Budget Speech

Minister of Finance

T A Manuel

21 February 2001

Madam Speaker
President Thabo Mbeki
Deputy President Jacob Zuma
Cabinet Colleagues
Honourable Members
Honourable MECs
Governor of the Reserve Bank
Your Excellencies, Ambassadors and High Commissioners
Distinguished Guests
Fellow South Africans

Africa tell me Africa
Is this you this back that is bent
This back that breaks under the weight of humiliation
This back trembling with red scars
And saying yes to the whip under the midday sun
But a grave voice answers me
Impetuous son, that tree young and strong
That tree there
In splendid loneliness amidst white faded flowers
That is Africa your Africa
That grows again patiently and obstinately
And its fruits gradually acquire
The bitter taste of liberty[1]

Introduction

The *bitter* taste of liberty? Does the lemon always ripen before the sweet plum? Or do we have it in our power to determine for ourselves the quality of the liberty we earn from struggle?

The budget we table before this House today is the story of an irrevocable and powerful transformation. It is the story of a nation which has worked without rest to build a new history for its children. Like Diop's young tree at the edge of the ancestral savannah at the dawn of our continent's independence ours is a story of patience and obstinacy. Of determination and hope. Of activism not atavistic tolerance. Of choice not fate. We have sought to remove the thorns of neglect and inhumanity. To restore pride and dignity. To lift the crushing weight of poverty and disempowerment. We have sought to heal the scars and nurture the tree. We have sought to show

[1] David Diop, *Afrique! (translated).*

our children that we have the power to enjoy the sweet fruit of liberty. The Budget we table today is testimony to the success of our transformation policies.

These processes of transformation are not complete – the redress of past impoverishment and injustice will take time. But they are firmly rooted in our society and economy. We can now embrace a more confident and expansionary vision. This Budget tells the story of the choices and decisions we have made and which have advanced the transformation of our country and its economy to the point where we can now begin to enjoy the fruit. It tells the story of a young and proud democracy hard at work to improve the lives of all its people.

The 2001 Budget brings to this House the fruit of the macroeconomic transition we have undergone. Our 1996 strategy was designed to achieve stability, fiscal reprioritisation and consolidation to create the basis for sustainable growth and development. It focused on reversing the growth of debt, unsustainable deficits and the rising burden of interest payments, which threatened our young democracy. It was designed to ensure that a greater share of resources went to key priority areas such as education, health and social welfare targeted to the poor. It aimed to put the economy on a sound footing, improve competitiveness and strengthen access to global markets.

Today we can say that macroeconomic stability and fiscal consolidation have been achieved and we can move to the next phase of economic reforms.

It is instructive to reflect on how different things might have been. Debt service costs rose during the 1990s from 15 per cent to over 20 per cent of the budget in 1998/99, steadily eroding the resources available for delivery of services. If the trend had continued the headlines for today's Budget would have been "Interest on debt now R10 billion more than spending on education and rising". But we reversed that trend. Next year we will spend R10 billion more on education than on debt and by 2003/04, R15 billion more. Interest on debt in three years time will have retreated to 16,4 per cent of consolidated spending.

In order to reverse the rising debt trend, we have been prudent about overall spending, putting the emphasis firmly on reprioritisation and better quality of expenditure. Now we can reinforce public service delivery without threatening fiscal sustainability, and our children and grandchildren can look forward to a future unencumbered by debt.

So that the tree bears not the bitter but the sweet fruit of liberty.

This Budget heralds the beginning of a new cycle. It sets out a growth-oriented agenda of improved spending, significant increases in infrastructure allocations and ongoing tax reform, within the sound framework of fiscal management established over the last five years. It signals a shift from macroeconomic stabilisation to microeconomic reform. And in the new format of the *Estimates of National Expenditure* we are tabling today, we signal not just substantial increases in spending allocations, but a new approach to accountability and management of the resources this House appropriates for public purposes.

International developments

Our economic prospects are inextricably linked to developments in the global economy. Global economic growth peaked in the first half of 2000. There is considerable uncertainty about the likely severity of the slowdown in world growth and how long it will last. This will depend in part on the reaction of the US economy to the interest rate cuts earlier this year and monetary developments in Europe and Japan. At this stage it is expected that growth in the major industrialised economies will be in the region of 2,8 per cent for 2001, improving marginally to around 3 per cent in 2002.

The large current account imbalances in the US and the prospect of lower growth in Europe mean that continued euro and US dollar volatility remains a risk for the global economy. Implications for South Africa and other small emerging economies are hard to assess.

Ours is more than just a cursory interest in the growth statistics of the global economy for 2001. There are broader goals we share with many other nations – to ensure that developing countries share equitably in the benefits of globalisation, to adopt more effective collective strategies for overcoming the scourge of poverty, and to place these issues prominently on the agenda of the multilateral financial institutions, the World Trade Organisation and the consultative international groups with which we engage.

At the annual meetings of the International Monetary Fund and the World Bank held in Prague in September last year we drew attention to the rising threat that growing inequality poses for the long term prosperity of the global economy. We raised the importance of ensuring that the commitments made by the G7 nations to heavily indebted poor countries should be met in full, and that more effective and secure aid flows need to accompany debt reduction.

Fair trade and access to markets are fundamental to sustainable growth and development. It is shameful that so many of the wealthiest countries in the world persist with barriers to trade and protective subsidies, effectively excluding millions of producers in poor countries from the benefits of global trade. It is estimated that the value of their tariff protection is something like $1 billion a day. The common agricultural policy of the European Union and similar protectionist measures are exceedingly damaging for developing countries. It is now critical that the next multilateral trade round should get underway, and should address these injustices decisively.

As we have a shared interest in international stability and economic progress, we have to attend to the governance structures through which international reforms are pursued. The developing countries which constitute both clients and shareholders in the International Monetary Fund and the World Bank should have a greater voice in these institutions. We will continue to seek a common ground with other nations in democratising the institutions on which responsibility for international collaboration rests.

On our own continent, President Mbeki and Presidents Obasanjo and Bouteflika are spearheading a partnership which will bring African governments, the private sector and civil society together in new ways, as we face our challenges honestly and seek to mobilise our own resources more effectively. The Millennium Africa Plan signals our commitment to seeking solutions that will stand the test of time, a way forward that recognises the inextricable links between democracy, resolving conflict and building the economy. This initiative contributes to building a future of which our children can be proud.

So that they can taste not the bitter but the sweet fruit of liberty.

Macroeconomic performance

The economy grew by 3,0 per cent in 2000. This was the fastest rate of growth since 1996, buoyed by a strong recovery in household consumption spending and an increase in exports of over 7 per cent in real terms. Strong growth occurred in agriculture and in several specialised manufacturing industries, financial services and telecommunications.

Over the next three years, we expect growth to average 3½ per cent a year, underpinned by a steady recovery of gross fixed capital formation and continued robust trade performance.

In the path we have followed since tabling a macroeconomic strategy in 1996, our focus has been firmly on building the foundations for sustainable long-term growth. Taking account of the global environment, economic growth is expected to continue strengthening across most sectors next year.

For improved long-run growth, we need to foster higher levels of saving and investment. Over the past year, the level of household debt has eased and government dissaving has been reduced. These are both favourable developments in turning around our disappointing saving performance. Several measures in this Budget together with the favourable outlook for interest rates will contribute to strengthening investment over the years to come. Within the wider public sector, our restructuring efforts in the communications, transport and energy sectors include substantial new modernisation and capacity building investments.

Inflation and exchange rate trends

Price stability is an important part of the economic landscape. Inflation erodes the purchasing power of the poorest and most vulnerable in our society. It introduces uncertainty into decision making and colludes with debt to entrench poverty. It was for this reason that we decided last year to set the South African Reserve Bank an inflation target of 3-6 per cent for the year 2002.

Despite the sharp rise in international oil prices last year, consumer price inflation in South Africa remained moderate. The rise in oil prices and the prices of imported goods led to an increase in the CPIX inflation measure (consumer prices excluding mortgage interest) to 8,2 per cent for the year to October of last year. By December CPIX had fallen to 7,6 per cent and we expect a steady decline during the course of 2001.

These developments provide a strong indication of a structural reduction in the country's inflation pattern and the long term downward inflation trend. Lower inflation expectations in turn have contributed to the decline in capital market interest rates. Yields on medium-term government bonds reached a 7-year low of about 11,2 per cent by February 2001. Interest rate reductions in the United States and in Europe also contribute to the prospects for further easing of interest rates in South Africa.

However, the rand came under considerable pressure in 2000, depreciating by about 9½ per cent in real terms during the year. International uncertainty has contributed to capital outflows and currency weakness in many emerging markets in recent years. South Africa has adjusted well to these pressures, partly because we have deep and well-functioning financial markets. Over the year ahead the exchange value of the rand is expected to stabilise.

International economic relations

Our economic restructuring has been particularly dramatic in our engagement with the international economy. Non-gold merchandise exports rose from 11½ per cent of GDP in 1990 to nearly 19 per cent last year, testimony to the success of our trade policies in stimulating exports in a wide range of industries traditionally dominated by developed countries. A rising contribution is also made to our export earnings by tourism and related services sectors.

Despite the strong recovery of growth last year, the deficit on the current account of the balance of payments remained low – less than ½ per cent of GDP. In the current international environment, where financial flows to emerging markets remain both subdued and unstable, this is a considerable strength. South Africa experienced large swings on the financial account last year – a deficit of nearly R6 billion in the first half of the year, followed by a surplus of R10 billion between July and December. In this context the improvement in reserves recorded by the Reserve Bank and in

particular the continued reduction in the uncovered foreign exchange forward position of the Bank are significant achievements.

Against this background we are able to take several further steps towards the removal of controls on foreign exchange transactions.

The restructuring of our financial relations with the rest of the world in recent years has been rapid. Both the bond and equities markets have seen substantial flows of investment from abroad. At the same time, South African firms and individuals have diversified their investments, raising the level of foreign assets held from about 15 per cent of GDP to over 40 per cent today. This diversification attracts the headlines when it involves major corporate mergers or acquisitions, but it also contributes to reducing the risks ordinary people face in their pension funds or life savings and broadening the markets within which our industries do business.

Exchange control liberalisation has played a role in promoting this diversification.

We have now reached a point where the foreign asset holdings of the major financial institutions are reaching levels in line with appropriate prudential limits. With this in mind, the current limits on the foreign asset holdings of institutional investors are to be retained as part of a broader shift to prudential regulation. These limits are 15 per cent of total assets for long term insurers, pension funds and fund managers, and 20 per cent of total assets for unit trusts.

The institutional asset swap mechanism has served a useful purpose in the past in facilitating a fairly rapid portfolio rebalancing after many years of exclusion from foreign investment. However, it suffers from a lack of transparency and is no longer appropriate in the context of normalised diversification levels. The asset swap mechanism pertaining to institutions is to be terminated. However, institutions will continue to be able to invest in foreign portfolio assets, up to the defined foreign asset limits, through cash transfers based on a prescribed percentage of the previous year's net inflow of funds. Details will be provided by the South African Reserve Bank.

The global expansion of South African firms holds significant benefits for the economy – expanded market access, increased exports and improved competitiveness. In order to support this expansion from a South African base, the limit on the use of South African funds for new approved foreign direct investment is increased from R50 million to R500 million. As part of Government's commitment to African economic recovery, South African firms will be permitted to utilise up to R750 million of local cash holdings for new approved foreign direct investment in Africa. In addition, firms will continue to be able to use local cash holdings to finance up to 10 per cent of the remaining investment outlay.

From macroeconomic stabilisation to microeconomic reform

Moving our economy onto an expansion path means moving beyond the macroeconomic stabilisation we have achieved. This Budget sets out a number of fiscal interventions in support of the broader economic reforms we seek – measures that enhance the volume and quality of investment, that encourage employment creation and promote skills development, and measures that will improve the efficiency of asset use.

In support of investment:

- A new tax incentive is proposed for companies embarking on approved strategic industrial projects.

- The tax depreciation rules applicable to small businesses in the manufacturing sector will be favourably amended.

- Substantially increased allocations for capital spending by national and provincial departments are proposed.

Our investment in people remains the cornerstone of our long-run growth strategy. Education, health and welfare services remain the largest functions in the consolidated budgets of national government and provinces. The skills levy goes up from ½ per cent to 1 per cent of payroll, 27 Sector Education and Training Authorities have been established and we expect to see a range of new learnership programmes get underway this year. In this Budget a new wage incentive is proposed to be administered through the income tax system.

In promoting more effective use of assets, several wide-ranging initiatives are in progress.

- The restructuring of public enterprises will reach a notable milestone this year with the initial public offer of shares in Telkom.

- The Treasury's Public-Private Partnership Unit now has 38 projects of both national and provincial departments under review, from eco-tourism parks and toll roads to hospital equipment and prison management.

- Perhaps most important of all, we have taken the first steps today in the *Estimates of National Expenditure* to give effect to the requirement of the Public Finance Management Act that by the 2004 Budget, the main divisions of expenditure appropriated by this House should be accompanied by "measurable objectives", so that departments are properly held accountable and their service delivery performance is open to public scrutiny.

Improved economic performance is of course the outcome of a wider set of public policies than those represented in the annual budget papers. The initiatives of Cabinet colleagues in many diverse areas are as important:

- Promoting competition and appropriate regulatory oversight of public utilities,

- Restructuring municipal governance so that household services can be effectively managed and financed,

- Ensuring an appropriate balance between the rights of employees and market adaptability in the labour environment,

- Encouraging the research and technology advances that will keep our industries competitive,

- Extending land ownership and agricultural market access to those historically denied these opportunities.

So that we may all taste the sweet fruit of liberty.

In these, amongst many other aspects of public policy, it is frequently the details of legislation, procedures, regulations or market structure that are decisive if long run growth and competitiveness are to be assured.

Public-private partnerships can contribute significantly to the extension and quality of services, for example, while transferring a substantial portion of project life risk to the private sector. However, these benefits are not automatic. They have to be earned by tough performance agreements,

appropriate pricing rules and accounting standards, competitive tender processes, strong management of contracts, and an appropriate assignment of risks and rewards.

Outcome of the 2000/01 Budget

Before outlining proposals for next year, a few remarks on the outcome of the 2000/01 Budget are in order.

Revenue exceeded the main budget estimate by R7,7 billion in 1999/00 and is expected to outperform the 2000 Budget projections by about R3 billion. Both the company tax and secondary tax on companies are expected to exceed projections, as are value-added tax and customs revenue. The revised revenue estimate for 2000/01 is 7,5 per cent more than last year's receipts.

Expenditure in 1999/00 was R830 million above the original budget estimate – less than ½ per cent – bringing the deficit down to R16,2 billion, or 2,0 per cent of GDP. This year, after taking account of appropriations approved in the Adjustments Budget, expenditure is projected to be R1,6 billion above the main estimate, bringing the budget deficit to R21,7 billion, which is 2,4 per cent of GDP.

The revised estimates indicate a saving of R304 million on state debt costs this year. At this stage, departmental savings of R1,7 billion are anticipated and disbursements of skills levy receipts will be about R430 million less than budgeted. These funds remain earmarked for skills development and will flow once sectoral and other programmes are in place.

Nationally and in provinces, the outcomes for the last two years indicate more careful budgeting and improved spending discipline, to the credit of both Ministers and MECs and their accounting officers.

2001 Budget framework

We turn now to the framework and proposals for the 2001 Budget.

The Budget is always about finding a balance between several broad objectives:

- Providing for social and developmental expenditure to overcome poverty and provide safety and security,
- Enhancing investment in infrastructure and maintenance of government's capital stock,
- Reducing the overall burden of tax, so as to lower the costs of investment and job creation, and release household spending power,
- Stabilising the level of debt and reducing the budget deficit to contribute to lower interest rates and fiscal sustainability.

This year, the balance shifts decidedly towards promoting growth and strengthening investment.

The main budget provides for expenditure of R258,3 billion in 2001/02, increasing to R297,5 billion in 2003/04. Revenue increases from R233,4 billion to R273,1 billion over the same period. A deficit of 2,5 per cent of GDP is anticipated on the main budget in 2001/02, falling to 2,1 per cent of GDP in 2003/04.

Including social security funds and foreign technical cooperation, consolidated national expenditure of R267,1 billion is projected in 2001/02 or 27,1 per cent of GDP and 9,6 per cent more than the revised 2000/01 estimate.

The revised economic outlook allows Government to increase allocated spending on public services by R10,2 billion in 2001/02 and R16,0 billion in 2002/03 above the levels projected in the 2000 Budget forward estimates. These adjustments compensate for somewhat higher anticipated inflation and raise real non-interest expenditure growth to 3,8 per cent a year over the next three years. Provinces receive 56 per cent of the available additional resources, national departments 38 per cent and the local sphere receives 6 per cent.

Provision for state debt commitments amounts to R48,1 billion in 2001/02. Interest on debt was 5,5 per cent of GDP in 1999/00, and will fall to 4,4 per cent of GDP in 2003/04.

As in the past, the budget framework for the next three years includes a contingency reserve to allow for future uncertainty and unforeseeable spending commitments. An amount of R2 billion is set aside in 2001/02, rising to R8 billion in 2003/04. (Xhosa translation)

Expenditure proposals

The revised budget framework allows for substantial additions to the baseline projections for the next three years:

- Additional allocations of R16 billion are proposed for provinces to strengthen social service delivery and other priority needs.
- More than R4 billion is allocated to the criminal justice sector for increased personnel, additional vehicles and an improved salary dispensation for police.
- A R7,8 billion supplementary infrastructure investment and maintenance programme is proposed, part of which will go to repair flood damage in poor areas.
- More than R2 billion will go to key administrative services, including the SA Revenue Service for improved tax administration and the Department of Foreign Affairs for its extended diplomatic responsibilities.
- An additional R2,6 billion is proposed in support of local government restructuring and delivery of basic services.

Details of the main budget spending proposals are set out in the *Estimates of National Expenditure,* which includes relevant policy developments and proposed outputs and service delivery indicators for the programmes or main divisions of each vote. Parliament is invited to agree to these proposals, as set out in the 2001 Appropriation Bill.

Supplementary allocations

The budget framework also accommodates several spending proposals not yet allocated to departmental votes:

- A further R85 million in 2001/02 and R100 million in 2002/03 for repairs to flood-damaged infrastructure of national departments,

- R1,2 billion for rehabilitation of flood-damaged provincial infrastructure, of which R600 million is expected to be spent in 2001/02,
- R120 million in 2001/02 for short-term poverty relief measures, including interventions in response to cholera outbreaks,
- Amounts of R300 million in 2002/03 and R313,5 million in 2003/04 for targeted HIV/Aids interventions,
- An amount of R3,75 billion for provincial infrastructure spending over the next three years – road construction and maintenance, school building, hospitals and clinics and rural development,
- R2,5 billion for infrastructure projects of national departments over the next three years.

Spending in 2001/02 from these supplementary allocations will be brought to the Assembly in the Adjustments Estimate, once likely project disbursements have been finalised.

Of the supplementary amounts available to national departments over the next three years for infrastructure:

- R863 million is set aside for police stations, courts and prisons.
- R580 million will go to water supply and sanitation projects, particularly in areas affected by cholera.
- R390 million is for key infrastructure projects in support of industrial development.
- R100 million is for the refurbishment of SA Rail Commuter Corporation rolling stock.
- R50 million will go to complete the new Lubombo road linking northern Kwazulu-Natal, Swaziland and Mozambique.
- R80 million is allocated for the development of emergency call centres by the Department of Communications.

Spending policy objectives

In formulating spending plans for the 2001 medium term expenditure framework, Government has sought to balance a number of broad policy objectives:

- Economic growth,
- Job creation,
- Equity and social development, and
- Strengthening the safety and justice sector.

Promoting growth and employment

By setting aside substantial supplementary resources for infrastructure investment and maintenance, we seek to broaden access to opportunities, lower the costs of transport and communication and improve standards of living in poor communities. In implementing this investment programme, Government will also contribute directly to the creation of jobs.

In addition, R1,5 billion a year is allocated to a range of targeted poverty relief programmes, many of which contribute to employment and construction in support of local economic development.

Government's rural development, land reform and agricultural policies are also designed to reduce rural poverty by supporting access to land, investing in rural infrastructure and broadening access to markets.

Poverty reduction priorities are evident in the provision of resources to subsidise basic services. Funds for low cost housing and subsidisation of public transport reduce the costs of these household requirements. Government's approach to financing local government and pricing of basic services recognises that some municipal services should be available to poor households free of charge.

Social development

The social services – education, health and welfare – take up about 58 per cent of the consolidated national and provincial non-interest allocations, and will grow steadily over the MTEF period. The largest single redistributive programme of Government is the system of social grants delivered by provincial welfare departments. These include the old age, disability and child support grants and provide support to more than 3 million South Africans every month.

Zulu and Afrikaans translations.

The maximum old age and disability grants will increase from R540 to R570 a month in July this year, and the child support grant will increase from R100 to R110 a month. The MTEF allows for inflation-related adjustments to social grants in subsequent years.

Justice and protection services

This Budget recognises that the services of the integrated justice sector are critical to the quality of life of all our people. Raising spending capacity and improving its quality in the justice system are clear priorities of Government. Additional allocations go to the Safety and Security vote in support of restructuring of its specialist units and strengthening of operational activities at police stations throughout the country. The more streamlined operation of the Legal Aid Board is recognised in its increased funding level and additional allocations are made for the prosecution service and special investigations.

Members of this House will know that we have unfinished business in relation to the recommendations on reparations of the Truth and Reconciliation Commission. Allocations to the President's Fund on the Justice and Constitutional Development vote for 2001/02 and 2002/03 will bring the amount available for final reparations to about R800 million. These will be paid in once-off settlements and the Budget allows the programme to be concluded over the next two years.

Measuring improved service delivery

Once-off allocations are also made on the Statistics South Africa vote to provide for the 2001 census – itself an important step in developing our capacity to measure progress in the social and economic challenges this Budget seeks to address.

Changing the way in which Government operates is a key element of improved service delivery and better value-for-money in the purchase of goods and services outlined in the budget. Improving service delivery means confronting poor management:

- Getting teachers to teach with enthusiasm is partly about strengthening discipline in the classroom and diligence in the school district office.

- Reinforcing an ethic of care and compassion in our clinics and hospital wards is also about combating theft of medicines and imposing a cost-effective laundry or building maintenance regime.

- Respect for the rights of both the victims and the accused means that court backlogs must be shortened and the criminal justice system modernised.

The 2001 Budget substantially increases the resources available for public service delivery over the next three years. It does so without fear of the crushing burden of debt. And in doing so, it challenges us to focus more keenly on ensuring that the funds we appropriate impact on the quality of people's lives – that more infants live past their first birthday, that more children pass successfully through our schools, that our roads become safer, that every family should have access to clean water.

The form and content of the new *Estimates of National Expenditure* invite all of us in this House and all South Africans to be vigilant in ensuring that we meet the goals we set ourselves.

So that the tree bears not the bitter but the sweet fruit of liberty.

Provincial and local government finance

Improved provincial finances

Our Constitution provides for three spheres of government. For the tree to grow strong all three branches have to be healthy.

The equitable share to provinces rises by 7,7 per cent a year for the next three years providing for significant real growth in critical spending. This is supplemented by a variety of grants, bringing the total provincial share of non-interest allocations on the national budget to 56,4 per cent in 2001/02.

Provincial governments have made striking progress in improving financial management. It is easy to forget now that in 1997 a number of provinces faced serious financial difficulties. The overdraft problems in Eastern Cape and KwaZulu-Natal have been dealt with and the need to set aside funds to deal with the debt overhang no longer holds provincial spending plans back. In Gauteng, over a R1 billion has been reserved for major capital projects, and in all provinces the next three years will see growth in both the main social services and targeted investments in economic infrastructure.

The sound state of provincial finances is testimony to the commitment of the Budget Council to working together as a team. With patience and clarity of vision, much can be achieved, even over a 3-year time horizon.

Local government challenges

For local government, the challenges of transformation largely lie ahead. We have to merge different local authorities with diverse needs, financial systems and procedures, and we must build a new ethos of financial responsibility. As ‘team finance’ we stand ready to work with local government to manage this complex and challenging transition. The aim is to nurture this branch, so that the whole tree can bear sweeter fruit.

Local government is responsible for providing many basic services such as water, electricity, sanitation, refuse collection and basic household infrastructure all of which impact directly on the lives of people. The local government elections marked the completion of the process of rationalising the number of municipalities, from 843 to 284, laying the foundations for the emergence of better managed and delivery focused organisations. The process of merging municipalities will take time to complete. The financial viability of some municipalities is not secure, and the pressing need to provide universal access to basic municipal services remains.

However, our metropolitan and bigger cities have considerable capacity and have already taken significant steps on the road to stabilising their finances. This can be seen in the transformation of Johannesburg, which is moving away from crisis management, and beginning to find the resources for capital spending once again. It can be seen in Durban, which is demonstrating how to provide free basic services like water to the poor.

To support municipalities in addressing the challenge of providing free basic services, national government is increasing the equitable share to local government significantly. The allocation now rises to R2,6 billion, and is projected to increase to R3,6 billion in 2003/04. This represents an average annual increase of 11 per cent over the period. The equitable share formula favours poor municipalities with limited revenue raising capacity.

Total transfers to local government rise from R6,5 billion in 2001/02 to R7,8 billion in 2003/04. These funds include R2,2 billion in allocations for the extension of basic municipal infrastructure to poor households.

The primary source of financing for local government remains local taxes and other revenues levied and collected by municipalities themselves, including property taxes, levies and user charges. The equitable share and other transfers that go to local government supplement these revenues and are targeted at the poorest municipalities whose local tax base is limited.

The additional allocations to municipalities and the provincial infrastructure grants underpin governments' commitment to urban renewal and integrated rural development strategies. Municipalities in the nodal points identified by the President will, for the first time, be able to budget for the full extent of resources at their disposal, and provide national and provincial departments with a focal point for the co-ordination of development projects. Moreover, the improved reporting systems proposed in the Division of Revenue Bill, 2001, will enable all spheres of government regularly to monitor progress in these nodal points.

It is important, however, not to think of the challenges ahead only in fiscal or monetary terms. There is a larger challenge of developing capacity and governance systems. Improving the credibility of municipal budgets, adapting strategies to meet local needs and circumstances and enhancing the quality of service delivery within affordable bounds are immense projects.

We must think of innovative ways of strengthening the capacity of local government and tap into experiences elsewhere in the world. The World Bank is running a project with 150 mayors of cities and towns in Latin America who meet each Saturday morning on the Internet to discuss issues of municipal government. The mayors talk and share experiences about such things as the collection of rates, building and maintenance of infrastructure, the running of fire brigades and other issues that constitute the daily work of municipalities.

Revenue issues and tax proposals

Over the past five years, considerable attention has been given to improving the structure of the South African tax system and the system of revenue administration, which are critical to Government's fiscal and macroeconomic policy initiatives. The income tax changes introduced in the 2000 Budget were the cornerstone of a general tax reform process that enhances the equity, efficiency and international competitiveness of the South African tax system. These are important building blocks on the path to sustainable economic development and a better life for all South Africans.

Since 1995, personal and corporate income taxes have been reduced significantly. Before this year's tax proposals, we have put R25 billion back into the pockets of individuals. Today, we give more back. A further R8,3 billion in personal income tax relief is devoted to ensuring that all South Africans share in the successes of fiscal discipline we have achieved. We are making good on the pledge we made to taxpayers: Pay your taxes now, and everyone will pay less in the future.

The package of tax reforms announced here complements other economic reform initiatives by releasing fiscal resources for investment, economic development and job creation.

Income tax proposals

SeTswana translation

The personal income tax reductions accrue mainly to workers earning below R80 000 a year and improve the equity of the overall tax system. This has been achieved by raising the primary rebate by 8,9 per cent and changing the tax brackets, ensuring sizeable benefits for lower- and middle-income taxpayers. Workers earning less than R23 000 will now pay no personal income tax and a worker earning R 70 000 will pay about 12 per cent less tax, increasing her take-home pay by 3 per cent (or an extra R140 a month).

In his opening of Parliament address, the President indicated that Government would explore the feasibility of "reducing the cost of labour without reducing workers' wages". In the 2001 Budget, R600 million is set aside for a wage incentive to encourage job creation by reducing the cost of hiring new workers and of offering learnerships. Over the next couple of months, SARS and the National Treasury will develop a tax measure that is both economically efficient and simple in administration and compliance. It is envisaged that this will be introduced from 1 October 2001.

The tax exemption on interest and dividend income is raised by R1 000 to R4 000 for people under 65 and to R5 000 for taxpayers age 65 and over. This provides further tax relief to those living on modest fixed-interest and dividend incomes.

Investment in strategic industrial projects that promise significant direct and indirect benefits to the South African economy are critical to placing South Africa on a higher sustainable growth path. I have agreed with my colleague the Minister of Trade and Industry that R3 billion over the next four years be set aside for incentives targeted at strategic industrial projects which meet agreed criteria, including job creation.

An allowance of either 50 or 100 per cent of an approved investment will be granted to companies undertaking strategic projects. The allowance will be calculated with reference to the cost of the investment undertaken. The National Treasury, SARS and DTI will finalise the details of these incentives before the end of March, including the stringent criteria against which projects must be assessed.

Government continues to support small businesses, which are key engines of job creation. In the 2000 Budget, a reduced tax rate of 15 per cent of the first R100 000 of taxable income was introduced for certain small businesses. The tax privileges for small businesses are extended in this Budget to allow for the immediate deduction of investment expenditure in manufacturing assets in the year in which the investment is made. This will cost R40 million.

So the fruits are truly much sweeter.

Structural reforms to the tax system

In the 2000 Budget several proposals were introduced with prospective effect, including residence-based income taxation and the capital gains tax. The residence-based income tax came into operation on 1 January 2001. This structural change to the income tax is necessary to ensure that the SA tax system keeps pace with globalisation and the integration of SA with the world economy.

Capital gains tax, estate duty and donations tax

Capital gains tax was to be introduced with effect from 1 April 2001. Government has listened carefully to the proceedings of Parliament's Joint Committee on Finance, which has held public hearings on the draft legislation. While it is imperative that this fundamental change be made, it is proposed that the implementation be deferred to 1 October 2001. This will give the private sector –

the financial services industry in particular – ample time to amend their management information systems to ensure effective implementation.

A key strength of the proposed capital gains tax is that it is levied when the owner of an asset dies or the asset is donated. To counter any perceived double taxation of these assets, it is proposed to reduce the estate duty and donations tax rates to 20 per cent.

Closing tax loopholes

Our ongoing tax reform programme aims to widen tax bases and reduce statutory rates. As in the past, this will include identifying and closing potential loopholes in the company income tax. Items to be investigated include:

- Section 24C of the Income Tax Act, which allows for the immediate deduction of future expenditure,
- Provisions allowing deductions for contingency reserves of short-term insurers,
- The taxation of intangibles, and
- The possibility of bringing all company directors into the pay-as-you-earn (PAYE) income tax system.

Unbundling transactions

Unbundling provisions were introduced to facilitate the dismantling of South African corporate structures. The internationalisation of the SA economy means that non-SA residents are benefiting from these provisions. SARS and the National Treasury will therefore review the unbundling provisions to ensure they are still appropriate in the current business environment.

Review of tax on banks

Government is concerned about the low effective tax rate on banks. Banks are able to defer and avoid tax by using derivative financial products and structured, asset-based finance techniques, amongst other devices. In 2001, Government will engage with the industry to address this. The initial focus will be on increased audit and possible legislative changes, including clarifying the distinction between capital and ordinary income for the sale of financial instruments, reviewing the tax rules regarding financial leases and ensuring the immediate accrual of certain income receipts that are postponed through artificial contingencies.

A number of countries have limited the scope for banks to avoid tax by introducing alternative minimum taxes or presumptive taxes on easily identifiable and audited tax bases, for example, on gross assets. We will engage with the banks on the appropriateness of this measure for South Africa.

Indirect tax proposals

Vat zero-rate on illuminating paraffin

Illuminating paraffin is an important energy source for low-income households in SA, especially in rural areas. As with other fuels, the price of IP has increased dramatically over the past year or two. To alleviate the plight of these poor households, Government is zero-rating paraffin for VAT purposes from 1 April 2001. This will reduce the price by about 40 cents a litre. We trust that the R400 million we are giving up will be passed on to consumers, thereby providing tax relief to the intended beneficiaries.

Specific excise duties

Revenues from specific excise duties have been a buoyant source of revenue. Changes to specific excises, informed by revenue and health considerations, include:

- Beer and cider taxes are raised by 6 per cent or 2,3 cents a can, in line with inflation.
- Sorghum beer and sorghum flour duties are raised by 5 per cent, which is below the rate of inflation. Duties on these products have not been raised for 2 years.
- Duties on all other alcoholic beverages are raised by 10 per cent.
- Taxes on tobacco products are raised by between 11,8 and 20,2 per cent to maintain the 50 per cent tax incidence. This increases the price of a packet of 20 cigarettes by 33,8 cents.
- Duties on soft drinks and mineral water are reduced by 25 per cent, or 2 cents a litre.

These measures will raise estimated revenue by R779 million.

Not so sweet.

Madam Speaker, in terms of section 58 of the Customs and Excise Act of 1964, I lay on the Table for consideration by the House the proposals in respect of customs and excise duties.

Fuel levy

Fuel prices have increased considerably over the past 2 years. Government is aware of the pressure this has placed on disposable income of household and business budgets.

Fuel taxes serve a variety of purposes. First, they are a significant source of general government revenue. Second, they play an important role in limiting demand for fuel products, which has important environmental and balance of payments benefits.

Given that the fuel levy is a specific excise tax, it is imperative for the sake of consistent tax policy that it be reviewed in the annual Budget, in line with macroeconomic projections of the inflation rate. In this context and recognising the impact of rising fuel prices on the economy, we are proposing to raise the fuel levy by less than inflation. The following increases in the general fuel levy are proposed:

- 2,4 cents a litre on leaded and unleaded petrol,
- 1,9 cents a litre on diesel.

These represent increases of only 2,5 per cent, which is below the anticipated inflation rate. These increases will be implemented with the normal price adjustments on 4 April 2001 and will raise R363 million.

Since the octane levels of leaded and unleaded petrol were equalised, there has been an equalisation levy of 3 cents a litre on unleaded petrol. It is proposed that from 4 April 2001 this be included in the general fuel levy. Thus, the general levy on unleaded petrol is raised by an additional 3 cents a litre and the equalisation levy is reduced by 3 cents a litre, with no net impact on the overall levies and, hence, the pump price.

Road Accident Fund

To meet the ongoing liabilities of the Road Accident Fund, the levy on petrol will be increased by 2 cents a litre from 4 April 2001. When the diesel concessions I alluded to earlier and will elaborate on shortly are introduced on 4 July 2001, the Road Accident Fund levy on diesel will be brought in line with that on petrol at 16,5 cents a litre. These measures will increase revenue to the Road Accident Fund by R437 million.

Diesel fuel concession for primary production

In the 2000 Budget, a diesel fuel concession was reintroduced for fishing and coastal shipping. Government committed itself to explore the possibility of extending this to other primary producers, contingent on developing an administrative regime to minimise the risk of fraud; and ensuring the concession is affordable within the broader fiscal framework.

The bulk of diesel fuel used in farming, forestry and mining is used off road. Given this, and to encourage the international competitiveness of especially our farmers, foresters and miners, the following diesel fuel concessions are proposed:

- 25,6 cents a litre of the general fuel levy on qualifying consumption,

- The full 16,5 cents a litre Road Accident Fund levy on qualifying consumption.

Qualifying consumption will be 80 per cent of total consumption. Diesel concessions will be implemented on 4 July 2001 and will cost R417 million a year.

Furthermore, the following additional concessions are proposed:

- Offshore mining and the National Sea Rescue Institute will receive a 100 per cent concession of the general fuel levy and the Road Accident Fund Levy;

- Spoornet will receive a 100 per cent concession of the Road Accident Fund levy.

Ad valorem excises

The National Treasury and SARS have reviewed the administrative system for *ad valorem* customs and excise duties. It is evident that considerable savings will result from reforming this system. From 1 July 2001, the value-determination formula for domestically-produced goods will be eliminated and duties will be levied on the invoice price of dutiable items. In addition, the maximum statutory rate will be decreased from 10 per cent to 7 per cent and the duty rate on

cosmetics will be reduced from 10 per cent to 5 per cent. This will result in a revenue loss of R210 million.

Tax administration

The South African Revenue Service is committed to improving tax administration and nurturing a climate of voluntary compliance with the objective of broadening the tax base so as to reduce the tax burden on all our citizens. As citizens, meeting our tax obligations and acting within the letter and spirit of the law is not optional. They are part of understanding that in a democracy rights and obligations are two sides of the same coin. Corporate and private citizens who evade the law are committing a crime and depriving the government of the resources needed to address poverty, fight crime and achieve other social and economic objectives. Tax evasion also undermines investor confidence and increases the burden of ordinary tax-paying citizens. I commend the actions taken by SARS to curb tax evasion and fraud in the past year, including efforts to root out corruption within the organisation. We will not tolerate this type of criminal activity.

SARS is committed to making it easier for our people to meet their tax obligations, by providing a better service. The groundwork for a new taxpayer charter has been laid, giving us important feedback about taxpayers' needs and concerns. The survey results have informed a major restructuring project, which has now entered its implementation phase. Kwa-Zulu-Natal taxpayers will benefit first from SARS's new way of doing business with the opening in October 2001 of a processing centre to improve turnaround times. This centre will be supported by a compliance centre and service centres. Other initiatives include electronic submission of certain tax returns (such as provisional tax and pay-as-you-earn) and a call centre focused on recovering outstanding debts. More than 17 000 taxpayers were contacted in the call centre's first week of operation and more than a million taxpayers can expect a call from us this year. SARS's budget will be supplemented over the next three years to enable us to provide better services to taxpayers and to reduce tax evasion and avoidance, including our ports and border posts.

Financing proposals

After taking account of our spending proposals and revenue estimates, there is a budget deficit of R24,9 billion to finance next year, or 2,5 per cent of GDP.

We expect to finance the deficit largely through restructuring proceeds.

To date total investment of R19 billion has been raised through restructuring state assets, mainly from international equity partners, of which R12,4 billion has been used to reduce debt. Given the accelerated pace of implementation some R18 billion from the restructuring of public enterprises is expected in 2001/02, decreasing the net borrowing requirement to R7,5 billion.

We propose to raise R3,5 billion in short-term loans next year, contributing further to the liquidity of this market. Net foreign borrowing to the value of R11,3 billion is proposed. This will allow domestic long-term debt to be reduced by about R7,4 billion – in effect, we propose to repay R7½ billion in long-term rand-denominated debt next year.

At the end of 2000/01, total net loan debt will amount to R397,5 billion, or 44,3 per cent of GDP, down from over 48 per cent four years ago. Debt will steadily decline as a share of GDP to a projected 39,1 per cent by the end of 2003/04.

…And its fruits gradually acquire

the sweet taste of liberty…

Conclusion

Madam Speaker, allow me to express my profound appreciation to:

- President Mbeki for his leadership and the challenges he puts before us, before this House, before our nation and before our continent,
- Deputy President Zuma and my Cabinet colleagues, particularly the members of the Ministers' Committee on the Budget, for your initiative in bringing forward budget suggestions and you good humour when these could not be accommodated,
- Deputy Minister Mandisi 'Sipho' Mpahlwa for sharing the duties we carry and for friendship,
- My "Team Finance" colleagues in the Provincial Executive Councils, who have led with courage and professionalism.

Our task has been greatly facilitated by several others:

- Governor Tito Mboweni and his team at the South African Reserve Bank,
- Murphy Morobe and members of the Financial and Fiscal Commission,
- Philip Dexter and Nedlac,
- Prof Michael Katz and the Tax Commission
- Ms Barbara Hogan and Ms Qedani Mahlangu, as Chairpersons of the Portfolio and Select Committee of Finance in Parliament, respectively.

The Budget is largely the fruit of the efforts of the National Treasury and the Revenue Service. Special thanks are due to Maria Ramos and Pravin Gordhan for the leadership they have given.

I would also like to thank my family for their support. The Mpahlwa family have continued to keep Sipho in good spirits, and the staff of the Ministry have tolerated us with good cheer.