



Budget Speech

2007

Minister of Finance

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We must place at the centre of our daily activities the pursuit of the goals of social cohesion and human solidarity. We must therefore, strive to integrate into the national consciousness the value system contained in the world outlook described as Ubuntu.

We must therefore constantly ask ourselves the question – what is it in our country that militates against social cohesion and human solidarity? I believe that none of us present here (tonight) would have any difficulty in answering this question.

I am therefore certain that we would all agree that to achieve the social cohesion and human solidarity we seek, we must vigorously confront the legacy of poverty, racism and sexism. At the same time, we must persist in our efforts to achieve national reconciliation.

President Mbeki, 4th Nelson Mandela Lecture, July 2006

The foundation of human association is the idea that human life has equal worth and human beings are equally entitled to political, economic and social rights which allow them to choose a life they have reason to live¹.

Human life has equal worth...

Motho ke motho, ga ana bosehlana (a human being is a human being, there is no lesser human being)

The idea, that human life has equal worth, and that this is the core value that unites us, invites us to ask whether we have done enough to give practical effect in South Africa today to our shared humanity. Have we acted in a manner that shows that human life has equal worth? Or do we still live in a society where the shadow of history dominates over the opportunities of an open society.

As our young nation enters its thirteenth year, we have much to be proud of. We are building a society founded on principles of equality, non-racialism and non-sexism. We have built institutions of democracy, creating an open society founded on the rule of law. After stabilising the economy and the public finances, we have created the conditions for rapid economic growth, job creation and broadening of opportunities.

Sound management of public finances and the improved tax compliance culture on which it rests provides us with the resources to invest in our public services, renew our infrastructure, reshape our residential areas, provide water, electricity, housing, sanitation, schooling, health care and access roads to millions who were previously denied these elementary building blocks of modern society. The social grant system has expanded, hunger is in retreat and vulnerable families are being lifted out of poverty.

Yet the idea that human life has equal worth demands more of us. President Mbeki's speech at the 4th Nelson Mandela lecture reminds us that...

¹ Will Hutton, *The writing on the wall*, 2007. P. 204.

...to achieve the social cohesion and human solidarity we seek, we must vigorously confront the legacy of poverty, racism and sexism.

The 2007 Budget strives to accelerate economic growth and work opportunities, modernise our public services and infrastructure and fight poverty and inequality, because we have a shared pledge to work together in action. We do this, consciously, as a choice of this government because without a powerful countervailing force, the shadow of history will dictate opportunities, entitlements and outcomes.

Impilo zabantu zinesisindo ngokufanayo (people's lives hold equal value)

The economic gains of the last 10 years enable us to begin to fulfil other key elements of our economic and social modernisation. Chief among these are the systems we create to plan and prepare for the long-term, to set in place the policies and institutions that will help us to achieve prosperity for all and social solidarity for future generations. As our economy adapts to an ever-changing global environment, and as we recognize over time new policy challenges and priorities, our public services must support transition and transformation by providing rising income security and protection to individuals, families, and communities.

In the State of the Nation address twelve days ago, President Mbeki indicated that the time is right to construct a broad-based social security system embracing all South Africans, and I am pleased to confirm that we are tabling the main proposals today.

Economic overview

Madam Speaker, we have had the good fortune since 2001 to report on the healthy and strengthening state of the economy. Once again, economic performance has exceeded expectations.

The economy continued to expand at a robust pace of 4,9 per cent in 2006, generating new jobs, broadening the consumer base and providing impetus for rapid growth in investment. Economic growth is projected to average just over 5 per

cent a year over the next three years. For 2007, somewhat weaker growth in the world economy and the interest rate increases of this past year are expected to result in a growth rate of 4,8 per cent.

While household spending is projected to slow from the lively growth rate of over 7 per cent in 2006, it is still expected to expand by close to 5 per cent a year over the medium term – a robust trend reflecting good growth in household income.

The expansion has been supported by a benign interest rate climate, with exceptional growth in the construction, finance, transport and communication sectors. The manufacturing sector has grown by more than 4 per cent a year since 2004. Conversely, poor performances by agriculture and mining weighed on growth in 2006.

Investment across the economy underpins the positive outlook for the period ahead. Investment increased by 11,7 per cent in the first nine months of 2006, and as a percentage of GDP rose to 18,4 per cent. Investment by public corporations, government and the private sector will remain central to strengthening economic expansion over the medium term, as government maintains its focus on the extension and improvement of transportation links, increasing electricity supply and reshaping the built environment.

More rapid growth has meant more rapid job creation. According to the December 2006 Quarterly Employment Statistics, employment in the non-agricultural parts of the economy rose by over 3 per cent in the first nine months of 2006.

The global economy has remained supportive of our growth performance, in response to exceptional growth in China and India, healthy growth in G7 countries and high commodity prices. The commodity price rally has entered its sixth year. Between the end of 1999 and the end of 2006, the gold price rose 121 per cent, the oil price rose 144 per cent, and the prices of both platinum and coal rose by more than 150 per cent.

Our current account deficit has risen to levels close to 6 per cent of GDP last year, and we expect the deficit to continue running at between five and six per cent over the medium term. This is a sign of robust economic growth. And South Africa is not alone in this regard. A number of fast growing, oil importing, and commodity exporting markets such as Australia and New Zealand are also running sizeable current account deficits.

Capital inflows are expected to cover the current account deficit as rand-denominated assets remain attractive to foreign investors. Net capital inflows (including unrecorded transactions) reached R96,3 billion in the first nine months of 2006.

High commodity prices, moderating household consumption trends and stronger exports will tend to put downward pressure on the deficit in the next few years.

At the same time, risks continue to arise from what economists call “global imbalances” – the large surpluses and deficits on the current and capital accounts of major world economies. The magnitudes involved are sobering. The American and Chinese current account deficits and surpluses have reached 6,6 and 7,2 per cent of their respective GDPs. The US deficit is equal to US\$869 billion or nearly R6 trillion. Partly as a result of these deficits, liquidity in global markets is at very high levels. The search for higher returns for those funds has led to unprecedented flows of capital into emerging markets. Further, we are seeing the use of low interest G7 currencies for leveraged speculation. The potential disorderly unwinding of these leveraged positions creates risk for emerging market economies including our own.

So while our higher current account deficit mirrors stronger growth and investment, we need to reemphasize the importance of more rapid and diversified economic growth and improving our export performance, rather than reliance on uncertain portfolio inflows.

In the first nine months of 2006 the volume of exports rose 2,2 per cent compared to the same period in 2005 and by an average of 3,9 per cent between 2000 and

2005. But a greater expansion in the volume and value of exports and export-related employment is needed to lift and sustain the economy's growth rate beyond 6 per cent a year.

After several years of relative stability, the volatility of global exchange rates increased in 2006, shifting the levels of many currencies as commodity prices retreated from all-time highs and investor sentiment towards emerging markets cooled. The exchange rate of the rand depreciated by an average 15 per cent over the course of 2006.²

Some volatility can be mitigated through a combination of increasing foreign exchange reserves, reducing debt denominated in foreign currency, promoting lower inflation, prudent fiscal decisions, and improving the economy's potential growth rate. In contrast, a more rigid approach to the exchange rate could stimulate larger capital inflows but make exports less competitive and overheat the domestic economy. The Reserve Bank has continued its prudent accumulation of reserves.

Further exchange control relaxation announced in this budget will be supportive of a greater two-way flow of capital and moderation in the movement of the exchange rate.

Led by our Deputy President, the Accelerated and Shared Growth Initiative (ASGISA) lists clear areas where more work needs to be done to raise our trend growth.

- We will grow faster when we export more goods and services and accelerate investment in areas of competitive advantage
- We will grow faster when our levels of productivity are raised and our ability to generate more low skilled jobs is enhanced
- We will grow faster when bureaucratic red tape that hobbles business is tackled head on

² On a trade weighted basis.

- We will grow faster when the performance of the public sector is improved so that the state can become an effective tool for reconstruction and development
- We will grow faster when infrastructure capacity is enhanced, especially in relation to telecommunications, rail, roads, ports, electricity and water.

We have more work to do to ensure that economic expansion can be sustained and participation broadened. Part of the answer lies in our fiscal and investment decisions and part in ensuring that our economy is able to adjust to global risks and opportunities.

CPIX inflation has remained within the inflation target band, averaging 4,6 per cent in 2006, compared to 3,9 per cent in 2005. Inflationary pressures in the short term, including high food prices, should abate during the year. CPIX is projected to rise in the first half of the year, thereafter receding to the middle of the target band, remaining within the 3-6 per cent range over the medium term.

The increase in foreign exchange reserves and the present fiscal position are considerable strengths. Mr. President, when you took office in April 1999, gross foreign reserves stood at US\$5,5 billion, the public debt to GDP ratio stood at 49 per cent of GDP, job creation was rising by about 200 000 a year and economic growth was 2½ per cent. There is now US\$25,9 billion in reserves, our debt ratio is now 26 per cent of GDP, the economy is creating about 500 000 jobs a year and we have economic growth of 5 per cent. Under your stewardship, our economic transformation is well and truly underway.

Fiscal stance

Madam Speaker, we are planning for a budget surplus in the coming fiscal year. The fiscal stance creates space for our future social security reforms and allows for rising funding levels for public sector infrastructure, improvements to education and other government priorities, while enhancing the competitiveness of the economy and sustaining the current growth trajectory.

Tax revenue has grown by an average of 17 per cent a year for the past three years, much faster than the rate of economic growth. Alongside the new taxpayers created by a growing economy, legislative, administrative and technological changes have broadened the tax base significantly. All of these developments are exceedingly positive and will benefit us long into the future.

Public spending has risen by over 9,2 per cent a year in real terms over the past three years. The strong revenue trend and declining debt service costs have provided us with the room to invest in the modernisation of our services and infrastructure. This allows us to add further to our spending plans, raising public spending a further 7,7 per cent a year over the next three years as government ensures that effective programmes and promising new initiatives are funded in line with government's capacity to implement them. We are able to do this without leaving a legacy of debt for future generations.

In a country like ours with a low level of savings, the planned fiscal surplus is government's contribution to a national savings effort and we would like our citizens to follow this example.

In summary, our fiscal stance is a careful balance between increasing spending on services and infrastructure, providing moderate tax relief to raise household income and savings, lower business costs, while increasing government savings. Furthermore, the fiscal position helps keep a check on emerging imbalances in the economy.

Despite generous tax relief and rate reductions, the tax to GDP ratio has risen considerably in the past three years, reflecting economic buoyancy and the broader tax base. For the fiscal year ending in March 2007, our revised estimate for revenue is R29 billion higher than the original budget. Company tax and Value Added Tax receipts have exceeded expectations due to higher profits and strong domestic consumption. Personal income tax has also surpassed our estimates, driven by both rising employment and real income gains. We are expecting the strong growth in revenue to continue into 2007/08 leading to a revenue estimate of R545 billion or 28 per cent of GDP. As private sector investment increases and as household

consumption moderates slightly, we expect revenue as a share of GDP to decline to about 27 per cent of GDP by 2009/10.

The revised estimate for spending in 2006/07 is R470,6 billion, R3,6 billion less than the adjusted budget. As a result, contrary to our initial expectations, the budget balance for 2006/07 indicates a surplus of R5 billion.

We are budgeting to spend R534 billion in 2007/08 rising to R650 billion in 2009/10. Since tax revenues are likely to grow more strongly than spending for at least another year, we are budgeting for a fiscal surplus of about 0,6 per cent of GDP in 2007/08, reverting to a moderate deficit by the end of the forecast period.

Debt interest costs continue to fall as a share of GDP and are set to reach 2,1 per cent by 2010. Madam Speaker, the savings on interest that we have seen since 2001 provides an additional R33 billion a year to spend on services and infrastructure, money that we would not have had if we kept on borrowing at the level it was in 1994.

In 1994, we had a choice, to expand spending by borrowing, or reprioritise while reducing dependence on debt. The choices that we have made, consciously made, provide us with the fiscal space to spend more on education, on health, on public transport. It has also provided us with the policy room to contemplate long-term reforms to our social security system that will benefit all South Africans.

Chairing the G20

Much of our economic and fiscal policies has been aimed at increasing fiscal space and reducing our vulnerability to financial instability. These questions, and how governments think about them in a global context, will also be highlighted in the meetings of the G20, hosted in 2007 by South Africa. The G20, or Group of Twenty Finance Ministers and Central Bank Governors, includes seven industrialised countries and 13 of the most systemically significant emerging market economies, whose main purpose, is the pursuit of global financial stability. This forum offers a unique platform to identify common objectives and common solutions to global financial and economic challenges.

The theme for the G20 in 2007 is “Sharing – Influence, Responsibility, Knowledge”. South Africa has prepared a detailed work programme for the year focused on three major areas. In addition to the area of fiscal space, the G20 will look at the issue of increasing the voice of developing countries on the global economic stage by giving impetus to efforts to strengthen the voting power of emerging markets and low-income countries in the International Monetary Fund and World Bank. A final area of focus seeks better to understand the impact of high commodity prices on macroeconomic management and the implications for countries’ financial systems.

South Africa will also use the opportunity of its host year to improve and strengthen knowledge, within the forum, of African economic and financial policy challenges – and to facilitate a sharing of knowledge with African countries – through a series of parallel discussions between the G20 and African finance ministers and governors.

Spending priorities

The budget framework allows us to provide an R89,5 billion in additional spending over the next three years in comparison with our spending plans from a year earlier. Our spending priorities are informed by overriding objective of accelerating growth, modernising our public services and infrastructure and reducing poverty and inequality. Over the next three years, we are budgeting to spend almost R2 trillion. Madam Speaker, that’s a two, followed by twelve zeros.

We must use these resources so that human life can indeed have equal worth.

Impilo zabantu zixabisa ngokulinganayo (people’s lives have equal value)

Motho ke motho ga ana bosehlanana (*a human being is a human being, there is no lesser human being*)

Social services

If we truly want to create a society where human life has equal worth and where every child has an equal opportunity to succeed, we must improve the quality of our schools. This will not happen on its own. We need concerted action to make things change.

Madam Speaker, our teachers are the frontline of our education system. It is in their hands that we place our 11 million children each day. In most cases, our teachers do a sterling job under difficult conditions. We pay tribute to them and we ask no more than that they continue to serve with dedication and integrity. We also know that a minority of teachers do not prepare their lessons adequately, are frequently late and are unfit to be in the position where they are asked to nurture children. We cannot let the minority of teachers denigrate a profession based on love for children and a desire for learning.

Over the next three years, we are making available an additional R8,1 billion to hire additional teachers, teaching assistants and support staff in schools and districts and to improve remuneration levels of teachers. The many people who submitted suggestions to the Tips for Trevor campaign will be pleased to hear this. The Minister of Education will lead the process of determining how these resources should be used, focusing on the need to reward good teachers, provide support to poor schools and improve the quality of schooling in general. We are also setting aside R700 million for bursaries for teachers to encourage young people to train as teachers and to pursue careers in our public schooling system. This should benefit about 13 000 teachers over the next three years. Together with resources set aside in the provincial equitable share for the implementation of no-fee schools, and a substantial increase in resources for classroom building and providing water, electricity and sanitation in schools, the investments announced in this budget constitute a concerted effort to improve the quality of schooling in our country. It is a step change in resources going to schools, and we want to see a step change in results too.

The South African Schools Act recognises that the strength of our democracy is dependent on the depth of involvement in our democratic institutions, such as school governing bodies. We need committed parents to stand up and make a contribution to the success of their children's schools, so that we can build a society where human life has equal worth.

The national Department of Education receives a further R850 million for a step up in its adult basic education and training programmes. The 2007 budget also makes

available a further R2,2 billion to support our university sector to meet its objectives of increasing enrolment and producing more science, engineering and technology graduates. The further education and training sector receives R600 million for bursaries for deserving students.

Since the shifting of the social grants function to the Social Security Agency, provinces have been able to focus on rebuilding their welfare service capacity. A new bursary scheme for social workers is established, with an initial allocation of R365 million. Together with steps taken to increase social worker salaries in 2005, this initiative aims to revive interest in a profession critical to the well-being of our communities and the development of a more caring society.

The health sector receives a further R5,3 billion to spend on increased remuneration for health workers and an increase in staffing levels. We are budgeting to increase the number of health workers by about 30 000 over the next five years. Our previous budget framework made provision for the treatment and care of about 250 000 people who are ill with Aids. We are likely to reach that figure in the next few months. Health receives a further R1,7 billion for this programme, presently being delivered through 272 sites, allowing for a doubling of the uptake over three years. Spending on dedicated HIV and Aids programmes by health, education and social development departments will exceed R5 billion by 2009/10. The hospital revitalization programme, one of our more successful infrastructure programmes, receives a further R1 billion taking total spending on this programme to R6,8 billion over the next three years. In addition, the sector receives R1 billion for the modernization of tertiary services, with particular emphasis on diagnostic equipment.

Madam Speaker, one of the clearest ways in which we are able to act against poverty is through our system of social grants. We presently have just under 12 million people receiving social grants of which over seven million are beneficiaries of the child support grant. There is strong evidence that South Africa's social grants are well targeted and account for a substantial share of the income of poor households. Grants are associated with a greater share of household expenditure on food and hence improved nutrition, and the child support grant contributes

measurably to the health status of young children. Statistics SA data shows that the proportion of households where children often or always went hungry decreased from 6,7 per cent in 2002 to 4,7 per cent in 2005. This means that we can say to many more children, hunger is no longer knocking on the door.

Die lewe van alle mense is gelykwaardig (the lives of all people are equal)

Social grant increases

Three years ago, the Department of Social Development initiated measures to curb fraud in our social grants system. With the help of the Special Investigating Unit, over 130 000 people have been removed from the system and about 2 500 charged with fraud so far. This has contributed significantly to the stability of the system. Ensuring that we eliminate fraud and corruption from the social grants system is critically important. The state old age pension, disability and care dependency grants will rise by R50 to a maximum of R870 a month, providing a strong signal that money released from the reduction of corruption will be given back to those who deserve it. Child support grants increase by R10 to R200 a month and foster care grants rise to R620 a month.

Protection services

Let me turn to our criminal justice sector. To quote President Mbeki, “while we have already surpassed that targeted figure of 152 000 police officers...and while we have improved the training programme, we recognise the fact that the impact of this is not yet high enough.”

There has been a significant increase in resources going to the fight against crime. Since 2003/04, allocations to the Safety and Security ministry have increased by 43 per cent. Over the next three years, resources going to the police will rise by a further 34 per cent from R33 billion in 2006/07 to R44 billion in 2009/10. The budget for the Department of Justice increased by 41 per cent in the past three years and will rise by 52 per cent over the next three years.

In this year's budget, we are allocating an extra R2,4 billion to the police to further expand police numbers and invest in technology and forensic equipment. By 2010, we will have close to 190 000 police officers on our streets. Electronic fingerprints and dockets will become the norm. The 2007 Budget also allows for the implementation of the salary upgrade programme that commenced in 2005.

The Department of Justice receives a further R1,5 billion over the next three years to improve court capacity, reduce case backlogs and modernise the administration of justice.

Our government recognises the seriousness of the crime situation and will continue to provide leadership in the fight against crime. But, effective crime fighting depends on partnerships between our law enforcement agencies and communities. Through community police forums, all citizens have the opportunity to contribute towards making their communities safer. In this way, each person can help in the construction of a society where human life has equal worth.

Madam Speaker, even as we step up the fight against crime, we must ask ourselves what cultural, social and economic conditions give rise to crime. We have spoken in the past about the destructive effects of the relentless pursuit of individual self-enrichment at the expense of the broader development and progress of society. We cannot escape the fact that the culture of greed plays a role in driving crime. Long-term, sustainable solutions lie in addressing the causes of crime and the conditions that give rise to the alienation of some in our communities. Only a stronger sense of society, of community, of family; a sense of responsibility to each other – *Umntu ngumuntu ngabantu* – can heal the fractures that give rise to crime.

We also need to insist that honesty and integrity are core values of our economic and financial institutions. We continue to see instances of flagrant abuse of this principle, often involving hundreds of millions of rands. In addition, we continue to see extraordinary methods to evade tax and the legal obligations relating to anti money-laundering legislation.

I want to make it clear that we will not tolerate a situation where individuals pillage and plunder millions from the companies they run or from ordinary South Africans who are poor and humble people whose entire life savings get destroyed in the process.

I have instructed the Financial Intelligence Centre, the Financial Services Board and the South African Revenue Service to work collaboratively with the South African Police and prosecutors in dealing with financial crime and its proceeds. I have also asked that fiduciary and trusteeship responsibilities need to receive the highest priority in the oversight activities of our regulators. We must ensure that neither organised crime nor abuse of stewardship obligations should be allowed to violate our hard-earned democracy and the integrity of our country.

The built environment

Since 2001, we have channelled an ever greater share of our resources into capital spending. Our investment in infrastructure has been focused on two major areas: the built environment and economic infrastructure. The built environment refers to a cluster of activities and services that centre on building viable, secure residential communities – housing, water, electrification, sanitation, roads, sports facilities, police stations and schools and clinics. These programmes seek to change the landscape across both urban and rural areas, to turn barren, dusty land into places that people feel proud to live in.

In the past two years, we have added considerably to our public transport budget. In 2005, we created the Public Transport Infrastructure Systems Grant, aimed mainly at putting in place passenger transport services that would facilitate the movement of people for the FIFA World Cup. This, together with the impetus that the World Cup provided, has resulted in something of a revolution in municipal planning for public transport and forward thinking about urban development. The bids that we have seen are impressive in terms of knitting together communities with places of work, recreation and leisure. In particular, the development of Bus Rapid Transit schemes offers exciting opportunities to improve municipal public

transport systems. To ensure that the World Cup leaves us with a legacy of better public transport, we are adding a further R2,3 billion to this programme.

Our housing budget receives a further R2,7 billion taking the total allocation over the next three years to R32 billion. To give you a sense of the scale of increase in our housing budget, Madam Speaker, in 2003/04, we spent R4,6 billion on housing. By 2009/10, the end of our present budgeting period, the budget rises to R12,5 billion. Allocations for water, sanitation, electrification and municipal roads all rise in a complementary fashion. Our government is determined to meet the targets set by the President in 2004 in relation to water, sanitation, electrification and housing.

Motho ke motho, ga ana bosehlana (a human being is a human being, there is no lesser human being)

The Neighbourhood Development Partnership Grant, a new innovative funding model, encourages private participation in the rejuvenation of townships. Our urban landscape is often described as dysfunctional with large townships far from city centres, far from places of work and leisure. This landscape will not change of its own accord. We will not be able to reshape our cities, integrate our townships, create residential communities unless we intervene, unless we act decisively. The Neighbourhood Development Partnership Grant has already allocated money for technical assistance to upgrade Bara Central in Soweto, Njoli Square in KwaZakhele, Ngangelizwe in Mthatha. Planned interventions include eThekweni Bridge City and KwaMashu town centre.

Many of the programmes outlined above are labour intensive, and form part of the Expanded Public Works Programme, aimed at drawing in marginalised communities in the 2nd economy. Since its inception, this programme has created about 300 000 work opportunities, mainly in rural areas and mainly for women. Taking our cue from the State of the Nation Address, together with the Minister for Public Works, we will review this programme to see how it can be amended and further ramped up to increase the number of work opportunities that it creates. A

further R125 million is allocated to the Department of Public Works to improve coordination and oversight of this programme.

2010 FIFA World Cup

I am happy to announce that the Local Organising Committee for the FIFA World Cup has reached agreement with municipalities on the budgets for the construction and upgrading of stadiums and that these agreements are within the R8,4 billion set aside for stadiums. These agreements set a firm precedent - that we must go out of our way to ensure a successful tournament and a lasting legacy beyond 2010, but fiscal prudence and sound budgeting principles must be adhered to at all times.

The South African National Roads Agency and the Rail Commuter Corporation receive a further R1,7 billion to upgrade roads, and stations in areas critical to the World Cup. In total, over R9 billion will be allocated by national government for municipal transport, roads and precinct upgrading relating to the 2010 FIFA World Cup.

Economic services

Agencies and entities falling under the Department of Trade and Industry receive an additional R1,7 billion to promote industrial development, black economic empowerment and small business development. To support the process of broadening participation in the economy, the National Empowerment Fund receives a further R380 million as a capital injection. The critical infrastructure programme is allocated a further R300 million to leverage private sector investment, especially into our industrial development zones and the film and television production incentive gets another R300 million to encourage local and international film makers to film in South Africa.

Our research and development capacity has been strengthened in the past five years through targeted investments to our science councils and universities. This year, we are setting aside a further R1,2 billion for science and technology of which R500 million is for government's contribution to the Square Kilometre Array, contingent on the success of our bid. The South African Research Network, a joint

project of the Departments of Public Enterprises and Science and Technology aimed at providing low-cost broadband links for the local academic community receives R95 million and R60 million is allocated to set up science research chairs at our major universities.

Madam Speaker, the Budget framework includes a contingency reserve of R3 billion for 2007/08. This allows for unforeseeable and unavoidable expenditure that may need to be accommodated in the Adjustments Budget this year, and allocations to several state-owned enterprises that are not yet finalised. Our commitment to finance 51 per cent of the capital requirements of the Pebble Bed Modular Reactor project over the next three years amounts to R6 billion. An allocation to settle the land claim and other obligations relating to Alexkor mine has yet to be finalised and will be provided for in the Adjustments Budget, which will also include further equity contributions for the InfraCo telecommunications initiative and Sentech's investment requirements, contingent on the approval of business plans and resolution of outstanding regulatory requirements.

General government, administration and international affairs

South Africa's foreign policy objectives seek to achieve greater unity and solidarity between African countries, accelerate political and socio-economic integration and promote peace, security and stability. Support for key institutions of the African Union remains a priority. In addition to peace-keeping operations, South Africa has also provided significant logistical support during elections on the continent and support for post-conflict reconstruction. The African Renaissance Fund, through which most of the initiatives are funded, is given a further R275 million. Our commitments to host the Pan African Parliament also requires a further R113 million.

In a short period of time, our defence force has already assisted significantly in helping reduce a number of conflicts on the continent. We now have peace-keeping operations in the Democratic Republic of the Congo, Burundi, Sudan and the Ivory Coast. The SA National Defence Force receives additional allocations to acquire airlift capacity, for exchange rate adjustments to the strategic defence package and

for the military skills development programme, an innovative programme aimed at introducing young people into the military.

Improving service delivery in the Department of Home Affairs has positive benefits for government, the economy and all citizens. The Minister of Home Affairs is working with colleagues to finalise a plan to turn this department around and we pledge our full support. A further R900 million is allocated to the department to support its turnaround, to fill critical posts, purchase a new passport printer and modernise IT and back-office operations.

Following considerable tax policy changes in the 1990s, the past five years have been characterised by better services to tax payers, improved compliance and a broader tax base. The 2007 Budget provides a further R1,3 billion to upgrade core IT systems in the South African Revenue Service. The modernisation of the South African Revenue Service will enable it to manage increased administration volumes. A single customer view, automation, e-business and improved walk-in services will be supported by enhanced risk management.

Priority is given to modernising customs administration to cope with significant increases in volumes at all our land, sea and air border posts. The acquisition of cargo and container scanning equipment will enable SARS to perform non-intrusive inspections on goods going through our ports.

Intergovernmental transfers

Madam Speaker, our budget allocations must reflect the priorities that government sets. In recognition of the critical role that provinces and municipalities play in the delivery of social and household services, these two spheres receive 64 per cent of the additional R89.5 billion allocated in this budget.

Transfers to local government grow by 19 per cent a year. In addition, municipalities receive the bulk of the allocations for stadiums and related infrastructure for the 2010 FIFA World Cup. The local government equitable share receives a further R5 billion for the delivery of free basic services, which now reach an average of about 80 per cent of households. The Municipal Infrastructure Grant receives a

R400 million more for a final push to eradicate the bucket system. A further R600 million for the electrification programme, R1,4 billion for bulk water and sanitation infrastructure and R950 million to deliver water and electricity to schools and clinics. Total infrastructure transfers to municipalities now total R52 billion over the next three years.

Ubjamo bethu busho siyalingana empilweni

Transfers to provinces grow by 12,7 per cent a year with the major additions going to education and health personnel, social welfare services and for provincial infrastructure. This year, we introduce a new conditional grant called the Community Library Services grant to develop the infrastructure and stock of books in local libraries. To spread the joy of books to millions more children and to provide access to information to teachers and parents, the grant starts off with an initial allocation of just under R1 billion over three years. The provincial equitable share formula, through which 86 per cent of provincial transfers flow, is updated to reflect changes to provincial boundaries.

Preliminary assessments of provincial budgets indicate that allocations are broadly in line with the priorities outlined in last years' Medium Term Budget Policy Statement. Spending on both education and health at a provincial level are projected to grow by 10.5 per cent a year and welfare services grow rapidly from R5.3 billion in 2006/07 to R8,8 billion in 2009/10. Over the next three years, provincial capital spending totals R65 billion. I wish to commend provinces for the steady progress being made in rolling out their infrastructure programmes. In 2005/06, only 8 per cent of infrastructure funds were unspent as opposed to 14 per cent in 2004/05. This year, spending for the first nine months is 35 per cent higher than in the same period last year.

Tax policy

Madam Speaker, over the past decade, we have created a tax policy regime which is internationally competitive. We have broadened South Africa's tax base while at

the same time provided billions of rands in tax cuts to improve the equity of the tax system.

Mr. A S Smit submitted a Tip for Trevor which suggested “Kan u in u begrotingsrede belastingbetalers bedank vir hul bydrae.” Meneer Smit is heeltemaal korrek so ek vra om verskoning indien ek dit nie genoegsaam in die verlede gedoen het nie, en spreek ons gesamentlike dankbaarheid uit aan alle belastingbetalers. Admonished by Mr Smit, I thank all South African taxpayers for their diligence in contributing to our revenue pool. Ndo livhuwa nga maanda!

This year, individuals benefit from moderate personal income tax cuts and the elimination of the retirement fund tax. Business benefits from reforms to the secondary tax on companies. We extend accelerated depreciation allowances to certain infrastructure and the cost of corporate reorganisation is reduced.

The 2007 Budget provides personal income tax relief amounting to R8,4 billion, increasing the level below which no income tax is levied for people under the age of 65 to R43 000. Changes to the personal income tax brackets provide relief to compensate for the negative effects of inflation on taxpayers, and to partially offset the effects of changes to the taxation of medical aid contributions and car allowances. I appeal to taxpayers to use this relief to first settle their debts or save, rather than for consumption.

The monthly monetary caps for tax-free medical aid contributions are increased from R500 to R530 for each of the first two members and R300 to R320 for each additional beneficiary. This measure is aimed at further incentivising people to join low-cost medical schemes, and for the market to respond to demand in this area.

Public benefit organisations play an important part in the social fabric of our society. During the last few years the tax regime applicable to these organisations has been reformed to give due recognition to their contributions to society. I'm pleased to announce that tax deductible contributions by both individuals and companies to specific public benefit activities will be increased from 5 per cent to 10 per cent of taxable income. In addition, the tax free income threshold from trading activities by

PBOs will be doubled, from R50 000 to R100 000. Arising from discussion with Cricket SA recently, amendments are also proposed to ease the tax liabilities of professional sport bodies that contribute meaningfully to the development of amateur sports.

In order to promote saving for retirement, we propose to this house the abolition of the retirement fund tax from 1 March 2007. We call on trustees to ensure that the benefits of this reform accrue to the contributors and beneficiaries of retirement funds. The proposal will cost R3 billion a year and is part of a number of related measures aimed at encouraging household savings. With the same objective in mind, the interest income exemption is raised from R16 500 to R18 000 for those under 65 and from R24 500 to R26 000 for those 65 and over. In addition, the annual exclusion threshold for capital gains or losses will be increased from R12 500 to R15 000.

Most countries have a dividend tax at the shareholder level. We have a secondary tax on companies collected directly from a few thousand companies as opposed to millions of shareholders. To further improve the transparency and equity of the tax system, we are proposing that it be phased out and replaced with a dividend tax at shareholder level. This reform would consist of two phases. We propose reducing the rate from 12,5 per cent to 10 per cent and that the base be redefined to apply to all distributions. This will come into effect on 1 October 2007, except for standard anti-avoidance measures that will commence on conclusion of this speech.

The conversion to a dividend tax collected at the shareholder level will be completed by the end of 2008 subject to the renegotiation of a number of international tax treaties.

The taxation of gains realised from the sale of shares is presently subject to ambiguous procedural treatment. In order to provide equitable treatment and certainty for both taxpayers and SARS, all shares disposed of after three years will trigger a capital gains tax event.

Our tax laws provide for depreciation of buildings used in manufacturing but not for commercial purposes. We are proposing that tax depreciation allowances for the economic wear and tear of newly constructed, or upgraded, commercial buildings be implemented. A 20-year write-off period is envisaged. The income tax act has not kept pace with changes to the local and international environmental regulatory regime. It is proposed that environmental capital structures such as dams and tanks, which are presently not depreciable, qualify for depreciation allowances.

Consideration is being given to facilitate investments in high risk investments such as mining exploration by junior mining companies. The introduction of flow-through shares will be investigated, and a final decision in this regard will be made next year.

Now for the excise tax increases:

- Tax on a packet of 20 cigarettes goes up by 60 cents
- Tax on a 340 ml can of beer goes up by 5 cents
- Tax on a 750 ml bottle of wine up by 10 cents; and
- Tax on a 750 ml bottle of spirits up by R1,88.

These changes to the excise taxes will raise R1,5 billion.

The general fuel levy is increased by 5 cents a litre and the Road Accident Fund levy is also increased by 5 cents a litre.

Entrepreneurship remains a vital ingredient in the growth of our economy. In this regard, we have previously announced measures to assist and encourage small businesses, including a tax amnesty for small businesses announced last year. The small business tax amnesty offers those outside the system a fresh opportunity to become compliant and benefit from the myriad of support measures offered by government. The amnesty ends in May this year, and over the coming weeks SARS will be intensifying its efforts to ensure that all businesses with a turnover of

R10 million or less are afforded the opportunity to apply. So far, about 12 000 have come forward to apply for amnesty.

The task team appointed to investigate the fiscal regime applicable to windfall profits in the liquid fuels sector submitted its final report to me on 9th February 2007. It has exhaustively inquired into the fiscal and regulatory aspects of the industry. I want to thank the team led by Dr. Zav Rustomjee for their efforts in completing their work in such a short space of time.

In responding to the report, I will refer the regulatory matters to the Minister of Minerals and Energy for further consideration. The task team has made two substantial fiscal recommendations, involving a possible tax on windfall profits and an incentive arrangement for new investment in liquifuel production capacity. I believe there is merit in these proposals. However, we will consult the industry before we finalise this matter.

The task team's report will be released for public and stakeholder comment by the end of the week.

Exchange control changes

The gradual process of exchange control relaxation has focused on enabling an orderly process of global reintegration, encouraging South African firms to expand from a domestic base and allowing South African residents to diversify their portfolios through domestic channels. The continued strength of the South African economy and financial markets support further steps in this regard, including:

- Lowering the current shareholding threshold for foreign direct investment outside of Africa from 50 per cent to 25 per cent to further enable South African companies to engage in strategic international partnerships;
- Simplifying the Customer Foreign Currency accounts dispensation by allowing a single CFC account for trade and services related payments, and expanding the range of permissible transactions; and

- Further developing South Africa's financial markets and increasing liquidity in the currency market by permitting the Johannesburg Securities Exchange to establish a Rand futures market.

Tips for Trevor

As has become tradition, I have received hundreds of Tips for Trevor. Thank you for taking the time and effort to write to me. The strength of our democracy is measured by the depth of involvement by ordinary people in the affairs that affect them. The overwhelming sense I get from reading these tips is that almost all South Africans recognise that the challenges we face can only be overcome through a full-on frontal assault on poverty and that the best way to achieve this is through a combination of faster economic growth and active intervention by government, on the side of the poor. Because human life has equal worth.

Magoshu Motau writes to ask that the tax-free lump sum portion of retirement funds be increased since it has been at R120 000 for some time now. Mr. Motau is very perceptive, and correct. It could also be added that the formula required to calculate this tax-free lump sum is incomprehensible to the average person. We are accordingly proposing an increase in this threshold and will simplify the whole calculation.

Last year, I received a suggestion that we should make lobola tax deductible. This year, I've been given a suggestion that I should impose VAT or tax lobola trusts since some people are making money out of them. These issues seem far too complex for me or my officials to handle. I'm going to have to consult our elders on this one.

Poverty line

In concert with the task of growing the economy and creating new opportunities for work, we have been hard at work since 1994 to push back the frontiers of poverty, recognising that no people can be truly free until they have cast aside the shackles of poverty and underdevelopment.

It is for this reason that the eradication of poverty has been at the centre of our policies and programmes since the first democratic elections. To help measure progress in the fight against poverty, Statistics South Africa will pilot a poverty line for an initial period to allow for public comments and consultations before its design is finalised. Alongside the Budget, we are publishing a discussion document that sets out our proposal for a national poverty line. I appeal to you to continue to advise us on the appropriateness and usefulness of this measure.

Social security reforms

Ubuntu acknowledges that all people are an integral part of broader society and humankind, and our individual fortunes are intimately connected to the fortunes of the whole.

Madam Speaker, in the past decade, we have gradually expanded our system of social grants providing income support to vulnerable groups, children, the disabled and the elderly. Our social assistance grants provide an effective income safety net for the poor, and about 3½ per cent of GDP is spent on this redistributive budget programme.

But it is also important to encourage saving and self-reliance. The tax system contains a retirement savings incentive that particularly benefits higher-income individuals. But for working people who fall below the tax threshold, there is effectively no incentive, and indeed there is the perverse effect that if you save enough you might lose the old age pension because of the way the means test works. So although we have a well-developed retirement industry, and most employees are covered by pension or provident fund arrangements, in practice too many people surrender their policies or cash in their benefits when they change jobs. It is estimated that more than half of those who contribute to retirement funds, reach retirement age with a pension that is less than 28 per cent of their final wage or salary and over two thirds of people are dependent on the state old age pension.

The time has come to put in place a new arrangement in which all South Africans will share, and that provides a basic saving and social protection system that meets

the needs of low-income employees. We are therefore proposing a mandatory, earnings-related social security scheme to provide improved unemployment insurance, disability and death benefits targeted at the income needs of dependants and a standard retirement savings arrangement. This will be financed by a social security tax administered by the South African Revenue Service, and collected in individual accounts in the name of every contributor. Significant capacity building and institutional reform are needed on both the tax side and to administer benefits. This work has begun, with a view to implementation by 2010.

To offset the cost of the social security tax for low-income workers and to lower the cost of creating employment, we are proposing the introduction of a wage subsidy for those whose earnings fall below the income tax threshold.

Madam Speaker, these proposals are bold and ambitious. Much work still needs to be done. The principles that will underpin these reforms are:

- Equity – there must be fair and uniform rates of contribution and benefits for all
- Pooling of risk – collective funding arrangements and non-discriminatory rules and entitlement must apply
- Mandatory participation – there will be compulsory participation of employees and inclusion of self-employed individuals on reasonable terms
- Administrative efficiency – streamlined use of pay-roll based contributions, modern information systems and efficient payment arrangements are essential
- Solidarity – minimum benefits will be assured through continued social assistance grants programmes financed through the budget.

Alongside the phasing in of social security arrangements, several reforms to the regulation, governance and tax treatment of occupational and individual retirement funds will be implemented over the period ahead.

Madam Speaker, these are far-reaching reforms and as the President has indicated, consultation will be needed before finalization of legislation, administrative systems and transition arrangements. We aim to conclude these discussions with trade unions and employers during the second half of this year.

We do this, Madam Speaker, to proclaim loudly that human life has equal worth. Our sense of community, our sense of humanity is dependent both on our own well-being and the well-being of those around us.

Members of the House should be advised that following steady improvements in the financial position of the Government Employees Pension Fund over the past decade, it has been possible to award increases to civil pensions this year that fully compensate for inflation, and that also correct for past erosion in real values. This substantially improves the position of many elderly pensioners and spouses.

I am pleased to introduce to the House Phineas Tjie, who has been appointed head of administration of the Government Employees' Pension Fund. I am grateful for the wise leadership that Martin Kuscus gives to the Board of Trustees.

We should also pay tribute to the work of the Public Investment Corporation, ably managed by chief executive officer Brian Molefe. Under their expert investment management, the GEPF has again recorded excellent financial results.

Conclusion

The budget is a culmination of a full year of preparation involving literally thousands of people at national, provincial and local government, and in many of our public entities. Madam Speaker, the preparation of a Budget relies on the hard work of many

Under the stewardship of President Mbeki and the drive and determination of Deputy President Mlambo-Ngcuka, Cabinet has been instrumental in shaping this budget. I would like to thank members of the Ministers' Committee on the budget for the long hours and thousands of pages of documentation they've had to endure to craft this budget.

Deputy Minister Jabu Moleketi continues to bring his sharp analysis and intellectual insight to the budget process. I would like to thank provincial MECs for Finance, who are in the midst of finalising their own budget speeches, for the work that they have done in strengthening discussions in the Budget Council and to Salga for their efforts in guiding our understanding of the issues relevant to local government.

I would also like to express a word of gratitude to:

- Governor Tito Mboweni and the staff of the Reserve Bank for their support and assistance
- The Financial and Fiscal Commission Chairperson Dr. Bethuel Setai and the other Commissioners and staff for their sound advice and considered contributions to our intergovernmental framework.
- Herbert Mkhize who has skilfully steered our discussions with business, labour and community representatives in Nedlac
- Pali Lehohla continues to drive ongoing improvements in the extent and quality of government statistics, supported by the Statistics Council chair Howard Gabriels.

Thanks to Nhlanhla Nene, chair of the Portfolio Committee on Finance, Tutu Ralane who chairs the Select Committee on Finance, and the joint chairs of the Budget Committee, Louisa Mabe and Buti Mkhali, for diligently working on holding government to account.

Madam Speaker, could I beg your indulgence and ask that the house joins me in wishing the South African Revenue Service a happy 10th birthday. It is remarkable that an organisation, just ten years old, can do so much good for our country and our people – congratulations Commissioner Gordhan to you and your dedicated band of 15 000 staff.

Lesetja Kganyago, continues to lead an inspired group of professional staff at the National Treasury, always striving to do better, and in the result, driving everybody

crazy. Thanks too to the officials in the Ministry who give their all, especially at the time of the budget.

Lastly, thanks to my family who continue to inspire me to build a society that values our shared humanity.

President Mbeki has also advised

What this means is that when we talk of a better life for all, within the context of a shared sense of national unity and national reconciliation, we must look beyond the undoubtedly correct economic objectives our nation has set itself.³

When our forebears formed the African National Congress in 1912, in response to being excluded from the formation of the Union of South Africa, they were driven by the single-minded belief...Human life has equal worth.

When Nelson Mandela and Walter Sisulu tabled the 1949 programme of action to spur more active resistance to discrimination, they believed that Human life has equal worth.

In 1955, when our parents came together in Kliptown at the Congress of the People, to proclaim loudly that South Africa belongs to all who live in it, black and white; they were united by the belief that human life has equal worth.

In 1983, when we launched the United Democratic Front in Mitchell's Plain, hundreds of community organisations said with one voice: Human life has equal worth.

In 1994, when we stood in line and voted as equals in our first democratic elections, we could feel the mood, and the mood said, 'Human life has equal worth.

³ Fourth Nelson Mandela Lecture

When our constitution was unanimously adopted in this house in 1996, our declaration to the world was loud and clear, human life has equal worth.

And today, we proclaim loudly...human life has equal worth ... and we will be unwavering in our dedication to the social cohesion and human solidarity that we seek.