

# A framework for accelerated growth and broad-based development

*South African economic growth has gained impetus over the past year, job creation has quickened, investment has accelerated and inflation has moderated. This improved economic performance rests in part on policy reforms of the past decade, but also reflects rising business confidence and dynamic adjustments to regional and international opportunities and constraints. The favourable economic outlook allows for a progressive expansion of public services and promotion of broad-based development. Building on its review of progress in the first decade of democracy, the Government has adopted a medium term strategic framework focused on five policy priorities for the period ahead:*

- *Increasing the rate of growth and productive investment*
- *Promoting economic and social mobility, encouraging links between the first and second economies through employment and enterprise development*
- *Social development, income support and mobilising human resources*
- *Improving the State's capacity to promote growth, broaden development and combat crime*
- *International relations for growth and development.*

*The Medium Term Expenditure Framework proposes additional allocations of R50 billion over the baseline estimates for the next three years. Allocations to provinces and municipalities will be progressively increased, alongside measures to strengthen financial management and local revenue capacity. The period ahead will see significant improvements in ports, rail and road infrastructure, an expansion in electricity supply capacity and investment in regional water schemes. New avenues for partnership, in keeping with the spirit and commitments of the Financial Sector Charter, open up greater opportunities for social development, empowerment and investment in infrastructure.*

## A medium term strategic framework

South Africa's development challenge is to build a single and integrated economy that benefits all, encompassing both growing, competitive relations with the global economy and a

*Development challenge to promote growth and redistribution*

caring, inclusive network of social services and support for the disadvantaged. This is, on a larger scale, the central challenge also of international relations – the struggle for modernisation and solidarity against deeply embedded inequalities, conflict and prejudice.

*International spotlight on South Africa's reconstruction and development*

Having emerged from a history of racial domination, South Africa is reconstructing its social and economic order under intense international scrutiny. For those who believe that inequality and fear can give way to development and compassion, our progress during the first decade of freedom has been a source of hope. Our success in building a dynamic economy and better opportunities for our children and grandchildren will assist also in charting a new course for overcoming divisions in a fragmented world.

*Broadening participation in growth and development...*

In reviewing achievements since 1994, Government has acknowledged the central challenge of achieving broadening participation in social and economic development. *“Required are both focus and decisiveness on the part of government, the will to weight trade-offs and make choices, as well as strategies to inspire all of society to proceed along a new trail... (to) enter a road of faster economic growth and job-creation, faster and more efficient provision of quality services, increased social cohesion and reduction of the paradigm of exclusion prevalent among sections of society.”*<sup>1</sup>

*...requires a coherent medium term strategic framework*

The strategic framework required for the period ahead can be summarised as follows:

- Accelerating the pace of growth of the economy, and the rate of investment in productive capacity
- Promoting opportunities for participation of marginalised communities in economic activity, and improving the quality of livelihoods of the poor
- Maintenance of a progressive social security net, alongside investment in community services and human development
- Improving the capacity and effectiveness of the state, including combating crime and service-oriented public administration
- Regional and international partnerships for growth and development.

*Demographic trends as both constraints and opportunities*

In shaping the vision for growth and broad-based development over the next decade, it is important to take account of several important demographic trends under way. While fertility rates and population growth have declined markedly over the past fifteen years, the South African labour force has expanded rapidly and will continue to grow over the decade ahead.

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<sup>1</sup> *Towards a Ten Year Review*, Government of South Africa, 2003.

However, the school-age population is now declining, creating opportunities for improving quality and extending further education to a rising proportion of school-leavers. Migration into metropolitan and urban areas has accelerated – intensifying pressures on housing and municipal services and at the same time reinforcing opportunities for industrial and commercial development. Understanding the policy implications of these trends is a key element in overcoming the blight of poverty and marginalisation.

The policy challenge also involves important choices about the sequencing and complementarity of critical interventions.

*Policy choices involve sequencing reforms*

In the short-term, investment and job creation can be accelerated through targeted incentives and public works programmes; for sustained longer term growth, required interventions include investment in economic infrastructure, spatial development reforms, and a more effective competition policy. In the short-term, immigrant skills may be critical; in the longer term, further education and training yield increasing returns. In the short-term the distribution and pricing of water and energy resources can be made more efficient, in the longer term new supply capacity has to be built.

*Short-term interventions include investment incentives, public works programmes and improved administration of prices*

Similarly, in social policy there are sequencing and coordination issues. Housing development can be accelerated, but it also needs to be better aligned with spatial plans, job creation and community services. Social health insurance can contribute to better integration of public and private health networks, but the modernisation of public hospital infrastructure and administration is a critical precondition. Land redistribution and agricultural development need to be given greater impetus, but completion of the restitution programme is a more pressing claim on resources over the MTEF period ahead.

*Improved planning and community services to accompany housing development*

The *Medium Term Budget Policy Statement* provides a concise overview of Government's economic, social and development policy priorities, in the context of projections for the performance of the economy over the next three years and a coherent framework for fiscal policy and the national budget. Its point of departure is a medium term strategic framework that recognises the limits of the State's resources and the importance of promoting a vibrant competitive market-based economy.

*Medium term framework recognises contribution of both state and private sector to development*

### ***Increasing the rate of investment***

Government aims to facilitate an increase in the rate of investment – gross fixed capital formation in both the public and private sectors – from 16 per cent of GDP at present to 25 per cent by 2014.

*Investment to increase to 25% of GDP*

*Accelerating investment by private business sector*

The investment required for growth must largely come from the business sector. Private sector gross fixed capital formation growth of 7,0 per cent in 2003 and 7,6 per cent a year in the first half of 2004 is encouraging. An environment supportive of continued investment growth in the years ahead will include the following:

- Moderate inflation, low real interest rates and a broadly stable competitive real effective exchange rate
- Effective capital markets and sound financial institutions
- Implementation of appropriate microeconomic reforms, including streamlining of regulatory arrangements and effective sectoral development strategies
- Revitalisation and recapitalisation of further education and training institutions
- Incentives for technology adaptation and research and development
- Improved communications, transport and freight systems.

*Public sector investment challenges in transport sector, in addition to community infrastructure*

Overhaul of public transport systems, investment in ports and renewal of rail rolling stock are key challenges for the public sector, and will rely in part on appropriately structured public-private partnerships. Public sector investment priorities also include health and education infrastructure, roads, housing and water and electricity services.

*Local business environment is critical*

The investment environment is also shaped in important respects by local planning and municipal development initiatives. Improved alignment between local, regional and national investment plans, and streamlined procedures for business registrations and planning approvals, must enjoy greater priority.

### ***Facilitating economic activity within the second economy***

*Mobility between informal and formal economy needs to be promoted*

Acquisition of skills, emergence of new businesses and agricultural improvements, better work opportunities and improved livelihoods – these are critical determinants of social and economic mobility, and thus links between the first and second economies, between security and vulnerability, between accumulation and survival.

*Broad-based policy framework in place*

Policies and programmes organised around this objective cover a wide spectrum:

- The expanded public works programme aims to extend job creation into a widening array of public services and infrastructure needs.
- New directions in housing and municipal grants seek to give greater impetus to community development.

- Small and micro-enterprise development is set to be boosted by regulatory reforms, micro-credit initiatives and business support channelled through such initiatives as Government's multi-purpose community centres.
- A progressive expansion of investment in skills is under way, including growing numbers of registered learners in workplace opportunities, revitalisation of further education and stepped up financial assistance for students.
- Land restitution, land reform and agricultural support programmes aim to expand the opportunities and resources of rural communities.

### **Social services, income support and human development**

South Africa's social security net is under severe strain. Rapid growth in disability and foster care grant applications indicate both rising income support needs and apparent deficiencies in administrative systems. The caseloads of public hospitals and clinics reflect, amongst other factors, the rising burden of HIV and Aids-related diseases. Unemployment and social dislocation impact on crime and household insecurity. Social welfare services are unable to respond adequately to the range of needs and distress that confront them.

*Social security and health services face rising pressures*

Government's aim is to reduce dependence on social grants, and deepen the capacity of households and communities to meet their basic needs through normal participation in the economy and collective civil society endeavours. However, the present trajectory cannot be reversed in the short term: the social security system and public health services will continue to be important sources of support for significant proportions of the population.

*Social security provides relief for many poor people*

Nonetheless, there are important directions for reform:

- The consolidation of administrative capacity in a single Social Security Agency should contribute in time to more cost-efficient grants distribution and improved targeting of income support programmes.
- Welfare services will remain a provincial function and are due for a comprehensive overhaul and reorientation of partnerships with non-governmental service organisations.
- Comprehensive proposals for the modernisation of tertiary health services have been developed, building on the successful implementation of targeted hospital rehabilitation projects over the past five years.

*Reforms aim to consolidate social grants administration, modernise hospitals and improve education quality*

- Renewal of the primary school nutrition programme is in progress, following its transfer to provincial education departments. Steady progress is being made with early childhood development programmes and the reorientation of further education colleges.

*Future reforms may include contributory social insurance arrangements*

Over the longer term, as formal employment grows, South Africa will need to strengthen its “second pillar” of contributory social insurance arrangements to accompany state-financed services. Elements of this reform include extending participation in retirement funds, reform of unemployment, occupational injury and road accident compensation, and evolution of a social health insurance framework.

### ***Improving the capacity of the state***

*Public sector service delivery needs to rest on capable administrations*

A further challenge for the decade ahead is to improve the performance of the State – to consolidate the institutional reforms of the democratic transition, to build capacity where service delivery falls short and to promote greater participation and interaction of people with organs of government.

This is partly about creating an environment conducive to growth and development, particularly in respect of local government planning, administration and promotion of business opportunities.

*Administrative capacity improvement includes better municipal planning, e-government initiatives, multi-purposes community centres and better monitoring and evaluation of services*

Over the next three years, Government aims to:

- Complete the consolidation of municipal grants programmes, complemented by a support programme to improve municipal financial management and economic planning
- Introduce a mechanism to improve mobility of public servants between national, provincial and local government, and public entities
- Operationalise e-government communication and transaction capabilities
- Step up the creation of multi-purpose community centres and employment of community development workers
- Extend monitoring and evaluation systems into all areas of government service delivery
- Reinforce a culture of *batho pele* and a spirit of partnership with other sectors of society across all of government.

*Improved remuneration of police and educators*

Expanding public services needs to be appropriately balanced against the costs of equitable compensation of public service employees. The 2005 Budget will provide for further improvements in remuneration of police and educators.

Government's responsibilities for combating crime and violence, ensuring safety on roads and security in commuter transport services, promoting an efficient and effective justice system and contributing to international vigilance relating to terrorism, transnational crime and corruption, enjoy particular priority. Although there are corresponding responsibilities of citizens and the private sector, there is a fundamental duty of the State to promote safety, security and the rule of law.

*Combating crime and improving safety and security remain key priorities*

### ***International relations for growth and development***

South Africa's partnerships with other states in the SADC region and across Africa are aimed at promoting both democracy and more rapid development. Priorities include development of efficient transport and communications networks, cooperation in energy and water affairs, expansion of business and trade links and promotion of shared interests in the wider international community.

*Regional integration to be promoted*

Pressing challenges includes normalisation of the situation in Southern Africa, including Zimbabwe, the Democratic Republic of the Congo and Angola, with a view to faster economic growth and strengthened relations within the SADC region.

Participation in peace-keeping missions will remain an important responsibility. Within the context of NEPAD, strengthening the institutions of the African Union and the SADC is an ongoing priority.

*Peace-keeping missions and building institutional capacity in Africa*

South Africa continues to play an active role in multilateral institutions, in pursuit of a more just international order and more rapid growth and development of Africa.

Greater coordination between government and the private sector is needed in South Africa's own international marketing – tourism promotion, trade and industrial relations, a financial centre for Africa and hosting of international events. Planning is under way for South Africa's largest international opportunity yet, the hosting of the 2010 Soccer World Cup.

*Marketing South Africa requires partnership with the private sector*

## **Overview of the Medium Term Budget Policy Statement**

### ***Macroeconomic developments***

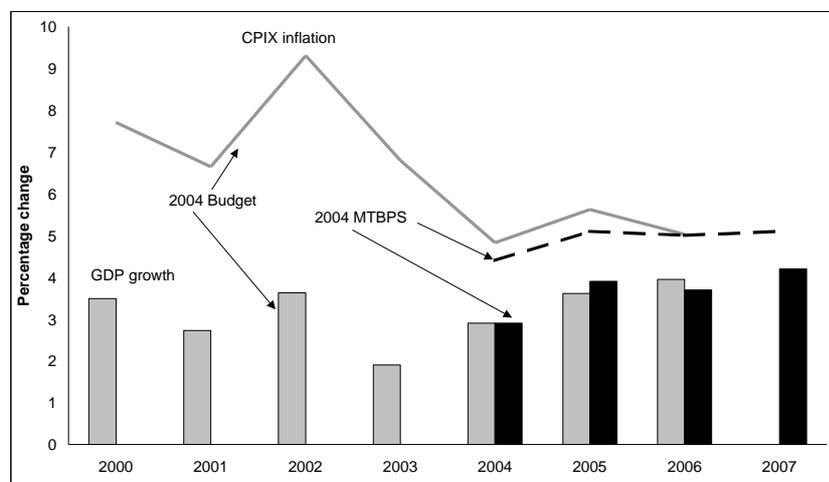
Chapter 2 of the Medium Term Budget Policy Statement reviews trends in the international economic environment, growth and development policy considerations and the medium term outlook for the South African economy.

*Economic growth has recovered strongly, while inflation remains subdued*

Following a mild slowdown in 2003, economic activity has picked up strongly in 2004 and growth is expected to average about 4 per cent a year over the next three years. Inflation remains subdued, despite the rise in oil prices this year, in part because of continuing rand strength. South Africa has benefited from the buoyancy of commodity prices in the context of strong growth internationally, particularly in China.

The South African economic recovery is broad-based, including much of the manufacturing sector, construction and tertiary services. Rising production appears to have contributed to a significant increase in the rate of job creation in 2003 and 2004.

**Figure 1.1 GDP growth and inflation estimates: 2000-2007<sup>1</sup>**



<sup>1</sup> 2004 Budget (February) and Medium Term Budget Policy Statement (October) estimates

*Mixed impact of the strength of the rand*

The appreciation of the rand since early 2003 has had a mixed impact. It has contributed to inflation reduction, which in turn has allowed benchmark interest rates to decline by 600 basis points. For industrial producers, the lower price of imports reduces the costs of investment in new plant and equipment. For exporters or import-competing firms, however, the relative strength of the rand lowers profit margins. Many South African firms have adapted successfully to the pressure of international competition, but cutbacks have been unavoidable in some mining operations and in other sectors.

*Foreign exchange restrictions on outward investment to be lifted*

Taking into account the strengthening of the balance of payments since 2002 and financial sector developments, exchange control limits on outward foreign direct investment by South African companies are to be abolished, together with removal of restrictions relating to repatriation of foreign dividends. These steps in the gradual liberalisation of exchange controls will provide further scope for global expansion of South African companies.

**Table 1.1 Macro economic projections, 2003 – 2007**

Calendar year	2003	2004	2005	2006	2007
		Estimate		Forecast	
<i>Percentage change unless otherwise indicated</i>					
Final household consumption	3,0	4,3	3,9	3,5	3,7
Final government consumption	4,6	5,4	2,9	3,1	3,3
Gross fixed capital formation	8,4	9,6	8,2	7,7	8,0
Gross domestic expenditure	4,2	5,4	4,5	3,9	4,3
Exports	-0,5	2,3	3,7	4,9	6,9
Imports	9,7	12,7	5,9	5,7	7,0
<b>GDP growth (real)</b>	<b>1,9</b>	<b>2,9</b>	<b>3,9</b>	<b>3,7</b>	<b>4,2</b>
GDP deflator	5,9	5,7	4,9	5,3	5,2
<b>GDP at current prices (R billion)</b>	<b>1 120,9</b>	<b>1 315,0</b>	<b>1 433,7</b>	<b>1 564,9</b>	<b>1 715,9</b>
CPIX	6,8	4,4	5,1	5,0	5,1
Current account balance (% of GDP)	-0,8	-2,2	-2,7	-2,5	-2,8

For the period ahead, Government seeks to step up the pace of investment, both in private businesses and in critical economic and social infrastructure. The economic policy challenge also includes reducing poverty and unemployment. Policy priorities include reducing the regulatory burden on small businesses, investing in skills and education, land reform and agricultural development, improved municipal development planning and appropriate social development initiatives.

*Both investment and broad-based development remain key policy priorities*

### ***Fiscal policy and tax considerations***

Chapters 3 and 4 review the fiscal policy stance and budget framework and outline developments in tax policy. The proposed framework for the 2005 Budget takes into account the rapid growth currently in social grants programmes, the need to provide for salary progression of educators and police personnel and the priority of investment in economic infrastructure, housing and municipal services.

*Fiscal policy accommodates social grants payments and increased investment spending*

The preliminary outcome of the 2003/04 main budget included total revenue of R299,4 billion, expenditure of R328,7 billion and a budget deficit of 2,4 per cent of GDP. For the current fiscal year, revenue is expected to rise to R328,2 billion, marginally higher than the February budget estimate. Expenditure is projected to increase to R371,7 billion, including additional allocations to provinces to meet social grants commitments and adjustments to take account of the public sector wage settlement. The budget deficit rises to R43,5 billion, or 3,2 per cent of projected GDP.<sup>2</sup>

*Budget deficit of 3,2% of GDP in 2004/05*

<sup>2</sup> National accounts estimates in the *Medium Term Budget Policy Statement* are taken from the September 2004 *Quarterly Bulletin* of the Reserve Bank. Revised estimates, incorporating the new annual estimates for the past two years and five-yearly benchmarking and rebasing of the national accounts, are due to be published by Statistics South Africa in November 2004. These revisions are expected to lead to material upward adjustments in the nominal GDP aggregates.

**Table 1.2 Main budget framework, 2003/04 – 2007/08**

R billion	2003/04	2004/05	2005/06	2006/07	2007/08
	Outcome	Estimate	Medium-term estimates		
<b>Total revenue</b>	<b>299,4</b>	<b>328,2</b>	<b>363,0</b>	<b>399,1</b>	<b>440,5</b>
<i>per cent of GDP</i>	24,3%	24,5%	24,7%	25,0%	25,1%
<b>Total expenditure</b>	<b>328,7</b>	<b>371,7</b>	<b>413,6</b>	<b>449,7</b>	<b>488,2</b>
<i>per cent of GDP</i>	26,7%	27,7%	28,2%	28,1%	27,8%
Debt service cost	46,3	49,6	53,2	58,2	63,7
<i>per cent of GDP</i>	3,8%	3,7%	3,6%	3,6%	3,6%
Non-interest expenditure	282,4	322,1	360,5	391,5	424,5
<i>per cent of GDP</i>	22,9%	24,0%	24,6%	24,5%	24,2%
<i>real growth (non-interest expenditure)</i>	9,3%	9,1%	6,5%	3,4%	3,2%
Contingency reserve	–	–	3,0	4,0	8,0
<b>Deficit(-)</b>	<b>-29,3</b>	<b>-43,5</b>	<b>-50,6</b>	<b>-50,6</b>	<b>-47,7</b>
<i>per cent of GDP</i>	-2,4%	-3,2%	-3,5%	-3,2%	-2,7%
<i>Gross domestic product</i>	1 232,5	1 340,7	1 466,8	1 598,6	1 755,7

*Growth in real expenditure of 4,3% a year*

For the MTEF period ahead, the budget framework provides for real non-interest expenditure growth of 4,3 per cent a year, continuing the expansionary stance of recent years. Debt service costs stabilise at about 3,6 per cent of GDP. The budget deficit rises to 3,5 per cent of the GDP in 2005/06, before declining to 2,7 per cent in 2007/08. The overall public sector borrowing requirement is expected to rise moderately to 4,6 per cent of GDP, as parastatal capital spending gathers momentum.

*Budget framework provides for tax-GDP ratio of 24,7% in 2005/06*

The resilience of tax performance in 2004 despite a downturn in company profits is indicative of the underlying strength of the recovery in the South African economy. For the 2005/06 year, national budget revenue is projected to rise to 24,7 per cent of GDP, buoyed in part by further broadening of the tax base.

*Tax reforms include simplification of tax compliance for small businesses*

Tax measures given effect this year include encouragement of broad-based employee equity participation, tax relief for investments from other countries within the Common Monetary Area, clarification of tax treatment of government grants and exempt entities and removal of shortcomings in the treatment of hybrid financial instruments. For the year ahead, tax reforms are likely to include simplifying tax compliance for small enterprises, revised treatment of health care benefits and motor vehicle allowances and amendments to facilitate hosting the 2010 Soccer World Cup.

### ***The medium term expenditure framework and division of revenue***

Chapters 5 and 6 set out proposed expenditure priorities for the 2005 Budget and the anticipated allocations of nationally collected revenue to provinces and municipalities.

The 2005 medium term expenditure framework reflects the following spending priorities:

*Spending priorities include land restitution, social grants, roads and health services*

- Rapidly rising expenditure on social security, mainly because of growth in disability and foster care grant numbers
- Completion of the land restitution programme, while also reinforcing support for emerging farmers
- Implementation of a new housing delivery strategy emphasising investment in sustainable communities
- Stepped up rehabilitation and maintenance of roads
- Further improvements in hospital infrastructure and administration
- Salary improvement for educators and police
- Improving the efficiency of courts and expanding the South African Police Service
- Ongoing support for peace-keeping and development initiatives in Africa, and South Africa's hosting of the Pan African Parliament.

**Table 1.3 Medium term expenditure framework and division of revenue, 2004/05 – 2007/08**

R billion	2004/05	2005/06	2006/07	2007/08
	Revised	Medium term estimates		
National	122,0	133,1	143,2	154,7
Provincial	185,4	207,8	226,4	242,4
Local	14,8	16,6	17,9	19,4
<b>Total</b>	<b>322,1</b>	<b>357,5</b>	<b>387,5</b>	<b>416,5</b>
<b>Changes from baseline<sup>1</sup></b>	<b>7,1</b>	<b>10,8</b>	<b>14,4</b>	<b>24,7</b>
National	2,4	2,1	3,5	8,0
Provincial	4,2	8,1	10,1	15,3
Local	0,5	0,6	0,8	1,4

1. Baseline allocations comprise the medium term estimates published in the 2004 Budget, together with standard increases of 5 per cent in 2007/08 over the 2006/07 allocations.

National transfers to provinces and local government will grow by 4,0 per cent and 4,3 per cent a year in real terms over the 2005 MTEF period. The two spheres receive additional allocations amounting to R36,3 billion over their baseline to reinforce spending on social services, infrastructure and basic municipal services.

*Additional allocations of R36,3 billion to provinces and municipalities*

A significant change in the intergovernmental budget framework will take effect next year as primary responsibility for the social grants programme will shift from provinces to the national Department of Social Development. National transfers to provinces will amount to R207,8 billion in 2005/06, and grants to local government will total R16,6 billion.

*Social grants to become a national function*

Annexure A contains detailed tables on the outcome for 2003/04 for all national departments and key provincial departments as well as spending estimates for the first six months of this fiscal year.

## Conclusion

*Medium term strategic framework as a shared development vision*

Government's medium term strategic framework seeks not just to mobilise the apparatus of the state, but is – in the phrase of *Towards a ten year review* – a “framework of encompassing interest”: a shared social and developmental vision “which not only helps better integrate the activities of government, but also harnesses the efforts and support of civil society to realise the national development objectives.”

*Meeting development objectives requires partnership between government and private sector*

These objectives can be realised only if the resources of the state are complemented by well-directed private sector investments and community-based initiatives. Joint frameworks for development involve hard work and planning, culminating in deliberate and considered partnership agreements. The Financial Sector Charter is one such agreement. Since its launch in October 2003, targets for transformation have been agreed, benchmarks have been set against which progress can be measured and funding levels have been negotiated to contribute to low-income housing, small and medium-sized enterprises, financing of resources for poor black farmers and public infrastructure.

*Financial Sector Charter agreement challenges Government to develop effective partnerships*

Financial institutions have set themselves ambitious targets for transformation, but in so doing they have challenged government to contribute the policies, programmes, plans and partnerships that will effectively mobilise these resources, translating Charter commitments into development projects. The *Medium Term Budget Policy Statement* signals Government's readiness for this challenge.

The MTBPS aims to encourage debate in Parliament and throughout civil society on Government's plans and priorities. Comment on the proposals set out for the 2005 Budget can be emailed to [tipsfortrevor@treasury.gov.za](mailto:tipsfortrevor@treasury.gov.za), or posted to:

“Tips for Trevor”

Ministry of Finance

Private Bag X115

Pretoria

0001