

Sustaining growth and accelerating development

South Africa is experiencing a sustained period of economic growth. Sound macroeconomic policy, an expansionary fiscal stance and a supportive international environment have seen growth average 4,2 per cent over the past four years. Rising consumption expenditure and strong increases in investment in productive capacity have resulted in expanded employment, with the creation of more than 1 million jobs over the past three years.

The economic challenges facing the country are to sustain this growth, broaden participation and extend opportunities to all, strengthen industrial development and trade performance, and accelerate the pace of job creation. These challenges will be met, in part, through sound tax policy and continued expansion in public spending within a fiscal framework that takes account of international and domestic risks. The key public spending priorities over the 2007 medium-term expenditure framework (MTEF) include:

- *Investment in stadiums and public transport to ensure a successful 2010 FIFA World Cup*
- *Strengthening the criminal justice sector, with particular emphasis on visible policing and improving court case flow*
- *Stepping up investment in the built environment in the form of housing, roads, water, sanitation and community facilities*
- *Contributing to improved economic efficiency through investment in roads, rail, electricity generation and supply, dam construction and skills development.*

The medium-term strategic framework

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

- Accelerating the pace of growth, and the rate of investment in productive capacity

A framework to enhance the social, cultural and economic welfare of all South Africans

- Decisive interventions to advance the involvement of the marginalised in economic activity through expanded job creation and the promotion of sustainable livelihoods
- Maintaining 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 2006 *Medium Term Budget Policy Statement* presents the policy framework that flows from these overarching goals and gives an overview of key spending areas.

2010: an historic opportunity for the African continent

The 2007 MTEF will carry the full costs of government's contribution to preparations for the 2010 FIFA World Cup – an historic opportunity for the African continent that serves also as a major driver of infrastructure development and tourism, promoting national cohesion and contributing to the long-term strengthening of the South African economy and social fabric. Discussion of this infrastructure investment programme is followed by a review of policy challenges addressed over the next three years, and an overview of the subsequent chapters of the *Medium Term Budget Policy Statement*.

Preparations for 2010 FIFA World Cup

Preparations for the World Cup are well underway

Just under four years from now South Africa will host the world's largest sporting event. Preparations for the 2010 FIFA World Cup are well underway, with the bulk of the work taking place in the nine host cities.

Government is committed to making the necessary infrastructure, logistics, communications and security-related investments to ensure a successful event. Strategic investments are being targeted to leave a lasting legacy, particularly in the areas of tourism promotion, sports development and public transport.

R14,9 billion allocated for major capital projects

An overall amount of R14,9 billion has been allocated for major capital projects, including the construction or upgrading of stadiums and the development of the surrounding precincts. Five new stadiums will be built and five existing facilities will be upgraded to meet FIFA requirements. A protocol has been developed to guide the flow of funds from the national fiscus to the municipalities and provinces that will execute projects.

A comprehensive extension and upgrade of transport networks

Successful management of an event of this magnitude requires the rapid and efficient movement of large numbers of people without unduly disrupting normal traffic. The Department of

Transport has prepared a comprehensive plan for transport network extensions and upgrades encompassing road, commuter rail and the airports. Other key projects include the development of training venues and fan parks, strengthening safety and security, ensuring sufficient accommodation in host cities, investment in the communications infrastructure and increasing the capacity of emergency health services.

Infrastructure investment over the next few years will provide a strong platform for accelerated future growth. It forms part of government's broader capital investment programme, focused on creating economic opportunities for businesses and individuals, and progressive improvements in household living conditions.

Infrastructure investment provides strong platform for accelerated future growth

Pursuing sustainable growth

In support of sustainable growth and long-term growth targets, government will continue to promote macroeconomic stability, a favourable investment climate and expanded economic opportunity, while mitigating international and domestic risks. Work will continue on reforming trade and industrial policy.

Promoting macroeconomic stability, investment and expanded opportunity

Government's accelerated and shared growth initiative (AsgiSA) aims to lift sustainable growth from about 3 per cent a year between 1996 and 2003 to at least 4,5 per cent a year between 2005 and 2009, and to achieve an average growth rate of at least 6 per cent thereafter.

There has been substantial progress over the past three years. South Africa's sustained economic expansion has been underpinned by robust investment and domestic expenditure, historically low interest rates and buoyant commodity prices. The global economic environment has also been supportive, with exports continuing to grow as seen in the second quarter of 2006. However, the widening deficit on the current account of the balance of payments signals the importance of further industrial and trade policy reforms.

Widening current account deficit signals importance of further reforms

Figure 1.1 below shows the strong recovery in GDP per capita growth that began in 1994 following a long decline. Growth in GDP per person has increased from 1,4 per cent in 2003 to 3,5 per cent in 2005. Economic policy will work to sustain this positive trajectory going forward.

Figure 1.1 GDP per capita, 1967 – 2006



Investment to grow to 10 per cent a year by 2009/10

Investment spending is expected to remain strong over the medium term, driven by major capital expenditure projects. Growth in investment is expected to accelerate to 10 per cent a year by the end of the three-year period. The increase in real gross fixed capital formation to 18,4 per cent of GDP is a clear indication that both the private sector and public corporations are increasing productive capacity through higher capital expenditure.

Substantial resources for road and rail networks and the built environment

The 2007 MTEF supports the drive to increase the investment rate to 25 per cent by 2014. Substantial resources are provided to key transport networks – notably road and rail. The residential and local built environments are again prioritised, including investments in bulk infrastructure at the local level. Communications infrastructure also receives attention as part of the modernisation drive in this sector.

Building on projected growth of 4,4 per cent in 2006, growth is expected to accelerate to 5,3 per cent by 2009, supported by continued global economic expansion, improved export performance and a competitive currency.

Large-scale job creation has been underway for several years

Broadening economic participation

There are clear signs that the economy's capacity to create jobs is improving. Rapid growth in domestically oriented sectors and nascent improvements in more export-oriented sectors will continue to shift the economy onto a more labour-absorbing growth path. The Labour Force Survey indicates an increase in total employment from about 11,2 million jobs in September 2001 to 12,4 million jobs in March 2006. The official unemployment rate has dropped to a six-year low of 25,6 per cent – a decline of 3,8 percentage points compared to September 2001.

Job creation has been broad-based. Strong consumer spending boosted employment levels in the wholesale and retail trade sectors, while significant job creation also took place in agriculture, manufacturing and construction. As unemployment continues on its downward trajectory, government will increasingly focus on the nature of jobs being created to ensure that job creation is accompanied by skills development and improved working conditions.

Skills development, improved working conditions should accompany job growth

Compared to other emerging markets, South Africa has a relatively small informal sector. Raising the level of economic activity in historically disadvantaged communities requires direct interventions by government in support of small business development. Through its integrated service delivery network, the Small Enterprise Development Agency extends support services and products to small businesses while government's preferential procurement policies increase market access for goods from this sector.

As part of AsgiSA, government has prioritised several sectors for development, particularly in areas with high labour-absorption capacity. Business process outsourcing and tourism are two such sectors receiving targeted support from government. These sectors are well suited for rapid job creation and can provide growing opportunities for small businesses. Other candidates for targeted support include the film industry, which receives assistance through the Film and TV Production Incentive scheme.

AsgiSA prioritises sectors with high labour-absorption potential

Employment creation is also directly promoted through government expenditure. The expanded public works programme will receive a further boost to scale up the labour-intensive refurbishment of rural roads, and several social sector initiatives are contributing to job creation in local communities. A number of programmes help individuals obtain access to economic opportunities. A mass adult literacy programme is planned over the medium term. A programme is also being developed to upgrade the qualifications of teachers currently in the education system.

Government plans a mass adult literacy programme and will upgrade teacher qualifications

Social services, income support and human development

In April of this year, the South African Social Security Agency took over responsibility for the administration of social grants from provinces. This transfer of responsibilities was accompanied by strategic improvements in key administrative systems. Efficiency gains are expected to materialise from these investments, both in terms of cost of service delivery and the time taken to disburse grants to eligible beneficiaries.

Efficiency gains to emerge from social security reforms

Orphans and vulnerable children to benefit from new service delivery initiatives

The transfer of the social grants function to national government has created space for provinces to improve social welfare services in general. The national and provincial social development departments are working together to improve the quality of service delivery. The main beneficiaries of these initiatives will include orphans and vulnerable children, older persons, people with disabilities and other vulnerable groups. The number of social workers will be increased through bursary schemes in order to meet the legislative requirements of the Children's Act and Older Persons Act, among others.

As of March 2006, 10,8 million people were receiving income support in the form of a social grant.

In addition to strengthening the social safety net, government is bolstering its human development initiatives. 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 programmes
- Upgrading hospitals and modernising tertiary services
- Increasing funding for students attending FET colleges
- Instituting a major drive to boost adult literacy
- Increasing funding for higher education institutions to accommodate increasing student numbers.

Accomplishments of government expenditure include increased school enrolment

Notable outputs benefiting the poorest members of society include increased enrolment ratios for both primary and secondary schooling, which should continue with the phasing in of no-fee schools in 2006. Greater access to health care is evident in the rise in visits to primary health care clinics from 81,9 million in 2000/01 to 101,8 million in 2005/06. The health sector has also managed to increase the number of health workers by 16 000 over the past two years. Of these, 10 000 are health professionals such as nurses, doctors and pharmacists. A new remuneration dispensation for health professionals is also being finalised.

Improving the capacity of the state to deliver

Steps taken to strengthen capacity of the state

Government is taking steps to strengthen the capacity of state institutions to deliver on their mandates. A set of complementary interventions is required, including improved coordination between national, provincial and local government; capacity building in local government; and the introduction of a monitoring and evaluation system that can track the progress of development outcomes.

Research led by the Cabinet's governance and administration cluster has highlighted capacity gaps throughout government. It identified in detail skills needed to implement AsgiSA, and to strengthen government management systems in support of service delivery. This includes the modernisation of financial management practices, and targeted interventions focused on dysfunctional institutions or programmes.

Interventions to modernise financial management address institutional failure

In March 2006 the Deputy President launched the joint initiative on priority skills acquisition (JIPSA), which focuses on attracting and retaining scarce and critical skills. This initiative will support the alignment of FET colleges and higher education institutions in their work of producing graduates that can be employed to meet the needs of public and private sector employers.

Special attention is being paid to local government to alleviate service delivery bottlenecks. Investment in planning, project management and technical capacity in municipalities is spearheaded by the *Siyenza Manje* initiative of the Development Bank of Southern Africa and Project Consolidate. These initiatives will deploy experienced professionals and managers to local government to improve project implementation and maintenance capabilities.

Siyenza Manje provides support to local government

The public entities and development finance institutions are also under review – particularly the Industrial Development Corporation, the Land Bank, the Development Bank of Southern Africa, the National Housing Finance Corporation and the National Development Agency. The review covers operational and governance issues and seeks to optimise the contribution of these institutions to government's objectives in areas such as infrastructure finance, small business development and social development.

Review of public entities and development finance institutions underway

A key area targeted for ongoing improvements in service delivery is the fight against crime. Government has committed itself to attain a 7–10 per cent annual reduction in the incidence of all contact crimes. In line with this commitment the number of police personnel continues to be expanded, with the focus on strategic locations and sector policing. Justice administration will also be strengthened by increasing and retaining personnel throughout the justice environment.

To fight crime, police and justice personnel numbers continue to be increased

International relations

South Africa is becoming increasingly active on the global stage. Beginning next year, South Africa will take its place as a non-permanent member of the United Nations Security Council for a two-year period.

A Security Council seat for South Africa

Chairing the G20 forum of industrialised and developing economies

South Africa assumes another major responsibility next year when it becomes the chair of the Group of Twenty (G20). The G20 is a forum consisting of the seven most industrialised countries and 13 systemically significant developing economies. It promotes open and constructive discussion between finance ministers and central bankers from industrial and emerging-market countries on key issues related to the global economy.

The implementation of the revised Southern African Customs Union (SACU) Agreement demonstrates an enduring and shared commitment to improve trade relations with the rest of the world and a development-oriented distribution of customs and excise revenue between South Africa and Botswana, Lesotho, Namibia and Swaziland.

Support for African development includes initiatives from Mali to the Congo

South Africa's commitment to supporting African development comes in several forms. Government continues to support peacekeeping and postwar reconstruction projects in the Democratic Republic of Congo, Sudan, Mali and Cote d'Ivoire, among others. Financial and technical assistance is also increasing from South Africa to several African countries through the African Renaissance Fund. However, there is a need to develop better coordination of the various initiatives of government departments and other agencies with the rest of the continent.

South Africa has taken responsibility for hosting the Pan-African Parliament, and will continue to support the coordinating secretariat of the New Partnership for Africa's Development, along with the institutions of the African Union and the Southern African Development Community (SADC).

The SADC heads of state are reviewing the slow pace of economic integration within SADC. Both the ratified SADC Protocol on Trade and the regional indicative strategic development plan envisage a free-trade area by 2008 and a customs union by 2010. These high-level strategic initiatives are intended to liberalise intra-regional trade in support of higher economic growth rates and poverty alleviation in the region.

Medium Term Budget Policy Statement overview

Macroeconomic outlook

Chapter 2 discusses economic policy and the macroeconomic outlook.

South Africa's seven-year economic expansion has been driven by strong growth in consumption expenditure, supported by accelerating investment, prudent macroeconomic policy and continuing economic reform.

A seven-year expansion driven by growth in consumption expenditure

The benefits of this economic expansion include a marked acceleration in employment creation since 2004. Employment gains have been concentrated in the construction, services and trade sectors. While the national skills shortage remains a serious concern, there has been measurable progress in registered training and skills development activities, and productivity continues to improve.

Progress in productivity, training and skills development

The medium-term economic outlook remains positive. However, challenges remain, both in terms of continued reform of the economy to improve trade performance and broaden participation, as well as maintaining a sustainable growth rate in an environment characterised by volatile global markets.

Economic growth is forecast to average about 5 per cent a year over the medium term, supported by healthy investment levels and a recovery in exports alongside a moderation in consumption expenditure.

Growth forecast to average about 5 per cent a year over medium term

Table 1.1 Macroeconomic projections, 2005 – 2009

Calendar year	2005	2006 Estimate	2007	2008 Forecast	2009
<i>Percentage change unless otherwise indicated</i>					
Final household consumption	6,9	6,6	4,4	4,5	4,7
Final government consumption	5,6	5,6	4,5	4,6	4,6
Gross fixed capital formation	9,2	9,5	9,0	9,3	10,0
Gross domestic expenditure	5,9	7,2	4,3	5,2	5,7
Exports	6,7	2,7	6,5	6,3	6,4
Imports	10,1	13,0	5,7	7,4	7,6
Real GDP growth	4,9	4,4	4,4	4,8	5,3
GDP deflator	4,7	6,5	6,6	4,8	4,5
GDP at current prices (R billion)	1 523,3	1 693,4	1 885,0	2 069,6	2 277,2
CPIX	3,9	4,6	5,5	4,4	4,5
Current account balance (% of GDP)	-4,2	-5,7	-5,3	-5,6	-5,8

Domestic vulnerabilities and global risks over the short to medium term require careful policy management to ensure that the growth momentum generated over the past few years is taken forward into the forecast period.

Long-term accelerated growth depends on industrial and trade reforms that boost exports

The current account of the balance of payments has widened from a deficit of 4,5 per cent of GDP in the second half of 2005 to a deficit above 6 per cent during the first half of this year. While financial inflows more than offset the current account deficit at present, accelerated growth over the longer term will depend on industrial and trade policy reforms that bolster exports and moderate South Africa's trade deficit. Increased government savings over the medium term will further reduce risks associated with the current account deficit.

Average annual CPIX inflation to remain within the 3-6 per cent target band

CPIX inflation remains within the 3-6 per cent target band, but inflation has been trending upward from a low of 3,7 per cent in April 2006. This trend, combined with the more sharply rising producer price inflation, has prompted the Reserve Bank to raise interest rates by a total of 1,5 percentage points since June 2006. Over the next three years inflation is expected to average 4,8 per cent.

Fiscal policy and tax considerations

Fiscal policy, discussed in Chapter 3, supports South Africa's economic growth momentum and the progressive realisation of social goals. Targeted real increases in expenditure address areas of pressing social and economic importance. Continued growth in revenue supports the expansion in expenditure, while the budget balance takes account of the risks posed by emerging imbalances in the domestic economy and uncertainty regarding the trajectory of global growth.

Table 1.2 Main budget framework, 2005/06 – 2009/10

R billion	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome	Estimate	Medium-term estimates		
Total revenue	411,7	466,4	543,0	586,4	633,5
<i>Percentage of GDP</i>	26,3%	26,7%	28,2%	27,7%	27,2%
Total expenditure	416,7	474,2	533,7	590,2	643,7
<i>Percentage of GDP</i>	26,7%	27,2%	27,7%	27,8%	27,6%
Debt service cost	50,9	52,6	53,8	54,1	52,4
<i>Percentage of GDP</i>	3,3%	3,0%	2,8%	2,6%	2,2%
Non-interest expenditure	365,8	421,6	479,9	536,1	591,3
<i>Percentage of GDP</i>	23,4%	24,2%	24,9%	25,3%	25,4%
<i>real growth (non-interest expenditure)</i>	9,9%	9,7%	8,3%	7,1%	5,5%
<i>Contingency reserve</i>	–	–	2,2	6,0	10,0
Budget balance ¹	-5,0	-7,8	9,3	-3,8	-10,2
<i>Percentage of GDP</i>	-0,3%	-0,4%	0,5%	-0,2%	-0,4%
Gross domestic product	1 562,8	1 745,8	1 928,3	2 119,9	2 330,5

1. A positive number reflects a surplus and a negative number a deficit.

Proposed increases in expenditure over the next three years total R80 billion, representing average real growth of 7 per cent a year. The additional funds are targeted mainly at preparation for the 2010 FIFA World Cup, improvements in the criminal justice system, continued investments in the built environment, and investment in human development.

R80 billion in new spending over the medium term

Table 1.3 Medium-term expenditure framework and division of revenue, 2006/07 – 2009/10

R billion	2006/07	2007/08	2008/09	2009/10
	Revised	Medium-term estimates		
National	215,6	242,3	263,1	286,4
Provincial	178,3	201,5	224,9	248,0
Local ¹	27,7	33,9	42,0	46,8
Total	421,6	477,6	530,1	581,3
Changes from baseline¹	3,5	16,8	22,5	40,7
National	0,7	8,3	8,6	16,0
Provincial	1,6	5,2	7,4	15,6
Local	1,2	3,4	6,5	9,1

1. Baseline allocations comprise the medium term estimates published in the 2006 Budget, together with an inflation projection and growth assumption in 2009/10 over the 2008/09 allocations.

Buoyant economic conditions continue to find expression in the revenue trend, with gross tax revenue projected to outperform the budgeted amount by R29,6 billion in 2006/07. The budget balance is expected to reach a surplus of 0,5 per cent of GDP in 2007/08, before moving towards a deficit of 0,4 per cent in 2009/10.

The prudent fiscal stance results in the continued reduction in debt stock as a percentage of GDP and improved savings by government, which further contributes to the sustainability of government expenditure in an uncertain economic environment.

Prudent fiscal stance sees debt decline as percentage of GDP

A contingency reserve of R2,2 billion in 2006/07, R6 billion in 2008/09 and R10 billion in 2009/10 remains unallocated in the framework for the 2007 Budget.

Tax policy is discussed in Chapter 4. Gross tax receipts continue to be boosted by the current economic environment, resulting in revenue collection being about R29,6 billion higher than budgeted. SACU transfers are buoyed by a significant increase in customs duties, which results in main budget revenue exceeding the budgeted forecast by R20,0 billion. Tax revenue is expected to remain buoyant in 2007/08, fuelled in part by the stabilisation of commodity prices at relatively high levels and modest currency depreciation. Mindful of potential economic risks, government will review available tax policy choices.

Tax revenue boosted by robust economic environment

Tax amnesty aims to help bring small business into formal economy

The chapter also reviews progress on the implementation of tax proposals from the 2006 Budget. These include income tax relief for individuals and the small business tax amnesty. By improving the culture of tax compliance, the amnesty will bring more small businesses into the formal economy. Other measures that support savings included reducing the tax on retirement funds. Substantial transfer duty relief promotes home ownership and has supported growth in residential investments.

Policy priorities and the division of revenue

Chapters 5 and 6 set out the proposed expenditure priorities for the 2007 Budget and the allocations of nationally collected revenue to provinces and municipalities. Annexure A provides details of the expenditure outcome for national departments and provinces in 2004/05, together with provisional mid-year spending outcomes for 2005/06.

Expenditure outcome for 2005/06 slightly under estimate

The national budget expenditure outcome for 2005/06 is R2,3 billion lower than the revised estimate of R419,0 billion published in February. For the current year, national departments had spent 46 per cent of the main budget estimate by September and provincial spending amounted to an estimated 45 per cent of their consolidated budget estimate.

The *Medium Term Budget Policy Statement* proposes the following changes to the division of revenue:

- R18,6 billion of additional resources to the provincial equitable share
- R9,6 billion to supplement conditional grants to provinces
- R18,9 billion for local government, of which R12,1 billion consists of conditional grants in support of the 2010 FIFA World Cup
- R32,9 billion for national department functions, which includes provision for the recapitalisation requirements of state-owned enterprises.

Provincial allocations support broadening access to services

Increased allocations to the provincial equitable share take into account the need for quality improvements in social services as well as broadening access. Key economic services that support growth are also funded.

Local government allocations support infrastructure-related spending and the extension of basic services to poor communities.

Table 1.4 Consolidated expenditure, 2007/08 – 2009/10

R billion	2007/08	2008/09	2009/10
	Medium-term estimates		
Education	103,3	113,0	123,7
Health	61,0	66,7	73,4
Welfare and social security	88,2	97,3	106,0
Housing and community development	43,1	52,0	56,3
Police, prisons and courts	57,2	62,1	67,2
Defence and intelligence	29,7	31,8	34,4
Economic services	103,9	114,0	129,5
General administration	39,2	43,7	47,1
Non-interest expenditure	525,8	580,7	637,7
Interest	57,5	58,0	56,6
Unallocated	2,2	6,0	10,0
Total expenditure	585,4	644,6	704,3

South Africa in the premier league of budget transparency

South Africa scores 85 out of a possible 100 on the Open Budget Index 2006, produced by the International Budget Project – a nongovernmental organisation based in Washington DC that promotes budget transparency.

The index evaluates the quantity and quality of information provided to citizens in the seven key budget documents that all governments should make public during the course of the budget year. South Africa placed fourth out of 59 countries and is the only developing country in the top tier of the index.

South Africa scores highly in all areas, but particular mention is made of the pre-budget statement (the *Medium Term Budget Policy Statement*), the executive's budget proposal and the People's Budget (a popular newspaper-sized version of the budget). The report also points out that there is room for improvement in areas such as mid-year estimates, year-end actual spending reports and the accessibility of audit reports.

New Zealand scores highest on the index (89), followed by France (87), Britain (86), and South Africa.

The index can be accessed at www.openbudgetindex.org

Conclusion

Sustaining the present growth momentum requires a balanced macroeconomic and fiscal approach that takes account of domestic and international risks. Economic growth will remain robust over the next three years. The fiscal stance will result in broadly balanced revenue and expenditure growth, while infrastructure and social services continue to be prioritised in spending. Improved government savings and a more export-oriented policy environment will moderate external risks and strengthen growth.

Fiscal stance results in broadly balanced revenue and expenditure growth

Sustainable growth is also about better-focused policies and government programmes, improved public administration and well-targeted regulation. The fiscal policy framework, tax measures, investment plans and spending proposals for the 2007 Budget will provide further impetus to growth and

Well-targeted regulation will be a feature of future growth

Budget policy statement aims to encourage debate in Parliament and society

broadening participation in the economy over the MTEF period and beyond.

The *Medium Term Budget Policy Statement* aims to encourage debate in Parliament and throughout society on government's policies, plans and spending proposals. Comments on the framework set out for the 2007 Budget can be emailed to tipsfortrevor@treasury.gov.za, or posted to:

“Tips for Trevor”

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