



# **Budget Speech**

## **2005**

**Minister of Finance**

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*...We assert that our country, as a united nation, has never in its entire history enjoyed such a confluence of encouraging possibilities. On behalf of our government, we commend our programme to the country, confident that its implementation will help to place us on the high road towards ensuring that we become a winning nation and that we play our role towards the renewal of Africa and the creation of a better world.*

*Acting together, we do have the capacity to realise these objectives. And sparing neither effort nor strength, we can and shall build a South Africa that truly belongs to all who live in it, united in our diversity!*

*President Thabo Mbeki, 11 February 2005*

Madam Speaker

We have recently celebrated the international success of Ladysmith Black Mambazo's new album *Lift Your Spirit Higher*. This past weekend, the world acclaimed the production of the popular opera, *Carmen*, sung in isiXhosa, and filmed here in Khayelitsha, which won the Golden Bear award as the best film at the Berlin Film Festival. It is entirely fitting that the new season of hope and rising confidence of our nation, in this second decade of democracy, should be proclaimed in this way, in music and in theatre.

We also celebrate this year the pledge of the Congress of the People fifty years ago that we would strive together, side by side, to win equal rights and opportunities for all South Africans, black and white. Even as we enjoy the fruits of the progress made in our first decade, we know that our work is not complete until all our people have achieved freedom from want, freedom from fear, freedom from prejudice, freedom from injustice.

In order to complete this liberation, the most vulnerable among us must see their rights to development being realised with each passing year, through progressive advances in access to land, education, training, health care and economic opportunity. This is achieved, as President Mbeki has reminded us, through the *Programme of Action* of a Government that cares for its people, that makes socially just choices and that is committed to service delivery in the spirit of *batho pele*.

In this context, and with the President's permission, I would like to convey the best wishes of our Government and people to the delegates who are now convening at the United Nations in New York to undertake a ten-year review of the Beijing commitments, relating to the critically important issue of the emancipation of the women of the world. What we will say today is also focused on ensuring that we achieve further advances in our own pursuit of this central aspect of the new society we are working to create.

We have noted with concern the recent violent demonstrations in some areas, including local communities in the Free State and a number of our institutions of higher learning. As our President has said, the Government must act firmly against those who break the law and destroy public property or attack the police. Nonetheless, we understand the impatience that motivates some of those who are drawn into these demonstrations. Part of our task as public representatives is to continue to explain, even as we celebrate our progress, that just as Rome was not built in a day, neither will the new South Africa be liberated from its painful past in a day.

Madam Speaker, the 2005 Budget seeks to contribute to the season of hope of which we have spoken, through reinforcing the momentum of our social and economic progress. In framing the Budget, it is this vision that has been our practical guide – a vision rooted in the actual, lived experience and struggles of ordinary people.

Thousands of South Africans have again taken the time and trouble to provide me with advice in the form of “Tips for Trevor”. As always, it has been both humbling and inspiring to share in some of the many ways in which the public finances impact on people’s daily lives.

Education and skills development, quite rightly, feature strongly. Tshepiso Mathabatha writes:

*We should invest more in education, because people need the skill and knowledge to be able to compete in a job market with relevant experience.*

Then there were interesting proposals on financing new priorities. Anesce Stapelberg of the Hoërskool Wonderboom suggested a special bond issue to finance infrastructure for the 2010 World Cup:

*With the money brought in, we can build stadiums, roads or whatever is needed. Then use the profit made from the soccer games to pay the bondholders back, and that way the whole of South Africa can be a part of the journey towards building a better future.*

And from a remote rural village, Lutendo Nethononda captures the feelings of many South Africans:

*It has become necessary that we shift our priorities to Infrastructural Development. This is important because even the old lady of Maliboho requires a taxi or bus to move from the mountains to the nearest shop to buy mieliemeal... Infrastructural development will create jobs, improve the rural economy, improve accessibility, and alleviate poverty...*

Lutendo goes on to remind us of the social dimensions of our tax policies:

*Sin taxes should be increased. Alcohol and smoking are major causes of troubles in our country.*

Not everyone agrees with that, of course. Mthetheleli Baqwa has a different view:

*We cannot live without entertainment and if you always increase the price of beer and brandy then the culture of entertainment will die, which will be unfair for human nature...*

There was also the advice, from someone whose name I should perhaps not disclose, that lobola money should be a tax-deductible expense,

*...as it is a social responsibility put upon one's shoulder unwillingly.*

Which simply goes to illustrate that you can't keep everybody happy, all of the time... But the messages I have received, and the voices we have heard in our *izimbizo*, convince me that South Africans, black and white, urban and rural, are overwhelmingly in agreement on the key values that should underpin our budgetary policies. We agree that we need more rapid growth of our economy. We agree on a development strategy that is broad-based and invests in all our people. We agree on the need to reduce inequality and fight poverty.

Acting together, Madam Speaker, we have the capacity to realise these objectives.

### **Growth, development and equity**

*More rapid growth.* Over the past decade we have laid the macroeconomic and fiscal foundations on which increased investment and a stable business environment rest. In the years ahead we must see more rapid expansion in the productive capacity of our businesses, creating jobs for workseekers, while also growing the revenue base that makes possible an expanded envelope of public services to citizens.

*Broad-based development.* Over the past decade we have invested in meeting basic needs, expanded investment in municipal infrastructure and extended social grants to children and others in need. In the decade ahead, we must invest in improving the quality of education, housing and health services. These elements of the social wage contribute over time to skills and productive opportunities, so that dependence can give way to self-reliance.

*Fighting poverty and inequality.* Over the past decade we have transformed social policy and service delivery based on principles of non-racialism and non-sexism. In the years ahead, we must make more rapid progress in building a society founded on solidarity, in which we give practical expression to our shared interest in addressing the needs of the most vulnerable.

We can face the new season of hope with eyes of pride, acting together to realise a shared vision.

#### *Accelerating economic growth*

Let me comment briefly, Madam Speaker, on our economic progress over the decade past and the policy framework for the years ahead.

Growth of the South African economy has averaged 3,2 per cent a year over the past four years. We expect a continued expansion of between 4 and 4½ per cent over the next three years, signalling a significant step-change in the pace of economic growth. At the same time, we have seen consumer price inflation fall to 4,3 per cent for the year to December 2004, and it is expected to remain comfortably within the 3 to 6 per cent target range over the period ahead.

This is a marked improvement on the position we were in a decade ago. It is the fruit of sound macroeconomic performance and monetary management, improved competitiveness, structural reform and a fiscal policy framework designed to underpin sustainable growth and investment.

Real income per person over the past decade has increased by 15 per cent.

With average growth projected at over 4 per cent a year over the period ahead, real per capita income will rise by at least 30 per cent in the second decade of freedom. We surely need to target growth of at least this order of magnitude if we are to see the progress we desire in making hunger history, in facing the season of hope with pride and vision.

We must also confront the challenge of making our growth pro-poor. Four aspects of our development policy for the decade ahead are particularly critical:

- As we step up the pace of investment in modern transport, communication, water and energy networks, we need to ensure that we build a more efficient economic landscape, that we contribute to more balanced development between suburbs and townships, between urban and rural areas and between the first and second economies. We need to press more urgently on the labour-absorbing potential of infrastructure and building programmes.
- We also seek to strengthen the links between further education and training and workplace requirements. This means we need to modernise our colleges, bring industry and commerce more actively into the governance of education and training, and ensure that funds set aside for skills development are more effectively used.
- We must address the barriers to small business development and job creation that arise from cumbersome municipal planning and approval procedures, or from overly burdensome administration of the tax laws, environmental regulations or labour market controls.
- We need to mobilise, with a greater sense of partnership directed at long term development, both our capacity to save and the accumulated capital under the stewardship of our financial institutions and corporations. Although there is still work to do, I am encouraged by the progress and commitments that have emerged from the Financial Sector Charter process. I believe we have a shared understanding that will lead to public and private sector funding of infrastructure, housing,

empowerment and business development rapidly growing over the decade ahead, giving practical expression, appropriate for our times, to a pledge, fifty years ago, that the national wealth of our country is the heritage of all South Africans.

There are aspects of these economic challenges to which I will return shortly, in dealing with our tax and spending proposals.

*Advancing social development*

More rapid growth makes greater progress in social development possible, and, in turn, well-targeted investments in human capabilities contribute to rising productivity and sustained growth.

Over the past decade we have made steady progress in raising the proportion of spending on social services that goes to the poorest 40 per cent of our people. Welfare and social assistance, education, land restitution and housing have evolved into strongly redistributive expenditure programmes, bringing the average value of services, or the social wage, that went to the poorest 40 per cent of households 3 years ago to an estimated R956 a month. Social security programmes now account for 14 per cent of consolidated non-interest expenditure, up from 9½ per cent five years ago.

Over the decade ahead, there will be other priorities in our social development strategy.

- There is, for example, the imperative to provide every child with education opportunities that meet both the knowledge requirements and social challenges of our future, and to ensure that a caring and competently managed health service is available in every community.
- There is the complementary challenge of transforming the desolate landscape of townships and new housing settlements into sustainable and viable communities, whose riches speak for themselves, whose streets carry songs of laughter, whose character reflects our season of hope. In this Budget, we recognise the need to give greater impetus to

investments in housing, in community infrastructure, in municipal services and in local economic development – not just as projects of government departments or municipalities, but as constructive partnerships that mobilise local enterprise, private capital, indigenous creativity.

- Then there are rural development challenges to address. We will propose allocations to the Department of Land Affairs today that will enable the land restitution programme to complete its work over the next three years. We have put in place a comprehensive agricultural support programme for emerging and resource-poor producers, and the Minister of Agriculture will introduce this year a new credit scheme for small-scale farmers.
- Social solidarity also encompasses the work of reducing crime and insecurity, investing resources in more effective policing and a robust justice system. We have set ourselves daunting targets for reducing the incidence of serious crimes. We are also called upon to play a part in promoting peace and security elsewhere in Africa.

In all these, and many other dimensions of social development, there is an unavoidable tension between the magnitude of the challenge and the limits of our capacity. The Budget is, as always, the practical resolution of this tension, in so far as the period ahead can be planned and programmed. But its implementation is the real expression of our social intent, and this relies on the shared efforts and energies of public servants, workers, businesspeople, citizens, all our people, who embrace the future with hope, and eyes of pride.

Acting together, Honourable Members, we do have the capacity to realise these objectives.

*Equity and redistribution*

This social intent also embodies our commitment to build a more just, more equal society, in which steady progress is made in reducing the gulfs that divide rich and poor, black and white, men and women, rural and urban.

On some dimensions, there have been notable advances. Real wage improvements and public expenditure on services have contributed to rising living standards of many people. A recent research report indicates rapid growth in the numbers of black households entering middle income bands, associated in part with higher demand for skilled and professional labour. Empowerment targets and transformation initiatives in education, in employment and in procurement are contributing to better racial and gender representivity. Corporate restructuring and equity participation schemes have brought changes to the ownership, management and strategic direction of many companies.

Yet our income distribution remains highly unequal. We are gaining a deeper understanding of the role of public policy in shaping the distribution of income and opportunities. Today sees the release of the results of a study of the shifts since 1995 in the distribution of government expenditure on education, health, welfare services and housing. This research shows that whereas aggregate social spending increased in real terms by 14 per cent per person between 1995 and 2000, spending on the poorer 40 per cent of households increased by 25 per cent per person – signalling a steady increase in the redistributive social wage.

There is nonetheless room for further improvements in the quality and targeting of services, and the management and effectiveness of government programmes.

So, for example, we have directed attention this year at the costs and complexity for small businesses of the tax code, because there is compelling evidence that simplified arrangements can assist significantly in creating an environment conducive to enterprise development.

Under the leadership of the Ministry of Education, we have developed proposals for improving the targeting of funding for schools and the regulations governing school fee exemptions, because this is such an important vulnerability for poor households.

Mindful of the difficulties many young people find in breaking into the job market, we have worked with the Ministry of Labour in promoting learnerships, backed by tax deductions for participating companies, and we will learn more about options for skills development and work initiatives from the projects of the Umsobomvu Youth Fund and the expansion of public works programmes this year.

The National Empowerment Fund receives further funding this year, and we are certain that it will make a growing contribution to broadening the reach of business empowerment and transformation. Through Government's procurement framework, an increasing proportion of contracts are going to small businesses and to black-owned or women-owned businesses. The Minister of Trade and Industry has taken the lead in developing both improved support for small and new businesses, and common codes to guide the design of empowerment projects.

Two further distributional aspects of public policy receive attention in today's Budget. As announced last year, there will be changes to the way in which travel allowances are taxed, as these deductions have created unwarranted benefits for higher income earners. There will be a change, also, to the tax treatment of medical scheme contributions, which will have the effect of reducing the cost of medical scheme membership to lower income families. Expanding medical scheme membership, and ensuring that our public hospitals provide an accredited cost-effective service to both uninsured patients and medical scheme members, are critical hurdles to be overcome before a more inclusive social health insurance arrangement can be implemented.

Members of the House will appreciate that the measurement of inequality and the impact of public services on relative disparities in standards of living is

difficult, and needs to be the subject of further work. Several commentators have suggested that social policy would be assisted by our adoption of an official poverty measure, as is done by many countries. I believe this proposal has merit and will seek further advice this year on the design of a poverty line for South Africa.

### **Economic outlook**

Madam Speaker, let me return briefly to the outlook for the economy, before detailing this year's spending plans and tax proposals.

#### *Global economy*

Growth in the global economy accelerated to nearly 4 per cent in 2004, from 2,4 per cent in 2003. China and developing Asian economies are continuing to industrialise and deepen their services sectors rapidly, on the strength of high savings rates, broad skills pools and competitive export sectors. Growth has also recovered strongly in the United States, but its sustainability is threatened by huge imbalances in both the fiscal accounts and the balance of payments.

Economic growth on the African continent has averaged about 4 per cent over the past three years, with encouraging signs of an improved trade response in several countries to the global expansion. However, the pace of economic development in Africa remains tenuous. Far more needs to be done to attract investment, intensify education and training, deepen financial markets, open up trade relations and harmonise regulatory and legal environments. We will continue to give support to initiatives of NEPAD directed at these challenges, and we note that the Commission for Africa has given impetus to the international response to the trade and finance issues facing our continent. These are reforms that cannot take root in a context of war, or constitutional uncertainty, or political opportunism. And so all of us, all of Africa, and all who recognise Africa as part of a shared humanity, owe an immeasurable debt of gratitude to those who are tirelessly working for peace and overcoming the fractures that trouble our continent.

Global expansion is expected to slow in 2005, with further moderation in 2006. High oil prices and the overhang of the US deficits are likely to hold back growth – and some commentators anticipate an extended slowdown as a result of international trade and financial imbalances. Although our economy remains vulnerable to this uncertainty, our trade and financial links are increasingly diversified and our growth has a robust domestic impetus – both sources of strength in an uncertain world.

South Africa has experienced strong growth in commodity exports in 2004, but has also seen rising imports in response to domestic demand and the strength of the rand. Expenditure on maritime vessels, new airplanes and, in the third quarter, oil, added significantly to the import trend in 2004. This resulted in a widening of the current account deficit to an estimated 2,3 per cent of GDP, and it is expected to continue to widen moderately over the next three years.

For this reason, it is important that we should continue to attract foreign investment and portfolio inflows, providing the external capital required to finance the shortfall between our export earnings and import costs.

The cumulative surplus on the financial account was over R60 billion in the first nine months of 2004, partly attributable to a resurgence of foreign investment in shares on the Johannesburg Securities Exchange. We have seen further upgrades in the rating of government's domestic and external debt, which also signals foreign capital market confidence in the South African economy.

#### *Prospects for the domestic economy*

Several fundamental strengths lead us to project further upward momentum in our economic growth performance over the next three years.

- Moderation of inflation and the sound and consistent management of monetary policy by Governor Mboweni and the Reserve Bank have brought interest rates down to their lowest levels in 24 years.

- Gross fixed capital formation increased by 9 per cent in 2003 and an estimated 7½ per cent in 2004, contributing to a broader and deeper platform for growth and productivity advances in future.
- Following several years of decline, South African mining production expanded by over 4 per cent a year in 2003 and 2004. Output of gold mines has continued to decline, but platinum, coal, diamonds and other minerals are benefiting from growth in demand and prices on international commodity markets.
- Value added in the construction sector grew by over 6 per cent in 2004. There is strong growth in the residential property market. Further impetus will be given to building and construction growth by inner city refurbishment encouraged by our urban renewal tax incentive, accelerated investment in low-income housing and municipal infrastructure and several large economic infrastructure projects over the decade ahead.
- Official foreign exchange reserves have increased to over US\$15 billion, which is more than four times the current short term debt level. Reserves held by the private banking sector have also increased strongly, contributing to a marked improvement in the nation's overall balance sheet and reduced vulnerability to the inherent volatility of international financial flows.
- There are also encouraging signs of progress in broadening participation and greater resilience of small enterprises across many areas of economic activity. The official labour force survey suggests that non-agricultural employment has increased by about 280 000 jobs a year since 2000. Small and medium-sized contractors are competing increasingly successfully for government roads and public works projects. Micro-enterprises offering cellphone services, catering, accommodation, entertainment, household and personal services are both a growing feature of the economic landscape and at least to some

extent a bridge to further opportunities and more formal business formation. The notable growth of 18 per cent in the VAT revenue base this year is just one indicator of a steady expansion in the numbers of registered, viable business enterprises.

Taking into account the anticipated global slowdown and the continued relative strength of the rand, our expectation is that the South African economy will grow by 4,3 per cent this year and an average of 4,2 per cent over the next three years. Gross fixed capital formation growth is projected to average 7 per cent a year with exports rising by about 4½ per cent a year. We expect CPIX inflation to average 4 per cent in 2005, rising to between 5 and 5½ per cent in 2006 and 2007.

Madam Speaker, it is pleasing to note that we have revised upward the growth estimates for 2004 and 2005 tabled before this House in February last year. Changes in the economic outlook arise partly from changes in the global or domestic market environment. But at least two critical areas of economic performance are firmly within the scope of our influence and responsibility. I refer to the need to accelerate the pace and quality of infrastructure investment, partly a responsibility of government departments and partly of our major parastatals, and to the need to address deficiencies in municipal planning and service delivery and in the regulatory and administrative environment that impede business development and job creation. These were rightly amongst the urgent priorities articulated by President Mbeki in the State of the Nation Address on 11 February.

### **Budget framework**

Madam Speaker, the fiscal policy considerations and broad outline of a proposed framework for the 2005 Budget were set out in the *Medium Term Budget Policy Statement* tabled in October last year. We outlined a framework for accelerated growth and broad-based development, focused on five policy priorities:

- Increasing the rate of growth and productive investment
- Encouraging employment and development of the second economy
- Social development and mobilising human resources
- Improving the State's capacity to promote growth, broaden development and combat crime, and
- Strengthening international relations for growth and development.

Due to the strength of the economy and the excellent work of Commissioner Gordhan and his tax and customs team, we are now projecting to raise R11 billion more this year than budgeted. Non-interest spending is R5,2 billion higher than the original estimate, with the largest adjustments being for social grants, drought relief and municipal rates and taxes. Our deficit this year should come in at 2,3 per cent of GDP, and debt service costs will be 3,5 per cent of GDP. Members of the House will recall that debt service accounted for 5,6 per cent of GDP six years ago, and I know you will share my firm intent not to reverse this progress.

Our budget framework for the next three years sees revenue as a share of GDP average 24,2 per cent. We anticipate a deficit of 3,1 per cent of GDP next year, falling to 2,7 per cent by 2007/08. Total expenditure, excluding interest costs and a contingency reserve, rises from R363 billion in 2005/06 to R428 billion by the end of the MTEF period.

These projections allow an additional R74,4 billion to be added to the baseline allocations of national departments, provinces and municipalities over the next three years. Consolidated real non-interest expenditure will grow at 7½ per cent next year, and an average of 5 per cent over the MTEF period ahead.

In framing these projections, we have been mindful that infrastructure spending by municipalities and public enterprises is expected to grow strongly over the years ahead, complemented by rising spending on public assets through public-private partnerships of various kinds. Significant projects include:

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- completion of the Port of Ngqura,
- the Berg River Water Scheme in the Western Cape and further development of the Olifants River and Groot Letaba River dam systems in Mpumalanga,
- recommissioning of the Camden, Komati and Grootvlei power plants and upgrading of the Matimba plant,
- construction of a hydroelectric pumped storage scheme at Braamhoek and two coastal gas turbine plants,
- investment of some R27 billion in electricity transmission and distribution networks over the next five years,
- building of a demonstration plant by the Pebble Bed Modular Reactor company,
- Transnet's R4,9 billion locomotive and wagon fleet renewal and modernisation programme,
- upgrading of the Coallink line to Richard Bay and the Sishen-Saldanha link,
- a new container terminal for Durban and port capacity expansion in Cape Town, Richards Bay and Saldanha, and
- the building of a new multi-purpose Durban-Johannesburg-Pretoria fuel product pipeline.

The contingency reserve and unallocated funds for transport infrastructure in the MTEF proposals for the next three years allow for additional allocations to critical infrastructure investment projects in the Adjustments Budget, where project planning is well advanced and business plans have been approved.

## **Division of revenue**

Madam Speaker, nationally collected revenue is divided equitably between national departments, provinces and local government, as required by the Constitution. The resulting allocations, and details of various conditional grants to provinces and municipalities, are set out in the Division of Revenue Bill tabled before the House today. National departments account for 37 per cent of the allocations and provinces almost 58 per cent. Grants to municipalities total 5 per cent of available resources, growing by 13,3 per cent a year, which is the fastest growing component of the budget.

The intended consolidation of social grants administration in a single national Agency reporting to the Minister of Social Development results in a significant change to the budget framework. Social grants and associated administrative expenditure are now fully budgeted for on the national Social Development vote, as conditional grants to provinces. These funds will be ring-fenced and separately managed by provinces, as an interim step towards establishing the new Social Security Agency.

In 2005/06, R135 billion will be distributed between provinces in terms of the equitable share formula, and R75 billion will be allocated as conditional grants from national departments.

Provinces and municipalities are at the front-line in providing the many services required by our people. The last decade saw their establishment, and steady increases in the resources transferred for basic services. For the decade ahead, the intergovernmental framework will see significant changes:

- New allocation formulas are being phased in for both the provincial and local government equitable shares,
- Conditional grants are under review, and will be reformed to reflect more appropriately their role in giving effect to national policy objectives for concurrent functions,

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- The RSC levies will be eliminated in 2006, and
- Metropolitan and selected urban municipalities will play an increasing role in the delivery of housing and related services.

The Government's Programme of Action rightly highlights the importance of addressing those weaknesses in governance systems or financial administration that hold back public service delivery, both in provincial departments and municipalities. Our season of hope rests in considerable degree on the pride and vision with which provincial officials, local councillors and municipal staff take up this challenge. Acting together, we do have the capacity to overcome the administrative weaknesses.

### **Medium term expenditure allocations**

#### *2005 Budget priorities*

Madam Speaker, we indicated in the *Medium Term Budget Policy Statement* that significant additional allocations for social grants would be made in today's Budget, that land restitution would be a priority and that community and social infrastructure investment would be accelerated.

We have already noted the immense contribution of our social grants system to the income security of the most vulnerable, and in particular to the support of children under the age of fourteen. This expansion in the redistributive thrust of the budget carries a cost. Of the R74 billion in additional allocations over the MTEF, a total of 30 per cent is added to the social grant programmes, bringing aggregate social security spending to R55,4 billion next year and 12,7 per cent of consolidated spending by 2007/08.

In addition to providing for rising beneficiary numbers, the MTEF allocations provide for inflation-related adjustments to social grants. With effect from April 2005, the maximum old age, disability and care dependency grants will rise by R40 to R780 a month, foster care grants increase by R30 to R560 and the child support grant goes up by R10 to R180 a month.

The 2005 Budget provides for several other significant spending adjustments:

- R2 billion for the new comprehensive housing strategy and R1,7 billion for municipal and sanitation infrastructure,
- R6 billion to complete the land restitution programme,
- R3 billion for transport infrastructure and services,
- R1 billion for improved buildings and equipment for further education colleges, and R776 million for the National Student Financial Aid Scheme,
- R6,9 billion to contribute to improved salaries for teachers and R4,4 billion for pay progression in the SA Police Service,
- R1,4 billion to support our African development agenda, including peace-keeping operations, institutions of the African Union and the Pan African Parliament.

*Economic development and investment*

Our developmental objectives require a careful balance between direct income support, improved public services such as education, health and municipal services and investing in social infrastructure such as housing, water, sanitation, roads and public transport. Some of these priorities, Madam Speaker, are exclusively or mainly the responsibility of government. But in other areas, such as economic development and investment in productive capacity, we seek to complement and reinforce private sector growth and initiative.

We are particularly mindful of the need to improve the alignment between public infrastructure and investment plans and business development opportunities.

Increased investment in transport infrastructure and systems accordingly features strongly in the 2005 Budget proposals. These are shared

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responsibilities of national, provincial and local government, and details of the additional R3 billion to be allocated will be tabled in the Adjustments Appropriation later this year. Projects related to the requirements of hosting the 2010 Soccer World Cup will receive early priority.

Other economic development initiatives for the MTEF period ahead include the following.

- A new Micro Agricultural Finance Scheme is proposed, to complement the Comprehensive Agricultural Support Programme and provide further assistance to emerging farmers and land reform beneficiaries. An amount of R1 billion is available for this initiative, of which R600 million is expected to be allocated over the next three years.
- R400 million a year is allocated to the Trade and Industry vote for the National Empowerment Fund.
- R885 million over the next three years goes to the taxi recapitalisation programme, together with additional resources on the Transport vote for improved traffic law enforcement.
- R400 million is proposed on the Communications vote to contribute to investment by the South African Broadcasting Corporation in the modernisation of its equipment and technology.

### *Social services*

As in the past, Madam Speaker, additional allocations for social service functions mainly go to provinces. In addition to substantial adjustments for social grants, this year's Budget provides for improved salaries for educators and social workers, a new conditional grant for further education colleges, funds to enable provinces to fulfil their responsibility for primary health services formerly provided by non-metropolitan municipalities, and an additional R180 million a year for tertiary health services.

Recognising the critical role of technical skills in a growing economy, R1 billion will be invested over the next three years in improved facilities, equipment and support in further education and training colleges. Through strengthened ties with the skills development programme, sector education and training authorities and employers, colleges have to take their rightful place at the forefront of industrial progress and technology change.

Additional allocations go the Arts and Culture vote for management of Robben Island Museum as a World Heritage Site and for hosting the 29<sup>th</sup> session of the World Heritage Committee this year.

In addition to supplementary resources for the National Student Financial Aid Scheme which assisted about 100 000 students in 2004, the National Department of Education receives funding for an education management information system to integrate the flow of information from schools and colleges.

The Department of Labour receives additional allocations for an integrated call centre and improved inspectorate services. Its oversight of the national skills development strategy remains a central priority, as the flow of funds to sectoral education and training authorities and the National Skills Fund will amount to R5 billion in 2005/06, rising to R6 billion by 2007/08.

#### *Housing and community development*

Let me turn to the challenge of building houses, security and comfort for all.

We cannot, in good conscience, build dormitory suburbs characterised by neglect, settlements that have no sports facilities, entertainment, business opportunities, social or policing infrastructure.

If Sophiatown, in the midst of its destruction fifty years ago, could give birth to the rhythms of kwela, the patha-patha jive, the musical genius of Miriam Makeba and Kippie Moeketsi's Shantytown Sextet, and the talents of Todd Matshikiza, Can Themba, Walter Nhlapo – how much more will be possible as the shadows come to life in District Six, Marabastad and Cato Manor – and as the new spirit

of *uCarmen eKhayelitsha* emerges in Botshabelo, Motherwell and Chatsworth?

On the strength of a new Plan for the Development of Sustainable Human Settlements, the period ahead will see a shift of direction and greater impetus given to investment in housing and the development of residential communities. The central aim is to replace or upgrade all informal settlements, which currently house some 1,4 million households, by 2014. In this practical way, we seek to give further expression to the vision President Mbeki has reminded us of: that South Africa belongs to all who live in it.

Municipal allocations, through which free basic services and investment in infrastructure for low-income communities are supported, increase by a total of R5,4 billion over the MTEF baseline amounts.

*Justice, crime prevention and security*

Within the justice, crime prevention and security cluster, additional allocations are made to the Safety and Security vote to continue the expansion of police numbers and improve remuneration, to Correctional Services to increase the capacity of prisons and establish a seven-day working week, and to Justice and Constitutional Development to improve court administration and continue to modernise information systems and strengthen court security.

Government plans to increase the number of police officers from 139 000 in 2003 to 165 850 by 2008. The Department of Justice plans to appoint 40 new magistrates over the new year, and 1 000 vacancies will be filled at courts and to support prosecutorial services. Over the next three years, accommodation capacity in correctional service facilities will increase by 12 000 bed spaces.

*Governance and administration*

Members of this House are well aware of our responsibility to ensure that we have a capable state, one that is able to give effect to its administrative duties and responds effectively to meeting the needs of the poor. We are conscious of many shortcomings in our present system of administration. Better governance

and administration must remain a central focus of both the executive and our legislatures.

The services rendered by the Department of Home Affairs are critical to providing citizens with access to basic benefits and other government services. Additional allocations of R800 million over the MTEF period are recommended for strengthening capacity of the Department and implementation of its transformation strategy. The Independent Electoral Commission also receives supplementary funding, primarily for the forthcoming local government elections.

Other revisions to core administrative functions include:

- R1,6 billion for the Public Works vote, to address shortfalls in municipal rates and service payments on government buildings, to upgrade buildings at land ports of entry and address maintenance backlogs at government buildings
- Replacement of the preliminary allocations on the Statistics South Africa vote for a census in 2006 with allocations for a new community survey and improvements in the quality of various economic and social statistical series, and
- An additional R250 million for Parliament's MTEF, to improve both internal governance and services to committees.

*International relations, peace and security*

Lastly, Madam Speaker, let me refer to the contribution of the fiscus to our international relations, peace and security commitments. The 2005 Budget will again reflect our rising contribution to a season of hope for the African continent, and to putting the concerns of the poor on the agenda of world opinion.

Additional allocations amounting to R350 million over the MTEF period are proposed for the Foreign Affairs vote, contributing to the costs of hosting the

Pan African Parliament, expanding representation in Africa and elsewhere, contributing to the African Union's peacekeeping programme and modernising the department's information systems.

On the Defence vote, further amounts of R300 million a year are allocated for peace support operations in the Democratic Republic of Congo, Burundi and the Sudan.

### **Tax proposals**

Turning now to our tax proposals – we have enjoyed the benefit in the past year of strong revenue growth associated with the economic recovery, and for the period ahead we can again provide moderate tax relief while continuing to promote certainty, consistency, fairness and a broad-based tax structure. The revenue requirement for 2005/06 is R370 billion, or 9½ per cent more than the 2004/05 revised estimate of R338 billion.

Tax measures are again prominent in “tips for Trevor”. Nobathembu Dwenga suggests that it is time to abolish the secondary tax on companies, Marianne Visser proposes that public servants should be exempt from paying personal income tax, Warren Smith writes again that the tax on retirement savings should be abolished. Unfortunately we cannot do all of these things. But I am pleased to be able to advise Sarah Uys, who has written for the past two years on the question of income tax on pensions, that we are deeply mindful of the difficulties of elderly people who often care for several other family members, and of widows trying to make ends meet without becoming a burden on their children. Further relief to pensioners is part of this year's tax package.

#### *Personal income tax relief*

The proposed revisions to individual income tax rates and brackets for the 2006 tax year provides relief of R6,8 billion for individuals and households. This represents compensation for the effects of inflation and real tax relief in all income groups, with about 62 per cent of the total relief going to those earning below R200 000 a year. Personal income tax relief also benefits many self-

employed individuals and micro-enterprises, providing a further stimulus to small business development.

The income tax threshold, below which no tax is payable, is raised from R32 222 to R35 000. For taxpayers over the age of 65, the threshold increases from R50 000 to R60 000.

In addition, the interest income exemption for individuals is raised from R11 000 to R15 000, and for those over 65 from R16 000 to R22 000. These adjustments will cost about R310 million, and serve in part to encourage savings further.

#### *Tax treatment of health care funding*

A reform of the tax treatment of medical scheme membership and health care costs is also proposed. The present allowance for two-thirds of a medical scheme contribution to be paid tax-free will be replaced by a capped tax deduction. This will have the effect of limiting the tax loss associated with more expensive medical scheme options, while increasing its monetary benefit to lower income taxpayers, thereby enabling more people to afford medical aid. The change will also remove the present disparity between employed and self-employed individuals. Other adjustments to the deductibility of medical expenses will accompany this reform. For administrative reasons, and to allow employers and employees to adapt their remuneration arrangements, the changes will take effect in 2006 and will only lead to a revenue loss in subsequent years.

#### *Motor vehicle allowances*

As indicated at the time of the 2004 Budget, a revised approach to the calculation of deemed business travel expenses against a motor vehicle allowance will be introduced this year. The change will lower the tax benefit associated with deemed motor vehicle use calculations, particularly where the vehicle value exceeds R360 000. From 1 March 2006, the monthly taxable value of the use of a company car is to be increased from the current 1,8 per

cent to 2,5 per cent. These changes will yield an additional R1,5 billion a year, but only once assessments for 2005/06 are finalised in the course of 2006. Taxpayers are advised to anticipate higher final payments on assessment in 2006.

*Transfer duty*

Taking into account the steep rise in property prices over the past two years, it is proposed that the transfer duty exemption threshold should be raised from R150 000 to R190 000, together with an increase in the upper threshold from R320 000 to R330 000. The duty payable on a property of R330 000 or more will fall by R2 300, making houses slightly more affordable. The total revenue loss is estimated at R450 million.

*Empowering small business*

Both the National Treasury and SARS have focused closely over the past year on aspects of the tax law and its administration that inhibit small business development. We are now able to initiate a series of programmes aimed at making life easier for small businesses, some of which will be implemented immediately and others over the next three years. Following the call of the President in this house two weeks ago, three broad reforms are proposed.

- Tax relief of R1,4 billion is targeted at small business companies to make resources available for growth and investment. This includes the extension of relief to a broader range of service companies, and raising the turnover limit for eligibility from R5 million to R6 million. In addition, the graduated rate structure will be adapted as follows: qualifying small companies will pay no tax on the first R35 000 of taxable income, 10 per cent on income in the range R35 000 to R250 000, and 29 per cent thereafter. Small businesses will also be eligible for a simplified 50:30:20 depreciation write-off rate for non-manufacturing assets, while manufacturing assets will continue to qualify for 100 per cent write-off.

- Secondly, additional relief of R367 million will form part of streamlining ongoing filing obligations. This will involve halving the number of VAT payments small businesses make in a year and exempting them from the skills development levy.
- Thirdly, a package of administrative interventions by SARS will be implemented to assist small businesses on the ground with their tax and – in an innovative step – their broader business management. SARS will provide community tax helpers, help desks, extended hours and accounting packages, free of charge.

### *Company tax*

Madam Speaker, the special tax allowances for strategic industrial projects introduced four years ago will lapse in July 2005. Since its announcement, a more favourable depreciation regime for manufacturing assets has been introduced and a more direct programme of government investment in critical infrastructure is under way.

The revenue laws this year will also contain measures to facilitate company restructurings, deal with undesirable tax avoidance arrangements in the film industry, and to assist public benefit organisations that rely in part on income from business activities.

Taking into account the overall improvement in our effective rate of tax on companies achieved through base-broadening measures and more effective tax administration, the company tax rate will be reduced from 30 per cent to 29 per cent for the year ahead. This results in a revenue loss of R2 billion.

### *Removal of transaction taxes on debit entries*

Members of the House will share our concern that access to banking services should be kept affordable and efficient. This is largely a matter for the banking sector to address and we welcome the progress made in making low-cost bank services available over the past year. We understand that some 550 000 Mzanzi accounts have already been registered. Government must also play its

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part, and so we propose to remove the stamp duty on debit entries and instalment credit agreements with effect from 1 March 2005, as these fall disproportionately on lower income groups and are administratively inefficient. This will cost R350 million a year.

### *Excise duties*

This year's changes in excise duties on alcoholic beverages are as follows:

- Tax on beer is raised by 11 c per 750ml bottle or 5 c per 340 ml can.
- Tax on fortified wine rises by 23 c per 750ml bottle and on natural wine by 18 c a bottle.
- Ciders and alcoholic fruit beverages go up by 5 c per 340 ml can.
- Duties on spirits are increased by R1,47 per 750 ml bottle.

Duties on tobacco products are increased by between 7 and 15 per cent, maintaining the present 52 per cent total tax burden. A packet of 20 will cost 52 cents more.

The increases in alcohol and tobacco product duties will raise R1,6 billion in additional revenue.

In keeping with these health-related fiscal measures, we propose also to abolish excise duties on sun protection products, at a cost of R10 million a year.

The Air Passenger Departure taxes will be increased by 9 per cent this year, to R60 for travel to SACU countries and R120 for international departures to other destinations.

### *Fuel levies*

The general fuel levy on petrol and diesel will be raised by 5 cents a litre on Wednesday 6 April, broadly in line with inflation. This increase will raise an

additional R950 million. At the same time, the diesel refund concession for primary producers will be raised.

With effect from January 2006, when the octane structure of petrol sold in South Africa will be changed, a supplementary levy on 95 octane unleaded petrol in inland areas will be imposed for demand management reasons.

The Road Accident Fund levy will again increase by 5 cents a litre, to permit further progress to be made in clearing claims backlogs and stabilising the financial position of the Fund.

### **Proposed use of exchange control amnesty proceeds**

Members of the House will recall that in 2003 we announced an exchange control amnesty and accompanying tax measures to allow past transgressors of exchange controls to declare their assets and regularise their financial positions. More than 43 000 applications have been received and total assets disclosed are estimated at R65 billion.

On the strength of the amnesty levy proceeds and the permanent increase in the income tax base associated with foreign asset disclosures, we propose to set aside R3 billion over the next three years for investment in community infrastructure, targeted at lifting the quality of life in new housing areas, upgraded informal settlements and old townships. This development challenge, that we may demonstrate visibly that South Africa belongs to all who live in it, has to be a shared project of national and provincial government, municipalities, community organisations and the private sector. We must seek to build partnerships that mobilise our most creative energies in constructing recreational and sports facilities, health and education services, administrative infrastructure, business opportunities and community resource centres.

And so, with eyes of pride and vision, acting together, we can embrace the season of hope ahead.

Madam Speaker, let me conclude by returning to the words of former President Mandela, in his recent appeal to world leaders to join the Make Poverty History Campaign: “Do not look the other way; do not hesitate. Recognise that the world is hungry for action, not words. Act with courage and vision.”

In preparing this Budget, we have been privileged to have President Mbeki’s guidance at hand, and his resolute commitment to our Programme of Action.

I would like to express appreciation also to Deputy President Zuma, to my Cabinet colleagues, and especially members of the Ministers’ Committee on the Budget, for support and sharing this responsibility.

Deputy Minister Jabu Moleketi has brought a fresh and welcome perspective on our deliberations.

We have also had the privilege of working with nine new Provincial Executive Council members responsible for finance. They have distinct challenges to face, and I am profoundly grateful for their expertise and energy, and for the commitment and enthusiasm with which they have joined the finance team.

We continue to enjoy valued support from many others:

- Governor Tito Mboweni and the staff of the Reserve Bank,
- Statistician-General Pali Lehohla, his staff and members of the Statistics Council,
- Renosi Mokate and members of the Financial and Fiscal Commission,
- Convenors and representatives of the business, labour and community constituencies of Nedlac, and its head, Herbert Mkhize,
- Nhlanhla Nene and Buti Mkhali, co-chairs of the Joint Budget Committee, Tutu Ralane who chairs the Select Committee of Finance and Rob Davies, chair of the Portfolio Committee.

Madam Speaker, I introduced Lesetja Kganyago as the Director-General of the National Treasury to the House at this time last year. I am pleased to report that his leadership and dress sense continue to be inspirational.

Pravin Gordhan remains a pillar of strength, and we are all deeply indebted to the staff of the Revenue Service, National Treasury and the Ministry of Finance.

Members of the House, fellow South Africans, *our country, as a united nation, as President Mbeki has asserted, has never in its entire history enjoyed such a confluence of encouraging possibilities... sparing neither effort nor strength, we can and shall build a South Africa that truly belongs to all who live in it, united in our diversity!*

## 2005 Budget Speech

### Summary of the National Budget

R million	2004/05		2005/06	2006/07	2007/08
	Budget estimate	Revised estimate	Budget estimate	Medium term estimates	
<b>REVENUE</b>					
<b>Estimate of revenue before tax proposals</b>			<b>379 250</b>		
<b>Tax proposals</b>					
<b>Taxes on individual and companies</b>			<b>-10 862</b>		
Personal income tax			-7 110		
<i>Adjust personal income tax rate structure for inflation</i>			-6 800		
<i>Increase in interest and dividend exemption under 65 years</i>			-170		
<i>Increase in interest and dividend exemption 65 years and over</i>			-140		
Corporate income tax			-2 000		
<i>Reduction in corporate tax</i>			-2 000		
Small business incentives			-1 752		
<i>Introduce VAT payments from every 2 months to every 4 months</i>			-275		
<i>Exemption from Skills Development Levy</i>			-92		
<i>Graduated rate structure</i>			-900		
<i>Accelerated depreciation for all assets</i>			-485		
<b>Financial transaction taxes</b>			<b>-800</b>		
Adjust for transfer duties			-450		
Elimination of stamp duties on debit entries			-350		
<b>Taxes on goods and services</b>			<b>2 281</b>		
Increase in duties on alcohol			690		
Increase in duties on tobacco products (52% incidence)			620		
Abolish <i>ad valorem</i> excise duties on sun protection products			-10		
Abolish duty on base oils for lubricating			-1		
Increase in Air Passenger Departure Tax			32		
Increase in fuel levy			950		
<b>Estimate of revenue after tax proposals</b>	<b>326 956</b>	<b>337 960</b>	<b>369 869</b>	<b>405 427</b>	<b>444 643</b>
<i>Percentage change from previous year</i>			9,4%	9,6%	9,7%
<b>EXPENDITURE</b>					
<b>Statutory and standing appropriations</b>					
Cost of servicing state debt	50 432	48 901	53 125	56 603	59 381
Provincial equitable share	159 971	164 084	134 706	146 757	157 678
Skills development levy	4 300	4 300	5 000	5 600	6 000
Other 1)	963	975	1 060	1 121	1 177
	<b>215 666</b>	<b>218 260</b>	<b>193 891</b>	<b>210 081</b>	<b>224 235</b>
<b>Appropriated by vote</b>					
Current payments	58 860	59 004	66 133	71 858	77 696
Transfers and subsidies	85 284	87 454	149 140	162 149	174 806
Payments for capital assets	5 594	5 395	6 155	6 305	6 656
	<b>149 738</b>	<b>151 853</b>	<b>221 428</b>	<b>240 312</b>	<b>259 159</b>
<b>Plus:</b>					
<i>Unallocated funds</i>	1 000	–	500	2 000	3 500
<i>Contingency reserve</i>	2 500	–	2 000	4 000	8 000
<b>Estimate of national expenditure</b>	<b>368 904</b>	<b>370 113</b>	<b>417 819</b>	<b>456 393</b>	<b>494 894</b>
<i>Percentage change from previous year</i>			12,9%	9,2%	8,4%
<b>2004 Budget estimate of expenditure</b>		<b>368 904</b>	<b>404 654</b>	<b>439 058</b>	
<i>Increase / decrease</i>		1 209	13 165	17 335	

1) Salaries of Members of Parliament, salaries of judges and standing appropriations (claims on guarantees and subscriptions to funds of the World Bank, African Development Bank and International Monetary Fund).

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### Summary of the National Budget

	2004/05		2005/06	2006/07	2007/08
	Budget estimate	Revised estimate	Budget estimate	Medium term estimates	
<b>R million</b>					
<b>Revenue</b>	<b>326 956</b>	<b>337 960</b>	<b>369 869</b>	<b>405 427</b>	<b>444 643</b>
<b>Expenditure</b>	<b>368 904</b>	<b>370 113</b>	<b>417 819</b>	<b>456 393</b>	<b>494 894</b>
<b>National budget deficit</b>	<b>-41 948</b>	<b>-32 152</b>	<b>-47 950</b>	<b>-50 966</b>	<b>-50 251</b>
<i>Percentage of GDP</i>	<i>-3,1%</i>	<i>-2,3%</i>	<i>-3,1%</i>	<i>-3,0%</i>	<i>-2,7%</i>
Plus: Extraordinary transfers	-7 000	-7 136	-7 000	–	-4 328
Less: Extraordinary receipts	2 742	1 720	1 529	527	712
<b>Net borrowing requirement</b>	<b>-46 206</b>	<b>-37 569</b>	<b>-53 421</b>	<b>-50 438</b>	<b>-53 867</b>
<b>Financing</b>					
<b>Change in loan liabilities</b>					
<b>Domestic short-term loans (net)</b>	<b>6 000</b>	<b>6 000</b>	<b>4 974</b>	<b>6 000</b>	<b>6 000</b>
<b>Domestic long-term loans (net)</b>	<b>34 328</b>	<b>31 045</b>	<b>25 768</b>	<b>40 299</b>	<b>42 247</b>
Loans issued for financing:					
New Loans	27 328	24 540	18 768	40 299	42 247
Less: Discount	57 526	53 902	48 431	70 589	74 548
Less: Discount	-3 666	-3 013	-3 291	-5 222	-3 957
Redemptions (net of book profit)	-26 532	-26 350	-26 372	-25 067	-28 344
Loans issued for switching	–	-494	–	–	–
New Loans	7 000	8 031	7 000	10 000	–
Less: Discount	–	-171	–	–	–
Loans switched (net of book profit)	-7 000	-8 354	-7 000	-10 000	–
Loans issued for extraordinary purposes	7 000	7 000	7 000	–	–
New Loans	7 000	7 000	7 000	–	–
<b>Foreign loans (net)</b>	<b>5 878</b>	<b>4 795</b>	<b>12 039</b>	<b>2 639</b>	<b>4 120</b>
Market loans	7 400	6 533	9 390	7 090	7 870
Arms procurement loan agreements	4 675	3 683	4 708	3 860	2 800
Less: Discount on issues of new loans	–	-85	–	–	–
Redemptions (including revaluation of loans)	-6 198	-5 336	-2 059	-8 311	-6 550
<b>Change in cash balances</b>	<b>–</b>	<b>-4 271</b>	<b>10 640</b>	<b>1 500</b>	<b>1 500</b>
<b>Total financing (net)</b>	<b>46 206</b>	<b>37 569</b>	<b>53 421</b>	<b>50 438</b>	<b>53 867</b>

