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Overview of the 2002 Budget

Following the macroeconomic reforms and fiscal consolidation since 1996, an expansion in government spending and robust tax performance over the past year provide a sound platform for responding to the challenges of slower global growth and the depreciation of the rand.

The 2002 Budget reinforces the growth-oriented stance of last year's Budget. It deepens Government's commitment to support the redistribution of economic opportunities, encourage investment and promote growth and development, in partnership with communities, labour and business.

The Budget heralds further acceleration in social and infrastructure spending, together with substantial tax relief for individuals and to encourage business investment. A budget deficit of 2,1 per cent of GDP is projected in 2002/03 and debt service costs will continue to fall as a share of expenditure, releasing resources for extending and improving delivery of public services.

Introduction

Positive outlook for the SA economy, despite global slowdown

South Africa's economic outlook remains positive, although global economic growth has slowed and the rand declined sharply towards the end of 2001. These developments have unsettled growth and inflation trends. However, the strengthening of the balance of payments and the public finances of recent years has continued. Building on a stable policy framework and steady improvements in productivity and competitiveness, South Africa is well set to take advantage of economic recovery in the year ahead.

The Budget aims to reinforce growth and social development

The 2002 Budget extends the growth-oriented bias of last year's fiscal stance and deepens support for both social development and infrastructure investment. Tax relief will again benefit wage-earners and consumers and encourage business investment and job creation. Additional funding is proposed for pensioners and health care, fighting crime, municipal services and compensating for the effects of the depreciation of the rand.

Spending to grow by 4,1 per cent a year in real terms

Against the background of an unprecedented gain in company tax revenue, the budget deficit is expected to be 1,4 per cent of GDP in 2001/02. Government is able to budget for growth in real spending on public services of 4,1 per cent over the next three years, while continuing to reduce the tax burden and keep the deficit well within prudent limits.

Budget documentation

The *Budget Review* accompanies the presentation to Parliament of the annual *Budget Speech* by the Minister of Finance. It provides an overview of the economic outlook, fiscal policy, revenue issues, financing strategy, expenditure plans and developments in provincial and local government finances. Annexures to the *Review* include a glossary of economic and financial terms, a statistical appendix, details of the tax proposals, an overview of government financial accounts, an explanatory memorandum on the division of revenue and a concise summary of the budget proposals.

The national, provincial and local are set out in the Division of Revenue Bill

At the time of the Budget the Minister of Finance tables the *Division of Revenue* Bill and an *Appropriation Bill* in the National Assembly, through which the executive seeks Parliamentary authority for its spending plans for the forthcoming year.

Three-year spending plans are published alongside the annual Appropriation Bill

The *Estimates of National Expenditure* elaborate on the national spending plans, detailing the objectives of each Government department, three-year spending estimates, 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:

- The *Estimate of Revenue for the year ending 31 March 2003* sets out revenue projections before and after tax proposals
- The *People's Guide* is a straightforward summary of budget highlights, published in five official languages.

Economic policy and outlook

International developments and the rand

Global growth slowed in 2001, depressing commodity prices and emerging market prospects

The past year saw a sharp decline in United States economic growth and a steep drop in interest rates as the Federal Reserve Bank responded to the slowdown and the shock to world markets of the 11 September attacks. A moderate recovery is expected in Europe, Japan remains deeply depressed, commodity prices remain subdued and several emerging market economies are in serious difficulties.

Highlights of the 2002 Budget

On the economy:

- Growth slowed to 2,2 per cent in 2001 and is expected to be 2,3 per cent in 2002, rising to 3,3 per cent in 2003 as the global economy recovers.
- CPIX inflation will average about 6,9 per cent in 2002 before declining back to the target 3-6 per cent range in 2003.
- Real wages and productivity have increased by over 20 per cent since 1994, bringing rising living standards to millions of people and improving the competitiveness of the economy.
- Exports are increasingly diversified, with manufactured products up from 9 per cent in 1990 to 27 per cent of the total in 2001.
- Following the depreciation of the rand, both exports and inward investment are expected to strengthen in 2002 and the years ahead.
- South Africa's balance of payments and public finances are in good health, providing a firm foundation for sustainable growth and development.

Tax proposals:

- Income tax cuts will put R15 billion back into taxpayers' pockets, mainly benefiting low and middle income workers.
- Individuals earning below R27 000 a year (R42 640 for senior citizens) will not pay any personal income tax.
- The interest income exemption is raised to R6 000 (R10 000 for taxpayers over 65).
- A tax allowance is introduced to encourage learnerships.
- Accelerated depreciation allowances are proposed to encourage business investment and employment.
- Tax relief for small businesses is extended, to encourage emerging entrepreneurs.
- The general fuel levy remains unchanged, while the Road Accident Fund levy is increased by 2c a litre.
- A packet of cigarettes will cost 34c more. Beer goes up by 3,2c a 340ml can, a 750 ml bottle of wine by 4,5c and a 750 ml bottle of spirits by R1,08. Duties on soft drinks are abolished.

Spending plans:

- Real spending on services will grow by 4,1 per cent a year over the MTEF period, while interest on debt falls from 4,8 per cent of GDP last year to 4,1 per cent in 2004/05.
- Education remains Government's first priority, rising to R59,5 billion next year, or 24 per cent of non-interest expenditure.
- To fight crime, R31,8 billion goes to Police, Justice and Correctional Services in 2002/03, while R20,6 billion is allocated to Defence and intelligence services.
- Provinces receive R132,4 billion next year, or 56 per cent of the national Budget, including:
  - Improved funding of tertiary hospital services and an enhanced response to HIV/Aids
  - Increases in old age and disability grants (8,8 per cent) and child support grants (18 per cent), brought forward to April
  - Additional funding for roads, schools, clinics and rural development.
- Assistance for municipalities grows by 18 per cent a year, including support for water and sanitation, electrification, free basic services and local economic development.

Depreciation of the rand in late 2001 was overdone

Numerous explanations have been advanced for the depreciation of the rand in the fourth quarter of 2001. While South Africa is not immune from the global slowdown, the underlying health of South Africa's balance of payments is not in question and the depreciation towards the end of the year was overdone. An investigation into foreign exchange transactions that might have contributed to the depreciation is under way. The rand has recorded greater stability in the opening weeks of 2002.

A partial recovery in the real value of the rand expected

Government remains committed to phasing out exchange controls and to the deepening of currency markets. While some volatility may persist, it is expected that a recovery in the value of the rand will continue during 2002 and 2003, partially restoring the real value of the currency lost in 2001.

Rand depreciation and inflation

Consumer price inflation as measured by CPIX averaged 6,6 per cent in 2001. For much of the year the inflation trend declined, falling below 6 per cent in September and October.

CPIX is expected to average 6,9 per cent in 2002

However, rising food prices and the depreciation of the rand began to affect prices in November and December and will unavoidably affect the price trend during the course of this year. CPIX is now expected to average 6,9 per cent in 2002, before returning to the target range in 2003 and beyond.

Economic growth and employment

The economy grew by 3,4 per cent in 2000 and about 2,2 per cent in 2001, underpinned by a moderate recovery of capital formation and a strong export performance in the first half of last year.

Strong growth in wages and productivity reflect greater competitiveness

While growth has slowed, the structural realignment of the South African economy continues to promise improved performance going forward.

- Real wages and productivity have increased by over 20 per cent since 1994, bringing both rising living standards to millions of people and strengthening the competitiveness of industry.
- General government investment spending shows signs of recovery, together with stronger capital formation in manufacturing and construction.
- Export diversification continues, in both traditional and non-traditional manufactured goods, as well as in service sectors such as tourism.
- Improved performance of the school system, higher education restructuring and renewed investment in training are under way.

Employment creation remains critical challenge

However, employment creation remains weak and efforts to promote training, small business development and accelerate investment in infrastructure have not turned the employment trend around. Building the social and developmental foundations on which stronger growth and job creation will rest remains a central focus of Government's economic and fiscal policies.

Macroeconomic forecast

Growth expected to average 3,1 per cent over next three years

A steady recovery of economic growth is expected in 2002 and beyond, following last year's sluggish performance. Founded on stable economic policies, productivity improvements, a competitive exchange rate and the anticipated turnaround in the global economy, growth is projected to average 3,1 per cent over the next three years. Macroeconomic projections are summarised in table 1.1 and discussed in more detail in chapter 2.

Figure 1.1 GDP growth and CPIX inflation

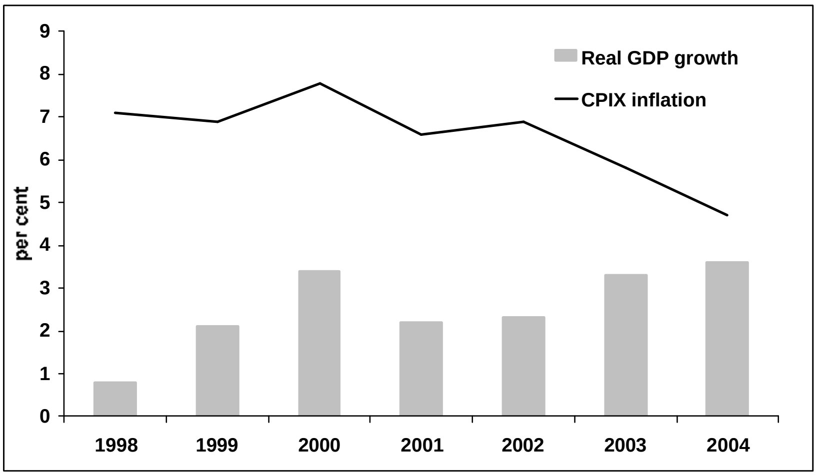

Table 1.1 Summary of macroeconomic projections

	2001	2002	2003	2004
Real growth				
Household consumption	2,7%	2,5%	2,8%	3,1%
Capital formation	3,2%	4,5%	5,5%	7,1%
Gross domestic product	2,2%	2,3%	3,3%	3,6%
Consumer price inflation (CPIX)	6,6%	6,9%	5,8%	4,7%
Balance of Payments current account (% of GDP)	0,0%	-0,5%	-0,5%	-0,7%

Fiscal policy and budget framework

Expansionary fiscal policy

The fiscal policy stance remains decidedly growth-oriented, providing for strong real spending growth, declining debt service costs and an intensification of spending on alleviating poverty and investing in infrastructure.

Revised budget framework

Main budget revenue appears set to reach 25 per cent of GDP in 2001/02, over R15 billion more than the 2001 Budget estimate.

Growth in company tax creates scope for income tax relief

The outstanding revenue performance for this year is largely the outcome of a sharp improvement in company tax receipts. The robust revenue trend makes possible substantial relief to taxpayers again in the 2002 Budget, which will in turn contribute to a recovery in household spending and economic growth over the medium term.

Budget deficit of 1,4 per cent of GDP last year

Taking into account the revised revenue estimate and provision for additional expenditure on social grants, the budget deficit for 2001/02 is expected to be 1,4 per cent of GDP. Substantial tax relief and strong growth in spending will raise the deficit to an estimated 2,1 per cent of GDP next year, followed by a moderate easing to 1,7 per cent by 2004/05.

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.

Improved position of social security funds

The financial position of the social security funds is expected to stabilise in the years ahead. The Unemployment Insurance Fund will receive support from the national budget during its restructuring over the next three years. A 2c a litre increase in the fuel levy assigned to the Road Accident Fund will assist in bringing its revenue in line with expenditure.

Foreign assistance provides targeted RDP support

Foreign assistance continues to provide valued support in many critical social and developmental priority areas, with a strong emphasis on poverty reduction. Foreign assistance is expected to include increased support for the New Partnership for Africa's Development.

Table 1.2 The consolidated national budget framework

R billion	2001/02	2002/03	2003/04	2004/05
National Revenue Fund				
Revenue	248.4	265.2	288.7	313.2
Expenditure	262.6	287.9	311.2	334.6
Main budget deficit	14.1	22.7	22.5	21.4
% of GDP	*1.4*	*2.1*	*1.9*	*1.7*
RDP Fund & foreign technical cooperation				
Receipts	1.0	0.8	0.8	0.8
Social security funds				
Revenue	8.6	9.6	10.0	10.3
Expenditure	8.2	9.1	9.6	10.2
Consolidated national budget				
Revenue	**257.4**	**275.2**	**299.2**	**324.1**
% of GDP	*26.0*	*25.4*	*25.4*	*25.4*
Expenditure	**270.7**	**297.4**	**321.4**	**345.4**
Deficit	**13.3**	**22.1**	**22.2**	**21.2**
% of GDP	*1.3*	*2.0*	*1.9*	*1.7*
GDP	*990,0*	*1 082,8*	*1 178,9*	*1 277,5*

National budget spending of R288 billion in 2002/03

The main budget provides for expenditure of R287,9 billion in 2002/03, rising to R334,6 billion in 2004/05. Revenue increases from R265,2 billion to R313,2 billion over the same period. The revised main budget framework provides for expenditure of R10,6 billion more in 2002/03 and R13,7 billion more in 2003/04 than the 2001 Budget forward estimates.

Increased contingency reserve provides for higher inflation and unforeseeable expenditure

Recognising that the depreciation of the rand will impact on inflation and public service salary adjustments in 2002, the revised framework includes a R3,3 billion contingency reserve in 2002/03, rising to R9 billion in 2003/04. The reserve also provides for possible unforeseeable and unavoidable expenditure in the budget year and macroeconomic uncertainties or new priorities in the years ahead. Supplementary funds are once again set aside for new infrastructure spending.

Debt costs decline as per cent of GDP

The main budget medium term expenditure framework is outlined in table 1.3. Debt service costs are expected to fall from 4,8 per cent of GDP in 2001/02 to 4,4 per cent next year and 4,1 per cent by 2004/05, releasing some R10 billion for spending on services.

Total allocations of R237 billion in 2002/03

After setting aside provision for debt costs and the contingency reserve, the framework provides for total allocations to national departments, provinces and assistance for local government of R237,1 billion in 2002/03, rising to R273,1 billion in 2004/05.

Table 1.3 Main budget expenditure framework, 2001/02–2004/05

R billion	2001/02	2002/03	2003/04	2004/05
Total expenditure	**262,6**	**287,9**	**311,2**	**334,6**
Less:				
Debt service costs	47,5	47,5	49,8	52,4
Contingency reserve	–	3,3	5,0	9,0
Total allocations	**215,1**	**237,1**	**256,4**	**273,1**
% increase	*14,6%*	*10,2%*	*8,1%*	*6,5%*

Public sector borrowing requirement of 1,4 per cent of GDP

Taking into account the expected proceeds from the restructuring of state assets, the overall public sector borrowing requirement – the financing requirements of the main budget, extra-budgetary institutions, provinces and local authorities and the expected borrowing of public corporations and government enterprises – is expected to be R14,9 billion in 2002/03, or 1,4 per cent of GDP.

Investing in growth

Recognising the need to reinforce the growth momentum of the economy, the 2002 Budget aims to invigorate several key policy initiatives.

Infrastructure investment remains a key priority

Supplementary allocations for infrastructure were announced in the 2001 Budget. Increased funding of physical construction is again prioritised, and steps have been taken to improve capacity to spend. Allocations for electrification have been stepped up, and spending on roads and rail services will increase. Capital investment in support of industrial development is also supported in the national budget. Provincial spending on social infrastructure has improved and municipal infrastructure financing receives substantial increases in allocations over the next three years.

Complementing direct expenditure by government, the investment programmes of public enterprises and public-private partnership agreements – including transport projects, government buildings and several eco-tourism initiatives – will also contribute to rising infrastructure spending in the years ahead.

Targeted support for improving quality of expenditure

Economic performance is also enhanced by a cluster of measures focused on the quality of public expenditure. These include the overhaul of the shape and organisation of the public finances and a robust new framework for financial accountability across all three spheres of government. Managerial capacity building programmes have been strengthened, information systems upgraded and financial management training enhanced. Steady departmental progress in meeting the requirements of the Public Finance Management Act is a key element in improving expenditure management and accountability.

Investing in people is foundation of long term growth and development

Government's most critical commitment to long-run growth and redistribution of economic opportunities is investment in education and skills. Reshaping our universities and technikons, improving learning and teaching in schools and creating new skills development programmes for workers and work-seekers are among the key elements of the strategy for human development. Projects of the Umsobomvu Fund, adult education and literacy initiatives and the transformation of technical colleges are further elements in addressing the human development challenge. The 2002 Budget includes details of a new tax incentive in support of the development of skills and job creation.

Revenue issues

Strong growth in tax revenue has underpinned the healthy fiscal outcome for the 2001/02 year and provides a platform for further tax relief in this Budget.

Tax proposals

2002 Budget provides substantial income tax relief and encouragement of investment

The main tax proposals are as follows:

- R15 billion in individual income tax relief
- Interest income exemptions raised to R6 000 for taxpayers under age 65 and R10 000 for senior citizens
- Accelerated depreciation allowances for investment in manufacturing plant
- Small business turnover threshold increase to R3 million and a raised threshold for the 15 per cent company tax rate
- No increase in the general fuel levy, and a 2c a litre increase in the Road Accident Fund levy
- A levy to replace VAT on renewable environmentally friendly fuels, at an advantageous rate
- Moderate increases in taxes on tobacco and alcoholic beverages
- Elimination of the excise duty on soft drinks

- Reduced duty on property transfers
- Removal of the levy on Lloyd's insurance premiums and certain financial transaction taxes.

Table 1.4 summarises the expected 2001/02 revenue outcome and the effects on revenue in the year ahead of the 2002 Budget tax proposals.

Table 1.4 Summary of tax proposals

R billion	2001/02 Budget estimate	2001/02 Revised estimate	2002/03	
Tax revenue (gross)	236,8	252,2		283,7
Non-tax revenue	4,8	4,4		5,0
Less: SACU payments	-8,2	-8,2		-8,3
Total revenue	**233,4**	**248,4**		
Revenue before tax proposals				**280,4**
Personal income tax relief			-15,0	
Interest and dividend exemption			-0,2	
Accelerated depreciation allowances			-0,3	
Adjustments to transfer duty			-0,3	
Increase in duties on alcoholic beverages			0,4	
Increase in duties on tobacco products			0,4	
Removal of duty on soft drinks			-0,1	
Other tax changes			-0,1	
Tax proposals			**-15,2**	
Revenue after tax proposals				**265,2**

Consolidation of earlier reforms is under way

Details of the learnership incentive announced last year and the R3 billion strategic investment incentive are set out in this *Review*. There has been further progress in administering tax relief to public benefit organisations. Legislation laying the ground for SARS to collect contributions from employers on behalf of the Unemployment Insurance Fund has been drafted.

Company tax receipts reflect resource-based profit surge

Revenue in 2001/02 is expected to exceed the original budget estimate by R15 billion, raising main budget revenue to 25,1 per cent of GDP. Revenue gains have largely been in company tax receipts, following the strong performance of the export sector and resource-based industries. High levels of profitability of commodity producers benefiting from the depreciation of the rand are expected to persist in the year ahead, contributing to continued income tax growth.

Tax administration

SARS administrative reforms continue

Against the background of the announcement of a residence-based income tax in the 2000 Budget and the introduction of a capital gains tax, the current proposals signal a period of consolidation in the tax structure. Organisational and administrative reform has gathered impetus, together with a new assertiveness in the approach of SARS to tax compliance and the customs laws.

This year will see further steps in the implementation of the Siyakha ("we are building") transformation project, which includes concentration of activities in processing and compliance centres, reinforcement of customs posts, enhancement of audit capacity and consolidation of collection processes. A pilot project in KwaZulu-Natal last year will be followed by implementation in the Western Cape and Gauteng during 2002. In addition, a new enforcement strategy has been implemented, targeting areas of high risk and aggressive tax evasion. Tax education initiatives focused on the informal economy are planned.

Regional tax cooperation

New SACU agreement expected to take effect next year

The restructuring of the Southern African Customs Union formula, to give effect to principles agreed by the SACU Ministers of Finance in September 2000, is expected to take effect in 2003/04. The new agreement will contribute to stabilising the distribution of the customs and excise pool and will see the introduction of a development fund targeted to support the less developed members of the Union.

Regional tax coordination under way

South Africa is also playing a leading role in promoting tax cooperation within the SADC, including capacity building initiatives, developing a tax database for the region, formulating a common approach to tax incentives, administrative coordination and eliminating harmful tax practices.

Asset and liability management

Financial management and debt restructuring remain key priorities

Improved governance and financial management of South Africa's overall portfolio of government assets and liabilities continues to be a major part of the reform of the public finances.

Key developments include:

- Further assurance of international confidence in South Africa's financial management with the announcement of a credit rating upgrade in November 2001
- Reduction in domestic long-term debt of R11,1 billion in 2001/02, and R11,0 billion to be repaid in 2002/03
- Foreign borrowing of R33,2 billion in 2001/02, with a further R16,3 billion planned for 2002/03
- An active debt management and buyback programme under way, deepening the bond market and reducing future debt costs
- The planned initial public offer of shares in Telkom, expected to proceed in 2002/03.

Liability management

Reduced domestic public sector borrowing

Proceeds from state asset restructuring, a slowdown in borrowing by public entities, the marked reduction in the budget deficit and an increase in foreign borrowing have combined to reduce the reliance of the public sector on the domestic bond market. This, in turn, has contributed to lower interest rates and has led to a resurgence in corporate bond issues.

A formal risk management model now is in use by the National Treasury, providing a tool for assessing debt management options. Drawing in part on this analysis, it is envisaged that over the next three years debt will be consolidated further in a limited number of liquid issues, as the buyback and switch programmes continue, while foreign-denominated debt has increased to about 19 per cent of total net loan debt. By taking advantage of favourable market opportunities to borrow abroad, the fiscus is contributing to reducing the net open forward position of the Reserve Bank.

Domestic debt consolidation in progress, together with increase in foreign borrowing

Table 1.5 summarises the anticipated trend in total debt and state debt costs.

Total government loan debt as a percent of GDP is projected to decline from 42,9 per cent at the end of March 2002 to 37,4 per cent by the end of the 2004/05 year.

Government debt to fall to 37,4 per cent of GDP

Table 1.5 Projected state debt and debt costs, 2001/02–2004/05

R billion	2001/02	2002/03	2003/04	2004/05
Net loan debt (end of year)	**425,1**	**436,6**	**457,8**	**477,9**
% of GDP	42,9%	40,3%	38,8%	37,4%
Domestic debt	350,9	344,1	359,1	385,7
Foreign debt	81,1	96,6	110,7	96,1
State debt costs	**47,5**	**47,5**	**49,8**	**52,4**
% of expenditure	18,1%	16,5%	16,0%	15,7%
% of GDP	4,8%	4,4%	4,2%	4,1%

Asset management

The state assets restructuring programme aims to broaden economic participation, recapitalise public enterprises and reduce state debt. Since 1997, a total of R27,5 billion has been raised, of which R16,7 billion has been paid to the National Revenue Fund to reduce debt.

Restructuring has contributed R16,7 billion to the fiscus since 1997

Further progress has been made in the sale of state forests and Safcol assets, and a strategic equity partner has been announced for Denel. Plans for the establishment of a holding company as the first step in creating regional electricity distributors are well advanced. Following the demise of Swissair, Transnet is expected to repurchase the 20 per cent stake in SA Airways sold in 1999.

Over the past year, the M-Cell transaction and a special dividend issue by Sasria yielded R 4,3 billion in extraordinary receipts to the fiscus.

Proceeds of R4,3 billion paid to the fiscus in 2001/02

The restructuring process is complemented by various measures to improve financial management of public entities. The state's corporate governance protocol is being updated in line with the King II report on Corporate Governance in South Africa. Implementation of the PFMA also strengthens the framework for financial management.

Medium term expenditure estimates

Policy priorities and the MTEF

Expenditure trends reflect social and economic objectives

In preparing the annual Budget, Government seeks a balance between competing spending priorities that reflects the nation's broad social and economic objectives – economic growth, job creation, equity and social development, and strengthening safety and the administration of justice.

Infrastructure allocations increase strongly

Boosting spending on public infrastructure remains a key challenge. Infrastructure allocations to both national and provincial departments increase strongly over the years ahead. Focused initiatives to reinforce capacity to manage construction and rehabilitation programmes are under way. Supplementary allocations for infrastructure will be targeted at creating jobs in support of urban and rural development.

Special emphasis on reducing poverty and vulnerability

The 2002 Budget gives special emphasis to Government's contribution to reducing poverty and vulnerability. Funding for social grants is increased and interventions to address the impact of communicable diseases will be extended.

Expansion of police and prisons capacity

Social progress also rests on effectively combating crime. This year's budget provides for a phased expansion of the SA Police Service together with reinforcement of the administration of justice. A substantial investment in expanding prison capacity is in progress.

Budget reflects a growing partnership with municipalities and local communities

Government is committed to working partnerships with communities and civil society. This Budget proposes to increase funding for the capital subsidy programme through which individuals are assisted in becoming home-owners and for investment in municipal infrastructure and services, electrification and recreation facilities. In seeking improved services, especially to the poor, Government also recognises the profound contribution that citizens and organisations bring to social development and extending economic opportunities to all.

Estimates of national expenditure

Increases in national spending allocations include infrastructure, administrative capacity, health services and fighting crime

Significant changes to national budget expenditure plans include the following:

- Increased Foreign Affairs allocations, compensating for the depreciation of the rand and to extend foreign representation
- Reinforcement of administrative capacity and information technology, particularly in Home Affairs, the SA Revenue Service and Justice and Constitutional Development
- Supplementary infrastructure allocations, including refurbishment of rail rolling stock, rural water supply and sanitation, construction of prisons, upgrading of courts and police stations, investment in national parks and harbours and construction of the Freedom Park monument

- Broadening of support for tertiary hospital services and an enhanced HIV/Aids initiative
- Increasing support for housing and municipal infrastructure and services
- Supplementary assistance for the Unemployment Insurance Fund and the Post Office
- Compensation for depreciation of the exchange rate in the strategic arms procurement programme
- Provision for expansion of the SA Police Service and enhancement of intelligence services.

Consolidated expenditure trends

Consolidated national and provincial spending to grow by 4,1 per cent a year in real terms

The medium term expenditure framework comprises the consolidated spending of national and provincial government over the next three years, including donor grants and the social security funds. Table 1.6 sets out consolidated expenditure in 2001/02 and 2002/03 and projected growth over the MTEF period.

Table 1.6 Consolidated expenditure growth

	2001/02 Revised estimate R billion	2002/03 Budget estimate R billion	Average growth 2001/02–04/05 %
Education	55.4	59.8	7.3
Health and welfare	65.8	75.3	9.7
Housing & other social services	8.4	9.8	9.8
Police, prisons & justice	28.8	31.8	8.8
Defence & intelligence	18.1	20.6	7.4
Water, agriculture & forestry, energy and mining	11.1	13.3	7.9
Transport, communication & other economic services	15.9	18.3	9.6
General administration	21.0	23.2	9.8
Total (excl. debt costs & contingency reserves)	224.4	252.1	8.7
Personnel costs	99.2	106.8	6.8
Other current expenditure	107.2	121.8	8.8
Interest on debt	47.5	47.5	3.3
Capital spending	18.0	23.5	18.1
Unallocated	–	3.6	
Total expenditure	271.9	303.2	8.8

Consolidated expenditure is expected to grow by an average 4,1 per cent a year in real terms over the MTEF period, following growth of 1,7 per cent a year over the previous three years.

Social services account for 57 per cent of non-interest expenditure

Education, health, welfare and other social services take up about 57 per cent of non-interest allocations in 2002/03, and will grow steadily over the MTEF period. Phasing in of skills development funding, a subsidy for the Post Office, electrification and increased investment in transport infrastructure account for strong growth in economic services. General administration growth reflects increases in Foreign Affairs, SARS and support for local government restructuring.

Strong capital spending growth is projected

Capital spending is budgeted to grow by 18,1 per cent a year over the next three years, including strong investment in both social infrastructure – such as schools, hospitals and housing – and provision for investment in roads, water services and other economic assets.

Provincial and local government finance

Increased allocations to provinces and local government, together with reinforcement of financial management capacity

Key developments in the financing of provincial and local government include the following:

- Strong increases in the equitable share allocations to both provinces and municipalities, recognising their critical role in the delivery of social development, basic household services and infrastructure
- Modernisation of financial management as envisaged in the Public Finance Management Act, applicable to national and provincial departments and public entities, soon to be complemented by the Municipal Finance Management Bill
- Passage of legislation to deal with provincial tax proposals
- Evolution of a borrowing framework for provinces and local government
- Reform and consolidation of several of the conditional grants which supplement the provincial and local equitable share of nationally collected revenue.

The revised division of revenue for 2001/02 and for the next three years is summarised in table 1.7.

Table 1.7 The division of revenue, 2001/02 – 2004/05

R billion	2001/02	2002/03	2003/04	2004/05
National allocation	87,3	96,1	103,3	109,9
Provincial allocations	121,2	132,4	142,8	152,4
Equitable share	*107,5*	*119,5*	*128,5*	*137,1*
Conditional grants	*13,7*	*13,0*	*14,4*	*15,3*
Local government	6,6	8,6	10,2	10,9
Total allocations	**215,1**	**237,1**	**256,4**	**273,1**

Provincial and local allocations grow by 7,9 per cent and 18,3 per cent a year

The revised framework includes provision for an additional transfer of R2 billion to provinces in 2001/02 to meet backlogs in social grants. Excluding this once-off payment, the total provincial share grows by 7,9 per cent a year over the MTEF period, and the local government share increases by 18,3 per cent a year.

Provincial finances

A marked improvement in provincial financial management in recent years has led to better budgeting and expenditure control and some progress in strengthening infrastructure investment and maintenance.

Provincial supplementary grant phased out

Against this background, the former “supplementary grant” administered by the National Treasury has been phased out, with the funds transferred to the equitable share. The provincial equitable share also increases in the 2002 Budget to accommodate a reinforcement of health services and further extensions of social grants and welfare spending.

Distribution of funds between provinces is mainly based on an equitable share formula

The formula for distributing equitable shares between provinces has been updated this year to take account of the increased weight of welfare spending in provincial budgets and to take account of recent education enrolment data. The equitable distribution – which aims to reflect the relative demands for provincial education, health, welfare and other services – will be fully phased in by the 2003/04 year.

Revised health service grants are introduced

A new approach to allocating the provincial health service grants takes effect this year. A national tertiary service grant replaces the former central hospitals grant, and will extend support to specialised units in 27 hospitals located in all nine provinces. The new health professional and development grant is also aimed at strengthening services in under-served provinces, by encouraging a redistribution of post-graduate medical training capacity.

Increased allocations for HIV/Aids prevention

This Budget also sees a step-up in targeted allocations to health, education and welfare departments, complementing provision by provinces for an enhanced HIV/Aids strategy.

Increased allocations for infrastructure and housing

The substantial increase in grants for provincial infrastructure announced in the 2001 Budget is extended for a further year and the 2002 Budget provides additional funding for housing over the next three years.

Local government

Municipal services are largely paid for through service charges and local taxes. The national government contributes to meeting the cost of infrastructure and services for poor people. Transfers to local government are the fastest growing allocations on the national budget at present.

Reform of municipal finances is under way

Given added impetus by the demarcation of 284 new local authorities, a comprehensive reform of municipal governance and finance is under way. The Municipal Finance Management Bill, three year budgeting, the codifying of municipal accounting practices, a framework for municipal borrowing and new financial reporting standards are among the key elements of this transformation.

Strong growth in budget support for municipalities

The 2002 Budget provides for significant increases in allocations to municipalities:

- The local government equitable share, together with operating subsidies for water services, increases to R4,8 billion next year, up nearly 25 per cent above the 2001 Budget forward estimate, and will rise to R6,2 billion by 2004/05.
- Funding for the consolidated municipal infrastructure programme is raised by R600 million to R1,7 billion in 2002/03, rising to R2,5 billion in 2004/05. Other programmes targeted at residential services, including water schemes and electrification, bring the total contribution to local infrastructure spending to R3,3 billion next year.
- Capacity building, restructuring and financial management grants, amounting to R750 million in 2002/03, are under review and will be consolidated in the years ahead.

Municipalities to play key role in restructuring of electricity distribution

Restructuring of the electricity distribution industry will in due course substantially alter the structure and transparency of municipal finances. The aims of this reform include consolidation and greater administrative efficiency in the provision of electricity services to households and businesses, while continuing the extension of electrification to formerly unserved communities. It is recognised that municipalities have a key role to play in ensuring that service standards are upheld, management is reinforced and revenue is not adversely affected in this transition.

Conclusion

The 2002 Budget gives further impetus to investment in social development and economic growth, while providing for substantial tax relief within a sound and sustainable fiscal framework.

2002 Budget signals greater momentum of partnerships for development

These budget proposals aim to deepen Government's partnership for development – with communities, businesses, unions and ordinary people. By broadening access to services, improving the quality of public service delivery and building infrastructure for future growth, Government seeks to push forward the frontiers of opportunity before all our people.