ADDRESS TO THE NATIONAL ASSEMBLY ON THE INTRODUCTION OF THE 2002 MEDIUM TERM BUDGET POLICY STATEMENT AND THE 2002/03 ADJUSTMENTS APPROPRIATION BILL

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Madam Speaker

Our culture, our humanity, our spirit, our ability to reach out, to explore, to break new ground, to till the earth, to plant the seeds, to nurture, to care, to overcome adversity, to stand proud, is recounted in our oral history; it is etched on the walls that sheltered the Khoi and the San; it is the invisible genetic threads that bind us to the cradle of our humanity. It is the vision, intellect, the commitment of our forebears that saw beyond despair, assuaged the pain and lit the path through the darkest years of our history.

It is a short nine years since the freeing of our spirit and the birth of our democracy. It has been nine years of hard work as we have strived to build the foundations of an economy despite the shocks imposed by a faltering and volatile global economy. A caring economy where meeting the needs of the poor and most vulnerable occupy centre-stage. An economy that recognises the importance of growth and development as the lasting solution to eradicating poverty.

Our fiscal position is healthy and the economy is growing steadily, despite the very significant slowdown in the developed economies of the world. Our exports have increased significantly as we have penetrated new markets across the globe, allowing us to earn much needed foreign exchange and create new jobs. We have seen strong productivity improvements which contribute to making our economy more competitive and more attractive to investors, both local and foreign. We continue to create empowerment opportunities for black people, thereby providing for an environment where all our people can contribute to and share in the potential of our country.

We are now realising tangible and measurable gains from programmes designed to promote social and economic development. Nine years after the inception of the Reconstruction and Development Programme, access to basic services has increased significantly and Government is now seeking to provide a minimum package of free basic services for all.

History will surely record the fact that our democracy recognises the key role of women in our society and that they carry a disproportionate share of the burden of poverty. That we raised our voices loudly and consistently against the abuse of women and children. That we recognised the needs of the disabled and the importance of addressing these so that they too can share in the opportunities and contribute to the growth of our economy.

This period will also be recorded as one in which economic transformation proceeded at a blistering pace – budget reform; tax reform; financial reform; an entirely new fiscal system governing national, provincial and local government; financial market reforms; debt management reform; trade reform, reform of the labour markets, exchange control liberalization, monetary policy reform – and much, much more.

The enormity of the task of rebuilding our country has served to remind us of the importance of eradicating poverty in our region and our continent. As Africans we are determined to embrace these challenges and put our rich endowments to work for the benefit of our people. This is the spirit embodied in NEPAD and championed by our President.

It is fitting that, in this decade of intense reform and transformation, it was in Durban that the African Union was born, and that our President is its first guardian. To grow and flourish, the African Union needs support and nurturing and perhaps more importantly it needs us all to serve as its ambassadors. Our challenge is to ensure that ten years from now NEPAD and the AU become key institutions in the global architecture.

We also hosted the World Summit on Sustainable Development. President Mbeki reminded delegates that ten years earlier apartheid South Africa had been excluded from the Summit in Rio de Janeiro. The Johannesburg Summit was a remarkable success. It unambiguously recognised that people and the environment are key to sustainable development. But the Summit also allowed us to show the world just how much we have achieved as a nation. The beauty of our country, the precious legacies of our ancestors, the spirit of our people, the richness of our cultures, our present, and the future of the generations to come, meld together to create the will that has brought us here and that guarantees our future.

As we recognise our collective achievements we are also mindful of the enormity of the challenges that continue to lie ahead. Growth. Jobs. Education. The livelihoods of the poor and most vulnerable threatened by food shortages and famine in parts of our region.

Madam Speaker, the tabling in this House of our *Medium Term Budget Policy Statement* is an opportunity to reflect on the performance of the economy and our plans for the years ahead. It is an invitation to Parliament, and to the nation, to share in our deliberations about the challenges before us, on:

- How we promote more rapid, sustainable economic growth and development,
- How we progressively realise the social and economic rights promised in our Constitution,
- How we prioritise spending to achieve a balanced and effective delivery of services to our people, and
- How we raise the finances required, without unduly restraining economic activity or unfairly burdening the poor.

Economic performance and outlook

Despite uncertain international prospects, the economy has recovered strongly over the past year, with broad-based growth in response to domestic and foreign demand. In February, when this year's budget proposals were tabled, we expected the economy to grow by 2,3 per cent. We now expect an outcome for 2002 of 2,6 per cent, rising to 3,5 per cent next year, with further improvement in the medium term.

In particular, we are beginning to see important signs of investment in the productive capacity of the economy, with real gross capital formation rising by 6 per cent in the first quarter and over 7 per cent in the second quarter this year, on an annualized basis, with both private and public sectors contributing.

Private consumption expenditure is growing steadily at about 3 per cent a year, supported in part by tax reductions in the 2002 Budget, and spending on government services is also expanding in real terms. The proposals set out in this year's *Medium Term Budget Policy Statement* will reinforce this trend in the years ahead.

Against the background of persistent current account imbalances and foreign debt problems in many industrialised and emerging market economies, our balance of payments is in healthy shape.

For the first time since 1994 we expect a modest surplus on the current account, partly because our trade performance has responded favourably to the depreciation of the rand last year.

Net inflows from abroad of R30 billion were recorded on the financial account of the balance of payments in the first half of 2002, compared with a net outflow of R11 billion last year. These inflows include net foreign direct investment of over R8 billion, which reflects continued inward investment by foreign companies and the repatriation of offshore investments by South African companies.

Although our financial and trade links are global in their reach, growth has been especially rapid in our engagement with the rest of the African continent. The continuation of this trend is a critical success factor for the New Partnership for Africa's Development. And it is for this reason that the next steps in exchange control liberalisation will be focused on promoting expanded investment in Africa.

In the 2002 Budget, no changes to exchange control regulations were announced, pending the outcome of the Commission of Inquiry into the rapid depreciation of the exchange rate of the rand. The Commission has now completed its work, and its findings support Government's gradual approach to exchange control liberalisation. We are now in a position to announce the following changes, which take immediate effect:

- The allowance governing South African corporates' use of South African funds to finance new approved direct investment in Africa is increased from R750 million to R2 billion.
- The allowance for the use of South African funds is expanded from just the financing of new approved foreign direct investments to include also "top-up" funding for the financing of expansions of existing approved investments in Africa.

Details will be provided by the South African Reserve Bank.

Madam Speaker, I have alluded to the benefits that South African industry, and particularly our exporters, have gained from the more competitive level of the rand this year. The fiscus also gains, as higher profits by our mining companies and other exporters translate into higher tax payments.

But these gains will be short-lived if inflation simply rises to accommodate the effects of the depreciation of the rand. Following the depreciation of the currency last year, rising oil prices and marked increases in food prices this year, we have seen consumer prices rise faster over the past 12 months than we have experienced in a decade. The CPIX – consumer prices excluding mortgage interest – is expected to average 9,6 per cent this year, up from just 5,8 per cent in the year to September 2001.

The rise in inflation this year is a setback for the inflation reduction objectives agreed between the Government and the Reserve Bank. We had planned that inflation should fall within a 3 to 6 per cent range this year and next, coming down to a 3 to 5 per cent target in 2004. In response to rising inflation, the Reserve Bank has raised interest rates four times this year.

We believe that the rate of inflation will decline during the course of next year as the effect of the depreciation dissipates. Nonetheless, the inflation targets for 2002 and 2003 are likely to be missed, with the CPIX average unlikely to fall below 6 per cent until the last quarter of next year.

Under the circumstances, Governor Mboweni and I have agreed that the inflation target should remain 3 to 6 per cent for 2004. The 3 to 5 per cent target falls away until further notice.

Madam Speaker, details of the performance of our economy and prospects for the years ahead are set out in Chapter 2 of the *Medium Term Budget Policy Statement.* Let me turn now to the framework it outlines for the 2003 Budget.

Fiscal policy and the budget framework

Following the successful stabilisation period post-1996, the growth-oriented fiscal stance set out in the 2001 and 2002 Budgets will continue. Our priority will continue to be on programmes and policies that create jobs, encourage investment and growth, improve on the delivery of services and ensure that increased resources are allocated toward addressing poverty and inequality.

The budget framework provides for real expenditure growth of 4,7 per cent a year over the next three years. New allocations amounting to R57,1 billion over the 2003 MTEF period will be added to national, provincial and local baseline spending plans. In addition, adjustments for higher inflation amounting to R3,4 billion in the current year and R27,8 billion over the next three years are proposed.

General government tax revenue is projected to remain about 27 per cent of GDP, with national budget revenue stabilising at 24½ per cent of GDP. A budget deficit of 2,2 per cent of GDP is projected for 2003/04, falling to 2,0 per cent in 2005/06.

The framework takes into account financing arrangements to settle foreign exchange forward market losses incurred in recent years by the Reserve Bank, which are for the account of the fiscus.

Government bonds amounting to R7 billion have been issued to the Bank this year, and provision is made in the budget framework for further issues of R7 billion a year over the next three years.

These extraordinary payments raise future interest costs above the levels projected in the 2002 Budget, but debt service costs are still projected to decline steadily to just under 4 per cent of GDP by 2005/06.

National budget revenue collection this year is running ahead of target, offsetting in part both the adjustments to expenditure proposed and the costs of compensating the Reserve Bank for forward losses. At this stage, we expect revenue this year to exceed the February budget estimate by R8 billion. This reflects continued improvements in tax administration, together with the positive revenue impact of higher than anticipated GDP.

Following far-reaching reforms to the income tax structure in recent years, tax policy is presently in a consolidation phase. Reforms announced in the 2002 Budget – including introduction of a learnership allowance, further relief for public benefit organisations, accelerated depreciation allowances for manufacturing assets and extended tax relief for small businesses – have been dealt with in this year's Revenue Laws Amendment Bills. Incentives in terms of the new strategic investment programme have to date been awarded to five projects, entailing investment of R2 billion and an estimated 10 573 new jobs.

Robust revenue growth allows for a moderate real reduction in the personal income tax burden again next year, concentrated on lower and middle-income earners.

A thorough review of the taxation of retirement savings is underway, with a view to legislative overhaul in 2004. In keeping with the provisions of the Minerals and Petroleum Resources Development Bill, a royalty regime will in due course be introduced, bringing the tax treatment of our extractive industries in line with international best practice. The National Treasury is also studying the possible role of taxes and charges in addressing environmental aspects of long-run sustainable development.

MTEF and the division of revenue

Chapters 5 and 6 of the MTBPS deal with the medium term expenditure framework and the division of resources between national departments, provinces and support for local government.

It takes as a point of departure the priorities highlighted by the President in his State of the Nation Address, and it draws on an extended assessment of policy options by Cabinet, the Ministers' Committee on the Budget and Provincial Executive Councils.

Let me take this opportunity to express my profound appreciation to colleagues in Cabinet, and Executive Council Members, for whose advice, good judgement and understanding of the fact that our spending plans have to be tempered by both realism and affordability, I am deeply grateful.

The proposed 2003 Medium Term Expenditure Framework prioritises the following areas:

- Extending social assistance, health and education programmes administered by provinces.
- Enhancing investment in municipal infrastructure and basic services in support of the rural development and urban renewal strategies.
- Expanding capacity in the safety and security sector to prevent and combat crime, including a particular focus on the functioning of the courts system.
- Higher education restructuring, including support for institutional mergers and investment in infrastructure.
- Accelerating the land reform and restitution programmes.
- Re-engineering services to citizens provided by the Department of Home Affairs.
- Increasing support for the national research and development strategy to enhance growth and technology advancement.
- A growing international role through increased regional representation, support for the African Union and NEPAD.

However, the 4,7 per cent real growth in non-interest expenditure will not on its own guarantee better outcomes, and Government will continue to strengthen administrative capacity and improve coordination between national and provincial departments and municipalities, to ensure that a higher proportion of spending reaches the intended beneficiaries, and that the quality of that spending is improved. In addition, we propose to target spending towards high impact components and initiatives. The MTBPS provides several examples of what we mean.

- Increased funding, for instance, will go to providing learner and support material in schools and medicine supplies in clinics – clearly it is our duty to ensure that the teachers and nurses we employ have at their disposal the basic tools of their trade.
- Additional resources will also go to the police and the courts for addressing crimes against women and children – there is no excuse any more for missing files or telephone calls that go unanswered.
- So too, we will progressively extend basic services to households – evidence shows, that not only have we been able to expand access to electricity, for example, from 30 per cent to 70 per cent of households, but we have also been able to reduce the unit costs of electrification as we have built capacity and improved efficiency over time.

Poverty reduction remains the over-arching goal of Government policy. Education, health services, welfare, social security and other social services account for 57,5 per cent of consolidated non-interest spending, and will remain our first priority in the years ahead. Within the social services cluster, spending on healthcare is expected to rise most strongly, as provincial health departments build their capacity to manage the enhanced response to HIV/Aids announced by Cabinet in April this year.

Our social assistance programmes remain the central platform in Government's income security and poverty reduction strategy. The recent inflation has particularly serious consequences for the poor. In this light, the proposed framework includes provision for an additional R5,6 billion over the next three years for adjustment to social grants in order to compensate for inflation. With effect from October 1, the old-age pension and disability grant is increased by R20, while the child support grant is increased by R10, bringing the total increases in grants this year to R70 (12,3 per cent) for the old age and disability grants and R30 (27,3 per cent) for the child support grant. In addition, provinces will budget for the continuing strong growth in enrolment of beneficiaries – particularly for the child support grant – over the years ahead.

We also recognize, however, that our established social assistance programmes, although in general well-targeted, cannot meet the needs of everyone. South Africa does not face the critical food shortages that confront several other countries in our region, but nonetheless rising food prices this year have threatened the livelihoods of vulnerable households. We expect food price inflation to moderate significantly over the year ahead, and Cabinet has indicated its intent to keep a close watch on the trend. However, in partnership with communities and relief organisations, we need to provide special assistance to the most vulnerable. Beginning this year, an amount of R400 million a year is set aside for emergency relief for those facing desperate circumstances as a result of food shortages and food price rises.

The proposed framework for the 2003 Budget shifts resources gradually towards provinces and local government over the next three years, in relative terms. Provinces will receive an additional R49,8 billion over the next three years, national departments R28,7 billion and local government R6,4 billion. Compensation for higher inflation comprises about one-third of the increases.

Supplementary allocations to provinces will support the broadening and deepening of social security and welfare programmes, education and health services and improved maintenance of provincial roads and other infrastructure.

Allocations to local government will continue to be focused on municipal infrastructure investment, which complements provincial spending on housing projects, and the broadening of access to free basic water and electricity services. Government’s rural development and urban renewal strategies provide a coordinating framework for creating jobs and extending development of communities.

This year we have not published an Intergovernmental Fiscal Review. We shall table the next IFGR about a month after the tabling of the 2003 Budget, in order to provide Parliament and provincial legislators with additional information for purposes of participating in budget debates.

In sum, Madam Speaker, the 2003 Budget will build upon the policy priorities of recent years, with continued emphasis on infrastructure investment, extension of the coverage and quality of basic service delivery, enhanced economic development and well-targeted interventions to meet critical needs.

I am pleased to commend the *2003 Medium Term Budget Policy Statement* to this House. In deliberating its proposals, let us remain mindful of the Constitutional mandate that is the bedrock on which our strategy rests – the progressive realisation of social and economic rights, within secure and sustainable fiscal policy foundations.

Adjustments Appropriation Bill for the year ending 31 March 2003

I turn now to the Adjustments Appropriation Bill, through which the Executive seeks Parliamentary authority for its revised spending plans for the current fiscal year.

The Adjustments Bill provides for various kinds of change to spending plans, detailed in section 30(2) of the Public Finance Management Act. As Members will recall, the law sets strict limits to the adjustments that may be proposed.

The adjustments proposed raise the Main Budget estimated expenditure level of R287,9 billion by a further R3,8 billion. Details are set out in the *2002 Adjusted Estimates of National Expenditure*, which includes breakdowns of all the changes on each national budget vote.

In the February Budget, an amount of R700 million was announced to supplement infrastructure spending this year. Strict criteria were applied in allocating these funds, with a view to supporting Government's broader urban and rural development strategies and to supplementing existing initiatives with a proven track record. The allocations include

- R120 million to accelerate the rehabilitation and revitalisation of hospitals,
- R115 million for sanitation programmes overseen by the Department of Water Affairs and Forestry, and R188 million for transport infrastructure, and
- some R250 million for renovations and refubishment of courts, police stations, museums, parks and heritage institutions.

Also announced in the February Budget was a contingency reserve of R3,3 billion, to provide for unforeseeable and unavoidable expenditure and in recognition of the likelihood that inflation would be higher than anticipated at the time the departmental estimates were prepared.

The revised estimates include a total of R3,4 billion for higher inflation adjustments and R3,4 billion for unforeseeable and unavoidable expenditure. A further R400 million is provided for, but not yet allocated to a vote, for emergency food relief. A total of R1,2 billion in roll-overs of funds unspent in 2001/02 is added to national department appropriations.

The inflation adjustments and provision for unforeseeable and unavoidable expenditure largely go to provinces. Including adjustments to conditional grants, the additional allocations to provinces amount to R4,4 billion and will assist in meeting inflation-related salary adjustments, the October adjustments to social grants, faster than expected growth in beneficiaries of social grants, stepped-up expenditure in education on learner support materials before the new school year and unanticipated cost increases in health services associated with the depreciation of the rand.

There are also adjustments proposed for local government. In addition to R100 million to compensate for higher inflation, an amount of R22 million will go to the Local Government Transition Fund in keeping with the settlement agreement between national government and the district municipalities of Uthukela, Amajuba and Zululand, which did not initially receive allocations from the local government equitable share.

As in the past, the Treasury Committee has been scrupulous in reviewing requests from national departments for funding of unforeseeable and unavoidable expenses. The additional allocations recommended amount to R1,4 billion, or about 1,4 per cent of the national share of total expenditure.

The largest amounts are the following.

- R67 million for Foreign Affairs, comprising unanticipated costs of hosting the inaugural summit of the African Union, provision for South Africa’s term as Chair of the African Union, costs of the secretariat established to give effect to the agreement between parties involved in the conflict in the Democratic Republic of the Congo, provision for the NEPAD secretariat and an obligatory contribution to the Commonwealth Fund for Technical Cooperation
- R157 million for the Home Affairs vote, mainly to compensate for unanticipated foreign exchange costs and price escalation on equipment and services for the national identification system project (HANIS)
- R202 million for Public Works, including R172 million for municipal rates and taxes which have increased as a result of the review of valuation rolls by municipalities and the incorporation of various state properties into the rates net
- R50 million for Statistics South Africa, as adoption of new data processing technology has made possible an earlier than anticipated completion of the 2001 Census process
- R212 million for the Department of Health, mainly to meet costs of HIV/Aids interventions and compensate the KwaZulu-Natal province for the costs of addressing the cholera epidemic
- R82 million to Defence for deployments in the Republic the Congo and in Burundi and for unanticipated expenditure on security associated with the World Summit
- R116 million to Safety and Security for World Summit costs and to comply with provisions of the Telecommunications Act
- R158 million to the Environmental Affairs and Tourism vote to meet unforeseeable and unavoidable costs associated with hosting the Summit on Sustainable Development
- R50 million to meet unanticipated progress with the land restitution programme
- R200 million for the Transport vote to address unanticipated commuter transport costs.

Madam Speaker, these and other changes are set out in the *Adjusted Estimates*. This year the explanatory memoranda on each vote include an outline of changes to key outputs, indicators and targets for service delivery, further extending the information available to Parliament through which departments are held accountable for the funds at their disposal.

I am pleased to be able to report that, partially offsetting these increases in expenditure, departments have identified savings of R38 million and the National Treasury has reduced its projection of the costs of servicing state debt by R267 million.

Taking these changes into account, we expect expenditure on the national budget this year to amount to R291,8 billion. The revised estimate of revenue is R273,3 billion, bringing the projected deficit for the year to R18,5 billion, or 1,6 per cent of GDP.

Madam Speaker, our culture, our history, our spirit as a people embolden us to persevere, to face the challenges, to choose not the easy road but the road that stretches furthest into the future. And, as we travel this road, as we seize the opportunities, as we tell our stories, we capture the richness of our past and the potential of our future.

Members will, I know, wish to join me in thanking my colleagues for their discipline in exercising oversight over expenditure but also for the progress made in improving and extending service delivery with the resources available to us. We also owe a vote of thanks to Commissioner Gordhan and his staff at the Revenue Service, and to the National Treasury for their hard work and dedication. The revenue that we raise, Madam Speaker, is given value and meaning by our spending plans and their effective and efficient implementation.

Our revised plans for this year, and our preliminary framework for the years ahead, are now tabled for discussion in this House.