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Overview of the 2007 Budget

South Africa's robust economy has reinforced high levels of business confidence, more rapid job creation and strong demand. Gross domestic product growth is expected to average about 5 per cent over the medium term. Anticipated budget surpluses in 2006/07 and 2007/08 indicate both the successful turnaround of economic performance over the past 10 years and the healthy state of public finances.

Reconstruction and development remain at the heart of the national agenda. Building on a sound foundation, government aims to accelerate growth, promote social development and meet basic needs. Progress in all these areas has gained momentum over the past decade.

With R89,5 billion added to departmental expenditure plans over the next three years, the 2007 Budget makes proposals, for consideration by Parliament, to modernise services and government institutions, and to move towards a social security system that provides income security for all. Infrastructure investment plans are outlined – from public transport to schools to housing – and these and other improvements to the built environment will profoundly reshape our society in the years ahead.

Economic policy seeks to widen participation and employment, support increased export levels, foster small business growth and lower the cost of doing business. Moderate tax relief and a repeal of the retirement fund tax support improved household savings. By improving government savings, the fiscal stance reduces external vulnerabilities.

Promoting growth, modernisation and security

Government will seek to accelerate growth beyond the 6 per cent target

South Africa's pressing development challenges demand a more rapid growth rate to generate the resources and vibrancy required to further reduce poverty and create jobs. More rapid growth is within reach, and government seeks both to accelerate the pace of economic expansion and to ensure that its fruits are shared more widely. Policy initiatives supporting higher rates of investment and growth will be accompanied by concerted improvements in the security and well-being of the nation.

The medium-term economic outlook remains positive, supported by the public investment programme and complementary private-sector investment, benign international economic conditions and a favourable domestic environment.

Management of public finances has created space to step up spending in key areas

The present economic expansion has its roots in both consistent macroeconomic and fiscal policies and favourable global conditions. Over the past decade, sound management of the public finances has created the space to step up spending in health, education, economic infrastructure and other growth-enhancing sectors. Significant levels of tax relief in recent years have also increased disposable income for households, supported savings and encouraged investment.

Following a period of fiscal consolidation and structural reform from 1996 to 2001, government has also invested in improving public services, renewing infrastructure and promoting human development. This lays a foundation for future economic growth, creating jobs and opportunities across a broad range of economic activities, while fundamentally improving the lives of millions of South Africans.

Modernising the economy, transforming the social landscape

Consolidating these gains requires concerted movement along several fronts that will promote the modernisation and further transformation of the economic and social landscape.

Sustained economic growth is a necessary precondition for South Africa's continued transformation. To step up growth beyond the medium-term projections, several interventions have been prioritised that underpin the accelerated and shared growth initiative (AsgiSA). These include strengthening exports, improving public sector performance, and continuing to invest in people through better education, health and training. Government will foster a climate for robust and sustained investment in productive capacity, while undoing barriers to growth embedded in the post-apartheid landscape.

Infrastructure investments improve competitiveness

Government's R416 billion infrastructure programme, now well under way, is a fundamental part of the modernising impetus and has contributed to a steadily rising gross fixed capital formation ratio, now at 18,4 per cent of GDP. Investments in electricity generation and electrification, roads, commuter rail, housing, bulk infrastructure, research and development, water and sanitation, and hospitals and clinics are contributing to a new competitive economic footing and improving the lives of people in rural and urban areas.

Preparations for a successful 2010 FIFA World Cup

Stadium upgrading and construction and improving public transport networks, in preparation for hosting a successful 2010 FIFA World Cup, form an important part of the infrastructure programme.

A long-term programme to modernise key institutions and administrative services will support the growth trend. Well-managed institutions with sound governance rules in both the public and private sectors are an important pillar of the development strategy.

In addition to the core elements of criminal justice, health and education, administrative departments also need to play a key role in ensuring that public service delivery is efficient and effective.

2007 Budget highlights

The economy and fiscal stance

- GDP growth of 4,9 per cent for 2006, averaging about 5,1 per cent a year over the forecast period.
- CPIX inflation averaging 4,7 per cent over the MTEF period.
- A main budget surplus of 0,3 per cent in 2006/07 and 0,6 per cent in 2007/08, moving to deficits of 0,1 per cent in 2008/09 and 0,4 per cent in 2009/10.
- Real growth in national government non-interest expenditure by an annual average of 7,7 per cent over the medium term.
- National budget revenue increases to R475,8 billion in 2006/07, or R9,4 billion more than expected at the time of the 2006 *Medium Term Budget Policy Statement*.
- State debt service costs as a percentage of GDP fall from 3 per cent in 2006/07 to 2,1 per cent in 2009/10.

Main tax proposals

- Net tax relief of R12,4 billion.
- Replacing the secondary tax on companies with a dividend tax and reducing the rate from 12,5 per cent to 10,0 per cent.
- Personal income tax relief for individuals amounting to R8,4 billion.
- Abolishing the retirement fund tax.
- Reducing the withholding tax on lump sum pension and provident fund payments to zero for persons earning below R43 000 per year.
- Increases in the excise duties on tobacco products and alcoholic beverages.

Main changes to spending over the MTEF

- An additional R13,3 billion for the 2010 FIFA World Cup, bringing the total contribution from national government to R17,4 billion – R8,4 billion for stadiums and R9 billion for transport infrastructure.
- The provincial equitable share is increased by R24,6 billion to improve the quality and access to health, school education, welfare services and for economic services.
- An additional R5 billion to the local government equitable share provides further support to municipalities for the delivery of free basic services.
- Spending on education is allocated an additional R4,6 billion for teacher bursaries, curriculum development and an increase in higher education subsidies.
- R11,6 billion for housing and community development.
- R3,7 billion for the comprehensive HIV and Aids programme, and the revitalisation and modernisation of hospitals and health facilities.
- R2,4 billion for industrial development, science and technology.
- R6,8 billion for justice and crime prevention and improved access to justice services.
- R4,7 billion for international relations and defence.

But strengthening disparate institutions alone will not yield the necessary synergies that arise from better coordination and planning. This will require spatial reorganisation of cities, towns and neighbourhoods to fundamentally alter the dysfunctional landscape inherited from apartheid.

Improvements in information technology and business processes

Public service delivery also requires investments in information technology and aligning business processes to client needs. Systems improvements are particularly relevant in the criminal justice environment, where an excessive reliance on paper flow hinders efficient administration of justice. Similarly, a revamp of information technology systems in central administrative departments will hasten service delivery.

Enhanced procurement systems can substantially improve delivery throughout the public sector, especially in the context of the major public enterprises' capital programmes.

Urban regeneration promotes safer, vibrant neighbourhoods

Reorganising and revitalising South Africa's cities will help to modernise the economy and improve security for all citizens. Urban regeneration is a long-term project. It involves integrating and extending the public transport networks, creating safe and vibrant neighbourhoods, upgrading informal settlements and developing a greater range of affordable housing options. Part of this work will require additional resources at the local government level to ensure that municipal infrastructure for sanitation, water, and electricity reticulation keeps pace with rising demand.

Towards a comprehensive social security system

A central feature of progressive societies is their ability to structure a comprehensive social security system that provides a basic level of income protection for all citizens. Over the past decade, government has consistently strengthened the social security net. The 2007 Budget signals further steps in social security reform, aimed at greater income security and reduced vulnerability of households, particularly at lower-income levels, while simultaneously boosting savings.

Fighting crime is a central priority of government

Combating crime and reducing violence are core priorities of government. The 2007 Budget continues to step up the resources dedicated to fighting crime – employing more police, strengthening detective services, and ensuring a more efficient criminal justice sector.

Policy priorities

Government's medium-term strategic framework defines the main priorities over the 2004-2009 period. It seeks to enhance the social and economic welfare of all South Africans as reflected in the following key objectives:

- Accelerating the pace of economic growth, and the rate of investment in productive capacity
- Advancing participation of the marginalised in economic activity through expanded job creation and the promotion of sustainable livelihoods
- Maintaining and expanding a progressive social security net, alongside investment in community services and human development
- Improving the capacity and effectiveness of the state, including combating crime and promoting service-oriented public administration

- Building regional and international partnerships for growth and development.

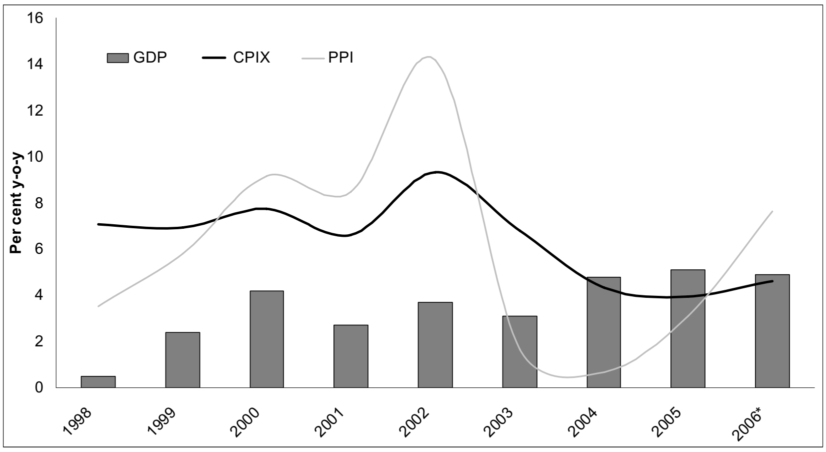
The sections below summarise these key social and economic objectives in relation to the 2007 Budget. Policy priorities and challenges for public service delivery are detailed in Chapter 7. Proposed reforms to social security are introduced in Chapter 6.

Sustaining and accelerating economic growth

GDP growth to average about 5 per cent over the medium term

GDP growth is expected to moderate slightly in 2007, before accelerating to 5,4 per cent in 2009. Over the medium term expenditure framework (MTEF) period, growth is expected to average 5,1 per cent. Although inflationary pressures have posed a risk to the economic outlook, monetary policy has helped to contain price pressures, and average inflation is projected to stay within the 3-6 per cent target band.

Figure 1.1 GDP growth and inflation, 1998 – 2006



**First nine months*

Export performance has lagged behind and needs to be stepped up

Maintaining the growth momentum requires action on several fronts. Export performance has lagged behind opportunity in recent years and needs to be stepped up. The costs of doing business can be reduced, in part by further streamlining regulations and reducing major input costs related to network infrastructure, including telecommunications, electricity and transport. Strengthening the skills base in line with industry requirements is a central priority.

Accelerated infrastructure investment

R35 billion added to infrastructure spending over the medium term

Infrastructure development provides an enabling environment for transportation and other key economic activities. The capital investment programme of government and public corporations is a key element underpinning the growth momentum. The 2007 Budget adds R34,8 billion to capital and infrastructure spending over the medium term for transport, community development and the built environment.

Major capital investment in public transport and infrastructure

Major infrastructure investments include significant budgets for rail rolling stock and signalling equipment totalling R8,6 billion, which will support the commuter rail turnaround strategy. To promote a more integrated public transport system, the budget for bus rapid transit systems rises to R2,3 billion for metros and large municipalities. Transport projects, including local transport infrastructure, total more than R7,9 billion over the next three years, and the National Roads Agency is expected to spend R12,3 billion on enhancing the main highway network.

Government infrastructure spending is supplemented by major investment commitments by state-owned enterprises. Strategic investments by Eskom and Transnet include power generation, the expansion of the freight rail network and a new multi-product pipeline. These investments reduce the cost of doing business by providing greater certainty in the supply of key services to industry.

Mitigating economic imbalances

Consumption growth has contributed to high current account deficit

Since 2001, South Africa has experienced strong increases in economic growth, investment and household consumption. Much of the investment and household spending has been on imported capital and consumption goods. This pattern was supported by low interest rates and a relatively strong exchange rate.

Increased volumes of imported goods and considerably higher oil prices in 2006 pushed South Africa's current account deficit up from 3,8 per cent in 2005 to an estimated 5,5 per cent in 2006.

Increases in meat and grain prices fuelled higher food costs

Inflationary pressures also increased in 2006. Supply constraints for some domestically produced goods exerted upward pressure on producer price inflation, while rising world grain and meat prices contributed to higher consumer prices.

A range of factors will help to moderate the current account deficit, including lower oil prices, higher export volumes, a more competitive exchange rate and strong commodity prices. The fiscal stance helps to sustain economic growth by improving government savings and prioritising spending programmes that strengthen the economy. In spite of these moderating factors, rising investments and associated imports growth are likely to keep the current account deficit between 5 and 6 per cent of GDP.

Broadening participation, promoting equity

More intensive reform required to ensure greater job creation

A key element of the Reconstruction and Development Programme is alleviating poverty and promoting social solidarity. Achieving sustainable growth requires government to address South Africa's widespread income inequality and expand job creation, reducing the large pool of unemployed. Since 2001, about 1,2 million jobs have been created, with stronger growth in employment after 2004. But overcoming economic and social marginalisation requires more intensive reform to ensure that the labour market more rapidly absorbs workers.

Employment, small business and community investment

The 2007 Budget broadens the reach of the expanded public works programme, with particular attention to improving access roads.

Small Enterprise Development Agency receives direct support

Government policies aim to encourage the creation of new business ventures by bridging the divide between the formal and informal economies. Direct support for small business development through the Small Enterprise Development Agency is one mechanism for nurturing new businesses and promoting entrepreneurship in historically disadvantaged communities. Government's preferential procurement policies help to foster new market opportunities. The recently finalised codes of good practice on black economic empowerment will also open up new opportunities for those previously excluded from economic opportunity. The small business tax amnesty allows businesses to register and gain access to support services.

Comprehensive housing and human settlements programme is expanded

Economic participation receives support through policy initiatives targeting housing and community investment. Creating sustainable livelihoods and safe neighbourhoods through urban development directly contributes to promoting social inclusion and reducing social disparities. The comprehensive plan for the development of sustainable human settlements aims to accelerate the delivery of housing through more streamlined municipal and residential development planning, government financial assistance and mobilisation of financial sector resources. The plan will extend support for social housing initiatives, upgrading of informal settlements and for a greater range of affordable housing options.

Towards income security for all

Fundamental reforms of the social security system proposed

The strong fiscal position allows government to propose fundamental reforms to the social security system that will make a profound difference in the welfare of all South Africans. The system being proposed requires the development of an agreed framework for the longer-term institutional evolution of social security and its financing. The aim is to require people to contribute, as they earn, to a basic savings and social insurance arrangement, giving practical expression to social solidarity within the context of South Africa's democratic transformation.

Beneficiaries will continue to receive direct income support

The existing system of social grants will remain unchanged in substance. Beneficiaries of the various social grants will continue to receive direct income support as the safety net expands. Nearly 12 million people receive direct income support through social grants.

In addition, government will consider the introduction of a wage subsidy, which would promote job creation in the low-wage end of the labour market.

Proposals to be tabled for broad public consultation in 2007

The proposed changes will be tabled for public consultation in 2007, with a view to implementation by 2010. At its broadest level, this approach aims to build a bridge over the "poverty trap" features of the present fragmented social security framework by encouraging household saving, accumulation and income progression, while providing for a broad-based, affordable, social security net. These reforms allow government to provide more targeted fiscal measures in support of job creation and growth.

Accelerating human development

Concerted policy measures target improvements to health, education

South Africa can only attain the fullest expression of human dignity and the universal benefits of a free society as job opportunities are created and poverty is progressively reduced. Concerted improvements in the quality of health and education services are central to this goal.

Over the medium term, government intends to improve access to education and public health care through:

- Strengthening the comprehensive response to HIV and Aids, including prevention and treatment
- Upgrading hospitals and modernising tertiary services
- Increasing funding for students attending further education and training (FET) colleges
- Instituting a major drive to boost adult literacy
- Increasing funding for higher education institutions to accommodate increasing student numbers.

These interventions seek to improve the policy outcomes in these two critical sectors so that all South Africans can enjoy an improved standard of well-being. Moreover, health and education are closely linked to the creation of a productive labour force that is able to meet the demands of a steadily growing economy.

Bolstering the comprehensive HIV and Aids prevention and treatment programme

An additional R1,7 billion is allocated to the revised comprehensive HIV and Aids prevention, care, treatment and nutrition programme in the 2007 Budget. Steps are being taken to improve performance in areas that have lagged behind in implementing these initiatives.

Other priorities in the health sector include improved working conditions for health professionals to retain skills and reward experience in hospitals and clinics. The number of health workers employed in the public sector is expected to steadily increase by a further 30 000 over the next three years.

Support for upgrading teacher skills, adult literacy programme and FET colleges

Education remains the largest category of government spending, and is key to sustaining long-term growth and reducing inequality. The 2007 Budget allocates major resources to the continued development of the education system, with increases specified for strengthening education personnel, further implementation of no-fee schools, adult literacy programmes, and support for higher education and FET colleges to expand the skills base.

No-fee schools improve access to education for poor students

The phasing in of no-fee schools in 2006 has improved access to education for poor students. The quality of education will also be enhanced through a programme to upgrade teacher qualifications, and strengthening the leadership and management skills of school principals. Provincial education budgets will be reviewed to pave the way for improved educator salaries and career progression for teachers in recognition of professional competencies.

Modernising service delivery capacity

Upgrading quality of public services is a priority

Improving the quality of public service delivery has been a consistent theme of government's policy framework and in the transformation of public service institutions since 1994. South Africans have experienced frustration with performance gaps in government, particularly at the local level, where vital municipal services are delivered. Upgrading the quality of public service delivery is a priority in the 2007 Budget.

Efficient public administration is essential for translating budgets into effective public services that contribute to positive social and economic outcomes. Government is committed to the improvement of public-sector institutions, especially the technical and managerial capacity of municipalities and service delivery departments.

Focused technical skills support through Siyenza Manje

Special attention has been directed to local government to alleviate service delivery bottlenecks. Investment in planning, project management and technical capacity in municipalities is spearheaded by the Siyenza Manje ("we are doing it now") initiative located in the Development Bank of Southern Africa, and Project Consolidate.

Boosting the fight against crime

Government will also boost its efforts in the fight against crime through additional resources and improved management systems. Critical aims include reducing contact crime, partly through concentrating law enforcement in identified priority areas and reducing the number of illegal firearms. In line with this commitment, the number of police personnel continues to be expanded, and the response to organised crime, corruption and fraud is reinforced.

Initiatives to expand the quality and capacity of the public service include:

- Upgrading capacity in government departments to address regulatory frameworks and interaction with industry
- Organisational and service delivery reform, improved information systems and financial management reforms at Home Affairs
- Reorganisation and modernisation of courts administration
- Development of the integrated financial management system
- Targeted training for public service managers
- Development of disaster management in local authorities
- Increasing use of public private partnerships in key service delivery areas.

Government to step up quality of performance management

Government is working to enhance performance management at all levels. Under the auspices of the Policy Coordination and Advisory Services in the Presidency, a framework has been developed for government-wide monitoring and evaluation. As an integral part of this initiative, the National Treasury and the Auditor-General have developed a programme performance information framework for strengthening performance management and budgeting across national, provincial and local government.

Partnerships in Africa and beyond

Consolidating the development agenda for Africa

South Africa's international engagement is organised around four themes: consolidation of the development agenda for Africa; cooperation between developing nations; improved global governance; and strengthening bilateral relations. Fostering regional and international partnerships to achieve common objectives is the centrepiece of this foreign policy agenda.

South Africa's two-year membership of the United Nations Security Council will allow it to further the interests of the African continent, and of developing countries in general. In addition, this year South Africa has also taken the rotating chair of the Group of Twenty (G20), a forum consisting of the most industrialised countries and systemically significant developing economies that discusses key issues related to management of the global economy.

SACU agreement: a shared commitment to improving trade relations

The implementation of the revised Southern African Customs Union (SACU) agreement points to a continuing and shared commitment to improve trade relations with the rest of the world, and a developmentally oriented distribution of customs and excise revenue between South Africa and Botswana, Lesotho, Namibia and Swaziland. Although the revised agreement has been in effect since 2004, there is a need to further refine the revenue-sharing formula.

Regional development initiatives will be strengthened to accelerate the pace of economic integration in the region. The Southern African Development Community (SADC) envisions a free-trade area by 2008 and a broader customs union by 2010.

Additional funds for peacekeeping capacity in Africa

South Africa has taken on a wide range of commitments throughout Africa in support of reconstruction and development. The 2007 Budget provides additional funds for expanded peacekeeping capacity and for the African Renaissance Fund. South Africa hosts the Pan-African Parliament, and will continue to support the secretariat of the New Partnership for Africa's Development and the institutions of the African Union (AU).

Economic policy and outlook

Chapter 2 reviews South Africa's broad economic policy, provides analysis of recent trends and presents the macroeconomic forecast.

Robust growth to continue over the medium term

Economic growth continued to strengthen in 2006, supported by benign global conditions and strong domestic demand. This positive trend is set to continue over the medium term. The economy is expected to grow at an annual average of about 5 per cent over the next three years, rising to 5,4 per cent in 2009. CPIX inflation is expected to remain within the inflation target band of 3-6 per cent over the forecast period.

Construction, finance and business services set the pace in 2006

The real economy grew briskly in the first nine months of 2006, particularly in construction, finance and business services. Wholesale and retail trade, transport and communications also performed well. However agricultural production remained under pressure and mining production was sluggish. Modest increases in plantings over the 2006/07 season will see a slight recovery in agricultural production, and a rebound in mining is expected in 2007 and beyond. The mining sector's overall profitability will remain buoyant due to favourable commodity prices.

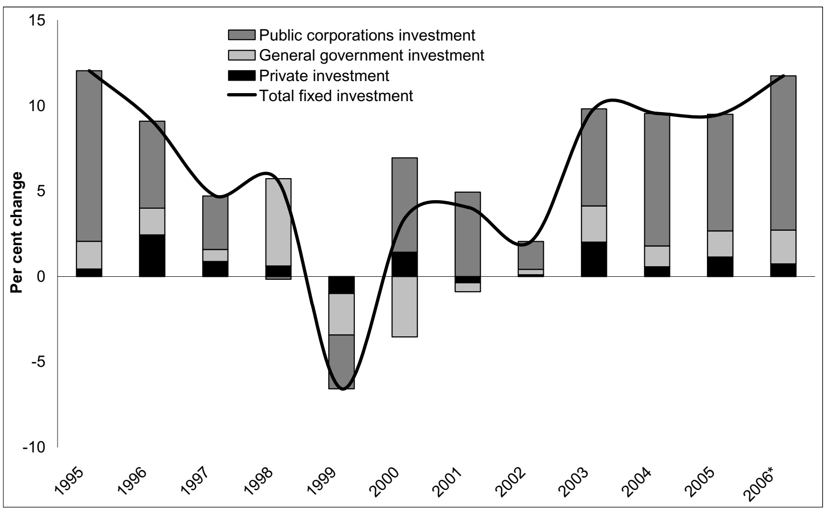
Steady gains in employment

Growth in the real economy is mirrored by steady gains in employment. Total employment in the formal non-agriculture sector rose more than 3 per cent in 2006, continuing a sustained trend in job creation that began three years ago. Employment growth has been broad-based, with almost all sectors adding jobs. There has also been a moderate rise in remuneration and productivity.

Robust household consumption growth

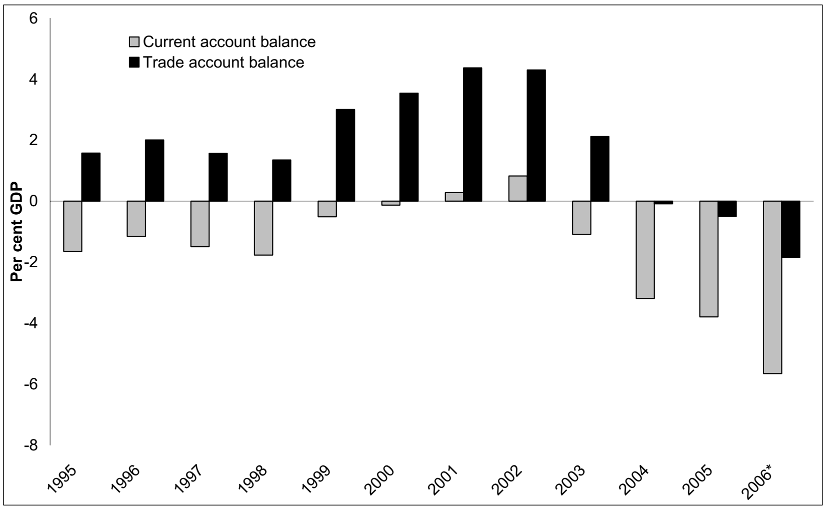
Employment and wage growth have increased household income, contributing to the strong consumption trends. Spending by households will remain robust over the medium term, although this spending growth is expected to ease to 5,2 per cent in response to the interest rate increases in 2006. Money supply and credit extension have increased, consistent with strong domestic expenditure and low debt-servicing costs. Mortgage advances and other loans and advances had the highest growth rates, while household debt as a percentage of disposable income rose to 73 per cent.

Figure 1.2 Annual change in gross fixed capital formation, 1995 - 2006



**First nine months*

Figure 1.3 Current account and trade balance, 1995 – 2006



**First nine months*

Brisk private-sector and public investment

Investment has been growing briskly since 2003, as illustrated in Figure 1.2. Fixed capital formation reached 18,4 per cent of GDP in the first nine months of 2006 and should rise to 19 per cent of GDP by 2008, as government infrastructure investment gathers pace. Strong investment growth will continue over the medium term as government accelerates transport infrastructure spending, investments related to the 2010 FIFA World Cup and other improvements to the built environment.

Sluggish export performance requires steps forward in trade and industrial policy

Higher imports of capital and consumer goods, income payments for foreign investment and transfer payments to SACU members contributed to the widening deficit on the current account of the balance of payments. Buoyant commodity prices have provided a significant boost to the value of exports. Sluggish export volume growth is a concern however, and requires significant further steps in trade and industrial policy.

Table 1.1 Macroeconomic outlook – summary

	2006	2007	2008	2009
	Estimate		Forecast	
Real growth				
Household consumption	7,0%	5,7%	4,8%	5,0%
Capital formation	12,0%	10,7%	10,9%	11,1%
Exports	3,9%	7,3%	6,3%	6,4%
Imports	14,3%	7,9%	8,4%	8,5%
Gross domestic product	**4,9%**	**4,8%**	**5,1%**	**5,4%**
Consumer price inflation (CPIX)	4,6%	5,1%	4,7%	4,5%
Balance of payments current account (percentage of GDP)	-5,5%	-5,3%	-5,7%	-5,9%

Reserve Bank raised reserves to US$25,9 billion by end of 2006

Capital flows have been responsive to changing dynamics in financial markets. While South African companies have taken advantage of increased levels of openness by expanding their interests outside of South Africa, foreign firms have taken advantage of attractive interest rates and growth opportunities in the domestic economy. Net capital inflows during the first nine months of 2006 rose to R96,3 billion, allowing the Reserve Bank to raise gold and foreign exchange reserves to US$25,9 billion at the end of 2006.

Fiscal policy and revenue issues

Chapter 3 provides a full discussion of fiscal policy and performance.

Expansionary fiscal stance continues

The 2007 Budget proposes substantial allocations for investment in infrastructure, contributing to increased capacity to deliver social and economic services. Key features of the 2007 Budget include:

- Real average growth in non-interest expenditure of 7,7 per cent a year over the MTEF period
- Additional allocations to spending of R89,5 billion over the 2006 Budget forward estimates
- Revenue growth, supported by buoyant consumer demand and corporate profitability
- A broadly balanced budget in 2006/07 and a surplus of 0,6 per cent of GDP in 2007/08 as a result of strong revenue growth
- Declining debt service costs as a share of GDP, from 3,0 per cent in 2006/07 to 2,1 per cent in 2009/10
- Real growth in capital allocations in line with government's commitment to accelerate economic growth and deliver a successful 2010 FIFA World Cup.

Real growth in non-interest expenditure averaged 9,2 per cent over the past 3 years

Real growth in non-interest expenditure averaged 9,2 per cent over the past three years. Government will reinforce the fiscal contribution to economic expansion as growth in capital expenditure increases relative to current expenditure. Alongside continued revenue growth, the overall budget balance has contributed positively to the fiscal position.

Improved budget balance a sign of economic health

The improved budget balance reflects the sustained accrual of revenue under favourable economic conditions, along with the progressive effects of deficit reduction and lower debt service costs. In combination with recent adjustments to monetary policy, the budget balance provides a stable platform for government to increase investment and to respond appropriately in the event of adverse economic conditions.

Fiscal framework

Estimated main budget revenue is R29,5 billion higher than anticipated

At R475,8 billion, estimated main budget revenue for 2006/07 is R29,5 billion higher than the 2006 Budget estimate. With total expenditure about R2,1 billion lower than planned, a budget surplus of R5,2 billion, or 0,3 per cent of GDP, is expected.

Non-interest expenditure grows in real terms by 7,7 per cent over the medium term. While non-interest expenditure rises, the sustained revenue performance allows for a budget surplus of 0,6 per cent of GDP in 2007/08. The budget balance is expected to move to a deficit of 0,4 per cent of GDP by 2009/10.

Table 1.2 Main budget expenditure framework

R billion	2006/07	2007/08	2008/09	2009/10
Total expenditure	**470,6**	**533,9**	**594,2**	**650,3**
Less:				
Debt service costs	52,2	52,9	53,0	50,9
Contingency reserve	–	3,0	8,0	13,0
Total allocations	**418,4**	**478,0**	**533,2**	**586,4**
Percentage increase	*14,4%*	*14,2%*	*11,6%*	*10,0%*

Debt service costs as a share of GDP continue their long-term decline, freeing additional resources for productive expenditure. Lower-than-anticipated debt stock and stable interest rates result in debt service costs declining from 3,0 per cent of GDP in 2006/07 to 2,7 per cent in 2007/08, and to 2,1 per cent by 2009/10.

Robust economy contributes to stronger national consolidated budget position

Due to significant positive balances on the Unemployment Insurance Fund and Compensation Funds, the consolidated national budget balance is higher than that of the main budget throughout the three-year period. The consolidated national government budget balance rises from 0,6 per cent of GDP in 2006/07 to 0,9 per cent in 2007/08 before declining to a deficit of 0,1 per cent in 2009/10.

After years of planning, the Gautrain rapid rail project reached financial close in January 2007. The project has a 54-month development period, with the first part of the commuter rail line scheduled to be in operation by June 2010. Over the next three years, national and provincial government each contribute R8,8 billion to Gautrain, and the private sector contributes R2,1 billion. The total projected cost to government for the development phase (2006/07 to 2011/12) is R22,6 billion.

Tax policy

Chapter 4 reviews tax policy, discusses revenue trends and presents the tax proposals for 2007/08.

Government aims to broaden the tax base and, where appropriate, lower tax rates to improve the overall equity of the tax system. At the same time, policy design will minimise the potential distortionary impact that taxes may have on economic growth and employment creation. The South African Revenue Service (SARS) is also implementing several reforms to cut compliance costs, enhance service, and improve tax and customs administration.

Proposals encourage long-term savings and provision for retirement

This year’s tax proposals encourage long-term savings, including higher levels of domestic savings and provision for retirement. The proposed abolition of the tax on retirement funds is an important part of strengthening retirement savings.

Revenue trends and medium-term projections

Main budget revenue is revised upwards by 6,6 per cent

Based on the revised macroeconomic projections outlined in Chapter 2 and the revenue trends, the main budget revenue estimate for 2006/07 is revised upwards by 6,6 per cent to R475,8 billion. In the 2006 Budget, main budget revenue for 2006/07 was expected to be R446,4 billion after accounting for tax proposals. The increased revenue estimates result from higher collections of company tax, personal income tax and VAT.

Taxes on income and profits are estimated to be 11,6 per cent higher than the original budget estimate. Personal income tax is estimated to reach R139 billion, which is R6,5 billion above the original budget estimate, mainly as a result of an increase in the tax base.

Higher corporate profits support increased revenue collection

The revised estimate for corporate income tax is R114,8 billion, which is 20,6 per cent higher than originally budgeted. Company income tax and the secondary tax on companies are expected to generate R19,6 billion and R1,9 billion more than budgeted as a result of higher-than-expected company profits.

Table 1.3 Summary of tax proposals

	2006/07		2007/08
R billion	**Budget estimate**	**Revised estimate**	**Budget estimate**
Tax revenue (gross)	456,8	489,7	569,0
Non-tax revenue	9,3	11,3	11,1
Less: SACU payments	-19,7	-25,2	-23,1
Total revenue	**446,4**	**475,8**	
Revenue before tax proposals			**557,0**
Tax proposals			**-12,4**
(Net) personal income tax relief			-8,9
Retirement fund tax			-3,0
Business taxes			-2,8
Taxes on goods and services			2,3
Revenue after tax proposals			**544,6**

Key tax proposals

The 2007 Budget tax proposals include:

Personal income tax relief of R8,4 billion

- Replacing the secondary tax on companies with a dividend tax, reducing the rate from 12,5 per cent to 10,0 per cent and broadening the base of this instrument.
- Abolishing the retirement fund tax
- Personal income tax relief amounting to R8,4 billion
- Treating the sale of shares (equities) held for more than three years as capital gains
- Extending the tax-free interest income threshold for taxpayers 65 years and older to include income from other retirement savings
- Reducing the withholding tax on lump sum retirement fund payments to zero for persons earning below R43 000 per year
- Increases in the general fuel and Road Accident Fund levies.

Individual tax burden reduced and number of those exempt grows

Several proposals will contribute to business confidence and supporting economic growth. These include proposed interim reforms to the secondary tax on companies and replacement with a withholding tax on dividends at shareholder level over the next two years; depreciation allowances for new commercial buildings; and changes in the way share disposals are taxed. The retirement fund regulatory reform process will also move forward in 2007.

Asset and liability management

Debt strategy and markets

Chapter 5 outlines South Africa's management of national government debt, reviews developments in the domestic and international debt markets, and updates current issues in state asset management.

Borrowing needs decline and credit ratings improve

As a result of sound economic policy and prudent management of the national debt portfolio, supported by increasing revenue from strong economic growth, South Africa's borrowing requirement continues to decline. The country's credit ratings are improving, enabling government to borrow at more competitive rates in the international capital markets.

The lower borrowing requirement reduces government debt issuance in the market, providing the opportunity for state-owned entities and other companies to finance their operations at lower cost. In 2006/07 and over the medium term, government will in net terms buy back R6,6 billion of debt, compared to net borrowing of R78,6 billion over the preceding four years. As a consequence, the debt burden on future generations is reduced.

Government is working to improve the performance of state-owned entities

Funds are set aside in the contingency reserve for possible capital requirements of state-owned enterprises over the period ahead. Government is also working to improve financial performance and corporate governance in state-owned entities.

Table 1.4 Projected state debt and debt costs

R billion	2006/07	2007/08	2008/09	2009/10
Net loan debt (end of year)	**475,5**	**470,2**	**478,2**	**492,2**
Percentage of GDP	*27,1%*	*24,3%*	*22,3%*	*20,7%*
Net domestic debt	396,8	387,6	394,2	408,1
Foreign debt	78,7	82,6	84,0	84,1
State debt cost	**52,2**	**52,9**	**53,0**	**50,9**
Percentage of expenditure	*11,1%*	*9,9%*	*8,9%*	*7,8%*
Percentage of GDP	*3,0%*	*2,7%*	*2,5%*	*2,1%*

Borrowing requirements, debt costs and debt trends

Net borrowing requirement is negative over the medium term

From 2006/07 to 2009/10, government's total net borrowing requirement is negative, reflecting an overall surplus position, with R6,6 billion of debt being bought back. The net borrowing requirement in 2006/07 amounts to a negative R4,4 billion and a negative R11,6 billion in 2007/08, rising to R1,8 billion in 2008/09 and R7,5 billion in 2009/10.

To decrease sovereign external vulnerability, government continues to work with the Reserve Bank to increase official reserves, which reached US$25,9 billion at the end of January 2007.

Low bond yields and greater international participation in local bond market

South Africa's low bond yields contribute to lowering the cost of doing business. Nominal yields on government bonds reached record lows in 2006/07. Turnover on the Bond Exchange of South Africa grew considerably during 2006, from R8,1 trillion in 2005 to R11,4 trillion, a 40,7 per cent increase. International investors showed an increased appetite for domestic bonds. Their participation increased from 16,5 per cent in 2005 to about 20 per cent in 2006, when they purchased a net R34,1 billion in bonds, supported by favourable risk-return ratios.

Policy priorities and spending trends

Social security reforms

Chapter 6 provides an overview of the existing social assistance programmes and social security funds, highlighting the extended reach of social grants achieved in recent years, particularly the child support grant. The chapter presents the broad outlines of social security and retirement funding reform options that are to be investigated over the next 12 months for implementation by 2010.

Social assistance beneficiaries grew from 3 million in 1997 to 11,8 million today

Expansion of the social assistance safety net has been prioritised over the past decade. The number of beneficiaries of social assistance has increased from under 3 million in 1997 to 11,8 million today, and consolidated expenditure on welfare and social security has increased from R23,6 billion in 1997/98 (3,4 per cent of GDP) to a projected R89,4 billion in 2007/08 (4,6 per cent of GDP).

The next phase of South Africa's maturing institutional development will involve a broadening of social security reform to include a basic earnings-related contributory system. This new "pillar" of the social security system will, over time, result in a collective, pooled, mandatory contributory system. The key contribution of such a framework to shared growth is that it will reduce the severity of cycles of progress and setback, employment and unemployment, advancement and catastrophe, that otherwise interfere with the efforts of the working poor to break out of poverty.

Wage subsidy proposal to be considered to raise labour earnings of the poor

A complementary proposal to be considered is that of a wage subsidy. It recognises that broader social security needs to rest on some form of cross-subsidy arrangement, contributing in the first instance to lowering the costs of employment and raising labour earnings of the poor. A wage subsidy makes it possible to introduce a social security financing arrangement as a standard payroll tax without imposing an employment-reducing burden on the labour market.

Medium-term expenditure allocations

Provincial equitable share gets R24,6 billion

Chapter 7 discusses government's policy priorities and related spending proposals in 2007/08 and over the medium term. The implications for the division of revenue, and for provincial and local government, are set out in Chapter 8. A more detailed review of new spending allocations for each national government department is set out in the *Estimates of National Expenditure*.

In line with the 2006 *Medium Term Budget Policy Statement* and government's strategic framework, the 2007 Budget provides additional allocations of:

- R24,6 billion for the provincial equitable share
- R3,9 billion for higher education, teacher development, and further education and training
- R3,7 billion for hospitals and the comprehensive HIV and Aids plan
- R13,3 billion for infrastructure associated with the 2010 FIFA World Cup
- R7,4 billion for national roads and rail rehabilitation, and provincial infrastructure
- R6,7 billion for justice and crime prevention
- R4,7 billion for defence and foreign affairs.

Table 1.6 provides a breakdown of consolidated government expenditure by economic classification for the three-year spending period. Table 1.7 shows consolidated expenditure by service area.

Table 1.5 Consolidated expenditure – economic classification

R billion	2006/07 Revised estimate	2007/08 Medium-term estimates	2008/09	2009/10
Current payments	**264,0**	**297,5**	**326,9**	**360,6**
Compensation of employees	172,3	193,8	211,2	229,6
Other current payments	91,6	103,7	115,7	131,1
Transfers and subsidies	**179,9**	**203,3**	**226,9**	**246,1**
Other government entities	66,8	76,1	86,5	92,0
Business enterprises	20,0	21,2	21,2	24,6
Households and non-profit institutions	93,1	106,0	119,1	129,5
Payments for capital assets	**29,9**	**40,2**	**46,5**	**53,3**
Contingency reserve	**–**	**3,0**	**8,0**	**13,0**
Consolidated non-interest expenditure	**473,8**	**544,0**	**608,3**	**673,1**
Percentage increase	*15,1%*	*14,8%*	*11,8%*	*10,6%*

Table 1.6 Consolidated expenditure growth

R billion	2006/07 Revised estimate	2007/08 Budget estimate	% Average growth 2006/07– 2009/10
Education	95,5	105,5	11,0%
Health	56,4	62,7	10,5%
Social security and welfare	81,2	89,4	9,8%
Housing and other social services	36,9	45,3	18,1%
Police, prisons and courts	51,1	57,9	10,9%
Defence and intelligence	27,8	30,3	5,8%
Economic services	91,3	109,8	14,3%
General administration	33,5	40,1	11,0%
Contingency reserve	–	3,0	
Non-interest expenditure	**473,8**	**544,0**	**12,4%**
Interest	55,3	56,1	0,3%
Total expenditure	**529,1**	**600,1**	**11,3%**

Division of revenue in the 2007 budget

Provincial and local governments get 49,6 per cent of national resources

The total main budget revenue of R544,6 billion in 2007/08 is divided among the three spheres of government, after making provision for state debt cost and unallocated amounts. National departments will receive 50,4 per cent of available resources, with 42,4 per cent allocated to the nine provinces and 7,2 per cent to the 283 municipalities.

The distribution of additional allocations, in line with the policy priorities described earlier, is as follows:

- Provincial governments receive R24,6 billion over the next three years for the provincial equitable share, and R14,6 billion to supplement conditional grants.
- Local government receives R5 billion through the equitable share.
- National departments are allocated an additional R32,3 billion.

Table 1.7 summarises the anticipated growth and distribution of consolidated national and provincial expenditure over the MTEF period, net of interest payments.

Community library services grant to help develop a culture of reading

After these additions, the provincial share shows a growth of 14 per cent between 2006/07 and 2007/08 and 12,7 per cent over the three-year spending period. The higher growth in conditional grants is mainly due to the upward revision of infrastructure-related grants, along with the introduction of the community library services grant. The provincial share grows from R202,8 billion in 2007/08 to R254,4 billion by 2009/10.

The national budget framework adds R18,1 billion to the local government budget framework over the three-year period to allow municipalities to speed up service delivery and enhance the quality of services, and to position host cities to meet the obligations of the 2010 FIFA World Cup.

Table 1.7 Division of revenue

R billion	2006/07	2007/08	2008/09	2009/10
National allocations	213,5	240,9	262,1	286,3
Provincial allocations	177,9	202,8	229,3	254,4
Equitable share	*150,8*	*171,3*	*193,5*	*215,8*
Conditional grants	*27,1*	*31,5*	*35,8*	*38,7*
Local government allocations	27,1	34,3	41,8	45,6
Total allocations	**418,4**	**478,0**	**533,2**	**586,4**
Changes to baseline				
National allocations	-1,5	7,3	8,4	16,5
Provincial allocations	1,2	6,2	11,5	21,5
Equitable share	–	*3,6*	*6,4*	*14,7*
Conditional grants	*1,2*	*2,7*	*5,1*	*6,9*
Local government allocations	0,6	4,3	6,3	7,4
Total	**0,3**	**17,8**	**26,2**	**45,5**

Other budget documentation

National Treasury issues a range of documents to accompany Budget

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

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

These documents and other fiscal and financial publications are available on the National Treasury web site at www.treasury.gov.za.