national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Address to the National Assembly on the tabling of the

2006 Medium Term Budget Policy Statement

and the

2006 Adjustments Appropriation Bill

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Wednesday, 25 October 2006

Chairperson

John Kani and Winston Ntshona have recently reunited to put on another run of *Sizwe Banzi is dead*. Written by Athol Fugard in collaboration with the two actors, the play tells of a young migrant worker who composes a letter to be sent to his wife. The story contrasts the cruelty of the pass laws and desperation of migrant workers, with the dreams and aspirations of people dressed up in their Sunday best, for a family photograph.

In the play, Styles describes his photo studio. I quote:

> *This is a strongroom of dreams. The dreamers? [he asks] My people. The simple people, who you never find mentioned in the history books, who never get statues erected to them, or monuments commemorating their great deeds. People who would be forgotten, and their dreams with them, if it wasn't for Styles. That's what I do, friends. Put down, in my way, on paper the dreams and hopes of my people so that even their children's children will remember…*

Sizwe Banzi is dead is set in 1971, at a time when Apartheid was most rigid, and the gulfs between rich and poor, between black and white were unrelenting. Today, twelve years into our democracy, we still have dreams beyond the world we know, and we still have mountains to climb in pursuit of fairness, justice and opportunity. But we have broken open that desperate strongroom of dreams; we are now living out our hopes and aspirations, writing laws that put people first, building institutions that respect people's rights, constructing houses, creating jobs, providing services.

Economic overview

South Africa is in the midst of its longest sustained economic expansion. Robust economic growth, supported by strong consumer spending and rising investor confidence, has created over one million jobs in the past three years. While unemployment remains our most pressing social and economic challenge, for the first time in a generation, the economy is creating jobs faster than new entrants are joining the labour force. Though it is too early to claim victory in the battle against unemployment, we can already see how growth and development work together to reduce poverty and improve livelihoods, how the policy choices we made a decade ago are bearing fruit.

The key challenges we face as a country are to sustain this growth, broaden participation and extend opportunities to all. We must strengthen our industrial capacity and deepen the quality of social development. We must accelerate growth and share its benefits.

In celebrating the solid performance of our economy, we must continue to be mindful that there are still too many South Africans who go to bed hungry, too many who stare at the fragile walls of their shacks and far too many for whom disease makes life a daily struggle.

In the past four years, our economy has expanded by an average of 4,2 per cent a year, with growth reaching almost 5 per cent last year. Some indicators of economic activity suggest that the economy may in fact be growing faster than the preliminary data suggest. But we know that more needs to be done. Sustained and broad-based growth depends on more rapid progress in our industrial sector, on export growth and trade performance and on improving education, skills and productivity.

Allow me to reflect briefly, Chairperson, on developments in the economy over the past five years. Coordinated fiscal and monetary policies have helped bring down inflation and interest rates to historic lows. Rising global commodity prices, solid growth in the domestic market, low interest rates in developed countries and continued inflows of foreign capital have created buoyant financial conditions and a favourable environment for investment.

The expansion of the social security system has contributed to poverty reduction and reduced vulnerability of many households. At the same time, real income tax relief for low and middle-income earners has raised disposable income. People have purchased more durable goods such as televisions, fridges, furniture and cars. We have seen an acceleration of consumer spending, an unprecedented rise in house prices – and steadily rising household debt.

At the same time, many companies have taken advantage of the low interest rate environment and relatively strong currency to retool – to invest in new machinery and technology to expand their businesses. Boosted also by rising public sector infrastructure spending, the construction sector has boomed, growing by 10,7 per cent a year in the past three years. The pace of fixed investment has surprised many of the upstream input sectors. As a result, we are now experiencing periodic shortages of cement, steel and refined fuel.

In some instances, these shortages have led to price increases. In others, we have seen imports to meet excess demand. But over time, these are the signals that lead to investment decisions and business expansions. And investment leads in due course to jobs, training, exports, earnings, and further investment.

The supply side of the economy takes time to respond to rising demand. But the response is clearly underway – companies are increasingly confident that the present boom is not just a temporary surge, but represents a structural shift in our economic trend and prospects. So, for example, gross fixed capital formation has risen from 15 per cent of GDP in 2002 to 18,4 per cent in the first half of 2006.

Just as production takes time to respond to demand, so also domestic savings lags investment growth. As incomes have risen, and taking advantage of more favourable credit conditions, South Africans have chosen to spend rather than save. This has left much of the investment to be financed from foreign capital. While this is appropriate for a country at the level of development as our own, it does increase the potential risks to the economy. We are integrally linked to global financial markets and are therefore able to attract and retain foreign capital inflows, but we must also raise our export performance and savings rate over time.

Investment growth is projected to grow by about 10 per cent a year to 2010. Though household consumption is expected to moderate, the economy is expected to record growth of about four and a half per cent next year, rising to about five and half per cent by 2009. Inflation, as measured by the CPIX is likely to rise further over the next six months, but should moderate thereafter, averaging 4,8 per cent over the next three years.

Adjustment Budget

Chairperson, I table before the House the 2006 Adjusted Estimates of National Expenditure and the Adjustments Appropriation Bill. Allowed adjustments to the expenditure level include underspending from the previous financial year that is approved for spending in 2006/07, unforeseen and unavoidable expenditure, changes to state debt cost, and the allocation of amounts that were announced in the 2006 Budget but not appropriated to a specific vote.

Key changes to the adjustments estimate include the following.

- R764 million is allocated for emergency funding in response to flood damage in Taung and the recent flood disasters in the three Cape provinces, to cover repairs to roads, bulk infrastructure and housing.

- R847 million and R80 million are allocated to Denel and Alexkor respectively.

- Government's initial equity in the proposed broadband telecommunications company, InfraCo, and a further investment in the PBMR demonstration plant, amount to R1,4 billion.

- R372 million rolled over to the 2006/07 Housing vote will contribute to financing the N2 Gateway housing project.

The adjustments budget also makes provision for the consolidation of Metrorail into the South African Rail Commuter Corporation, including operational losses of R180 million and R439 million to maintain the employee benefits of former Metrorail staff.

While total adjustments increase the expenditure level by R8,8 billion, the net increase in the budget is R1,5 billion after taking into account declared savings and the contingency reserve.

Honourable members, in February this year, we tabled a budget proposing R472 billion in spending. Taking account of changes in the adjustments budgets, total spending in 2006/07 is projected to be R474 billion, up nearly R60 billion, or 14 per cent, in comparison with last year.

Fiscal policy

Next year, expenditure will again increase by about R60 billion, continuing the strong expansion in spending on public services that has been achieved since 2000/01. Over the MTEF period, non-interest expenditure will grow by 7 per cent a year in real terms, with capital spending increasing by 13 per cent a year. Chairperson, this expansion in spending can be afforded, and in addition we anticipate that the budget balance will be in surplus next year.

The reason why we can afford to increase spending so rapidly is that we have created the fiscal space to do so.

- By reducing borrowing, we have lowered our interest costs from 21 per cent of spending in 1998/99 to 11 per cent in 2006/07, releasing resources for spending on service delivery.

- Through reform of our tax policy and administration, we've been able to broaden the tax base, bringing in more people into the tax net. As a result, tax revenue has continued to grow despite generous income tax relief.

Fiscal space provides government with an array of options: to spend more, to provide tax relief, to invest in infrastructure or to improve savings. More importantly, it provides a firm platform upon which we can reform our economy to ensure that we broaden opportunities to those still marginalised.

In the first six months of this year, tax revenue grew by 19,1 per cent over the same period last year. Strong revenue growth reflects rising consumption, robust company profits and healthy employment growth, features that have been with us for almost four years. For the present fiscal year, main budget revenue is projected to be about R20 billion higher than budgeted. The deficit for the present fiscal year is projected to be 0,4 per cent of GDP, down from the one and a half per cent budgeted for in February 2006.

Revenue growth is again expected to outpace spending growth next year. We anticipate a budget surplus of about half a per cent of GDP in 2007/08, putting the public finances on the strongest footing, Chairperson, that this House has ever contemplated.

Our fiscal stance contributes to overall savings at a point where a considerable gap has opened up between domestic savings and investment. It assists in containing consumption expenditure at a time when both the balance of payments and the inflation trend indicate the need for moderation. Furthermore, it adds to the fiscal space, providing a solid platform for increased spending on public infrastructure and the development of skills. And most importantly, Chairperson, it provides us with the room to respond when economic conditions become less favourable.

As the capacity of the public sector to spend on infrastructure improves and as development programmes gather momentum, the budget balance is projected to revert to a moderate deficit by the end of the forecast period.

Tax policy

Chairperson, the revenue performance introduces a series of difficult policy choices. Government has to ascertain what part of the revenue overrun is merely cyclical, given high commodity prices and consumption, and what part is likely to recur as part of the base broadening efforts of the South African Revenue Service. It does not make sense to spend once-off revenue on items that are likely to recur. Similarly, it does not make sense to provide tax relief in anticipation of revenue that may not be sustainable.

Our policy must be guided by the need to sustain growth in both the medium and long term, to contribute to an environment for robust investment, improved trade performance and rising domestic saving.

In May this year, a task team was appointed to investigate a possible additional tax on extraordinary profits generated by the liquid fuel industry, in particular the synthetic fuel industry. The task team has presented a comprehensive report within a very short period. It will be published for public comment next month and an announcement on the most appropriate intervention will be made in the budget next February.

The recent publication of the revised Mineral and Petroleum Resources Royalty Bill provides greater certainty and contributes towards an improved investment climate in the resources sector.

Tax reforms over the medium term will build upon past base-broadening initiatives, maintain and enhance the fairness of the tax system and support the growth and employment creation efforts of government.

Public spending

Let me turn, Chairperson, to the medium term expenditure framework. Over the next three years, we are in a position to add R80 billion to the spending plans tabled in February. The major priorities for additional spending are the following:

- Investment in stadiums and public transport to ensure a successful 2010 FIFA World Cup

- Stepped up investment in the built environment in the form of housing, electricity, water, sanitation and community facilities

- Contributing to improved economic efficiency through investment in roads, rail, research and development, energy and skills development

- Strengthening the criminal justice sector, with particular emphasis on visible policing and improving court case flow; and

- Improving the quality of education, health and welfare services through additional resources and targeted interventions to improve public administration.

2010 FIFA World Cup

Chairperson, the hosting of the 2010 FIFA World Cup provides South Africa and the region with a once-in-a-generation opportunity to showcase our land and and our hospitality in a sporting festival that knows no bounds. Hosting this event will require the effort of all South Africans, strong partnerships between communities, government and the footballing fraternity and joint action by the public and private sectors.

The 2007 MTEF period, which ends on 31 March 2010, has to carry the full costs of this investment. National government will provide a total of R15 billion for infrastructure related to the World Cup. Of this amount, R8,4 billion is for the stadiums and R6,7 billion for public transport initiatives and supporting infrastructure. These amounts will be complemented by contributions from local government and other partners. The Local Organising Committee is putting in place a framework to fast-track the construction of these stadiums to ensure that key facilities will be in place by mid-2009, when we host the FIFA Confederations Cup.

In addition to these amounts, the budget will also provide for costs associated with policing, arts and culture, emergency medical services and border control.

Investing in the built environment

In 2001, we began increasing spending on social and economic infrastructure. Sustainable, vibrant communities require houses but also much, much more. They require safe neighbourhoods, parks, street lighting, quality schools, roads, clinics and access to public transport. The main conduits of spending on the built environment are the provincial and municipal infrastructure grants, the integrated housing and human settlement development grant and the integrated national electrification programme. Funds channelled through the Department of Water Affairs and Forestry complement these programmes.

This year, we launched a new programme called the Neighbourhood Development Partnership Grant with an initial three-year allocation of R2.5 billion. To date, we have received 243 applications from 60 municipalities. Thirty five qualifying projects have been identified, involving total public and private sector investment of about R3,6 billion over the three year period.

Including changes proposed in the budget framework, over R83 billion is set aside for investments in the built environment with many of these programmes doubling over the next three years. Honourable members, we do these things so that the benefits of property and community investment should extend beyond Sandton, Constantia or Waterkloof. Recent research indicates that house prices in townships have shown rapid increases in the past three years. We are now seeing rising interest by property developers in the low-income housing market, supported by both lower interest rates and rising household incomes. Shared growth is about accelerating and reinforcing these trends.

As the economy grows, one of the constraints to broader economic participation is poor public transport networks across our major cities. The challenges facing the commuter rail system are particularly acute. Trains are often late, security is poor and there are safety concerns. Ageing signalling systems and deteriorating rolling stock contribute to unreliable and inadequate service. Additional resources are therefore recommended for both municipal transport systems and public transport relating to the 2010 FIFA World Cup. A further R1,1 billion is proposed for the South African Rail Commuter Corporation, bringing the total transfer to the corporation to R15 billion over the next three years.

In the 2006 Budget, we announced that we expect government and public enterprises to spend about R370 billion on infrastructure over a three-year period. We now expect spending on public infrastructure to grow by about 15 per cent a year, to reach about R150 billion a year by 2010. These investments are focused on social and household services and infrastructure that expands economic capacity. The proposed budget framework provides R28 billion of additional funds for spending on electrification, roads, commuter rail, housing, bulk infrastructure and research and development.

Fighting crime

Chairperson, we have always emphasised that bringing down crime requires a combination of social and economic programmes designed to improve community livelihoods, and that reducing crime requires a strong partnership between communities and government. However, the direct efforts of our criminal justice sector are critical to making our country safer.

As a government, we are committed to the reduction of crime, and particularly violent crime. We are acutely aware of the damage that crime does to our social fabric and psyche, and its impact on all South Africans, including the livelihoods of small businesses and the poor.

The 2007 Medium Term Expenditure Framework proposes to add further resources to support the fight against crime. We make provision for a further 10 000 people to be employed by the South African Police Service, raising overall policing levels to 193 000 by 2010. We also make provision for more people to be employed in the legal system, mainly to improve court case flow management. Spending on justice, policing and prisons will grow by 9,4 per cent a year over the medium term.

Enhancing economic capacity

Major infrastructure projects over the next three years include the Gautrain rapid rail link, King Shaka Airport, the de Hoop Dam on the Olifants River and the Vaal River augmentation project. Most of these projects use a combination of public and private sector funding and all are designed to complement and encourage private business investment or, in the case of the De Hoop Dam, open an entire area to new mining ventures. Much of the investment by state owned enterprises is also designed to facilitate greater export performance.

Improving economic performance and broadening economic opportunities cannot happen without further improvements in our investment in human capital. The 2007 MTEF proposes significant additions for enhancing the development of skills. A major step up in spending on adult literacy is proposed. Further additions are proposed for higher education, including resources for infrastructure investment at universities. Three new bursary programmes are envisaged. The first is to attract 1400 young people into the teaching professions and for 900 teachers to improve their skills through post-graduate education in maths, science and life skills. The second is aimed at raising the number of qualified social workers to work in both the public and non-governmental sectors. Thirdly, money is set aside for deserving entrants into out FET colleges.

Besides the adjustment for the current year for Alexkor and allocations for Broadband InfraCo, a total of R6 billion is set aside for the PBMR project over the period ahead. Subject to the necessary environmental, regulatory and safety considerations, this initiative places South Africa at the forefront of new generation energy technology development worldwide.

Improving the performance of the public sector

The last spending priority that I wish to deal with relates to the need to improve the capacity of government. There are many components of the civil service that work well, where departments deliver services of a high quality and citizens are treated with respect and dignity, many schools where effective learning takes place and many millions of people served by our clinics. However, there are also clear inadequacies. As public spending has accelerated in the past five years, we, as government, are becoming increasingly concerned that in many cases, increased resources have not translated into increased outputs. And so the public has not always seen the benefit of the significant rise in public spending.

This budget framework makes provision for increased salaries for certain categories of professions, especially in the health and social welfare sectors. It also makes provision for higher staffing levels in health, police, justice and social welfare. These are much needed improvements. Members of the House know that we share a responsibility to ensure that improved management and better accountability accompany the rising public sector wage bill.

Municipalities are confronted with several capacity challenges that hamper critical areas of service delivery, which impact negatively on the delivery of basic services and the achievement of water and sanitation targets.

The 2007 budget proposes to allocate more than R700 million over the next three years to Siyenza Manje – an initiative of government that is primarily driven by the Development Bank of Southern Africa. It aims to provide the necessary expertise in the fields of project and financial management, planning and other critical skills needed for the effective delivery of the local government mandate.

Division of revenue

Our intergovernmental fiscal framework is now an established part of our public finances. Last week, we published two documents covering provincial and local government. They set out spending trends and budgets, sectoral policy developments and non-financial performance information. I urge all members of this house to peruse these documents. They provide a compelling perspective on the state of service delivery in these two most critical spheres of government.

The division of revenue between the three spheres is made on the basis of the policy priorities determined by Government, articulated in the State of the Nation Address and given effect in legislation passed by Parliament. Of the additional R80 billion in spending, it is proposed that provinces receive R28 billion and local government R19 billion.

The provincial transfers fund higher spending in education, health and welfare services as well as further additions for infrastructure. The hospital revitalisation grant, programmes aimed at preventing and treating HIV and Aids and the provincial infrastructure grant receive more resources.

Transfers to local government remain one of the fastest growing categories of public spending. The additional resources proposed for the next three years go mainly for the 2010 FIFA World Cup. The local government equitable share is increased by R5 billion to help accelerate the delivery of free basic services. A further R1,4 billion will be allocated for bulk water and sanitation infrastructure, and R400 million for the eradication of the bucket system.

Public finance reform

Chairperson, this is the tenth medium term budget policy statement presented in this house. When we launched this statement in 1997, we said, “this is a significant step in increasing transparency, openness and cooperative government. For too long, budgets have been made behind closed doors. These are important decisions which affect all our futures.”

A coalition of international non-governmental organisations, under the umbrella of the International Budget Project, recently ranked South Africa fourth out of 59 countries for the transparency of our budget documents. The MTBPS, the Budget Review, Estimates of National Expenditure and our provincial and local expenditure reviews, all contribute to this achievement. But we are not yet where we want to be. We still have too little debate in this House and in the country on budget priorities. Over the course of the next few weeks, we will engage with Parliament on the budget framework and spending priorities mentioned here. We will also meet a number of external organisations, including our social partners at Nedlac and the People’s Budget Coalition to solicit their views on the budget framework.

A raised level of consultation and debate on priorities and greater scrutiny of the public finances not only strengthens our democracy but also places pressure on government departments to deliver. It is a valuable accountability mechanism.

Conclusion

Chairperson, the solid performance of our economy, in particular the creation of job opportunities and rising household incomes, allows us to turn the dreams of ordinary people into new realities. The expansion of infrastructure investment and the management of our public finances provide us with the capacity and resources to improve the services we provide to our people, to build hope and expand opportunities. The Medium Term Budget Policy Framework invites this House, and all South Africans, to embrace the challenges ahead as we prepare for 2010 and as we progressively broaden participation in a growing economy, with confidence in these shared commitments.