

Overview of the 2001 Budget

The policies pursued since 1996 of fiscal consolidation and macroeconomic reform have held South Africa in good stead through a period of dramatic political and economic transition. The 2001 Budget builds on these achievements.

The deficit has been lowered from 4,6 per cent of GDP in 1996/97 to 2,4 per cent, national debt has been reduced as a percentage of GDP, substantial cuts in income tax have been made and a thorough overhaul of spending policies and programmes is in progress.

The 2001 Budget sets out a growth-oriented agenda of improved spending, significant increases in infrastructure allocations and ongoing tax reform, within the sound framework of fiscal management established over the last five years.

Introduction

The 2001 Budget is presented to Parliament against the background of a steady recovery in economic growth and renewed focus in public policy on microeconomic and structural reforms.

Budget to support microeconomic reforms

Over the next three years, government spending will grow strongly in real terms. Supplementary allocations for investment and maintenance of infrastructure will support growth and industrial development, crime prevention will be reinforced, skills development funding increases and programmes aimed at overcoming poverty remain a key priority.

Spending increases on priority public services

Tax proposals this year include further relief for individuals, incentives for investment and a diesel rebate for primary sector producers. More effective tax administration continues to contribute significantly to government revenue.

Further tax relief

The budget deficit will remain well within prudent limits over the next three years. Taking into account anticipated proceeds from state asset restructuring and foreign borrowing, Government will begin to repay long-term domestic debt in 2001/02.

Restructuring proceeds to reduce debt

Budget documentation

Budget speech and other budget documents

The *Budget Speech* is the main statement of budget policy, and outlines key spending plans, tax proposals and the economic and social context within which these plans have been developed.

New format for Estimates of Expenditure

This year, Treasury is tabling an entirely new document, *the Estimates of National Expenditure*, which replaces the *National Expenditure Survey* and the printed *Estimate of Expenditure*. It details the objectives of each Government department, their spending plans, programmes, outputs and a set of service delivery indicators. The new format of the *Estimates* aims to strengthen the accountability of government and to enable budget allocations to be assessed alongside policy developments and output measures.

In addition to the Speech and the *Estimates of National Expenditure*, the Minister of Finance tables several other budget documents in the Assembly:

- The *Budget Review* provides an overview of economic developments and developments in the public finances.
- The *Estimate of Revenue for the year ending 31 March 2002* sets out revenue projections before and after tax proposals.
- The *Division of Revenue Bill* divides nationally raised revenue between the national, provincial and local spheres of government, and provides details of transfers to sub-national governments. An explanatory memorandum to the Bill is included as Annexure E of the *Budget Review*.
- The *People's Guide* is a straightforward summary of the budget highlights, published in five official languages.

Guide to the Budget Review

Budget Review contents

The Budget Review is an explanatory note to the budget. It sets out Government's tax, spending and fiscal policy priorities and the economic and social context within which these are framed. It also provides detailed public finance statistics and several explanatory annexures.

- Chapter 1 provides an overview of the budget.
- Chapter 2 discusses macroeconomic policy, recent trends and medium-term prospects for the economy.
- Chapter 3 outlines fiscal policy considerations and the overall budget framework.
- Chapter 4 outlines changes in tax policy, and provides estimates for revenue over the next three years.
- Chapter 5 reviews Government's restructuring of assets, debt management issues and borrowing strategy.
- Chapter 6 summarises the medium term expenditure proposals.
- Chapter 7 explains the division of revenue between national, provincial and local governments and trends in provincial and local government finances.

Highlights of the 2001 Budget

On the economy:

- The economy grew by about 3,0 per cent in 2000 and is expected to grow by 3,5 per cent a year over the next three years.
- Government is well set to meet its target for CPIX of between 3 to 6 per cent in 2002, with inflation expected to fall steadily throughout 2001.
- The positive effects of recent international trade agreements and the competitiveness of the rand will boost both export growth and inward investment.
- The restructuring of state assets, especially the initial public offering of Telkom in 2001, will increase foreign direct investment.
- The real effective exchange rate is projected to stabilise after its depreciation during 2000.

On the spending side, over the next three years:

- R7,8 billion increased infrastructure spending directed towards repairing flood damaged infrastructure, new investments in school building, roads, water and sanitation projects and rural development initiatives.
- R16 billion in additional money to provinces to strengthen social service delivery and enhance the capacity of provinces to deal with HIV/Aids.
- R4 billion to the criminal justice sector for an improved salary dispensation and other efficiency enhancing initiatives.
- R2 billion to administrative departments including SARS aimed at improved tax administration, and Home Affairs to technical capacity.
- R2,6 billion additional to local government for infrastructure and to support the provision of free basic services.

On tax:

- Personal income taxes have been cut, putting R8,3 billion back into the pockets of low and middle-income taxpayers.
- R600 million has been allocated for a wage incentive to encourage employment and learnerships.
- R3 billion has been allocated over the next 4 years for investment incentives for strategic industrial projects.
- An accelerated depreciation regime is proposed for small businesses.
- The annual interest and dividend income exemption is raised by R1 000.
- Tax on illuminating paraffin has been removed to lower fuel costs, especially for the rural poor.
- A diesel concession is proposed for primary producers to lower their input costs and enhance competitiveness.

Economic policy and outlook

The South African economy is adjusting well to the challenges posed by a changing global economy. The foundations are being laid for improved long-term economic growth – particularly in vital areas of policy consistency, the investment environment and infrastructure development. A series of growth-orientated microeconomic reforms will complement and sharpen the broader structural changes that have taken place through the economy.

Adapting to global change

The realignment of the exchange rate in recent years has contributed to the competitiveness of South African industry. However, uncertainty in international financial markets impacted negatively on

Increased competitiveness

the rand in 2000. The currency is expected to stabilise in the period ahead.

Improving the quality of spending

Social development and improved economic performance depend on gains in public sector delivery, restructuring of state enterprises and more vigorous capital formation. Investment in communications, transport and education are especially critical for sustained, accelerated growth.

Economic growth and employment

Accelerating economic growth

The economy grew by about 3,0 per cent in 2000, driven by steady gains in a number of sectors and a large increase in agricultural production. This was the fastest rate of growth for the economy since 1996.

Last year's economic performance reflects the rapid advances made primarily in specialised manufacturing industries, financial services and telecommunications. Tourism and related services sectors continue to attract investment and exhibit strong growth potential.

Inflation and the real exchange rate

A more competitive exchange rate and low inflation underpin the ongoing rapid expansion of exports in new and diverse manufacturing sectors, attracting investment and improving prospects for job creation.

Human capital development

Government recognises that progress in the quality of schooling, promotion of early learning opportunities and deepening the further education and higher education sectors are critical investments in future prosperity. Skills development receives a further boost this year as the financing of new learnerships get under way.

Increasing informal economic activity

The employment trends in several formal sectors of the economy have been disappointing in recent years. However, informal economic participation has expanded and there is evidence of considerable mobility and rising incomes outside of the formal economy.

Further steps being taken to reinforce growth include:

- Government's lower borrowing requirement, which will add to higher savings and lower interest rates
- Tax relief contributing both to domestic demand and competitiveness
- Increased allocations for social and economic infrastructure
- Further restructuring of state enterprises to improve efficiency, increase dividend flows and reduce debt.

International trade and finance

Current account deficit low

The current account deficit remained low (-0,1 per cent of GDP) in 2000 – reflecting both improved export performance and a moderation of import demand.

Global integration

The rapid integration of South Africa into the world economy is reflected in the increase in real merchandise trade relative to GDP.

Exports reached 18,8 per cent of GDP in 2000, up from 11,5 per cent a decade ago.

Export performance is set to improve over the next decade as exporters take advantage of the opportunities presented by the US Africa Growth and Opportunity Act, the free trade agreement with the European Union, and expanding trade links with Latin America and within SADC.

*Prospects for exports
bullish*

Diversification in the economy can also be seen in the development of tourism and other services exports, which have increased from 12 to 15 per cent of total exports over the last decade, while service imports have remained around 16 per cent of total imports.

*Trade in services continues
to strengthen*

Inflation and price stability

The 58 per cent increase in international oil prices (in US\$ terms) in 2000 led to a modest rise in inflation. While the domestic component of producer price inflation increased last year, structural inflation pressures, particularly unit labour costs and the pricing power of firms, continue to moderate.

*Oil prices temporary threat
to monetary stability*

Inflation as measured by the CPIX ended the year at 7,6 per cent, after having reached 8,1 per cent in October. Consumer prices are expected to decline steadily in 2001.

*CPIX and structural
inflation remain moderate*

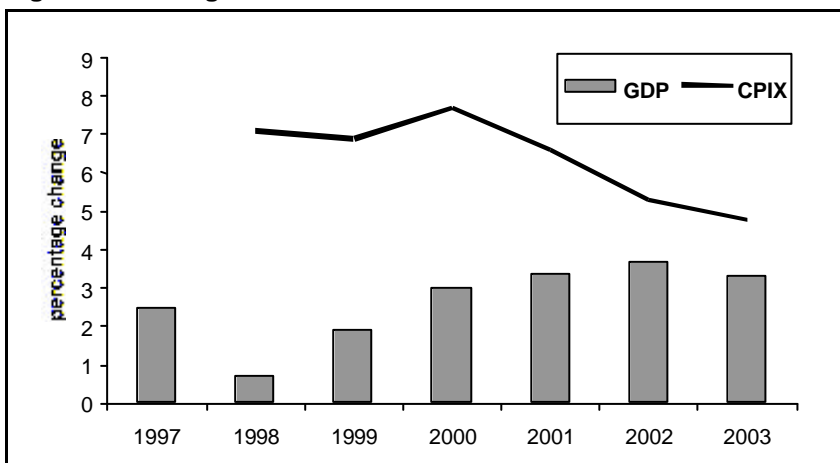
Over the medium term, declining inflation and the likelihood of further interest rate reductions in the United States and Europe should permit some easing of interest rates in South Africa.

Macroeconomic forecast

Economic growth is expected to continue strengthening in 2001 across most sectors. Economic growth is projected to average 3,5 per cent over the next three years. The more competitive real exchange rate should sustain prospects for manufactured exports, while steady growth in household spending will impact broadly on demand.

Broad-based growth

Figure 1.1 GDP growth and CPIX



Macroeconomic projections are summarised in table 1.1 and discussed in more detail in Chapter 2.

Table 1.1 Summary of macroeconomic projections

	2000	2001	2002	2003
Gross domestic product (R billion)	875,9	965,2	1 050,2	1 133,8
Real GDP growth (%)	3,0	3,5	3,7	3,3
Consumer price inflation				
Headline CPI (%)	5,3	6,1	4,9	4,6
CPIX (%)	7,7	6,6	5,3	4,7

Fiscal policy and the budget framework

Growth-oriented fiscal stance

The improved outlook for the economy described in Chapter 2 provides a firm foundation for the decidedly growth-oriented fiscal policy stance of the 2001 Budget.

Revised budget framework

Increased spending on public services

The revised economic outlook allows Government to increase allocated spending on public services by R10,2 billion in 2001/02 and R16,0 billion in 2002/03 above the levels projected in the 2000 Budget forward estimates. These adjustments compensate for somewhat higher anticipated inflation and raise real non-interest expenditure growth to 3,8 per cent a year over the next three years.

The revised Medium Term Expenditure Framework includes a R7,8 billion supplementary infrastructure investment and maintenance allocation, part of which will go to repair flood-damaged facilities.

Declining debt costs as per cent of GDP

Debt service costs on the main budget are expected to fall from 5,5 per cent of GDP in 1999/00 to 4,4 per cent in 2003/04, releasing some R10 billion for spending on services. The downward trend in debt costs relative to GDP follows the steady reduction in the budget deficit since 1992/93, lower interest rates in recent years and an increase in the anticipated proceeds from state asset restructuring.

Lower tax burden

Following several years of buoyant revenue growth, the substantial personal income tax relief announced in the 2000 Budget has led to an easing of the ratio of national revenue to GDP. Tax relief will again boost household spending power and, in particular, improve the disposable income of low- and middle income workers.

Extended framework includes social security funds

The overall framework for the national budget includes the revenue and expenditure of social security funds and estimates of foreign grants and technical assistance to government agencies. The consolidated national budget accounts, set out in Table 1.2 below, comprise:

- Revenue and expenditure of the National Revenue Fund (the main budget).
- Receipts and expenditure of the RDP Fund and foreign technical co-operation assistance to government agencies.
- Social security funds established by statute.

Table 1.2 The consolidated national budget framework

R billion	2000/01	2001/02	2002/03	2003/04
National Revenue Fund				
Revenue	213,4	233,4	252,9	273,1
Expenditure	235,0	258,3	277,3	297,5
Main budget deficit(-)	-21,7	-24,9	-24,5	-24,4
<i>Percentage of GDP</i>	<i>2,4</i>	<i>2,5</i>	<i>2,3</i>	<i>2,1</i>
RDP Fund & foreign technical cooperation				
Receipts	1,0	0,8	0,8	0,8
Social security funds				
Revenue	7,8	8,4	8,8	9,2
Expenditure	8,0	8,0	8,4	8,8
Consolidated national budget				
Revenue	222,1	242,6	262,4	283,1
Expenditure	243,7	267,1	286,5	307,1
Deficit(-)	-21,6	-24,4	-24,0	-23,9

The main budget provides for expenditure of R258,3 billion in 2001/02, increasing to R297,5 billion in 2003/04. Revenue increases from R233,4 billion to R273,1 billion over the same period.

Main budget deficit of 2,5% of GDP in 2001/02

A deficit of 2,5 per cent of GDP is anticipated on the main budget in 2001/02, falling to 2,1 per cent of GDP in 2003/04.

Taking into account the expected proceeds from the restructuring of state assets the overall public sector borrowing requirement – the financing requirements of extra-budgetary institutions, provinces and local authorities and the expected borrowing of public corporations and government enterprises is expected to be R12,4 billion in 2001/02, or 1,3 per cent of GDP.

Public sector borrowing requirement of 1,3 per cent of GDP

Structural reforms

Changes in the budget process and financial management are aimed at improving service delivery and providing better value-for-money in the purchase of goods and services outlined in the budget. Key reforms undertaken since 1994 in the structure and organisation of South Africa's public finances include:

Structural transformation of the public finances

- The introduction of a three-year medium-term expenditure framework.
- Increased budgetary and financial cooperation between the national, provincial and local spheres.
- The overhaul and modernisation of tax administration.

- The Public Finance Management Act, passed in 1999, setting out a new foundation for financial accountability in the public sector.
- The establishment of a Private Public Partnership unit in the National Treasury.
- The restructuring of state assets.
- Enhanced debt management, including the introduction of auction marketing arrangements for government securities and several successful foreign bond issues.
- A framework for the evaluation of project lending proposals.

Revenue issues and tax proposals

Tax reforms underpin growth prospects

Tax reform is an integral part of the overall fiscal strategy. Since 1994, considerable attention has been given to improving the integrity and structure of the tax system, as well as revenue administration and collection. These measures, including the fundamental structural tax reforms set out in the 2000 Budget, are critical to improving the efficiency, equity and international attractiveness of the tax regime.

Substantial income tax relief

Buoyant growth in tax revenue provides scope for tax reforms to complement other fiscal and macroeconomic initiatives aimed at encouraging economic growth and social development. The 2001 tax adjustments include:

- R8,3 billion in personal income tax relief.
- R600 million for a wage tax credit.
- Raising the annual interest and dividend income exemption by R1 000.
- Reducing the estate duty and donations tax rates.
- Raising provisional income tax thresholds.
- Investment incentives for strategic investment projects.
- Accelerated depreciation for small business investment.
- Depreciation allowances for certain airport infrastructure.
- Closing corporate income tax loopholes.
- Extending the VAT zero-rate to illuminating paraffin.
- Increasing excise duties on tobacco products and alcoholic beverages.
- Below-inflation increases in the fuel levy.
- Extending the diesel fuel concession to the primary production sectors for off-road diesel consumption.
- Reform of the *ad valorem* customs and excise duties.

The residence-based income tax announced in the 2000 Budget took effect from 1 January 2001. It is proposed that capital gains tax will be implemented from October 2001.

Tax reform to encourage investment and small businesses

Over the next four years, R3 billion of tax revenue will be foregone in favour of incentives for strategic investment projects. Further reforms have been made aimed at improving the performance of small business enterprises. The diesel fuel concession has been re-introduced for the primary production sector.

The net effect of these proposals is a reduction in tax revenue of R9,1 billion from the estimate of revenue before tax proposals. It is anticipated that some of this reduction will be recovered through improved collections, as SARS broadens the tax base by enhancing their audit and administrative capacity.

Revenue loss partially offset by administrative gains

Revenue estimate after tax proposals

Table 1.3 summarises the revenue effects in 2000/01 of the 2000 Budget tax proposals.

Table 1.3 Summary of tax proposals

R billion	2001/02
Revenue estimate before tax proposals	239,5
Efficiency gains	3,0
Personal income tax adjustments	-8,3
Wage credit	-0,6
Interest and dividend exemption	-0,2
Diesel concession	-0,3
VAT on paraffin	-0,4
Increase in tobacco & alcohol duties	0,8
Increase in fuel levy	0,4
Other tax changes (net)	-0,5
Tax proposals	-9,1
Revenue estimate after tax proposals	233,4

Asset and liability management

Changes to the management of the assets and liabilities of the state are a crucial part of the reform of public finances undertaken over the past five years.

Key developments over the next year include the following:

- Proceeds of R18,0 billion from the restructuring of public enterprises are expected in 2001/02.
- In keeping with principles underpinning the Public Finance Management Act, state owned enterprises will become taxpayers and pay dividends to Government.
- Alongside a more active debt management policy, a programme of improved risk management and debt consolidation is underway.
- Foreign borrowing is expected to raise R11,3 billion in 2001/02, building on the healthy international credit rating achieved in recent years.
- R7,4 billion of domestic long-term bonds will be repaid in 2001/02.

Asset management

<i>State assets being restructured</i>	In order to broaden economic participation, recapitalise public enterprises and reduce state debt, Government has embarked on a programme of restructuring state owned assets.
<i>R12,4 billion towards debt reduction</i>	To date a total investment of R19,0 billion has been raised, mainly from international equity partners, of which R12,4 billion has been paid to the exchequer to reduce debt. Restructuring proceeds of R2,8 billion have been raised in 2000/01, mainly flowing from the sale of Transnet's holding in M-Cell and Sasria.
<i>Telkom IPO set for 2001/02</i>	An initial public offering of shares of Telkom this year will mark the largest sale of a state asset to date. In addition, preparations are in progress for further equity partnerships or outright sale of other government businesses. An amount of R18,0 billion is anticipated for the reduction of state debt from restructuring proceeds during 2001/02.
<i>Corporate governance protocols</i>	The restructuring process is complemented by a number of measures intended to improve corporate governance and financial management of public entities. A corporate governance protocol for Public Entities provides a framework for service benchmarks, financial performance, including tax and dividend policies, and a code of corporate practice and conduct. In addition, the Public Finance Management Act and Regulations for Public Entities now formalise a framework for financial management.
<i>Dividend payments to the exchequer</i>	Eskom became a taxpayer in January 2000 and a first dividend is expected in 2001. Discussions with the Development Bank are continuing in order to normalise its tax status and dividend policy.

Liability management

<i>From strategic objectives to tactical policies</i>	The increasingly more active debt management strategy of the National Treasury reflects the need to maintain liquidity and integrity under conditions of a declining government funding requirement, and is facilitated by the growing sophistication and efficiency of South African bond markets.
<i>Commitment to prudent liability management</i>	Recent debt crises highlight the importance of prudent liability management. A risk management framework is being developed which aims to minimise government's long-term debt service costs.
<i>Foreign borrowing reflects confidence in country</i>	Government has tapped the public international bond markets regularly and is an established issuer with a well-developed yield curve in both the Euro and Dollar currencies. Over the next three years, about \$1 billion a year will be borrowed in the public international bond markets.
<i>Net borrowing requirement of R21,1 billion</i>	The net borrowing requirement for 2000/01 is projected at R21,1 billion, which is marginally higher than the figure published in the 2000 Budget. This is due to a lower than expected restructuring proceeds.
<i>Repayment of R7,4 billion in domestic bonds debt</i>	Proceeds from restructuring for 2001/02 of R18,0 billion decreases the net borrowing requirement to R7,5 billion. Net financing of

R3,5 billion in short-term loans and R11,3 billion in foreign loans will allow Government to reduce domestic long-term debt by R7,4 billion in 2001/02.

At the end of 2000/01, total loan debt will amount to 44,3 per cent of GDP down from a high of 48,2 per cent in 1996/97. It is projected to decline steadily to 39,1 per cent of GDP by 2003/04.

Ratio of debt and debt service costs to GDP declining

Table 1.4 Projected state debt and debt costs, 2000/01–2003/04

R billion	2000/01	2001/02	2002/03	2003/04
Net loan debt (end of year)	397,5	408,8	430,5	451,9
% of GDP	44,3	41,4	40,3	39,1
State debt costs	46,2	48,1	49,7	51,0
% of expenditure	19,6	18,6	17,9	17,1
% of GDP	5,1	4,9	4,6	4,4

Medium-term expenditure estimates

The 2001 Budget announces rapid real growth in non-interest expenditure growth of 3,8 per cent over the next three years.

Large real increase in spending

The additional expenditure allows Government to expand service delivery, invest strongly in human and physical infrastructure and broaden initiatives focused on HIV/Aids and other social needs. Expenditure on services rises by R10,2 billion in 2001/02 and R16 billion in 2002/03 over the forward estimates published in the 2000 Budget.

Budget accommodates Government's priorities

The budget reform process, the development of service delivery indicators, the implementation of the Public Finance Management Act and the new public management framework are all aimed at improving the quality of spending. The new format of the Estimates of National Expenditure, which will track service delivery performance, will allow Parliament and citizens to reinforce a culture of accountability and improved service delivery.

Improving the quality of spending

Significant changes to Government spending plans over the next three years include:

Budget reflects government priorities

- Infrastructure spending increases by R7,8 billion prioritising water and sanitation, schools, roads and rural development initiatives.
- Over R4 billion extra will go to the criminal justice to boost crime fighting initiatives, including an improved salary dispensation for police, hiring more people, purchasing more vehicles and increasing prison space.
- R16 billion additional for provinces to enhance social service delivery and to support provinces cope with the effects of HIV/Aids.
- R2,6 billion extra for local government to increase infrastructure spending and to support the delivery of free basic municipal services.

Consolidated expenditure trends

Consolidated expenditure growth of 8 per cent a year

The medium term expenditure framework comprises the consolidated spending of national and provincial government over the next three years, including expenditure funded from provincial own revenue, donor grants and the social security funds. Table 1.5 sets out consolidated expenditure in 2000/01 and 2001/02 and medium term trends.

Table 1.5 Consolidated expenditure growth

	2000/01	2001/02	Average growth	
	R billion	R billion	1997/98– 2000/01 %	2000/01– 2002/03 %
Education	52,8	58,5	5,5	7,8
Health and welfare	57,6	61,3	7,3	6,4
Housing & other social services	6,2	6,5	-6,5	10,0
Police, prisons & justice	25,7	28,5	10,2	8,0
Defence & intelligence	15,2	17,3	8,3	8,7
Water, agriculture & forestry	7,5	8,0	7,1	6,2
Transport, communication & other economic services	12,0	14,6	0,2	11,1
General administration	22,3	25,2	9,8	8,9
Total (excl. debt costs & contingency reserves)	199,4	219,7	6,4	7,9
Personnel costs	92,4	98,9	5,6	5,8
Other current expenditure	91,9	101,3	8,3	7,6
Interest on debt	46,2	48,1	5,8	3,4
Capital spending	15,1	19,0	1,4	20,7
Unallocated	0,1	3,0		
Total expenditure	245,6	270,4	6,3	8,1

Consolidated expenditure is expected to grow by an average 8,1 per cent a year over the MTEF period, following growth of 6,3 per cent a year over the previous three years.

Growth in defence and economic services

Education, health, welfare and other social services take up about 58 per cent of non-interest allocations in 2000/01, and are projected to grow steadily over the MTEF period. Allocations to the criminal justice sector continue their strong growth, reflecting the commitment of Government to fighting crime.

Personnel costs grow by 5,8% over MTEF

Personnel costs are projected to increase by 5,8 per cent a year. This increase is marginally higher than the rate of inflation, and follows growth of 5,6 per cent a year since 1997/98.

Strong growth in capital spending

Capital spending grows by 20,7 per cent a year, while other non-personnel recurrent expenditure grows by 7,6 per cent a year. The national budget framework includes a contingency reserve of R2 billion in 2001/02 and provinces have set aside reserves of about R500 million.

Provincial and local government finance

The financial management reforms instituted over the last four years have laid a strong foundation for consolidating public service delivery across all spheres of government.

Challenges of provincial and local governments

In order to improve service delivery, provinces are now targeting spending on infrastructure rehabilitation, construction and maintenance. Challenges include enhancing the efficiency and effectiveness of spending in education and health, accelerating the take up rate of the child support grant, addressing backlogs in infrastructure and housing and coping with the impact of HIV/Aids.

Provincial priorities

Municipalities still face significant consolidation challenges, following the demarcation of new boundaries and resulting mergers. Their immediate task is to ensure the effective amalgamation of staff, assets and budgets, and the integration of systems, while maintaining and improving service delivery and expanding infrastructure. The division of revenue is summarised in Table 1.6.

Local government priorities

Table 1.6 The division of revenue, 2000/01–2003/04

R billion	2000/01	2001/02	2002/03	2003/04
National allocation	74,4	84,3	89,9	95,4
Provincial allocations	108,7	117,4	126,6	135,2
Equitable share	96,2	104,1	112,6	120,2
Conditional grants	12,6	13,3	14,0	15,0
Local government allocations	5,7	6,5	7,2	7,9
Total to be shared	188,9	208,2	223,7	238,5

Provincial finances

In light of the improvements in provincial financial management and the challenges that face provincial governments, the provincial equitable share rises by 7,7 per cent a year over the next three years and is supplemented by conditional grants. As a share of total non-interest expenditure, allocations to provinces rise from 56,4 per cent in 2001/02, to 56,7 per cent in 2003/04.

Strong growth in provincial share

The redistributive nature of the formula that divides this equitable share means that poor provinces will benefit more from the increased allocations to provincial government. The hiring of essential personnel and increasing complementary inputs such as textbooks and medicines will benefit from spending growth.

Poor provinces benefit more

Strong real growth in provincial transfers and reduced debt repayment allow provinces to increase investment in infrastructure and social services.

Provincial priorities reflect national priorities

Conditional grants to provinces grow by 6,1 per cent per annum, mainly reflecting an increase in infrastructure grants of R500 million in 2001/02, rising to R2 billion in 2003/04. In addition, R1,2 billion is allocated to provinces over the MTEF period to repair flood-damaged roads, schools, clinics and other social infrastructure.

Conditional grants for infrastructure

Annexure E provides a detailed explanation of the division of revenue and the equitable share formula and comments on the advice of the Financial and Fiscal Commission.

Local government transfers

Local government grants grows by 11,2% a year

Transfers to local government grow by 11,2 per cent per annum over the next three years, taking local government to 3,3 per cent of total non-interest expenditure. These increases reflect the challenges posed to local government in amalgamating 843 local authorities into 243 local councils, and to make possible the provision of basic services to the poor.

Allocations to local government can be divided into three broad categories.

- The local government equitable share and operating subsidies for water schemes grow by 9,9 per cent over the MTEF period and provide support for the provision of basic municipal services.
- Several grants are dedicated to building systems and capacity in local authorities. The transition to the new system of local government has once-off costs that must be managed effectively to ensure long-term savings. These total R681 million in 2001/02 and increase to R892 million in 2003/04.
- A number of capital grants contribute to residential and related infrastructure programmes. These grow by 6,6 per cent over the MTEF period.

Conclusion

The 2001 Budget sets out fiscal policy measures that build upon and extend the sound framework established by Government since 1996. It complements microeconomic reforms with significant increases in public spending, within the context of prudent financial management. It introduces initiatives and policy measures that give fresh impetus to the national priorities of growth, job creation and poverty reduction.

Developments outlined in this chapter are elaborated in more detail in the remainder of the *Budget Review*.