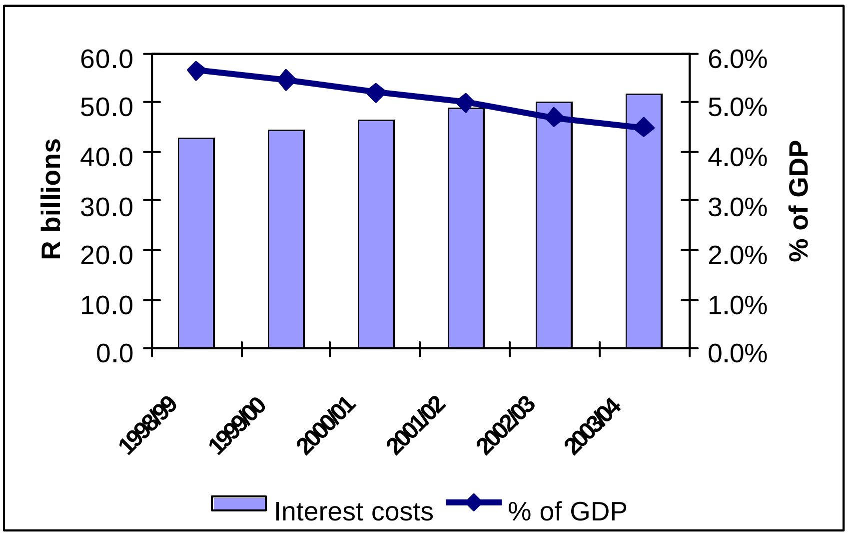


Table 3.6: Medium term national budget expenditure projections

R billion	1999/00 Outcome	2000/01 Budget	 Revised	2001/02	2002/03 Medium term estimates	2003/04
Debt service costs	44,3	46,5	46,3	48,7	50,0	51,5
Contingency reserve		2,0		2,0	4,0	8,0
Non-interest expenditure	169,5	185,0	188,9	206,4	221,5	235,9
Per cent increase	*8,0%*	*7,8%*	*10,1*	*9.3%*	*7.3%*	*6.5%*
Total expenditure[1]	**214,6**	**233,5**	**235,2**	**257,1**	**275,5**	**295,4**
Per cent of GDP	*26,2%*	*26,4%*	*26,4%*	*26,3%*	*25,9%*	*25,7%*
Per cent increase	*6,1%*	*8,1%*	*10,0%*	*9,3%*	*7,2%*	*7,2%*
Real growth (non-interest expenditure)	*1,0%*	*1,5%*	*4,1 %*	*4,5%*	*2,9%*	*3,4%*
Changes from 2000 Budget						
Debt service costs			-0,2	-0,8	-1,0	
Contingency reserve			-2,0	-2,0	-4,0	
Non-interest expenditure			3,9	7,8	13,2	

1. Including transfer of R855 million to Umsobomvu Fund in 1999/00.

Rolling drawdown from the contingency reserve

The budget framework includes a contingency reserve to deal with unforeseen circumstances. This ensures that Government can adjust to adverse macroeconomic developments, or make funds available for natural or other disasters, within the agreed overall expenditure programme. In the revised budget framework, R2 billion is retained as a reserve in 2001/02, increasing to R8,0 billion in 2003/04.

Increase in available expenditure

After debt servicing costs and allocations to the contingency reserve, the revised expenditure estimates provide for increases in non-interest expenditure allocations of R7,8 billion in 2001/02 and R13,2 billion in 2002/03. The projected functional and economic breakdown of expenditure is set out in Chapter 5, and the division of available resources between national, provincial and local government is discussed in Chapter 6.

The budget deficit

Budget deficit declines as a percentage of GDP

The deficit is projected to decline from 2,6 per cent of GDP in 2000/01 to 2,1 per cent by 2003/04.

Decrease in debt as a percentage of GDP

As a result of the rapid reduction in the deficit, lower interest rates and proceeds from privatisation, South Africa's debt to GDP ratio is now falling. National Government's debt to GDP ratio now stands at 45,1 per cent, after rising to 48,0 per cent at the end of March 1999.

National foreign debt has increased from 2,2 per cent to 3,3 per cent of GDP over the same period. As a result of increased international investor confidence, Government has raised its foreign borrowings, thereby increasing foreign inflows of capital and relieving pressure on local interest rates.

Stable interest rates

Healthy fiscal performance has contributed to securing stable interest rates over the past year. Lower debt and real interest rates are now helping to insulate the economy from external shocks. For this reason South Africa is less vulnerable to the renewed, if less severe, global financial market instability than was the case in 1998.

Public sector borrowing requirement

PSBR of 1,3 per cent of GDP in 1999/00

The public sector borrowing requirement (PSBR), which represents the full claim of Government on available savings, has declined from R35,6 billion, or 5,6 per cent of GDP in 1996/97 to an estimated R8,7 billion in 1999/00, or 1,1 per cent of GDP. This reduction has been achieved in part by increased receipts from the proceeds of privatisation.

PSBR target of 2,0 per cent of GDP by 2003/04

Despite a slight increase in the PSBR in 2000/01, Government will continue to moderate the public sector's claim on resources available for borrowing, and aims to bring the overall PSBR to 2 per cent of GDP by 2003/04.

Table 3.7 sets out the borrowing requirements of the various components of the public sector since 1996/97.

Table 3.7: Public sector borrowing requirement: 1996/97-1999/00

R billion *deficit (+) / surplus (-)*	1996/97	1997/98	1998/99	1999/00 2000 Budget estimate	1999/00 Preliminary outcome
Main budget deficit	**29,0**	**26,5**	**17,2**	**19,7**	**16,4**
Extraordinary payments			0,9	1,5	1,5
Extraordinary receipts	-1,6	-2,9	-2,7	-6,9	-7,1
Main budget borrowing requirement[1]	**27,4**	**23,5**	**15,4**	**14,3**	**10,8**
Social security funds	-0,9	-1,1	-1,4	-1,2	-1,1
Provinces	3,0	5,5	-0,5	-1,9	-3,0
Extra-budgetary institutions	1,1	1,4	1,8	1,5	-1,4
Local government	0,8	0,8	1,0	0,8	1,0
General government borrowing	**31,3**	**30,1**	**16,2**	**13,5**	**6,3**
per cent of GDP	*4,9%*	*4,3%*	*2,1%*	*1,7%*	*0,8%*
Plus:					
Non-financial public enterprises	0,5	2,3	8,6	1,2	2,4
Public sector borrowing requirement	**31,8**	**32,4**	**24,8**	**14,7**	**8,7**
per cent of GDP	*5,0%*	*4,6%*	*3,3%*	*1,8%*	*1,1%*

1. Due to classification and timing differences, these estimates do not correspond fully with the SA Reserve Bank government finance statistics.

Significant trends in public sector borrowing include:

- A slowdown in borrowing by public entities, following the steep increase in 1998/99
- A marked reduction in the main budget borrowing requirement since 1996/97
- A consolidated provincial deficit of R5,5 billion in 1997/98, followed by a cash-flow surplus of R0,5 billion in 1998/99 and R3,0 billion in 1999/00, which was used to repay this debt
- A marked improvement in the financial position of extra-budgetary institutions in 1999/00.

Projected stabilisation of public sector borrowing

Table 3.8 outlines the expected trends in the national budget deficit, the general government borrowing requirement and the public sector borrowing requirement over the next three years.

Table 3.8: Public sector borrowing requirement - medium term projections

R billion	1999/00 Outcome	2000/01 Budget	2000/01 Revised	2001/02	2002/03	2003/04
				Medium term estimates		
Main budget deficit	**16,4**	**23,1**	**23,1**	**24,9**	**24,0**	**24,4**
Extraordinary payments	1,5	2,2	2,2	–	–	–
Extraordinary receipts	-7,1	-5,0	-5,0	-6,0	-10,0	-10,0
Main budget borrowing	**10,8**	**20,3**	**20,3**	**18,9**	**14,0**	**14,4**
Other government borrowing[1]	-4,5	0,9	-0,6	1,0	3,1	3,5
General government borrowing	**6,3**	**21,2**	**19,7**	**19,9**	**17,1**	**17,9**
Per cent of GDP	*0,8%*	*2,4%*	*2,3%*	*2,0%*	*1,6%*	*1,6%*
Plus:						
Non-financial public enterprises	2,4	3,0	2,1	3,5	4,0	4,7
Public sector borrowing requirement	**8,7**	**24,2**	**21,8**	**23,4**	**21,1**	**22,6**
Per cent of GDP	*1,1%*	*2,7%*	*2,4%*	*2,4%*	*2,0%*	*2,0%*

1. Social security funds, provinces, extra-budgetary institution and local government.

Forward cover losses

A net profit of R5,2 billion was recorded in 1999/00 on the Gold and Foreign Exchange Contingency Reserve Account as a result of Reserve Bank foreign exchange forward market operations, bringing the accumulated loss on the account to R9,2 billion at 31 March 2000. Although these are liabilities of Government, they are not yet incorporated into government loan debt.

Public sector restructuring and financial reforms

Public enterprise restructuring

Restructuring aims to improve quality of services

The restructuring of state owned enterprises (SOEs) aims to improve the quality, cost-efficiency and distribution of services such as electricity, telecommunications and transport networks.

Enterprise efficiency can be improved through better corporate governance and by putting in place appropriate regulatory frameworks and competitive incentives. Competition and regulation are also important in ensuring that efficiency gains are passed on to the consumer in the form of better and more affordable services.

In addition, restructuring releases resources to be spent on other Government priorities, and allows for a reduction in government debt. Reduction of government debt makes it possible to shift spending from interest expenditure to spending on social and developmental infrastructure.

The restructuring of state owned enterprises

The Department of Public Enterprise's Policy Framework on the Accelerated Restructuring of State Owned Enterprises (SOEs) was launched in August. SOE restructuring will benefit all South Africans in the form of lower prices and better infrastructure services through:

- Increased SOE efficiency as a result of improved corporate governance and competition
- An injection of private sector capital, technology and expertise
- The introduction of transparent funding and measurement of Government's development goals

It is expected that most restructuring activities will be completed by 2004.

Transnet

- Spoornet's different business units will become separate corporate entities. Coallink, Orex, Luxrail and Linkrail will be concessioned. Spoornet's General Freight Business will be commercialised, followed by either an initial offer of shares to the public, or a strategic equity partnership.
- New ports policy and ports regulatory frameworks are being drafted. Portnet will be corporatised to form a port authority entity and a port operations entity. The port operations will then be privatised.
- A public share offer for SAA is proposed.
- Petronet will be corporatised and there will be an assessment of the synergies with other pipeline projects and restructuring options.

Telkom

- Telkom will offer shares to the public in the second half of 2001.
- A policy framework and process will be developed for licensing a second national operator.
- A similar framework and process will be developed for further liberalisation of the telecommunications market, including the allocationof third generation cellular licenses.

Eskom

- Eskom will be split into transmission, distribution and generation operations, each forming a separate corporate entity. Several generating companies will be formed to promote internal competition prior to the introduction of private sector participation. The Department of Minerals and Energy is currently co-ordinating the reorganisation of the electricity distribution industry.

Denel

- Denel will be corporatised and strategic equity partners sought for several of its business units. BAE Systems has been identified as the preferred strategic equity partner for Denel Ordnance and Aerospace. The preferred strategic equity partner for the Airmotive division of Aerospace has been identified as French company, Turbomeca. Both negotiations are scheduled for completion by March 2001.

Other restructuring initiatives

- The airports regulatory framework is being revised. On its completion, and subject to shareholder approval, a public share offer will be made for the Airports Company.
- The sale of certain Safcol forestry assets has been concluded, while other packages have been re-offered or are to be restructured.
- Options for the consolidation of the information technology capabilities of Datavia, Ariel Technology and Eskom are being assessed.
- Strategic management partnerships have been entered into for Alexkor, Aventura and the Post Office. Aventura has been earmarked for subsequent sale.The Department of Communications is investigating a restructuring strategy for Sentech Signal Distribution.

Framework for restructuring

These principles have been captured in Government's policy framework on the restructuring of state owned enterprises, which was released in August 2000.

The framework commits to improving SOE efficiency through performance contracts and shareholder compacts.

Equity sales (full or partial privatisation) have been identified as a means of enhancing efficiency, investment and innovation, notably in the telecommunications sector and electricity generation and transmission sectors.

A critical element of the restructuring strategy is the promotion of competition in key sectors such as electricity generation, telecommunications and rail services. Where competitive markets do not address social needs, the equitable provision of infrastructure will be dealt with directly through subsidies that will be either fully accounted for in the Budget, or made transparent within published price or tariff schedules.

Proceeds of restructuring contribute to reduced public sector borrowing requirement

Budget estimates take into account expected receipts from the restructuring of state assets of R5,0 billion in 2000/01, R6 billion in 2001/02 and R10 billion a year in 2002/03 and 2003/04. These receipts contribute to reducing the PSBR.

Public Private Partnerships

PPPs and service delivery

The use of public private partnerships (PPPs) in public service delivery has become increasingly common throughout the world.

The operational benefits of PPPs include:

- Improved specification of outputs and services
- Economies arising from integration of the design, building, financing and operation of assets
- Increased innovation in the use of assets
- Enhanced managerial expertise
- Improved risk management
- Contractual assurance of service standards and affordability.

Partnership contracts enhance accountability by clarifying responsibilities and focusing on the key service deliverables. Furthermore, managerial efficiency may benefit significantly as existing departmental financial, human and management resources are refocused on strategic functions.

Framework and support mechanisms

In recognition of the possible benefits of PPPs, the National Treasury has established a regulatory environment, and support structures, at the national and provincial level. These consist of:

- A strategic framework endorsed by Cabinet in December 2000
- Treasury regulations promulgated in terms of the Public Finance Management Act, prescribing PPP minimum requirements
- A set of *PPP Guidelines* for accounting officers
- A specialist PPP Unit based in the National Treasury to support departments in the development of PPPs and ensure compliance with treasury regulations.

The Department of Provincial and Local Government has established a similar support structure and regulatory framework for PPPs at the local level.

Projects under review

Government has already negotiated several major partnership projects, including the building and operation of two maximum security prisons and three long-term toll road concessions. Project proposals presently under review include:

- The outsourcing of both facility and fleet management
- The upgrading of information technology and payment systems
- The provision and management of government accomodation including prisons, hospitals, departmental offices and schools
- The concessioning of provincial toll roads, eco-tourism and rail projects.

Project loans

Project loans as part of broader partnership programmes

South Africa maintains valued relations with several multilateral financial institutions, including the African Development Bank, the European Development Bank and the World Bank. Consideration has recently been given to the possibility of project lending from international institutions, alongside the knowledge-based cooperation, technical expertise and grant-funded programmes currently in place. Cabinet has agreed that project loan proposals will be tested against the following criteria:

- A project loan must form part of a broader partnership, including supplementary benefits, such as technical expertise, additional grant funding and capacity building

- Expenditure to be financed through a loan must form part of a department's medium term expenditure plans, and will accordingly not add to total expenditure or Government's overall level of borrowing

- Financial terms and conditions of a loan must be acceptable, taking into account Government's broader borrowing strategy.

Currently the only World Bank loan entered into by South Africa is for the Industrial Competitiveness and Job Creation Project of the Department of Trade Industry. The loan amount is US$24,4 million and the project aims to stimulate the small enterprise sector and improve its competitiveness.

Projects under consideration in health and local government sectors

The Department of Health is currently in discussion with the World Bank on possible funding of its hospital rehabilitation programme. Government has also identified municipal infrastructure and local government development as possible areas of multilateral cooperation and project financing.

Provincial capital projects

Consideration is also being given by the Budget Council to allowing provinces to borrow for capital projects. Such borrowing will fall within targets set for the total PSBR and will encourage the adoption of best-practice project funding, and improved utilisation of private sector capacity for project implementation, monitoring and risk management.

Defence export credit facilities

Beginning this year, Government's foreign borrowing includes the export credit facilities negotiated as part of the arms procurement programme of the Department of Defence. The interest on these loans is included in state debt costs and repayments form part of Government's debt obligations, which are managed by the National Treasury. The expenditure on the arms procurement projects is fully provided for in the Defence medium term expenditure estimates.

Conclusion

South Africa's strong performance in meeting fiscal targets has allowed Government to increase spending, reduce tax rates and reduce the proportion of the budget that goes towards debt service costs. Government's fiscal position has contributed to lower interest rates and the moderation of the inflation trend in the economy.

Government's fiscal policy is supported by the transformation of state owned enterprises, public-private partnerships and the possible use of project loan facilities as part of broader development partnership programmes. These initiatives contribute to strengthening Government's ability to meet pressing social needs within a sustainable fiscal framework and, in doing so, help to create jobs, reduce poverty and foster economic growth.

4

Taxation

Within Government's overall fiscal framework, and in the context of rapid globalisation, Government's tax reform efforts since 1994 have sought to improve the efficiency, equity and international competitiveness of the South African tax system. Over the next three years:

- *Economic recovery and continued revenue buoyancy provide scope for further income tax reductions*
- *Tax reform will continue to be aimed at broadening the tax base while promoting the competitiveness of the economy*
- *A programme of regional tax co-operation will be advanced, enhancing regional economic development.*

Introduction

Far-reaching tax reform in 2000

The far-reaching changes that have been implemented in the tax system since 1994 are informed both by domestic fiscal policy priorities and the imperatives of globalisation.

Domestic priorities

National tax reforms are an integral part of a broader reform programme, which includes social security financing and revenue policy across the three spheres of government.

Broadening tax bases and reducing statutory tax rates are central pillars of Government's tax reform agenda, improving the efficiency and equity of the overall tax system. As outlined in Chapter 3, reducing the overall tax burden plays an important role in providing impetus to investment and economic growth.

Tax amendment proposals have been guided by the central tenets of good tax design and fundamentally sound tax principles. These are:

- Equity and fairness

- Efficiency
- Inter-sectoral neutrality
- Certainty and consistency
- Simplicity in administration
- A lighter compliance burden for taxpayers.

Challenges of globalisation

The opening up of international trade and finance has exerted a profound influence on the nature and role of fiscal policies in general and tax design in particular. Government policy responses address a number of key issues:

- The need to protect the income tax base against continued erosion by the avoidance opportunities that accompany capital mobility and advances in e-commerce
- The influence of taxation on the location of direct investment and the consequent need to move to a residence-minus income tax system
- The imperatives of Southern African economic integration and the need for tax co-ordination across the region.

National budget revenue

Preliminary outcome, 1999/00

Revenue collection exceeds budget forecasts

Preliminary indications show that national budget revenue for 1999/00 exceeded the February revised estimate by R1,9 billion.

Details are set out in table 4.1, which compares the estimates of revenue for the major categories of tax revenue set out in the 1999 Budget with the preliminary outcome for the year.

R7,2 billion more tax revenue in 1999/00

The 1999 Budget estimated that Government would raise R193,9 billion in tax revenue in 1999/00. This was subsequently revised upward to R199,6 billion in the 2000 Budget. Preliminary analysis indicates that total tax revenue collected was R201,1 billion, or 3,7 per cent more than the initial budget estimate.

In addition to enhanced collection efficiency by the South African Revenue Service (SARS), this increase in revenue can be attributed to higher nominal growth in the economy. The main increases were:

- Direct taxes on persons and individuals – personal income tax raised R86,0 billion, which is approximately 4 per cent higher than the original budget estimate and 10,1 per cent more than 1998/99 receipts

Table 4.1: National budget revenue, 1999/00 estimates and outcome

R million	Budget Estimate	Revised Estimate	Preliminary outcome
Taxes on income and profits	**111 680**	**117 178**	**116 696**
Persons and individuals	82 650	86 200	85 954
Companies	21 576	21 678	21 488
Secondary tax on companies	1 700	2 700	2 639
Other	5 754	6 600	6 615
Taxes on property	**2 885**	**3 573**	**3 812**
Domestic taxes on goods and services	**71 075**	**70 980**	**72 220**
Value-added tax	47 200	46 540	48 330
Specific excise duties	8 790	8 535	8 859
Levies on fuel	14 444	15 162	14 290
Other	641	743	741
Taxes on international trade and transactions	**6 625**	**6 272**	**6 777**
Stamp duties and fees	**1 621**	**1 590**	**1 619**
Total tax revenue	**193 886**	**199 593**	**201 122**
Non-tax revenue and repayments	4 211	3 906	4 250
Less: SACU payments	-7 197	-7 197	-7 197
Main budget revenue	**190 900**	**196 302**	**198 175**

- Secondary tax on companies (STC) – mainly due to a receipt arising from the realisation of reserves associated with the conversion of SASRIA into a state-owned company
- Tax on retirement funds – an increase of R734 million over the 1999 Budget estimate of R5,1 billion
- Taxes on property – revenue of R3,8 billion was almost R1 billion more than the original budget estimate
- Value-added tax – about R1,1 billion more than the 1999 Budget estimate was raised through robust VAT collections.

Revised estimates, 2000

The revenue estimates presented in the 2000 Budget have been updated to reflect actual revenue collections during 1999/00, revenue trends during this year and the revised macroeconomic forecasts set out in Chapter 2. Table 4.2 sets out the revised revenue projections alongside those of the 2000 Budget.

Total tax revenue up by R2 billion

The revised estimate of main budget revenue in 2000/01 is R212,2 billion, or R1,8 billion more than the original budget estimate. Anticipated total tax revenue is R2 billion higher than the Budget estimate. This is largely attributable to:

- A R1,3 billion increase in the estimate of revenue from taxes on income and profits

- A R1,7 billion increase in the estimate of revenue from taxes on international trade and transactions
- A reduction in the estimates of domestic taxes on goods and services of R1,4 billion.

Table 4.2: National budget revenue – medium term estimates

R billion	1999/00 Outcome	2000/01 Budget	2000/01 Revised Estimate	2001/02	2002/03	2003/04
				Medium term estimates		
Taxes on income and profits	**116,7**	**121,3**	**122,6**	**134,1**	**145,6**	**157,9**
Persons and individuals	86,0	87,8	87,8	95,5	103,3	111,6
Companies	21,5	24,6	24,4	27,2	29,9	32,8
Secondary tax on companies	2,6	2,1	3,0	3,3	3,6	3,9
Other	6,6	6,8	7,4	8,2	8,8	9,6
Taxes on payroll and workforce	**0,0**	**1,4**	**1,4**	**3,0**	**3,2**	**3,5**
Taxes on property	**3,8**	**3,3**	**3,8**	**3,9**	**4,3**	**4,6**
Domestic taxes on goods and services	**72,2**	**79,4**	**78,0**	**85,7**	**93,0**	**100,2**
Value-added tax	48,3	52,9	53,0	58,8	63,9	68,6
Specific excise duties	8,9	9,6	9,1	9,9	10,7	11,6
Levies on fuel	14,3	16,0	15,0	16,0	17,3	18,8
Other	0,7	1,1	1,0	1,0	1,1	1,2
Taxes on international trade and transactions	**6,8**	**6,5**	**8,2**	**7,5**	**7,4**	**8,4**
Stamp duties and fees	**1,6**	**1,7**	**1,7**	**1,9**	**2,0**	**2,2**
Total tax revenue	**201,1**	**213,7**	**215,7**	**236,2**	**255,5**	**276,8**
Non-tax revenue and repayments	4,2	4,2	4,9	5,0	5,1	5,4
Less: SACU payments	-7,2	-8,4	-8,4	-9,0	-9,1	-11,2
Main budget revenue	**198,2**	**210,4**	**212,2**	**232,2**	**251,5**	**271,0**
Per cent of GDP	24,3	23,8	23,8	23,8	23,7	23,6
Changes from 2000 Budget						
Total tax revenue			**2,0**	**5,3**	**8,2**	
Main Budget revenue			**1,8**	**4,8**	**7,9**	

2000 Budget tax proposals

A number of tax policy related changes were announced in the 2000 Budget. These include:

- R9,9 billion of personal income tax relief, through the restructuring of the personal income tax schedules
- An increase in the interest income exemption to R3 000 for taxpayers under the age of 65 and to R4 000 for those over 65
- A 0,5 per cent of payroll Skills Development Levy, which is to increase to 1 per cent on 1 April 2001

- Extension of tax-exempt status to a broader range of non-profit organisations, and widened deductibility of donations to certain non-profit organisations
- An air passenger tax on international air travel
- A lower tax rate of 15 per cent for qualifying small and medium enterprises
- Increases in the excise duties on tobacco and alcohol and further reductions in the specific duty on soft drinks
- A diesel rebate for the fishing and coastal shipping industries.

In addition, it was announced that from 1 January 2001, the source-based income tax system would be replaced by a residence-based system. A phased approach to this was adopted, with foreign dividends becoming taxable from 23 February 2000.

Government also plans the phased introduction of a capital gains tax.

The residence-based income tax

Since 1994, South Africa has rapidly integrated into the global economy. The residence-based income tax system addresses the fact that South African residents are able to invest and work outside the country.

Under the proposed residence-based income tax, South African residents are subject to taxation on their income in South Africa, regardless of where in the world that income arises, with appropriate relief to prevent double taxation of this income.

Benefits of a residence-based tax

The advantages to South Africa from this reform include the following:

- The tax base is broadened
- The income tax system is aligned with those of South Africa's major trading partners
- Residents make an appropriate contribution to meeting the cost of providing government services, thereby enhancing the fairness of the tax system
- The integrity of the income tax base is protected.

This reform is also necessitated by the expansion of e-commerce and the international mobility of capital and skilled labour.

Neutral impact on foreign direct investment

The principle of taxing foreign direct investment into South Africa only on the South African source income is retained. In other words, the transition from a source-plus to a residence-minus system is neutral with respect to foreign direct investment into South Africa.

Capital gains tax

Government will introduce a capital gains tax with effect from April 2000. This will strengthen the foundations of the corporate and individual income tax system. Government's proposals are currently being refined by SARS on the basis of the large number of representations made on this matter.

Taxation of public-benefit organisations

Tax-exempt status of public benefit organisations

New measures will regulate the granting of tax-exempt status to public benefit organisations in a more consistent and systematic manner and extend the range of organisations that can qualify for tax-exempt status. The Minister of Finance will publish a range of "public benefit activities" in which an organisation must engage in order to qualify for exempt status. Activities that qualify for inclusion on this list will be of a philanthropic and benevolent nature, having regard to the needs, interests and well-being of the general public.

Deductibility of donations

Tax-deductible contributions will include those made to:

- Pre-primary schools that offer an approved educare programme
- Primary schools
- Organisations involved in preventing HIV infection or providing care to those impoverished by Aids
- Children's homes providing care to abandoned, abused or orphaned children
- Organisations involved in caring for destitute aged persons.

In addition, the limit applicable to tax-deductible donations made by individuals has been increased to the greater of 5 per cent of taxable income or R1 000.

Tax exempt status of Eskom

Following Government's decision that Eskom should become a taxable entity, it was proposed in the Budget that its tax-exempt status would be withdrawn from 1 January 2000. The withdrawal of Eskom's tax-exempt status raised the question of the value of company assets that would qualify for deductions and allowances in terms of the Income Tax Act. After consultation, a coherent tax depreciation regime has been agreed, which takes cognisance of Eskom's investment plans, and any potential impact on the pricing of electricity.

The subsidisation of Government's electrification programme will now be advanced through the budget of the Department of Minerals and Energy.

Departure tax on international air travel

In the 2000 Budget it was announced that a R100 departure tax on international air travel would be introduced from 1 August 2000. Subsequent to the Budget, certain changes have been made to this measure, including the following:

- The implementation date was deferred from 1 August 2000 to 1 November 2000
- Tax will not be levied on tickets sold before the promulgation of the Revenue Laws Amendment Act, which gives effect to the tax
- Recognising the relatively higher effective tax burden on international flights to neighbouring countries, the tax on international air departures to Botswana, Lesotho, Namibia and Swaziland has been reduced from R100 to R50.

Fuel levy

The recent increases in the crude oil price have highlighted the sensitivity of economies around the world to high fuel prices.

In South Africa, as elsewhere, the fuel tax is a specific levy – i.e. a fixed amount per litre of fuel purchased. Thus, as fuel prices increase, the tax element relative to the pump price declines.

International crude oil price changes and SA pump price fluctuations

Petrol price changes in South Africa are affected by fluctuations in the international price of crude oil and by changes in the rand/US dollar exchange rate. Since these are influenced by international market forces, South Africa's petrol price fluctuations are largely beyond Government's control.

Although the price of oil and petroleum products and the exchange rate fluctuate daily, adjusting the petrol price this frequently is impractical. South Africa's petrol price is thus adjusted monthly, taking into account the fluctuations of the preceding month.

International comparison

In table 4.3, South African fuel taxes and prices of petrol (95 octane) are compared with several representative countries from the European Union (as of 3 April 2000) and Africa (as of May 1999). The comparison shows that South Africa's fuel taxes are moderate by European standards, and that several African countries are broadly in line with fuel taxes in South Africa.

In the 2000 Budget, the specific excise on fuel was increased by 5 cents a litre on petrol and by 3cents a litre on diesel fuel. These increases were below the expected inflation rate. A diesel fuel rebate was introduced for the fishing and coastal shipping industries, consistent with international best practice, in order to improve their competitives.

Additional diesel rebates

Until 1998, a similar rebate was granted to the agricultural sector. The Treasury and SARS have been consulting with representatives of the agriculture, mining and forestry industries to explore the possibility of introducing diesel fuel tax relief for off-road fuel consumption. A technical committee is currently investigating cost-effective administrative and compliance mechanisms to ensure that any diesel rebate can be effectively administered. The preconditions for such a rebate include the development of an appropriate administrative regime to minimise the risk of fuel tax fraud, and means of accommodating, and a mechanism to address, the potentially significant revenue losses within the broad fiscal framework.

Table 4.3 International comparison of taxes on 95-Octane petrol

(1) Country	Fuel taxes (as at 3 April 2000)	Other costs (as at 3 April 2000)	Retail price (as at 3 April 2000)	Fuel tax as percentage of retail price
	Euro / Litre	Euro / Litre	Euro / Litre	
Belgium	0,687	0,347	1,034	66,4%
Greece	0,414	0,352	0,766	54,0%
Spain	0,482	0,318	0,800	60,3%
France	0,777	0,321	1,098	70,8%
Ireland	0,523	0,310	0,833	62,8%
Italy	0,696	0,359	1,055	66,0%
Luxembourg	0,460	0,360	0,820	56,1%
Portugal	0,418	0,470	0,888	47,1%
UK	1,013	0,324	1,337	75,8%
	Rand / Litre	Rand / Litre	Rand / Litre	
RSA- coast	1,030	1,810	2,840	36,3%
(2) Country	**Fuel taxes (average for May 1999)**	**Other costs (average for May 1999)**	**Retail price (average for May 1999)**	**Fuel tax as percentage of retail price**
	Rand / Litre	Rand / Litre	Rand / Litre	
Kenya	2,287	1,669	3,956	57,8%
Mozambique	2,039	1,421	3,460	58,9%
Namibia	0,803	1,421	2,224	36,1%
Tanzania	1,669	2,225	3,894	42,9%
Zimbabwe	0,247	1,360	1,607	15,4%
RSA- coast	1,174	1,112	2,286	51,3%

Source:1: International Energy Agency, April 2000.
2. World Bank, May 1999.

Determining the petrol price

The South African petrol price, based on the Gauteng October petrol price of R3,72 per litre for 93 octane can be broken down as follows:

Non-tax components

The non-tax cost components of the petrol price amount to R2,58 per litre, or 69,3 per cent of the retail petrol pump price. These include:

- The basic price – 52,8 per cent. This consists of an average international refinery price, freight, insurance, ocean leakage, evaporation, landing and wharfage charges, Thus is deemed to be the price of petrol as it leaves a South African refinery.
- The wholesale margin – 4,9 per cent. This is aimed at granting wholesale marketers a guaranteed return of 15 per cent on the depreciated book value of assets.
- The retail margin – 7,1 per cent. This is determined on the basis of the costs incurred by the average service station operator in marketing petrol.
- Transport and delivery costs – 4,5 per cent. Transport and delivery costs to the different pricing zones are based on the most economical cost of transporting and delivering petrol from the coast to inland areas.

Tax components

The fuel tax on petrol is R1,14 per litre, or 30,7 per cent of the retail petrol pump price. The revenue obtained from this tax is distributed in the following way:

- The general fuel levy – 25,7 per cent. A general fuel levy of 95,6 cents a litre is used to finance general government expenditure. This raises about R9,4 billion a year to provide essential services to all South Africans. (R610 million of this amount is used for national road maintenance).
- The Road Accident Fund levy – 3,9 per cent. A Road Accident Fund levy of 14,5 cents a litre, which raises about R1,4 billion a year, finances the third party insurance scheme for all motorists.
- The customs and excise levy – 1,1 per cent. A customs and excise levy of 4 cents a litre assists South Africa's Customs Union neighbours (Botswana, Lesotho, Namibia and Swaziland) through the customs pool. The customs and excise levy raises R390 million a year.

Social security funding

South Africa's main social security grants – including the old age grant – are financed out of general government expenditure through the budgets of provincial departments of welfare. Several other social security benefits are financed through earmarked taxes. Social security funds include the Unemployment Insurance Fund, the Compensation Funds and the Road Accident Fund.

UIF reforms strengthen financial position

Reform of the Unemployment Insurance Fund (UIF) will be undertaken, following the recommendations of the Comprehensive Labour Market Commission and a separate UIF review. These changes, which aim to strengthen the administration of the Fund, included extending the coverage of the fund to all private sector employees. Previously only those earning R93 288 or less a year contributed to, and benefited from the Fund.

Social Security Funds

Several social programmes rely on mandatory levies or taxes. These include the social security funds. Such programmes are, by design, self-funding, with both their revenue flows and spending appropriated by separate statute or regulation, and not in the annual budget votes. These financial flows are nonetheless part of the wider public finances and are important instruments of Government's social and income policies.

Last year, Government expanded the scope of budget documentation to include the social security funds. These funds include the Unemployment Insurance Fund, Workmen's Compensation Fund, Road Accident Fund and the Mines and Works Compensation Fund.

As the table below shows, these funds ran a combined surplus of R1,1 billion in 1999/00. The Unemployment Insurance Fund is currently in deficit, while the Road Accident Fund and Compensation Fund run cash surpluses. The consolidated surplus is expected to decline in 2000/01 as the Road Accident Fund addresses its claims backlogs.

Consolidated social security funds : 1996/97 – 1999/00

	1996/97	1997/98	1998/99	1999/00	
R Million				**2000 Budget Estimate**	**Preliminary Outcome**
Total revenue	5 586	6 489	7 418	7 914	7 922
Per cent change		*16.2%*	*14.3%*	*6.7%*	*7.7%*
Total expenditure	4 852	5 362	5 996	6 733	6 819
Per cent change		*10.5%*	*11.8%*	*12.3%*	*15.8%*
Deficit (-) / Surplus (+)	734	1 126	1 422	1 180	1 103

Future tax reform initiatives

Future tax reform will advance Government's general fiscal policy. Continued robust revenue collections and the broadening of tax bases provide scope for further income tax relief in the 2001 Budget.

Investment incentives

The Department of Trade and Industry (DTI) has developed a range of incentives to encourage investment in industry, and job creation. The Department has already announced three programmes that will be funded through the Budget:

- An expanded small and medium enterprise development programme
- A skills support programme
- Investment in infrastructure critical to industrial development.

The National Treasury and DTI have explored the possibility of targeted tax incentives for strategic investment projects. These will be announced in due course.

Tax incentives for strategic projects

Regional tax co-operation

Southern African Customs Union

In September 2000, the Southern African Customs Union (SACU) Trade and Finance Ministers agreed on a new formula for the distribution of SACU customs and excise revenues. The revenue share accruing to each member state will be calculated from three basic components:

- A share of the customs pool
- A share of the excise pool
- A share of a development component.

The customs pool distributed according to intra-SACU imports

The first component is distributed according to each country's share of intra-SACU imports. Botswana, Lesotho, Namibia and Swaziland (the BLNS) obtain most of their customs and excise revenue from this component, since they all record significant trade deficits with South Africa. This component therefore entails considerable implicit compensation to the BLNS countries for any cost-raising effect or loss of fiscal discretion resulting from the Customs Union. The extent of this compensation will fall in relative terms as SACU external tariff barriers decline.

80 per cent of excise revenues retained by South Africa

Excise revenue will be distributed according to relative GDP. South Africa will receive most of its revenue allocation from this element, retaining about 80 per cent of total excise revenue.

Development fund by per capita GDP

A development fund will be created from 15 per cent of total excise collections. It will be distributed in relation to the inverse of each country's per capita GDP. This development fund will raise the revenue shares of the poorer SACU member states and help to stabilise future flows to the BLNS countries.

Certainty in revenue flows

In terms of the new formula, South Africa's share of the total revenue pool should rise from below 50 per cent in 2000/01 to close on 55 per cent in 2001/02. Future payments to BLNS countries are likely to be more predictable than in the past and will be better targeted in support of regional development.

SADC tax co-ordination

Southern African Development Community (SADC) Ministers of Finance and Investment have on several occasions expressed a common desire to advance a programme of tax co-ordination within the region.

Such an initiative is given impetus and urgency by the desire of SADC to harness the potential of its combined market. In particular, tax co-ordination has important roles to play in creating an attractive investment environment in the region, and in managing the revenue risks associated with the transition to a free-trade environment, as envisaged in the SADC Free Trade Protocol.

The formation of the SADC Tax Working Group under the auspices of the SADC Macroeconomic Subcommittee in November 1999 and the establishment of the SADC Tax Subcommittee in July 2000 provide a forum to advance this agenda.

Objectives of the SADC Tax Subcommittee

The SADC Tax Subcommittee, which is chaired by South Africa, came into being on 5 July 2000. Its core objective is defined as "the co-ordination of taxation policies to the extent necessary to improve efficiency in tax collection, safeguard the regional tax base and reduce obstacles to intra-SADC trade and investment."

Some of the initial focus areas of the Subcommittee will include.

- Creating a SADC tax database, covering key aspects of the primary tax instruments in each member state
- Determining a common SADC stance on tax incentives, especially in respect of tax incentives for foreign direct investment. This will minimise the risk to regional tax bases and to the efficient allocation of regional investment resources arising from harmful tax competition
- Devising a road map for the progressive elimination of internal tax barriers to intra-SADC trade
- Determining the compliance gap in respect of the major excise duties within the region, to reduce the revenue loss from cross-border tax fraud
- Identifying areas in which co-ordination of direct taxation might be appropriate
- Building capacity in tax policy-making and revenue collection, especially through the development of training institutes and tax seminars, in close co-operation with multilateral institutions.

5

Medium Term Expenditure Framework

The proposed framework for the 2001 Budget provides for real spending growth of 3,7 per cent a year, including provision for contingencies. The MTEF allows for:

- *Increases in infrastructure spending of R8 billion between 2000/01 and 2003/04, or by 10 per cent a year, in order to protect and expand the nation's physical asset base*
- *Extra spending on the integrated justice sector of R5,2 billion, or 6,6 per cent per year over the MTEF, following strong growth over the previous three years*
- *Increases in social service expenditure – mainly by provinces – of more than R21 billion over the MTEF period, reinforced by a R4 billion increase in spending on economic services, strongly focused on skills development*
- *A doubling of the level of transfers to local government to deal with fiscal stresses, delivery of basic services and the implications of the new demarcation of municipalities.*

Policy priorities and the budget

Reforming budget processes and tracking change

Certainty and increased expenditure

The overall macroeconomic and fiscal stance of Government, outlined in earlier chapters, has created increased certainty as to resources available to departments and has laid a foundation for real expenditure growth over the next three years.

Spending and Government priorities

Significant growth in expenditure further reinforces the need to ensure that spending is closely aligned to Government priorities.

In this chapter key trends are identified in government spending, both in the allocation of resources between the various spheres of government, and in expenditure on the main government priorities.

The chapter also briefly outlines key aspects of continuing budget reform. Financial reforms such as public enterprise restructuring and public private partnerships are discussed in Chapter 3. These initiatives aim to ensure that gains flow not only from increased expenditure but also through more effective and efficient spending.

Budget reform and service delivery improvement

Progress with budget reform

Broad array of reform initiatives

The budget reform process commenced in 1998/99 with the introduction of three-year rolling budgets. This mechanism has now been institutionalised and other components of budget reform introduced. Significant recent developments include:

- Refinement of the budget process to allow Government to consider priorities earlier in the budget cycle
- Introduction of a Division of Revenue workshop early in the budget process to provide a formal review of the intergovernmental financial flows, and to assess expenditure pressures in the national, provincial and local spheres of government
- Improved information on service delivery and the objectives and impact of departmental spending programmes – to be given effect at the national level through the integration of the current *Estimate of Expenditure* (The "White Book") and the *National Expenditure Survey* into a single document
- Reform of provincial budget formats to comply with standard classification requirements and to extend service delivery information
- Monthly and quarterly reporting in-year on departmental and provincial expenditure progress
- Revised treatment of improvements in conditions of service and capital, maintenance and accommodation costs in the budget, to ensure that the full costs of programmes are transparently reflected
- Reporting on a wider array of government accounts, funds and agencies, including social security funds and local government, with more detailed presentation of consolidated accounts and off-budget liabilities.

Remaining challenges

Further reforms will seek to generate appropriate indicators of service delivery, to establish regular information flows on these indicators, and to relate this information to budget decisions. These challenges are being taken forward jointly by the Treasury and the Department of Public Service and Administration.

Government priorities

Review of policy priorities

As part of the 2001 Budget process, the Ministers' Committee on the Budget, the Budget Council and Cabinet have given in-depth consideration to Government priorities and medium term spending options. These deliberations have contributed to the work of the Division of Revenue workshop and the Medium Term Expenditure Committee, which is responsible for preparing proposals on the national budget for Cabinet's consideration. The expenditure projections for the next three years outlined in this chapter draw on preliminary national and provincial treasury estimates, informed by Cabinet's review of priorities.

Priorities for the medium term

This review identified the following critical areas:

- Maintenance, rehabilitation and investment in economic and social public infrastructure
- Targeted interventions aimed at improving the efficiency of the criminal justice system
- Continued emphasis in the social services on improving the effectiveness of service delivery and strengthening the distributional impact of spending, while targeting additional expenditure at critical maintenance and operational needs
- Provision for the impact of HIV/Aids in welfare expenditure, public health and other services
- Programmes aimed at accelerating employment creation.

Increased spending in 2000/01

The Adjustments Estimate for 2000/01 adds R3,9 billion to national budget allocations. This includes:

- A reduction of R142 million in projected interest on state debt
- A transfer of R820 million to national departments and provinces to compensate for higher fuel costs and higher salary increases
- An allocation of R975 million to bring forward the payment of annual bonuses (13th cheques) in the public sector from April to the birthday month of individuals born in January, February or March

- Additional allocations of R891 million to national departments for unforeseeable and unavoidable expenditure
- An allocation of R595 million to provinces for repairing flood damage and disaster relief
- Additional transfers of R600 million to provinces
- A further R100 million for local government
- Approved rollovers of R2,1 billion out of unspent 1999/00 appropriations, partially offset by projected under-spending and savings of R2 billion in the current year.

Taking into account the provision for contingencies of R2,0 billion in the 2000 Budget, these adjustments raise the estimated expenditure level by R1,8 billion.

Spending by type of service

Table 5.1 presents a projected breakdown of consolidated national and provincial expenditure, classified by type of service. Totals do not include the provincial finance reserves and the national contingency reserve, which will be allocated to services during the MTEF period. These estimates exclude interest on debt.

Changes to the 2000 Budget MTEF estimates

The following are the main revisions that have been made to the 2000 Budget estimates.

Additional allocations for education, health and welfare

Spending in the social services increases by R1,7 billion in 2000/01 and R5,3 billion in 2002/03. This allows for average annual growth of 6,3 per cent in education, 6,7 per cent in health and 7,8 per cent in welfare services.

Protection services increase by 6,6 per cent a year

Additional spending on the integrated justice sector rises to R2,4 billion by 2002/03. This represents an average annual growth rate of nearly 6,6 per cent for this sector. Growth in defence expenditure reflects provision for the arms procurement programme.

Economic services include strong growth in skills development

Moderate increases are provided for economic services, which already grows strongly as a result of the phasing in of the skills development programme.

Growth of 10 per cent a year in infrastructure

Substantial additional allocations to infrastructure are projected, rising from an increase of R3,2 billion in 2001/02 to R4,7 billion in 2002/03. Infrastructure spending will grow by an average of 10 per cent per year. These allocations include provision for flood and disaster related damage.

Table 5.1: Consolidated national and provincial expenditure by type of service

R billion	1999/00 Outcome	2000/01 Revised	2001/02	2002/03	2003/04
			Medium term estimates		
Social Services					
Education	46,9	51,0	54,3	58,1	61,3
Health	24,8	27,2	29,2	31,1	33,0
Welfare	19,6	21,5	22,7	24,6	26,9
Protection services					
Defence and intelligence	10,7	14,0	15,6	16,8	17,9
Integrated justice system	22,6	24,8	26,6	28,5	30,0
Economic services	9,9	12,3	15,0	16,3	16,8
Infrastructure	21,4	24,1	27,1	29,7	32,0
Administration	11,4	12,1	13,3	13,4	14,6
Total	**167,4**	**186,8**	**203,8**	**218,6**	**232,5**
Changes from 2000 Budget					
Social Services					
Education		0,5	1,0	1,7	
Health		0,5	0,6	1,2	
Welfare		0,7	1,1	2,4	
Protection services					
Defence and intelligence		0,2	0,3	0,3	
Integrated justice system		0,5	0,7	1,2	
Economic services		-0,3	0,2	0,5	
Infrastructure		1,5	3,2	4,7	
Administration		0,2	0,2	0,3	
Total		**3,8**	**7,4**	**12,3**	

Key departmental and spending priorities

Table 5.2 provides a breakdown of government expenditure over the medium term by service share.

Social services account for 53,4 per cent of total non-interest spending

Social services continue to account for the major portion of national and provincial allocations, at 53,4 per cent of non-interest expenditure. Over the MTEF, however, their share of total expenditure will decline as infrastructure and economic services spending increases. A proportion of infrastructure spending will, however, be allocated to education and health, further boosting expenditure in these sectors.

Over the next three years allocations to protection services, infrastructure and economic services will increase, while allocations to the social services and administration will fall as shares of the total.

Table 5.2: Service shares and growth

Per cent	1999/00 Outcome	2000/01 Revised	2001/02 Medium term estimates	2002/03	2003/04	2000/01 to 2003/04 Average annual growth
Social Services	**54,5%**	**53,4%**	**52,1%**	**52,1%**	**52,1%**	
Education	28,0%	27,3%	26,7%	26,6%	26,3%	6,3%
Health	14,8%	14,5%	14,3%	14,2%	14,2%	6,7%
Welfare	11,7%	11,5%	11,1%	11,2%	11,6%	7,8%
Protection services	**19,9%**	**20,7%**	**20,7%**	**20,7%**	**20,6%**	
Defence and intelligence	6,4%	7,5%	7,7%	7,7%	7,7%	8,7%
Integrated justice system	13,5%	13,3%	13,0%	13,0%	12,9%	6,6%
Economic services	**5,9%**	**6,6%**	**7,4%**	**7,5%**	**7,2%**	**11,0%**
Infrastructure	**12,8%**	**12,9%**	**13,3%**	**13,6%**	**13,8%**	**10,0%**
Administration	**6,8%**	**6,5%**	**6,5%**	**6,1%**	**6,3%**	**6,6%**
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**7,6%**

Integrated justice system

Increased allocations

Significant additional allocations of R0,5 billion in 2000/01, R0,7 billion in 2001/02 and R1,2 billion in 2002/03 will be spent on the departments that make up the integrated justice system, namely Correctional Services, Justice and the South African Police Service (see table 5.1).

Continued prioritisation

These additional allocations reflect a continued prioritisation of the integrated justice system. Historically, increases in spending on this cluster have significantly exceeded growth in the rest of government, with allocations growing at an annual rate of over 9,5 per cent a year between 1996/97 and 2000/01.

Focus on improved co-ordination and special projects

Government's focus in the integrated justice system has been on increasing efficiency, enhancing inter-departmental co-operation and reviewing previous strategies. The latter, for instance, has led to the implementation of 'Operation Crackdown.'

Improved personnel remuneration

In addition, Government has sought to address some of the issues underlying low levels of morale by providing resources for the improvement of remuneration levels.

Directorate Special Operations

Allocations to the recently established Directorate of Special Operations (the 'Scorpions') have also been strengthened.

New allocations

The present additional allocations are intended to assist the integrated justice system to overcome current resource constraints. They target the following priorities:

- Renewing the SAPS vehicle fleet and upgrading the SAPS's physical infrastructure
- Improving the efficiency of the courts by investing in infrastructure and providing more resources for prosecution services
- Providing bridging finance for the Legal Aid Board as it moves towards a public defender system
- Relieving pressures on the operational spending of the Department of Correctional Services through the provision of resources for the provision of more prison space.

Full costs of arms procurement

The Defence budget provides for the full purchase costs of the arms modernisation programme negotiated in 1999, including provision for the effect of exchange rate depreciation on prices. The export credit facilities through which the arms procurements are financed are accounted for as part of the provision for interest and debt managed by the National Treasury.

Social services

Role of basic social services

The social service departments are entrusted with the crucial responsibility of building and protecting South Africa's human capital, enhancing living standards and thus providing the basis for sustained economic growth and development.

The key components of the sector are school and higher education, primary health care and hospital services, as well as means-tested welfare transfers to certain categories of the poor.

Provincial responsibility for service delivery

The bulk of these services are provided by provincial departments of education, health and welfare, with policy-making, co-ordination and monitoring centred at the national level. The sector will therefore benefit from the increasing proportion of revenue allocated to the provinces.

The social services allocations grew strongly following the democratic elections in 1994, and have now slowed as infrastructure, economic development and protection functions gather momentum. Nonetheless, current projections show real growth in this sector over the next three years.

Challenges to improve efficiency and quality

After managing the integration of highly fragmented delivery systems, and expanding access to services after 1994, health and education departments were confronted with rapidly growing salary bills subsequent to the 1996 wage agreements, as well as the challenge of improving efficiencies and quality of service delivery.

The Grootboom Case

On 10 October 2000, the Constitutional Court handed down a judgement in the matter of *The Government of the RSA and others v Irene Grootboom and others.*

Irene Grootboom was one of a number of people who approached the Cape of Good Hope Provincial Division of the High Court for an order requiring government to provide them with adequate basic shelter or housing until they obtained permanent accommodation. They had been evicted from land which they had illegally occupied and had had their building materials destroyed, leaving them homeless.

The High Court refused their claim to the right of access to adequate housing, but granted them the alternative relief which they sought, which was the right of their children to shelter. The High Court reasoned further that the best interests of the children required that they be sheltered with their parents.

The Constitutional Court upheld Government's appeal against this order. The Court held that the High Court's reasoning "produces an anomalous result" in that (1) it obliges the state to provide rudimentary shelter to children and their parents on demand if the parents cannot provide such shelter; (2) the obligation was held to exist independently of, and in addition to, the obligation of the state to take reasonable legislative and other measures to provide access to housing; and (3) it obliged the state to provide shelter irrespective of the availability of resources.

The Court declared, however, that the state has to devise and implement, within available resources, a comprehensive and co-ordinated programme that would progressively realise the right of access to adequate housing. It further declared that this programme must include reasonable measures to provide access to people without land or a roof over their heads, and who live in intolerable conditions or crisis situations.

The Constitutional Court made it quite clear that the socio-economic rights enshrined in the constitution are justiciable and should, within available resources, be realised. This judgement is likely to prove important in the policy-making and budget-allocation process of the national, provincial and local spheres of government. For this reason, government departments, including the National Treasury, have to plan and budget strategically to realise these socio-economic rights

Government is in agreement with the underlying philosophy of the judgement which, in effect, requires immediate action to improve the lot of the most vulnerable of South Africa's citizens.

Government is currently reviewing policies that give effect to the constitutional imperative to ensure the progressive realisation of socio-economic rights. In addition, government has devoted increased resources to some programmes – such as the Disaster Relief Fund – which aim to address the immediate needs of the poorest communities.

Expenditure and efficiency in education and health

Projected expenditure trends show that the health and education sectors have contained remuneration expenditure. Gains in efficiency and quality will be facilitated through strong growth in non-personnel expenditure.

Provision is made in the national budget for the continued piloting of early childhood development initiatives, which generate large efficiency gains in the education system. These sectors will also benefit from larger allocations for infrastructure spending.

Welfare expenditure

Welfare budgets will continue to face pressures as a result of annual inflation-related adjustments to grant values, the phasing in of the Child Support Grant and continued expansion in access to other grants. After an initially slow take-up, numbers of people in receipt of the child support grant have started growing rapidly, and are currently in excess of 500 000. Increased provision has been made on the national budget to support the improvement of the welfare grant payment system, the Welfare Payment and Information Service.

HIV/Aids and the social services

HIV/Aids will present an immense challenge to the social service sectors in coming years. Demand for services, especially in health and welfare, will increase substantially as a result of increased morbidity, household disruption and increased poverty among households. In addition, the supply of services will be constrained by the impact of the disease on the productivity and availability of suitable qualified and experienced personnel.

Social policies, institutional structures and budgets face a period of considerable adaptation as health, welfare and education services respond to the challenges of HIV/Aids.

Economic services and infrastructure

Strong growth in economic services expenditure

Increased social services and personnel expenditure have implied limited growth in expenditure on the economic services in the period up to 2000/01. This trend will be reversed, with strong increases in spending on economic services up to 2003/2004. This reflects the need to maintain and expand economic infrastructure and to build skills in the economy.

Skills development

The Skills Development Levy came in to effect on April 2000 at 0,5 per cent of payroll, and will increase to 1 per cent in subsequent years. Projected revenue in 2000/01 is R1,4 billion, increasing to R3,0 billion in 2001/02.

Twenty per cent of revenue will flow to the National Skills Fund for training of the unemployed and disadvantaged groups. The balance will be set aside to fund the operations costs of the 27 Sectoral Education and Training Authorities and for the provision of accredited training by employers.

Electrification

As a result of the removal from 2001 of the tax exemption that Eskom currently enjoys, and agreement on a dividend policy, Government will subsidise the national electrification programme through the Minerals and Energy vote.

The national electrification programme aims to achieve universal access to basic electricity services. Current estimates identify a backlog of 3,2 million households, 17 000 rural schools and 1 000 rural health clinics. The preliminary budget framework sets aside R600 million a year to take the electrification programme forward.

Forestry restructuring

While restructuring of the forestry sector is ongoing, progress has been slower than expected, necessitating the allocation of additional but declining funds to this function over the MTEF.

Stronger adjustments in outer years

Given the logic of three-year budgeting, planning and implementation constraints and the need for reasonable phasing in of sizeable new commitments, the economic services see more substantial increases in the outer years of the MTEF, particularly in 2003/04.

This will allow the strengthening and expansion of the programmes of the departments of Agriculture, Environmental Affairs and Tourism, Public Works and Transport in particular. The impact will be felt on basic services to households as well as transport infrastructure.

Government recognises that passenger transport is an important public good, and will continue to conduct transport policy in this light. As part of this commitment, Government will allocate funds for the recapitalisation of the taxi industry.

Administrative Services

Additional allocations for elections, foreign affairs and SARS

While there is a clear need to improve efficiency in the central administrative services, certain key functions require strengthening over the MTEF.

Additional provision has been made for the next general election with an additional allocation to the Independent Electoral Commission in 2003/04. The greater role that South Africa is playing in Africa and the rest of the world necessitates additional allocations to the Department of Foreign Affairs. Additional amounts have been allocated to strengthen the reforms underway at the South African Revenue Service, which are expected to enhance its revenue collection capacity further.

Poverty relief, Job Summit commitments and HIV/Aids

Poverty relief

Since 1998, Government has set aside a special allocation to address poverty directly, and to assist departments in refocusing service delivery on the poor.

After an initial allocation of R800 million, this allocation will reach R1,5 billion in 2001/02. Particular target groups are the rural poor, women, youth and the disabled. Although hampered by underspending in initial years, a number of key outputs have been successfully delivered. These include infrastructure and service to poor communities, short-term and long-term jobs, and training and support for the development of SMMEs.

Job Summit projects

After the Job Summit in 1998 a portion of the poverty relief allocation was utilised to fund the commitments made by Government at the Summit. These include housing development, Social Plan activities and local economic development initiatives.

Given limited capacity to spend the allocation fully, and urgent needs arising from natural disasters at the beginning of 2000, nearly R230 million of the poverty relief allocation was channelled to disaster relief. An outline of programmes funded in 2000/01 is provided in table 5.3.

Development funds

Government's broader poverty relief strategy and the specific allocation for poverty relief are supplemented by a number of dedicated funds and agencies. These include the Umsobomvu Fund, the National Development Agency (NDA) and, more recently, the National Lottery Distribution Fund.

Table 5.3: Poverty relief and Jobs Summit allocations 2000/01

Department	**Programme**	**Allocation R million**
Agriculture	Land care, water and veld management	35,0
Arts, Culture, Science and Technology	Investing in culture and agricultural processing	30,0
Environmental Affairs and Tourism	Local tourism development, tourism infrastructure and waste management	99,0
Health	Nutrition and household security project	7,0
Housing	Rental stock housing development	-**
Labour	Social plan projects in response to large scale retrenchments	3,4
Provincial Affairs and Local Government	Local economic development and social plan research	78,0
Public Works	Community based public works projects	249,0
Water Affairs and Forestry	Working for Water and community water supply projects programme	351,0*
Welfare	Income generating projects	120,0
Disaster relief	Contribution to disaster relief	227,6
Total		**1 200,0**

**Includes R60 million for integrated projects jointly managed with the Department of Agriculture (R30 million) and the Department of Environmental Affairs and Tourism.*

***Full allocation for 1999/00 of R75 million rolled over*

Umsobomvu

The Umsobomvu Fund is a Section 21 Company funded from a special charge on the demutualisation of Sanlam and Old Mutual. Its objective is to invest in young people, develop their skills potential and invigorate job creation. The proceeds of the special charge yielded R855 million. The Fund is expected to be operational in early 2001.

National Development Agency

The National Development Agency (NDA) was established in 1998 to provide support to non-governmental development and service organisations and to channel funding to these organisations. The NDA is funded from an initial transfer from the Independent Development Trust (R100 million) and an allocation of R90 million on the vote of the National Treasury in 2000/01. These amounts will be supplemented by an estimated R100 million of donor funding from the European Union over the next few years.

Aids prevention initiatives

Implementation of the integrated HIV/Aids prevention programme at national and provincial level has already started and focuses on four interrelated aspects:

- The rolling out of a focused life-skills programme in primary and secondary schools
- Improving access to voluntary counselling and testing
- Piloting alternative models of care for those infected
- A community outreached programme.

The distribution of funds between the components is outlined below.

Table 5.4 Special allocation for an integrated, preventative HIV/Aids programme for 2000/01

Programme	Allocation R million
Rolling out life-skills training related to HIV/Aids in schools	39,0
Expanding access to voluntary counselling and testing	20,2
Piloting alternative modes of care	13,0
Community outreach	2,7
Total	**75,0**

The National Lottery

The National Lottery has accumulated substantial funds which will be allocated to a range of organisations through the National Lottery Act. Distribution agencies will allocate the funds to charities and organisation involved in reconstruction and development, as well as in the arts, culture and the environment.

HIV/Aids prevention

Allocations for Aids prevention programmes and for piloting special care programmes are critical. These will reduce the rates of infection and develop alternative and more affordable care.

In addition to allocations on national and provincial budgets, Government introduced in 2000/01 a special allocation to promote the development of more integrated prevention strategies. R75 million has been set aside for this purpose in 2000/01. The allocation increases to more than R300 million in 2003/04. The programme is managed by the departments of Health, Education and Welfare.

Expenditure by economic type

Table 5.5 summarises consolidated national and provincial spending by economic type.

Personnel

Downward trend in personnel expenditure

Between 1996/97 and 1998/99 personnel expenditure rose steadily as a percentage of total non-interest spending. In 1999/00 it stood at more than 50 per cent of total expenditure.

However, its share will decrease to about 49 per cent in 2000/01. Further declines are predicted over the three years following this.

Table 5.5: Consolidated national and provincial spending by economic type

R billion	1999/00 Outcome	2000/01 Revised	2001/02 Medium term estimates	2002/03 Medium term estimates	2003/04 Medium term estimates
Current Expenditure	**152,8**	**170,0**	**181,0**	**193,5**	**204,8**
Personnel	85,5	91,9	96,5	103,0	108,9
Transfer payments	41,3	48,4	51,7	54,9	58,0
Goods and supplies	26,0	29,8	32,9	35,5	37,9
Capital expenditure	**14,6**	**16,8**	**22,7**	**25,1**	**27,7**
Acquisition of assets	7,5	7,0	9,3	10,1	10,8
Transfer payments	7,0	9,8	13,4	15,0	16,9
Total	**167,4**	**186,8**	**203,8**	**218,6**	**232,5**
Changes from 2000 Budget					
Current Expenditure		**2,8**	**3,5**	**6,4**	
Personnel		1,7	2,1	3,6	
Transfer payments		0,7	0,4	0,9	
Goods and supplies		0,4	1,0	1,9	
Capital expenditure		**1,0**	**3,8**	**5,9**	
Acquisition of assets		0,2	1,6	2,2	
Transfer payments		0,8	2,3	3,7	
Total		**3,8**	**7,4**	**12,3**	

In the *2000 Budget Review* Government set the stabilisation of personnel budgets as a specific objective. The purpose of this objective is to free up resources for capital and other non-personnel spending.

Government has been able to make significant progress in implementing this policy:

- Salary increases for the past two years have been in line with inflation
- Total expenditure is growing faster than inflation
- The size of the civil service has decreased by over 2 per cent over the past two year.

New remuneration policy

Early in 2000, Cabinet adopted a remuneration policy for the public service. This remuneration policy sought to align civil service remuneration and optimal service delivery through a balance of inflation-linked salary increases, incentives for good performers, reform of the promotions process in the civil service and enhancement of the ability of the civil service to recruit and retain skilled professionals.

Wage settlements

These objectives are substantially embodied in the 1999 and 2000 salary settlements. The settlements provide for:

- A salary increase averaging 6,5 per cent for all employees
- The abolition of near-automatic rank and leg promotions in June 2001
- Allowing sectors to negotiate their own pay progression systems to provide incentives for good performers
- An increase in paid maternity leave from three months to four months
- A restructuring of the leave system.

For the 2001 Budget, departments will again be requested to budget for salary increases in line with inflation.

Capital and infrastructure spending

Increasing infrastructure spending

Adjustments in the budgeting procedures are being made to increase funding available for infrastructure spending.

Table 5.5 shows that total capital expenditure is projected to grow from R16,8 billion in 2000/01 to R27,7 billion in 2003/04 – an increase of nearly 18 per cent per year. The rate of acquisition of physical assets will increase significantly in 2000/01, driven in particular by flood reconstruction and rehabilitation. Capital expenditure is set to grow to 12 per cent of consolidated non-interest expenditure by 2003/04. Allocations for infrastructure rehabilitation as a result of disasters stand at nearly R1 billion in 2000/01.

This increase in capital and infrastructure spending is driven by a number of considerations:

- The deteriorating condition of public infrastructure – including buildings, roads, and rail rolling stock – and the escalating cost of rehabilitating or replacing this asset base, has become a growing concern. The problem is particularly acute in the provincial and local spheres where budgetary and capacity constraints have led to marked reductions in infrastructure spending.
- Institutional weaknesses have led to inefficiencies, underspending and slower than anticipated delivery in areas where funds were allocated.
- The recent floods and other disasters have added to the urgency of rehabilitating the infrastructure and road network
- The labour-intensive nature of infrastructure maintenance, and the important role that infrastructure plays in facilitating sustainable long-run growth.

Local Government infrastructure

Local government performs a key role in the operation, maintenance and expansion of residential, social and economic infrastructure. Considerable progress has been made in rehabilitating and extending access to residential service access, partly through grant financing from the national level. Notwithstanding this progress, institutional problems and fiscal stresses have in some cases led to unsustainable investment, erosion of the infrastructure and large backlogs.

Various proposals are being explored to more clearly delineate the institutional responsibilities for infrastructure investment, to simplify the fiscal mechanisms used to support municipal infrastructure investment, to improve the manner in which accountability is exercised over the use of funds, and to improve the performance of local governments in meeting their development mandate.

Spending by sphere of government

Table 5.6 shows revised projected spending by national and provincial government and the national budget allocation to local government.

Table 5.6: Consolidated expenditure by sphere of government

R billion	1999/00 Outcome	2000/01 Revised	2001/02 Medium term estimates	2002/03	2003/04	2000/01- 03/04 Average annual growth
National spending (excl. conditional grants)	67,1	76,1	85,0	90,5	95,9	8,0%
Provincial spending	100,2	110,7	118,8	128,1	136,6	7,2%
Local government share	3,0	3,8	4,5	5,2	5,9	15,3%
National & provincial non-interest spending	**170,4**	**190,6**	**208,3**	**223,8**	**238,3**	**7,7%**
Social security funds	6,7	7,9	8,3	8,8	9,2	
Debt service costs	44,3	46,3	48,7	50,0	51,5	
Unallocated reserves	0,0	0,5	3,0	5,1	9,2	
Umsobomvu Fund	0,9					
Total	**222,3**	**245,4**	**268,3**	**287,7**	**308,2**	
Changes from 2000 Budget						
National spending		1,4	3,2	4,8		
Provincial spending		2,4	4,1	7,5		
Local government share		0,1	0,5	0,9		
National & provincial non-interest spending		**3,9**	**7,8**	**13,2**		

Consolidated national and provincial non-interest expenditure increases by R3,9 billion in 2000/01. This is funded from the draw down of the contingency reserve, lower debt service costs and increased revenue. Of the additional R3,9 billion, 62 per cent is allocated to provinces and 36 per cent to national government. The additional expenditure will be used for unforeseen and unavoidable expenditure (related primarily to the impact of disasters and the local government elections) and to compensate for those salary and inflation adjustments that exceed levels anticipated in the 2000 Budget.

Share of spending by sphere

Table 5.7 provides a breakdown of expenditure by share of total expenditure. Mainly as a consequence of the additional defence expenditure, national government's share of the total will increase from 39,4 per cent in 1999/2000 to 40,8 per cent in 2000/01. The provincial share, however, recovers from 2001/02, reaching 57,3 per cent of the total in 2003/04.

Table 5.7: Consolidated expenditure shares and growth

	1999/00	2000/01	2001/02	2002/03	2003/04
per cent	**Outcome**	**Revised**	**Medium term estimates**		
National spending (excluding conditional grants)	39,4%	39,9%	40,8%	40,4%	40,2%
Provincial spending	58,8%	58,1%	57,0%	57,2%	57,3%
Local government equitable share plus conditional grants	1,8%	2,0%	2,2%	2,3%	2,5%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

Additional expenditure in 2000/01

The allocation to local government will rise by more than 15 per cent per year, in recognition of the financial pressures that they have experienced, and the implications of the municipal demarcation process.

The shift of expenditure to provinces and local government is an indication of the increasing role that these spheres of government play in providing services.

Reserves to be allocated

Funding already allocated to the different spheres will increase by 7,7 per cent per year over the next three years. This is a 2,5 per cent real increase per year. This spending will be further boosted in coming years by distribution of the national contingency reserve and provincial reserves. An estimate of the distribution of these reserves between spheres is not yet available.

Social security funds

In order to provide a complete picture of government expenditure the 1999 Budget reported on the revenues and expenditure of the social security funds - the Unemployment Insurance Fund (UIF), compensation funds, and the Road Accident Fund.

Review of social security funds in progress

These funds are financed through employee and employer contributions and, in the case of the Road Accident Fund, an earmarked proportion of the fuel levy. Processes are in place to ensure the soundness of these funds and the activities that they undertake. These involve steps to integrate the compensation funds and their activities, legislative changes in the case of the UIF, and a Commission of Enquiry in the case of the Road Accident Fund.

Conclusion

Budget restraint over the last 5 years, reduction of the debt burden, and improved efficiencies in revenue collection allow for strong expenditure growth over the next three years within the framework of a sound and sustainable fiscal policy stance.

The increases in expenditure are spread widely over government functions but strengthens key government priorities, particularly the integrated justice sector, infrastructure development and the provision of social services.

While the social service sectors will benefit from growing allocations to the provincial sphere and the recovery of infrastructure spending, much improved discipline in personnel expenditure will provide for sizeable increases in expenditure on complementary inputs, improving both quality and outcomes.

Continuing budget and service delivery reform in government will further enhance the impact of substantial real increases in expenditure.

6

Division of Revenue

South Africa's intergovernmental system has been developed and consolidated over the past five years. This is reflected most clearly in the turnaround of the financial position of the provinces.

The 2001 MTEF will see dramatic increases in the share of nationally-raised revenues allocated to local government. This reflects the growing importance of the local sphere of government in the delivery of services, especially to the poor.

Although national government's share of revenues will grow initially, by the end of the MTEF the proportion of revenue allocated to the provinces will have recovered.

Introduction

Stabilising provincial budgets

As the 2000 provincial budgets show, provinces have stabilised their finances, are succeeding in paying off their debts and redirecting spending to key priority areas. This lays the foundation for increased infrastructure spending and implementation of the institutional reforms necessary to improve service delivery.

Municipal restructuring

The rationalisation of 843 municipalities into 284 new municipalities is also expected to lead to greater stability in municipal finances in the longer term, as less viable local authorities are phased out. Major municipalities such as Johannesburg, Durban, Cape Town and Port Elizabeth show improvements as they restructure their fiscal and institutional priorities. Large non-metropolitan municipalities, however, will face significant challenges in assuming service delivery responsibilities for the many poor households in adjoining rural areas.

Provincial and local government finances

The *Intergovernmental Fiscal Review 2000* analyses the fiscal performance of provincial and local government.

Turnaround in provincial finances…

After recording a deficit of R5,5 billion in 1997/98, provinces recorded surpluses of R0,5 billion in 1998/99 and R3 billion in 1999/00. These surpluses have been used to pay off debts accumulated in previous years when provincial budgets rose rapidly.

This turnaround in financial performance takes place despite strong cost pressures arising from the provision of social services, high personnel expenditure, and little real growth in provincial budgets.

…despite pressures of social services spending…

The social service sectors' share of the total provincial budget has increased from 81,8 per cent of total provincial expenditure in 1997/98 to 83,4 per cent of budgeted provincial expenditure in 2000/01. This is due mainly to increases in personnel expenditure following the 1996 salary agreement, and the increased take-up rate of social security grants.

… and high personnel costs

Personnel costs as a share of provincial expenditure rose from 54,7 per cent of total provincial expenditure in 1996/97 to 59 per cent in 1998/99 following the 1996 salary agreement. This is expected to decline over the MTEF.

Progress in large municipalities

An overall assessment of local government finances remains difficult, given the lack of uniformity in municipal budgets. However, available information confirms that performance is highly variable, and that some progress has been made, particularly by large and medium-sized urban municipalities, in restructuring fiscal positions to meet service delivery challenges.

Provincial and municipal fiscal powers

Building on these achievements, Government intends to extend the fiscal framework for provinces and municipalities.

National legislation has been prepared to facilitate the introduction of provincial tax proposals. This legislation will give effect to section 228 of the Constitution, and will allow provinces to impose selected taxes within a nationally determined framework. From 2002/03 provinces may also be permitted to borrow for capital expenditure.

New legislation governing financial management and the borrowing and tax powers of local government has also been published for comment, and is expected to be tabled in Parliament next year.

Rationalisation of the local government grant system

Reforms introduced in the national and provincial spheres will be extended to the local sphere. The local government grant system is to be rationalised and allocated on a three-year basis to promote better planning in both the municipal budgeting and financial planning processes.

While local government will continue to receive its share of nationally-raised revenue in the present manner, changes will be made to the manner in which conditional and other grants are allocated to the local sphere. These changes include:

- The distribution of grants between municipalities in an equitable manner, and through a transparent process
- Enhanced transparency, with grants reflected on municipal budgets
- The allocation of grants in a manner that encourages and enhances financial sustainability at municipal level
- Measures to ensure that allocations are not fragmented into a large number of small grants
- Measures to ensure that grant spending is well planned and outcome focused.

To this end, consideration will be given to the rationalisation of municipal infrastructure transfers, such as Consolidated Municipal Infrastructure Programme (CMIP), the Community Water Supply and Sanitation Programme (CWSS) and the Community-based Public Works Programme, into a single allocation. Such an allocation would be formula-driven.

The division of revenue between spheres

Role of provincial and local government

The provincial and local spheres are responsible for the delivery of many of the services and functions central to Government's overarching objectives of redistribution and poverty-alleviation.

Provinces are responsible for school education, primary and specialised health care, social security grants and welfare services. They also take responsibility for the delivery of services in the areas of agriculture, provincial roads and housing.

Municipalities are responsible for household infrastructure. This includes access roads and streets, street lights, refuse collection and the provision of basic services like water and electricity.

Vertical division of revenue

However, provinces and municipalities have limited capacity to generate their own funds. This requires that nationally raised revenue be divided equitably between the national, provincial and local spheres, in proportion to their fiscal capacity and functional competencies.

Determination of the division of revenue

The division of revenue between spheres is determined by Cabinet, and is informed by the recommendations of the Budget Council, the Budget Forum, the Ministers' Committee on the

Budget, the Financial and Fiscal Commission (FFC) and, for the first time this year, the recommendations of an inter-governmental Division of Revenue workshop.

The allocation of revenue between spheres reflects the following considerations:

- The increasing budgetary pressures arising from HIV/Aids and the Child Support Grant
- The priority of increasing infrastructure spending, in order to redress the backlogs in maintenance, rehabilitate and expand the infrastructure base and to stimulate economic growth
- The prioritisation of poverty-alleviation programmes, including social security grants, and the provision of free basic services to the poor
- The costs associated with establishing newly demarcated municipalities.

Revised provincial and municipal allocations

Additional allocations in Adjustment Budget

The Adjustments Budget in August allocated a further R1,8 billion to the provincial sphere, in addition to resources earmarked for flood-related spending.

The adjustments were made to take account of the higher than budgeted salary increases, to accommodate the high take-up rate of the Child Support Grant and to provide resources for flood reconstruction. The local government sphere also received R100 million to assist municipalities in meeting costs associated with the demarcation of new municipal boundaries.

The revised budget framework provides for an additional R7,8 billion and R13,2 billion for 2001/02 and 2002/03 above the baseline allocations.

Revised Budget Framework

Of these amounts, the provinces will receive R4,1 billion and R7,5 billion in the first two years of the MTEF. Local government will receive R469 million and R905 million respectively.

Table 6.1 illustrates the "vertical" division of these additional allocations between the three spheres of government.

Increasing local government share

Over the course of the MTEF period, the provincial share will remain stable at around 56,6 per cent of the allocated resources, while the local government share will rise from 2,0 per cent in 2000/01, to 2,5 per cent in 2003/04. The increase in the local government share reflects the inclusion of CMIP funds in the broader allocation to local government. In the past, CMIP funds were shown as part of the national allocation.

Funding arrangement for flood-related reconstruction

Over the next three years financing will be made available in four provinces to meet the costs of damage arising from the February floods. Current estimates set the cost of damage to public infrastructure at approximately R2 billion.

A total of R895 million has been allocated to provinces for 2000/01 for disaster relief and infrastructure reconstruction this year. This comprises an initial allocation of R300 million, which was made in June, and a further allocation of R595 million, as set out in the Adjustments Budget in October.

The initial allocation provided for emergency reconstruction, and assessments of both the extent of the flood damage, and the cost of effecting repairs and rehabilitating infrastructure. Provincial allocations of the funds are set out below.

The proposed 2001 budget framework makes provision for a further R1,2 billion for reconstruction and rehabilitation over the next three years.

2000/01 flood relief allocations by province

	R million
Eastern Cape	90
Free State	38
Gauteng	10
KwaZulu-Natal	142
Mpumalanga	241
Northern Cape	6
Northern Province	343

Real increases in provincial allocations

Overall, total provincial transfers increase at an average annual growth rate of 7,1 per cent over the MTEF. Local government transfers increase at an average annual growth rate of 15 per cent. This provides for real increases in provincial and local expenditure, accelerated service delivery and the budget pressures arising from HIV/Aids, the Child Support Grant and the costs associated with the demarcation of new municipalities.

Table 6.1 The vertical division

R million	2000/01 Revised	2001/02	2002/03	2003/04
		Medium term estimates		
National	76 071	84 974	90 490	95 887
Provincial allocation	108 406	116 048	124 674	133 022
Of which:				
Equitable share	*96 185*	*103 011*	*110 761*	*118 118*
Conditional grants	*12 221*	*13 036*	*13 913*	*14 904*
Local government allocation [1]	3 826	4 538	5 244	5 865
Total to be shared	188 304	205 559	220 409	234 774
Changes from baseline				
National allocation	1 415	3 224	4 778	–
Provincial allocation	2 373	4 138	7 514	–
Of which:				
Equitable share	*1 778*	*2 845*	*5 604*	–
Conditional grants	*595*	*1 293*	*1 910*	–
Local government allocation	100	469	905	–

[1] Excludes certain agency payments, grants-in-kind and other transfers to the local government sphere

Provincial share

Types of transfers to provinces

Transfers to the provincial sphere from national government take two forms: the equitable share and conditional grants. The equitable share allocation is used to fund the bulk of public services rendered by provinces. Conditional grants are used to support compliance with national norms and standards, to compensate provinces for providing services that may extend beyond provincial boundaries, and to ensure that national priorities are adequately provided for in sub-national budgets.

The provincial equitable shares

Table 6.2 sets out the provincial equitable shares for the MTEF period.

The equitable share is the largest of the provincial allocations. Over the course of the MTEF the equitable share allocation will rise rapidly from R96,2 billion in 2000/01 to R118,1 billion in 2003/04 – an average annual average growth rate of 7,1 per cent a year.

Table 6.2 Provincial equitable shares

R million	2000/01	2001/02	2002/03	2003/04
		Medium term estimates		
Eastern Cape	16,750	17,771	18,913	19,962
Free State	6,536	6,942	7,411	7,846
Gauteng	14,517	15,677	17,013	18,309
KwaZulu-Natal	19,241	20,807	22,578	24,292
Mpumalanga	6,539	7,128	7,793	8,447
Northern Cape	2,342	2,505	2,687	2,857
Northern Province	12,866	13,859	14,990	16,079
North West	8,158	8,666	9,241	9,771
Western Cape	9,235	9,656	10,137	10,549
Total	**96,185**	**103,011**	**110,761**	**118,118**

Horizontal division

Revenue allocated to the provincial sphere is divided "horizontally" between provinces in accordance with a formula, which is based on 1996 recommendations of the Financial and Fiscal Commission. This formula takes into account the demographic and economic profiles of the provinces.

Components of the formula

Although the formula has components for education, health and welfare, the share "allocations" are intended merely as broad indications of relative need. Provincial Executive Councils have discretion regarding the provincial allocations for each function.

The equitable share formula includes the following components:

- An education share (41 per cent) based on the size of the school-age population (ages 6-17) and the number of learners enrolled in public ordinary schools
- A health share (19 per cent) based on the proportion of the population without access to medical aid
- A social security component (17 per cent) based on the estimated number of people entitled to social security grants – the elderly, disabled and children – weighted using a poverty index derived from the 1995 Income and Expenditure Survey
- A basic share (7 per cent) derived from each province's share of the total population of the country
- A backlog component (3 per cent) based on the distribution of capital needs captured in the schools register of needs, the audit of hospital facilities and the share of the rural population
- An economic output component (8 per cent) based on the distribution of total remuneration in the country
- An institutional component (5 per cent) divided equally among the provinces.

Government Response to the FFC Proposals

In line with the Constitution and the Intergovernmental Fiscal Relations Act, the Financial and Fiscal Commission (FFC) makes recommendations to Parliament on the sharing of nationally-raised revenue between the three spheres of government. The FFC's *Recommendations 2001-2004 MTEF Cycle* were published in May 2000.

The report suggests a new approach to allocating funds to the provinces, which entails dispensing with the present formula, and estimating the actual cost of providing basic services in education, health and welfare. Cost estimates would reflect national norms and standards in each area. The "costed norms approach," deals only with education, health and welfare spending, and not with the costing of other provincial functions, nor with national and local government functions.

While welcoming the proposals, and encouraging the use of costed norms as an analytical tool to help analyse specific sectoral budgets, Government has decided not to adopt the costed norms approach for the following reasons:

- Changing the current formula (which was adopted with the support of the FFC) has the potential to destabilise provincial budgets if the formula results in significant changes to provincial allocations
- A bottom up iterative approach is not an appropriate way to determine budgetary priorities, which requires political judgement in making difficult trade-offs
- The application of the costed norms approach only to health, education and welfare would introduce a bias against other provincial functions, as well as against the local and national spheres
- The data required to estimate the cost of providing services are unavailable

Government will respond in greater detail to the FFC recommendations when it tables the annual Division of Revenue bill with the Budget in February 2001, as required by the Intergovernmental Fiscal Relations Act.

Phasing in of the equitable share formula

The 2001 Budget marks the third year of the phased approach to the application of the equitable share formula. The phased approach was developed as a response to differences between the data on which the formula was originally based, and the data contained in the subsequent Census of 1996. The view was taken that the alignment of shares with more accurate demographic data would be phased in over four years, in order to avoid disruptions in service delivery, especially in those provinces in which shares are to be revised downwards.

Conditional grants

Conditional grants are national government transfers to provinces for identified purposes.

Continuing refinement of the conditional grant system

This is the third year in which Government has used conditional grants. Adjustments have been made to improve the processes and systems used in the administration of these grants. Among these improvements are measures to enhance accountability and responsibility in monitoring and reporting on conditional grants, as set out in the Division of Revenue Act, 2000 and the Public Finance Management Act, 1999. Further streamlining of conditional grants is expected to follow the National Treasury's review of conditional grants.

Table 6.3 sets out the allocations of conditional grants over the MTEF period.

With the exception of grant funding for provincial infrastructure, the level of funding for programmes already funded through conditional grants will remain broadly stable.

Increase for provincial infrastructure

Grant financing for provincial infrastructure was introduced last year to supplement existing expenditure on infrastructure in the provinces. The baseline allocation for the grant was R300 million a year over the MTEF period. Mindful of the role of infrastructure in sustained economic growth and accelerated service delivery, Government will increase the grant allocation by a projected R500 million in 2001/02, R1,2 billion in 2002/03, and R2,3 billion in 2003/04.

Introduction of three new conditional grants

Three new grants will be introduced in the next year. These are the Pretoria Academic Hospital Grant, the Flood Disaster Reconstruction Grant, and the Early Childhood Development Grants.

The Pretoria Academic Hospital grant

The Pretoria Academic Hospital Grant will support the construction of a new hospital building.

The Flood Disaster Reconstruction grant

The Flood Disaster Reconstruction Grant provides financing for flood-related reconstruction. An amount of R1,2 billion, to be spent over three years, has been set aside in the MTEF for this purpose.

The Early Childhood Development grant

The Department of Education has identified early childhood development and pre-primary schooling as critical areas in its initiative to improve the level of educational achievement in South Africa.

The Department is therefore piloting a number of early childhood development projects which will be funded through conditional grants of R45 million in 2001/02, R85 million in 2002/03 and R120 million in 2003/04. This grant is not included in table 6.3 and will be funded from the national allocation.

Review of conditional grants underway

Most conditional grants – both in terms of number and share of total grants – have been made to the Department of Health. Apart from the integrated nutrition programme, all grants to the Department of Health are aimed at hospitals, and deal with spillover benefits and restructuring, in order to pave the way for a more equitable distribution of specialised services. The Department of Health is undertaking a major review of its grants, with the aim of speeding up its progress, and better aligning its policies with its budgetary processes. The results of this review will be incorporated into the 2002/03 MTEF.

Table 6.3 Conditional grants to provinces

R million	2000/01	2001/02	2002/03	2003/04
Health				
Central hospitals	3 112	3 273	3 417	3 580
Training and research	1 174	1 234	1 291	1 351
Redistribution of specialised services	176	182	189	198
Hospital rehabilitation	400	500	520	543
Nkosi Luthuli Academic Hospital	273	103		
Pretoria Academic		50	70	90
Integrated Nutrition Programme	582	582	582	582
Finance				
Supplementary grant	2 212	2 000	2 000	2 000
Provincial Infrastructure	300	800	1 550	2 314
Provincial Financial management	100	140	140	146
Flood Disaster Reconstruction	595	600	400	200
Education				
Financial management and Quality enhancement	202	213	224	234
Housing				
Housing fund	3 017	3 226	3 390	3 547
Capacity building	10	10	10	10
Human Settlement	20	100	104	109
Doornkop	3	–	–	–
Welfare and Population Development	–	–	–	–
Financial management	27	26	25	–
Child Support	17	–	–	–
Total	**12 221**	**13 036**	**13 913**	**14 904**

Local government share

Challenges of local government

Local government, like provinces, faces significant financial pressures.

Municipalities are expected to provide basic services to all residents, with the poorest receiving a minimum level free. Huge backlogs remain in the maintenance of household infrastructure, particularly in former townships. Despite this, capital expenditure has fallen since 1997/98, as a result of large deficits and liquidity problems in many municipalities.

In 1999/00, municipal budgets totalled R57,4 billion, with 81 per cent of resources directed toward operating budgets and the remainder used for capital projects.

The creation of the new (and larger) municipalities will result in significant transition costs, as various administrations are merged. Municipalities face both the challenge of containing personnel expenditure – which has risen rapidly to an average of

31 per cent in the last four years – and the pressure of equalising salaries across merged municipalities.

Allocations to local government

Additional allocations

Given the pressures facing local government, and subject to macroeconomic revenue estimates, extra allocations will be made over the course of the MTEF.

Table 6.4 shows the distribution of these additional allocations.

Table 6.4: Baseline Allocations from the National Sphere[1]

	2000/01	2001/02	2002/03	2003/04	2000/01	2001/02	2002/03
	Revised	Medium Term Estimates			Changes from 2000 Budget		
Equitable share	1 867	2 201	2 570	3 109	–	204	440
R293 personnel[2]	463	463	463	463	–	–	–
Subtotal: Equitable share & related	2 330	2 664	3 033	3 572	–	204	440
Restructuring	300	350	450	465	–	–	50
LG support	150	160	220	230	–	–	50
Subtotal: Restructuring	450	510	670	695	–	–	100
Transition	100	250	200	–	–	250	200
Financial management	50	60	120	125	–	–	50
SALGA Allocation	–	15	15	15	–	15	15
Land Development Objectives	13	45	47	49	–	–	–
Subtotal: Capacity & transition	163	370	382	190	–	265	265
CMIP[3]	883	994	1 159	1 407	–	–	100
Subtotal: Infrastructure	883	994	1 159	1 407	–	–	100
Local Government Allocation[4]	**3 826**	**4 538**	**5 245**	**5 863**	**–**	**469**	**905**

[1] Excludes agency payments, grants-in-kind, and other allocations, such as bus subsidies, CWSS and poverty relief allocations, that benefit the local government sphere.

[2] Excludes salary increases for R293 personnel

[3] Excludes other infrastructure transfers and assumes progress with rationalisation of infrastructure transfers.

[4] Figures not comparable with Budget Review 2000 due to revision of classifications, or with table 6.1 due to rounding errors

The national medium-term estimates initially provided for a total allocation to local government of R3,8 billion in 2000/01, rising to R4,5 billion in 2001/02. Table 6.5 shows increases beyond the current local government baseline of R469 million, R905 million and R1,3 billion. These allocations are in addition to the R100 million appropriated for local government in the 2000 adjustment budget.

Break-down of local government allocations

The total allocation to local government of R4,5 billion for 2001/02 is made up of the following components:

- The local government equitable share of R2,2 billion
- The "R293 personnel allocation" of R463 million
- The Local Government Support Grant of R160 million
- The Restructuring Grant of R350 million
- The Financial Management Grant of R60 million
- The Land Development Objectives Grant of R45 million
- The CMIP grant of R994 million
- An allocation to organised local government (SALGA) of R15 million.

Other grants-in-kind directed to the local sphere are not reflected in the local government allocation. These include

- The Community Water and Sanitation Operating Grant of R731 million
- The Community Water and Sanitation Capital Grant of R744 million
- The Community Based Public Works programme of R334 million.

Twin pressures of local government

The significant increases in allocations to the equitable share, and the introduction of a transition grant reflect the twin pressures facing local government: ensuring access to basic services for poor households, and local government restructuring.

Ensuring access to basic services

Government's commitment to a better life for all its citizens finds expression in ensuring that all households have access to at least a basic level of municipal services.

National government support of this objective is reflected in the allocation of the equitable share to local government. The equitable share is distributed to municipalities relative to the extent of poverty within their jurisdictions. The grant is targeted at households earning less than R800 per month, and aims to support the delivery of a basic package of services, including water, sanitation and municipal services – currently estimated at R86 per household per month.

Although the equitable share is an unconditional allocation, municipalities are urged to ensure that their budgets reflect this basic package of services. New budget formats and reporting requirements will ensure that municipalities report regularly on spending on poor households. National and provincial governments will monitor such spending.

Progressive expansion of the equitable share

Government remains committed to the progressive expansion of the equitable share mechanism. Further allocations to the equitable share will become possible once national department votes (such as existing allocations within the water services trading account) have been restructured.

Increasing allocations to conditional grant programmes will not undermine the relative importance of the equitable share mechanism within the intergovernmental fiscal system.

Support for transition

Demarcation, together with the evolving developmental role of local governments, requires an overhaul of the structures, systems, and financial resources available to municipalities.

The demarcation process will impose a number of significant short-term costs on municipalities. These include the costs of moving, integrating or aligning systems, and consolidating assets and liabilities. In some instances municipalities will have to meet the challenge of remaining financially viable and creditworthy in the short-term, while taking measures to improve their positions in the longer-term.

These measures should result in an expansion and enhancement of service delivery – particularly in areas of high poverty – and an improvement in the financial position of municipalities.

Conclusion

The provincial and local spheres of government are increasingly well positioned to face their considerable service delivery challenges. Significant additional allocations to each sphere reflect Government's commitment to address the challenges of redistribution and service delivery. The consolidation of grants and other reforms to the framework for intergovernmental transfers will further enhance the capacity of provincial and local government.

GLOSSARY

Adjustments estimate	Presentation to Parliament of the amendments to be made to the appropriations voted in the main budget for the year.
Appropriation	The approval by Parliament of spending from the National Revenue Fund, or by a provincial legislature from the Provincial Revenue Fund.
Balance of payments	A summary statement of all the international transactions of the residents of the nation with the rest of the world during a particular period of time.
Baseline	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 expenditure and budgeted revenues.
Capital gains tax	Tax levied on the profits realized from the disposal of capital assets or investments by a taxpayer. A capital gain is the excess of the selling price over the original purchase price of a capital asset.
Capital 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.
Consolidated expenditure	Total expenditure by national and provincial government, excluding allocations to local government other than *agency payments*.
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.
Consumption expenditure	Expenditure on goods and services that are used up within a short period of time, usually a year. Salaries absorb most of Government's consumption expenditure.
Contingency reserve	An amount that is set aside and not allocated in advance, in order to accommodate changes to the economic environment and to meet unforeseen spending pressures.
Core inflation	Consumer price inflation, excluding certain items such as mortgage costs, indirect taxes and the costs of certain foods.
Corporatisation	The transformation of state owned enterprises into commercial companies, subject to commercial legal requirements and governance structures, while retaining state ownership.

Cost-push inflation Inflation that is caused by an increase in production costs, such as wages or oil prices.

CPIX inflation Consumer price inflation excluding mortgage costs.

Current account deficit The difference between total imports and total exports, also taking into account service payments and receipts, interest, dividends and transfers.

Debt interest/service costs The cost of interest on government debt.

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.

Direct investment Investment from abroad in physical assets such as factories.

Direct taxes The term *current taxes on income and wealth* replaces *direct taxes*, and refers to taxes payable on incomes, profits and capital gains. In addition, the terms *current taxes on capital* and *miscellaneous current taxes* are introduced. The former refers to periodic taxes on the property or net wealth of institutions, with the latter applicable to poll taxes and license payments by households.

Dissaving The difference between current income and current expenditure, including the depreciation of fixed capital.

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

Domestic absorption Total spending in the economy on household consumption, government consumption and investment.

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.

Government debt The total amount of money owed by government.

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.

Gross fixed capital formation The addition to a country's fixed capital stock during a specific period, before provision for depreciation.

	before provision for depreciation.
Growth	An increase in the total amount of output, income and spending in the economy.
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.
Integrated Justice System	The cluster of government activities consisting of Correctional Services, Justice and the South African Police Services.
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.
Macroeconomic	The branch of economics that deals with the whole economy – including issues like, growth, inflation, unemployment and the balance of payments.
Medium Term Expenditure Committee (MTEC)	The technical committee responsible for evaluating the MTEF budget submissions of national departments and making recommendations to the Minister of Finance regarding MTEF budget allocations to national departments.
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 that deals with the behaviour individual firms and consumers.
Ministers' Committee on the Budget (Mincombud)	The political committee that considers key policy and budgetary issues that pertain to the budget process before they are tabled in Cabinet.
MinMEC	A MinMEC is a political forum where national and provincial departments in the same sector discuss policy issues. It consists of the national Minister and the nine provincial MECs, supported by key departmental officials.
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.
Money supply	The amount of money in an economy.
National budget	The projected revenue and expenditures which flow through the National Revenue Fund. It does not include spending by provinces or local government from their own revenues.
Nominal exchange rates	The current rate of exchange between the rand and foreign currencies.
Portfolio investment	Investment in financial assets such as stocks and shares or government bonds.

Primary sector	The agricultural and mining sectors of the economy.
Private sector credit extension	Credit provided to the private sector by banks. This includes all loans, credit cards and leases.
Public Private Partnerships (PPPs)	A contractual arrangement whereby a private party performs part of a government function and assumes the associated risks. In return, the private party receives a fee according to predefined performance criteria.
Public sector borrowing requirement (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 expenditure	The level of expenditure after taking account of inflation.
Remuneration	The costs of personnel including salaries, housing allowances, car allowances and other benefits received by personnel.
Repo rate	The rate of interest that the Reserve Bank pays on repurchase agreements with money market participants.
Reserves (foreign exchange)	Holdings of foreign exchange, either of the Reserve Bank only or of the Reserve Bank and domestic banking institutions.
Residence-based income tax system	A tax system where income that accrues to a resident of a country is subject to the taxes of that country.
Saving	The difference between income and spending.
Source-based income tax system	A tax system where income is taxed in the country where that income originates.
Southern African Customs Union (SACU)	An agreement that allows for the unrestricted flow of goods and services between South Africa, Botswana, Namibia, Lesotho and Swaziland.
Southern African Development Community (SADC)	A regional governmental organisation which promotes collaboration, economic integration and technical co-operation throughout Southern Africa.
Tax base	The aggregate value of income, sales or transactions on which particular taxes are levied.
Unallocated reserves	Potential expenditure provision not allocated to a particular use. Mainly consists of the *contingency reserve* and amounts of money left unallocated by provinces.
Unit labour costs	The cost of labour per unit of output. Calculated by dividing average wages by productivity (output per worker per hour).
Vertical division	The division of revenue between spheres of government.