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Weathering the storm, investing for growth

- The economic advances of the past five years have benefited all South Africans through higher employment, rising public spending, strong welfare gains and substantive investments in productive capacity. The economic outlook in the short term, however, is clouded by a deterioration in the global economy, rising inflation and supply constraints. In the face of these developments, the core priorities of public policy and the 2008 Budget are focused on investment in sustainable long-term growth and progressively raising living standards.
- Economic growth is projected to slow to 4 per cent in 2008, rising to about 4.6 per cent by 2010. Gross fixed capital formation reached 21 per cent of GDP in 2007 and the pace of investment is expected to remain robust. Public sector infrastructure spending is increasing rapidly to alleviate capacity constraints and congestion in various network industries.
- The fiscal stance enables government to raise public spending in key areas – increasing fixed investment, creating jobs, boosting export capacity, fighting poverty and improving public services – while providing a cushion against global volatility. Rising fixed investment, together with further microeconomic reforms, will raise the competitiveness of the economy, while reducing constraints in key areas, such as electricity and skills.

A resilient economy building for the future

Over the past seven years the world economy has experienced rapid growth on a scale with few modern precedents. The South African economy has benefited from this global expansion, and government's far-reaching reforms have strengthened the country's economic foundation and improved its competitiveness.

Far-reaching reforms have strengthened South Africa's economic foundation

The pace of global economic growth is slowing

Yet unmistakeable signs of an international slowdown have now emerged. From the subprime mortgage crisis in the United States to the subsequent credit crunch and volatility in global financial markets, major indicators suggest that the world economy is set to decelerate over the course of this year, with a recovery only likely in 18 to 24 months.

Slower global growth, in combination with higher inflation and supply-side pressures that include shortages of electricity and key skills, will affect medium-term domestic growth prospects. Whereas the economy has grown at an average of 5.1 per cent over the past four years, GDP growth is expected to average 4.3 per cent a year over the medium term.

Government's economic policies serve as shock absorbers for the economy

Over the period ahead robust investment and favourable commodity prices will help to sustain South Africa's economic growth despite the global slowdown. Macroeconomic and fiscal strength, monetary policy and the accumulation of foreign exchange reserves provide further insurance against risks. Slower consumption growth will assist in moderating demand pressures. Policies and institutions need to remain focused on expanding economic capacity for the long term and making the adjustments required for accelerated growth once the global economy strengthens. Policy priorities include skills development and further education, industrial and trade reforms, and broadening employment creation.

Rising capital expenditure, including 2010 FIFA World Cup investments, helps to sustain growth

Government's capital expenditure programme is central to long-run growth. The public sector infrastructure programme is being rolled out and state-owned enterprises are vigorously expanding investment spending. Private-sector fixed investment, which remains robust, is also essential to raise growth potential in the years ahead. Stronger coordination between government and the private sector is being fostered, focused on long-term development and joint initiatives to overcome barriers to progress. Over the medium term, stadium construction and other investments associated with preparations for the 2010 FIFA World Cup contribute to continued growth.

Eskom's capital investment programme must be accompanied by a new pricing structure

To relieve supply constraints in the energy sector, Eskom plans to invest more than R343 billion over the next five years, increasing generating capacity by about 5 800 megawatts to ensure that the country has the electricity required to grow more rapidly, even as the electrification programme is extended to more households. Government is working with Eskom's board and management to ensure that the required finance will be available. South African electricity users –industry, mines, the public sector and households – now know that consumption needs to be held back over the period ahead, and will need to adjust over time to higher prices. A new pricing structure must reflect the full economic costs of electricity to ensure that this resource is used more efficiently and to penalise wastage.

Progress in addressing socioeconomic marginalisation

Development and rising living standards are not only about investment in physical infrastructure. South Africa faces skills shortages, and needs to step up investment in training, while shifting production towards more labour-absorbing activities.

Budget supports programmes to alleviate poverty, create jobs and improve education

While the fruits of economic growth are progressively being shared more widely than before, millions of South Africans remain at the margins of the economy, trapped in poverty and unable to benefit from rising prosperity. The 2008 Budget funds specific programmes that target more rapid job creation, improved education, broader access to public transport and strengthening the social security safety net. These measures provide the underpinning for government's anti-poverty strategy and broad-based economic empowerment.

During the period of adjustment ahead, the economy will demonstrate its resilience

Economic resilience during the period of adjustment ahead rests both on broader participation and opportunities, and on deliberate development interventions. The 2008 Budget gives practical effect to the government's "apex priorities" announced in the State of the Nation speech. Ongoing reform and effective programme implementation are required to raise the potential of the economy to 6 per cent and beyond. The core economic policy priorities include:

- Increasing employment
- Investing in productive capacity
- Raising net exports
- Reducing poverty and inequality
- Improving public service delivery.

These priorities are summarised below, followed by an overview of the *Budget Review*.

Increasing employment

The economy's employment intensity needs to be increased

Reducing joblessness remains South Africa's most critical challenge. Government remains committed to halving unemployment from its 2004 level (28 per cent) by 2014. After peaking at over 30 per cent in 2001, the unemployment rate fell to 25.5 per cent in 2007 as the economy grew at a faster pace. However, the employment intensity of the economy – the number of people needed to produce a unit of GDP – remains too low, and job creation is therefore an explicit objective in both budget planning and in the implementation of public services.

Lowering the costs of doing business and raising competitiveness through reining in inflation, increasing access to markets and trade reform are essential ingredients of a long-term employment strategy. Similarly, industrial policy aims to support labour-intensive sectors.

Budget supports labour-intensive initiatives

The 2008 Budget supports labour-intensive initiatives, including projects under the umbrella of the expanded public works programme, and social services initiatives such as early childhood education, and community- and home-based care. Funding is also stepped up for delivery of municipal services and environmental improvement projects in a more labour-intensive manner.

Support is provided to labour centres, which are increasingly serving to bridge information gaps in the location of jobs and qualified people. Learnership and internship schemes are extended through spending and taxation measures, with special attention given to technical areas. Small enterprises employ a large number of workers and measures to support small businesses, including tax reforms, are proposed.

Skills development critical to raising employment and productivity

Increasing spending on education and skills development, especially in the further education and training – and in science, engineering and technology – will contribute to more rapid economic growth and higher levels of employment. Skilled immigrants also provide the economy with additional capacity.

2008 Budget highlights

The economy and fiscal stance

- GDP growth of 5 per cent in 2007, with growth averaging about 4.3 per cent a year over the forecast period.
- CPIX inflation rising to 7.1 per cent in 2008 before declining to 4.9 per cent in 2009.
- Gross fixed capital formation projected to rise from 21 per cent of GDP in 2007 to 24 per cent in 2010.
- Estimated consolidated national budget surpluses of 1 per cent in 2007/08 and 0.8 per cent in 2008/09, with projected surpluses over the three-year period.
- Real growth in consolidated government non-interest expenditure of 6.1 per cent a year over the MTEF.
- Government contribution to national savings projected to rise from 0.8 per cent of GDP in 2006/07 to 1.5 per cent in 2010/11.
- R60 billion to support Eskom's capital financing requirements over the next five years.

Tax proposals

- Total tax relief for individuals of R7.7 billion.
- Reduction in the corporate income tax rate from 29 per cent to 28 per cent.
- A simplified tax regime for small businesses.
- R5 billion in tax subsidies over the next three years for labour-intensive industries and industrial policy.
- An electricity levy of 2 cents per kilowatt hour.
- Fuel (petrol and diesel) taxes to increase, from 2 April 2008, by 11 cents per litre.
- A packet of 20 cigarettes will cost 66 cents more.
- A 750 ml bottle of wine will cost 9 cents more.
- A 340 ml can of beer will cost 5 cents more.
- A 750 ml bottle of liquor (spirits) will cost R2.17 more.

Spending on public services

Additions to spending over the next three years:

- R33.2 billion for provinces mainly for school education, health care, welfare services and roads.
- R6.5 billion to municipalities for the extension of free basic services.
- R12.5 billion for social grants, including extension of the child support grant to children up to their 15th birthday in 2009 and lowering of the age of eligibility for men to receive the old age pension to 60.
- R9 billion in conditional grants for school building, HIV and Aids, hospital revitalisation and school nutrition.
- R8.2 billion for public transport, roads and railway infrastructure.
- R6 billion for housing, water and general built environment infrastructure.
- R2 billion for 2010 FIFA World Cup Stadiums and related infrastructure.
- R2.5 billion for industrial development and small, medium and micro enterprises.
- R2.6 billion for agriculture and land reform.
- R2.7 billion for information technology network infrastructure, police forensic laboratories and additional police personnel, and R2 billion for correctional facilities.
- R1.4 billion for higher education, research and knowledge development.
- R1 billion for programmes under the expanded public works umbrella.

Investing in productive capacity

Rising fixed investment puts economy on higher growth path

To grow more rapidly, an economy has to invest in people, infrastructure and institutions. Capacity constraints of all kinds can only be eliminated by higher levels of investment.

Since 2001, gross fixed capital formation in South Africa has risen from 15 per cent to 21 per cent of GDP. This raises the growth potential of the economy and will support the creation of jobs well into the future. Government's investment plans cover capital projects financed directly from the fiscus and those financed by public entities and state-owned enterprises.

Public investment spending makes up a significant share of gross fixed capital formation. Spending financed by the fiscus includes transfers to municipalities and provinces to broaden access to water, sanitation and electricity, to expand public transport networks, and to improve conditions in hospitals and schools. National departments continue to invest in economic infrastructure as well as prisons, police stations, and network and telecommunications infrastructure. The 2008 Budget also emphasises the need for maintaining key infrastructure.

Infrastructure investment programmes of state-owned enterprises will expand productive capacity

Eskom, Transnet, the Airports Company, water authorities and rail utilities are all investing heavily to expand capacity, improve efficiency and broaden access to services. Capital spending by state-owned enterprises grew by 32 per cent in the first nine months of 2007 and is expected to grow by 19.4 per cent a year in real terms over the next three years, financed largely by retained earnings and access to capital markets. Eskom plans to spend about R343 billion to expand capacity over the next five years, with 73 per cent of this amount allocated to build new power plants. The planned Medupi and Bravo power stations represent the largest-ever investments in South Africa, totalling about R170 billion. Transnet is also planning to expand capacity at a number of ports. Plans to construct a new fuel pipeline from the coast to the highveld are well under way.

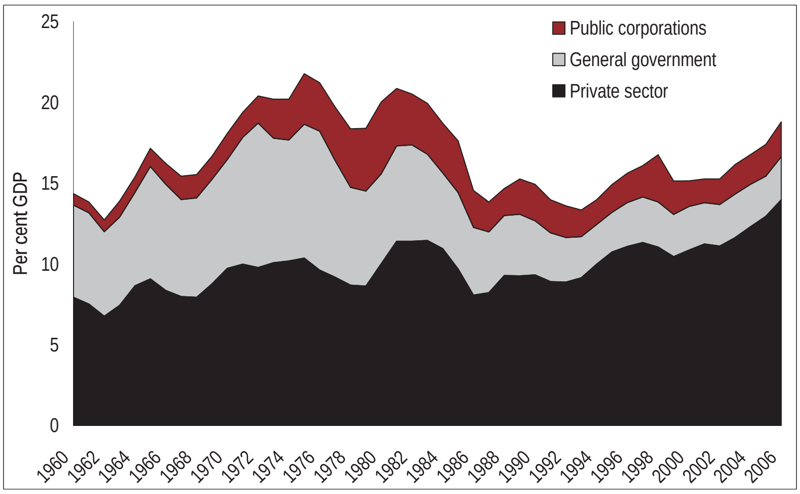
Sustained decline in investment by public enterprises since 1970s contributed to constraints

Figure 1.1 shows that investment by both general government and public corporations declined as a share of GDP from a peak in the mid-1970s. While this was to be expected given large-scale investment in entities such as Sasol, Mossgas and Iscor between 1970 and 1984, the sustained period of declining investment by state-owned entities has been a major contributing factor to the capacity constraints that the economy is experiencing today.

Government began ramping up infrastructure spending in 1994

Government began stepping up its investment spending in 1994. Over the next five years, investment by state-owned enterprises will continue to rise strongly, contributing to the goal of raising gross fixed capital formation to 25 per cent of GDP. Private-sector investment is at record-high levels, indicating confidence in the long-term economic outlook.

Figure 1.1 Gross fixed capital formation, 1960 - 2006



Appropriate tariff setting key to sustaining investment growth

The present electricity supply shortfall is a timely reminder of the importance of long-term planning and decision-making for economic growth and development. This applies not only to planning networks, adapting to climate change and setting targets for emission reduction – it is also central to the economics of tariff-setting. Sustainable energy and water investments, reduced wastage and effective maintenance of infrastructure will require phased increases in tariffs over the years ahead, along with more efficient resource use and better regulation.

Raising net exports

South Africa's current account shifted from a surplus of R10 billion in 2002 to a deficit of R143 billion in 2007. Three principal factors have contributed to the higher deficit:

- A relatively low rate of savings, requiring capital from abroad to fund growing investment needs
- Increased imports of capital equipment associated with rising investment
- Inability to meet rising demand through domestic industry.

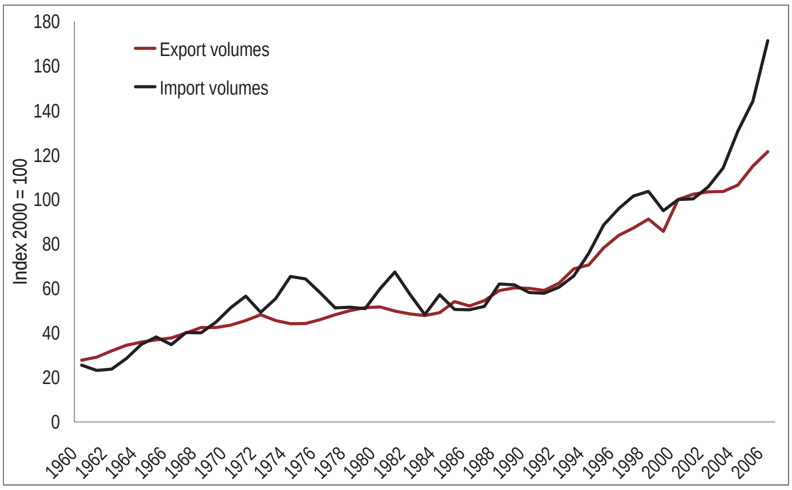
Export volumes have not kept pace with growth in imports

The high current account deficit signals the importance of strengthening trade and industrial policy. As Figure 1.2 shows, export volumes have not kept pace with growth in imports, especially since 2002. This makes the economy more vulnerable to external shocks, because foreign investment may wane during periods of greater global economic volatility. Given the high import intensity of capital equipment, it is essential to raise exports to pay for higher capital investment.

Higher exports will also support job creation

The international panel of economists advising government has pointed out that export industries tend to be comparatively labour-intensive, so that trade promotion also contributes to broadening economic participation.

Figure 1.2 Index of import and export volumes, 1960 - 2006



Raising net exports requires South African industry to develop a more competitive profile. Microeconomic support measures include appropriate steps in reforming import tariffs and customs procedures, cutting regulatory red tape, improving the efficiency of port operations, research and development incentives, assistance with technological development, marketing interventions, and targeted training and skills development programmes. The 2008 Budget includes substantial spending allocations and tax measures directed at industry and trade development.

Further microeconomic reforms are required to raise net exports

Reducing poverty and inequality

Since 2002, the number of people living in poverty has declined, mainly due to rising employment and the expansion of the social grant system. Furthermore, the expansion of the social wage – a reference to free or subsidised services such as education, health, public transport, housing, water, electricity and sanitation – has also contributed to rising living standards. Yet poverty and inequality remain defining features of South Africa's social and economic landscape.

Reduction in poverty driven by rising employment and widening social grant system

Government's comprehensive anti-poverty strategy synthesises a number of policy areas and programmes that are already under way. The strategy rests on three legs: broadening social assistance, creating jobs and enhancing the social wage.

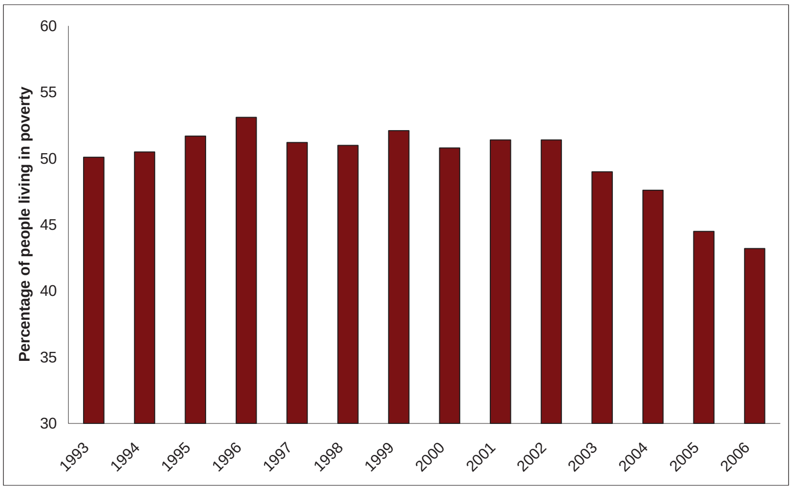
Further expansion of social wage will support poverty alleviation efforts

The social wage is also being expanded through further investment in basic services, expanding the school nutrition programme and ensuring access to education for the poor. Rising public transport subsidies also add to the social wage. Early learning opportunities are being expanded in poor communities, making success in later years in school more likely.

New proposals to support small business and to speed up land and agrarian reform are supported, and agricultural extension services are stepped up. These measures will help to draw more people into economic activity.

Land and agrarian reform important for reducing rural poverty

Figure 1.3 Poverty head count measure[1], 1993 - 2006



1. The poverty measure used is R3 000 per person per year in constant 2000 prices. Source: Van der Berg, et al (2006) based on AMPS data from various years, as quoted in Development Indicators, Mid-term Review, The Presidency.

In 2007, government announced that it would prepare proposals for significant reform of the social security system, providing greater security for all South Africans. Work on these reforms is continuing, with the focus on developing broad consensus on the design of a contributory retirement and risk benefit system.

Continuing social security reforms include extension of child support grant and equalisation of old age pension eligibility

As part of these reforms, the present social assistance net is gradually being expanded. The child support grant will be extended to children up to the age of 15 in 2009, while government is also considering the introduction of conditionalities such as school attendance and immunisation as criteria for receipt of the child support grant. Over the next three years, men between the age of 60 and 64 will benefit from the old age pension (until now, men were only eligible from age 65). The means tests used to ascertain need and eligibility for social grants are being reviewed to broaden the coverage of these grants and to reduce administrative difficulties.

Improving service delivery

Focus on implementation to help bridge the gap between spending and service delivery

Over the past five years, strong growth in public spending has not been matched by a concomitant improvement in service delivery. The period ahead must be characterised by greater focus on implementation – building institutions, capacity and systems. Increasing public accountability and legislative oversight are important elements of this effort.

The 2008 *Estimates of National Expenditure* includes more explicit measurable objectives and performance indicators for national departments. Many of these are quantifiable and can be tracked over time. Under the auspices of the Presidency's government-wide monitoring and evaluation system, the National Treasury has issued guidelines to support the development of sharply focused indicators that can be used to enhance accountability.

In developing the 2008 Budget, national departments were asked to identify about R2.3 billion in explicit savings from more efficient spending, with particular focus on reducing expenditure on unnecessary entertainment, travel, consultants and functions. Government is also a key part of the national plan to reduce energy consumption, which, in the medium term, will contribute to reducing costs.

Departments asked to identify explicit efficiency savings

Cabinet has taken a strong stance against departments that receive qualified audit reports. Departments have been asked to set out clear plans to fix recurring problems identified by the Auditor-General. Sound financial management is one pillar of good governance, and public trust in the way in which public resources are managed is central to this government's vision of people-centred democracy. In addition, government is taking various measures to reduce corruption in all levels of government, particularly in procurement systems.

Various measures are being taken to reduce corruption in government

Improving service delivery is a central priority for national, provincial and local government. It is also a key ingredient in the broader services economy – tourism and hospitality, retail enterprises, travel, business and financial services. As South Africa prepares to host the 2010 FIFA World Cup, there is a greater need for investment to promote higher standards of customer service. This requires renewed joint endeavours by the public and private sectors.

Overview of the 2008 Budget

Economic policy and macroeconomic outlook

Chapter 2 reports on economic trends and developments in major sectors of the economy, and discusses a number of reforms required to lift the rate of economic growth over the long term.

Market turbulence and the sharp economic slowdown in the United States are expected to have a negative impact on international growth. Financial markets have experienced considerable losses at the start of 2008. Global growth is forecast to slow from 4.9 per cent in 2007 to 4.1 per cent in 2008. Emerging markets may be negatively affected by reduced demand in core markets, although continued strong growth is expected in China and India in particular.

A US recession will make its mark on the global economy

Despite this less favourable global outlook, structural reforms undertaken during a difficult period in South Africa's economic transformation in the 1990s have placed the country on a higher growth path and increased the resilience of the domestic economy. South Africa's macroeconomic position is considerably better than in previous episodes of financial market contagion. The stronger reserves position and floating exchange rate will cushion the economy against shocks by reducing pressure on monetary policy. Changes to the exchange control regime are further indication of policy strength and resilience in our financial markets.

Structural reforms have contributed to building a more resilient domestic economy

Domestic economic growth remained buoyant at an estimated 5 per cent in 2007. GDP growth is projected to slow to 4 per cent in

2008, rising to 4.2 per cent in 2009 and 4.6 per cent in 2010. The near-term GDP forecast takes into account softer growth in household consumption due to higher interest rates, as well as slower global growth and the impact of power shortages on domestic industry. Growth is, however, supported by rising investment trends in both the public and private sectors, which tend to complement each other.

High commodity prices and strong fixed investment support growth

The economy continues to benefit from record-high commodity prices and strong fixed investment growth, which will raise capacity over time. Sustained economic growth has boosted job creation – with about 741 000 jobs added over the last two years – and enabled higher fiscal transfers, contributing to rising living standards. Net job creation continued in 2007, though at a slower pace than the previous three years. The unemployment rate remained about 25.5 per cent in 2007.

Current account deficit increases South Africa's vulnerability

The current account deficit increased to an estimated 7.2 per cent of GDP in 2007 compared with 6.5 per cent in 2006. Export growth remains sluggish and imports have been driven by high oil prices and strong investment. Sharp increases in commodity prices have benefited the terms of trade, raised national income and boosted tax revenues. The outlook for commodity prices remains positive, but the current account deficit is expected to remain large, reaching 8 per cent of GDP in 2010, driven in part by rising fixed investment.

High inflation driven by food and oil price spikes

Rising inflation presents an important policy challenge. Inflation increased to above 6 per cent in April 2007 and has remained above the target range, driven by sharp food and oil price increases, along with capacity constraints and strong demand in sectors such as construction. Domestic demand has begun to moderate in response to cumulative interest rate increases of 4 percentage points between June 2006 and December 2007, which should in due course lead to a decline in inflation. CPIX inflation is expected to average 7.1 per cent in 2008 and to decline to 4.9 per cent in 2009.

Table 1.1 Macroeconomic outlook – summary

	2007	2008	2009	2010
	Estimate		Forecast	
Real growth				
Household consumption	7.0%	3.7%	3.8%	4.2%
Capital formation	15.3%	9.6%	9.7%	9.9%
Exports	7.1%	3.8%	6.0%	6.4%
Imports	11.0%	7.0%	6.9%	6.3%
Gross domestic product	**5.0%**	**4.0%**	**4.2%**	**4.6%**
Consumer price inflation (CPIX)	6.5%	7.1%	4.9%	4.7%
Balance of payments current account (percentage of GDP)	-7.2%	-7.3%	-7.8%	-8.0%

Fiscal policy

Chapter 3 discusses fiscal policy.

Fiscal policy supports growth while also serving as a cushion

Average annual real growth in government spending in excess of 10 per cent since 2003/04 has enabled the public sector to make a substantial contribution to the welfare of all South Africans through expanding the social wage, increasing transfers to households, and accelerating infrastructure investment and service provision. Prudent policy choices have supported the stability and sustainability of the national finances, reflected in improving budget balances since 2004/05.

Table 1.2 Consolidated national government

R billion	2007/08	2008/09	2009/10	2010/11
Main budget revenue	**558.0**	**625.4**	**692.9**	**759.0**
Main budget expenditure	**542.1**	**611.1**	**681.6**	**744.7**
Debt service cost	52.8	51.2	51.1	51.2
Non-interest expenditure[1]	489.3	559.9	630.5	693.5
of which: Contingency reserve	–	*6.0*	*12.0*	*20.0*
Social security funds				
Revenue	22.5	24.7	27.3	30.0
Expenditure	18.0	20.5	22.5	23.8
Consolidated national budget[2]				
Revenue	580.4	650.0	720.1	789.0
Expenditure	560.1	631.5	704.1	768.5
Budget balance	**20.3**	**18.5**	**16.0**	**20.5**
GDP	*2 045.5*	*2 286.9*	*2 506.9*	*2 758.6*
Percentage of GDP	*1.0%*	*0.8%*	*0.6%*	*0.7%*

1. Includes transfers to provinces and local government, the National Skills Fund and sectoral skills development funds.

2. Flows between funds are netted out.

The 2008 Budget takes account of greater disequilibrium in the international economic environment. Given these conditions, and the fact that revenue growth is still likely to benefit from high commodity prices, positive budget balances will help to moderate demand pressures on inflation and the current account deficit in the short term.

Taking note of cyclical factors, government is budgeting for a surplus

The 2007 *Medium Term Budget Policy Statement*, which set out much of the policy context for the 2008 Budget, published an estimate of the cyclical revenue received by the fiscus, and noted that in recent years South Africa has benefited from temporary revenue gains associated with high commodity prices. In this context, government has chosen to budget for a surplus. Along with a steady accumulation of reserves, this also provides a cushion against the present turbulence in financial markets.

The fiscal stance supports macroeconomic stability and contributes to higher growth. Key features of the consolidated national budget include the following:

- Additional main budget resources totalling R115.6 billion over the 2007 Budget baseline. Expenditure grows 6.1 per cent in real terms over the next three years. Capital expenditure grows by 10.2 per cent a year in real terms over the next three years.
- Consolidated government revenue grows in line with the economy, averaging about 28.6 per cent of GDP over the medium term.
- Debt service costs show a continued decline as a result of prudent fiscal management.

- Consolidated budget surpluses of 0.8 per cent of GDP in 2008/09, 0.6 per cent in 2009/10 and 0.7 per cent in 2010/11 are forecast.

Public spending growth moderates to a healthy 6.1 per cent

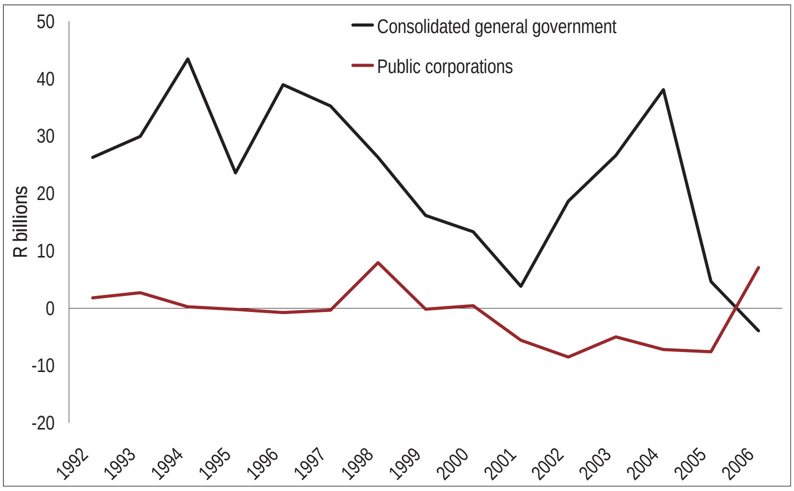
Over the next three years, public spending is projected to grow in real terms by a healthy 6.1 per cent, down from nearly 10.4 per cent in 2007/08. A more moderate rate of expenditure growth will assist in containing overall demand, while protecting public spending in the event of an economic slowdown.

Fiscal stance provides more room for state-owned enterprises to borrow in the capital markets

The more prudent fiscal stance also provides room in the capital markets for state-owned enterprises to borrow to finance their capital investment programmes. Over the next three years, state-owned enterprises are projected to borrow about R133 billion, mainly from the domestic debt market, to finance their estimated capital spending of R271 billion. The budget framework includes a contribution to support Eskom's capital-raising to finance investment in generating capacity. Government will provide finance of up to R60 billion on terms structured to assist in meeting medium-term cash requirements. An estimated R20 billion of this will flow during the medium-term expenditure framework period, provided for in the contingency reserve.

The public sector borrowing requirement is projected to rise from a surplus of 0.3 per cent of GDP in 2006/07 to a deficit of 1.4 per cent by 2010/11.

Figure 1.4 Public sector borrowing requirement, 1992 - 2006



Tax policy

Chapter 4 discusses tax policy, revenue trends and tax proposals for 2008/09.

Tax policy supports economy policy objectives

Tax revenue growth, which has a large cyclical component, is expected to moderate in line with a slower rate of economic growth over the medium term. The tax proposals outlined in Chapter 4 provide for moderate relief in personal income tax and a decrease in the corporate tax rate in recognition of the importance of private-sector investment to continued economic buoyancy.

Table 1.3 Summary of tax proposals

R billion	2007/08 Budget estimate	2007/08 Revised estimate	2008/09 Budget estimate
Tax revenue (gross)	556.6	571.1	652.8
Non-tax revenue	11.1	11.6	12.0
Less: SACU payments	-23.1	-24.7	-28.9
Total revenue	**544.6**	**558.0**	
Revenue before tax proposals			**635.9**
Tax proposals			**-10.5**
(Net) personal income tax relief			-7.7
Business taxes			-7.4
Taxes on goods and services			4.6
Revenue after tax proposals			**625.4**

Tax revenue in 2007/08 will amount to R571.1 billion, which is R14.5 billion higher than the figure budgeted a year ago and R5 billion higher than the revised figure indicated in the October 2007 *Medium Term Budget Policy Statement*.

Supply-side interventions are proposed to support sustainable growth

The 2008 Budget proposes additional measures to support small businesses, reducing compliance costs and encouraging the formalisation of informal businesses. Various supply-side interventions are proposed to support sustainable growth and to boost job creation. Government intends to embark on a coordinated approach, including the use of taxes and incentives, to support environmental protection.

The 2008 Budget proposes R10.5 billion in net tax relief. The proposals include:

- Personal income tax relief for individuals amounting to R7.7 billion
- A reduction in the headline corporate tax rate by one percentage point from 29 to 28 per cent
- A simplified tax package for very small businesses with an annual turnover of R1 million or less
- An increase in the compulsory VAT registration threshold from an annual turnover of R300 000 to R1 million
- R5 billion in tax subsidies over the next three years to support the emerging industrial policy
- A review of learnership allowances to encourage apprenticeships
- An electricity levy of 2 cents per kilowatt hour to support demand-management initiatives and to contribute to reducing reliance on carbon-based energy over the longer term.

Asset and liability management

Chapter 5 discusses developments in the domestic and international debt markets, government's debt portfolio, borrowing plans, contingent liabilities, credit risk and financial management of the state-owned enterprises.

Fiscal surplus provides more policy options

Government's positive fiscal balance provides greater flexibility in debt management choices. This debt portfolio will be actively managed to minimise risks and external vulnerability in the light of the high current account deficit. Government budget surpluses mean that there will be a net reduction in state debt, and that government will be a net redeemer of debt going forward. Over the medium term, government projects a net negative borrowing requirement of R42.1 billion, contributing to an increase in cash balances of R43.2 billion by March 2011.

Table 1.4 Projected state debt and debt costs

R billion	2007/08	2008/09	2009/10	2010/11
Net loan debt (end of year)	**456.1**	**449.6**	**444.5**	**438.0**
Percentage of GDP	*22.3%*	*19.7%*	*17.7%*	*15.9%*
Net domestic debt	377.7	367.7	364.6	353.4
Foreign debt	78.4	81.9	79.9	84.6
State debt cost	**52.8**	**51.2**	**51.1**	**51.2**
Percentage of expenditure	*9.5%*	*8.2%*	*7.4%*	*6.7%*
Percentage of GDP	*2.6%*	*2.2%*	*2.0%*	*1.9%*

Net loan debt and cost to service debt continue to decline

Surplus cash will be used to reduce the stock of debt in absolute terms and to achieve other macroeconomic objectives, such as a continued reduction in external vulnerability. Government's net loan debt declines from 22.3 per cent of GDP at the end of 2007/08 to 15.9 per cent of GDP at the end of 2010/11, while debt service costs continue to decline.

Upgrades by Fitch and Moody's in 2007

During 2007, Moody's Investor Service and Fitch Ratings revised South Africa's sovereign credit ratings from "stable" to "positive". A key factor behind the revised outlook is the country's reduced external vulnerability, due in large part to the prudent fiscal stance, the accumulation of reserves and the active management of external debt.

The National Treasury has completed financial modelling on the state-owned entities and assessed their treasury operations. This will allow for better financial oversight and ultimately improved performance of these institutions.

Social security reforms

Chapter 6 covers government's social grants programmes and the social security funds, and reviews the status of proposals for broader social security and retirement reforms.

Continuing expansion of the social security system

The number of social grant beneficiaries has grown from about 3 million in 1997 to a projected 12.4 million by the end of 2007/08. The main area for growth in beneficiaries has been the child support grant, but access to other grants has also improved.

Contributory social security funds provide conditional income support or compensation for defined-risk events. The present social security schemes include the Unemployment Insurance Fund (UIF), the Compensation Funds and the Road Accident Fund (RAF). They are financed through mandatory levies and taxes. These funds are expected to run a combined cash surplus of about R4.2 billion in 2008/09, compared with a surplus outcome of about R4.5 billion in the previous financial year, reflecting continued substantial cash surpluses at the UIF and Compensation Funds.

Progress in the design of a new contributory social security system

Progress has been made towards agreement on design options for a basic social security contribution and standard benefits, while further research and consultation is required on institutional arrangements and governance, and the design and regulatory reform proposals for private retirement funding arrangements. A government task team is driving the reform process. Efforts in 2008 will shift to more intensive engagement with the details of reform options, draft legislation, and institutional reform and implementation challenges. A task team has been established by the National Economic Development and Labour Council to facilitate formal consideration of reform proposals by government, business, labour and community representatives.

Medium-term expenditure allocations and the division of revenue

Chapter 7 discusses government's policy priorities and related spending proposals in 2008/09 and over the medium term.

Budget takes into account "apex" priorities announced in State of the Nation address

Government's Plan of Action covering the period 2004 to 2009 provides the basis for determining the spending priorities of the 2008 Budget. In addition, the budget takes into account the "apex priorities" announced in the 2008 State of the Nation Address. They include:

- Accelerating economic growth and development
- Speeding up the infrastructure programme
- Improving the effectiveness of interventions directed at the informal economy and poverty eradication
- Enhancing education and training
- Advancing towards the goal of health for all
- Revamping the criminal justice system to intensify the fight against crime
- Strengthening the machinery of government to ensure that it has the capacity to respond to development imperatives
- Enhancing South Africa's system of international relations, with particular focus on some African issues and South-South relations.

Non-interest public spending is projected to grow by about 6.1 per cent a year in real terms, slightly lower than the average over the past five years. The 2008 Budget adds about R115.6 billion to the spending plans set out in the previous budget. Additions to baseline target government priorities, taking into account the capacity of departments, provinces and municipalities to spend, as well as the quality of their plans.

Division of revenue reflects prioritisation of social and household services

Trends in the division of revenue between national, provincial and local government reflect a prioritisation of social and household services, with a slightly larger share of the additional resources going to provinces and municipalities. The largest category of additional allocations, about R16 billion, is directed to investment in water, sanitation and electricity infrastructure, as well as providing the resources necessary to broaden access to free basic services. Together with increasing investment in economic infrastructure, these investments support future growth.

Table 1.5 Division of revenue

R billion	2007/08	2008/09	2009/10	2010/11
National allocations	246.9	273.9	302.7	324.1
Provincial allocations	205.2	238.1	268.2	293.6
Equitable share	*172.9*	*199.4*	*225.5*	*246.3*
Conditional grants	*32.4*	*38.7*	*42.7*	*47.3*
Local government allocations	37.1	41.9	47.7	55.7
Total allocations	**489.3**	**553.9**	**618.5**	**673.5**
Changes to baseline				
National allocations	6.8	13.4	17.4	24.8
Provincial allocations	1.6	7.9	12.7	25.0
Equitable share	*1.6*	*5.9*	*9.7*	*17.6*
Conditional grants	–	*2.0*	*3.1*	*7.5*
Local government allocations	2.9	2.7	2.6	9.1
Total	**11.3**	**24.0**	**32.7**	**58.9**

Human capital formation critical to driving long-term growth

Spending plans reflect a continuing commitment to develop human capital in South Africa, with increased transfers to higher education institutions and for research and development. About R2.3 billion is allocated for industrial policy initiatives.

The criminal justice sector receives R8.2 billion in additions to baseline, mainly for network and information technology infrastructure, more police and prosecutors, forensic laboratories and prison space. The Home Affairs turnaround strategy also receives further support. Social security grants receive additional resources to cover the higher value of the grants and to phase in reforms to the child support and old age grants.

Costs of public service wage agreement and occupation-specific increases are reflected

Additional resources are also provided to take account of the cost of the 2007 public service salary agreement as well as occupation-specific salary dispensations, in particular for teachers and health workers.

Table 1.6 Consolidated expenditure growth

R billion	2007/08 Revised estimate	2008/09 Budget estimate	% Average 2007/08–2010/11
Education	105.7	121.1	11.5%
Health	68.2	75.5	10.6%
Social security and welfare	92.2	105.3	10.8%
Housing and other social services	45.5	52.6	14.4%
Police, prisons and courts	58.4	64.9	11.1%
Defence and intelligence	28.6	30.4	6.5%
Economic services	143.2	165.2	9.3%
General administration	34.9	40.3	10.4%
Contingency reserve	–	6.0	
Non-interest expenditure	**576.8**	**661.3**	**10.6%**
Interest	55.8	55.0	-0.1%
Total expenditure	**632.5**	**716.2**	**10.6%**

An additional R46 billion for provinces

Provinces receive significant increases (R46 billion in total), especially for education, welfare services and health, including R2.2 billion for the housing programme. The priorities at a provincial level include:

- Education – Early childhood education and inception-year schooling, school infrastructure, school nutrition, textbooks and teacher remuneration.
- Health – Hospital revitalisation, tertiary health services, treatment of multidrug-resistant TB, HIV and Aids programmes, and community- and home-based care.
- Welfare services – Early childhood development, more social workers and drug-treatment centres.
- Economic services – Rural and provincial roads. Tourism infrastructure, agricultural extension services and the expanded public works programme.

Conclusion

The *Budget Review* sets out the economic rationale and policy context for the major decisions embedded in the Budget. The 2008 Budget takes into account adjustments required in response to capacity constraints and the changed economic environment, while contributing to meeting government's objective of raising the level of economic growth and reducing poverty.

Sound macroeconomic policy will protect the economy from global volatility, and rising investment in human and physical capital will contribute to the removal of domestic constraints to higher growth. Government's fiscal stance, tax policies, financing strategy and resource allocations all contribute to the achievement of South Africa's economic and social objectives.

Other budget documentation

In addition to the *Budget Review*, the National Treasury produces a series of other documents relating to the Budget:

- The *Budget Speech* delivered by the Minister of Finance on Budget Day outlines the main policy features of the Budget.
- The *Division of Revenue Bill* sets out the division of nationally raised revenue across the three spheres of government, equitable share and conditional grant allocations to provinces and local government.
- The *Appropriation Bill* sets out the amounts to be appropriated by Parliament for each national vote, and the purpose of each programme.
- The *Estimates of National Expenditure* provides detailed information on allocations to national departments, key policy developments and measurable objectives for each programme.
- The *Estimates of National Revenue* sets out the main revenue estimates both before and after tax policy changes.
- The *People's Guide* is a popular summary of the Budget produced in all 11 official languages, and in Braille.

Two annexures to the 2008 *Budget Review* are available on the National Treasury website. These are Annexure W1 (Explanatory memorandum to the division of revenue) and Annexure W2 (Structure of the government accounts).

These documents and other fiscal and financial publications are available at: www.treasury.gov.za.