Medium Term Budget Policy Statement

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To obtain additional copies of this document, please contact:

National Treasury
Private Bag X115
Pretoria
0001
South Africa

Paledi Mothapo
Tel: +27 12 315 5948
Fax: +27 12 315 5160
e-mail: **paledi.mothapo@treasury.gov.za**

The document is also available on the internet at: www.treasury.gov.za

Foreword

Poverty reduction is the over-arching goal of South African economic and social policy. The allocation of a large part of the nation's resources to this end, through the budgets of national, provincial and local governments is a process that touches the lives of all South Africans.

Effective planning, budgeting and financial management is at the core of achieving Government's development agenda. The creation of a national budget brings together the plans and programmes of all sectors and spheres of government, and seeks to provide a single framework in which they can be realized.

Given the importance of the process, it requires transparency and consultation. Given its scale, it requires careful co-ordination and collaboration at a range of levels.

Policy only succeeds if it is has broad support; if those who operationalise it, and intended beneficiaries alike, participate in its formulation and implementation. That is why we have introduced the Medium Term Budget Policy Statement (MTBPS), of which this is Government's sixth.

In the MTBPS we present to Parliament our envisaged social, economic and fiscal framework for the next three years, providing an opportunity to the nation to discuss how we proceed with the progressive realisation of social and economic rights, promised in our Constitution.

Effective policy implementation depends on the collaborative efforts of the whole of Government. It depends on closer co-ordination between policies and budgets, as well as between Treasury and departments. It is intended that the 2003 Medium Term Expenditure Framework provide for this enhanced co-ordination, alongside increased allocations to the provincial and local spheres of government at the front-lines of delivering services.

Our policy priorities continue to be the creation of jobs, the delivery of services, enhancing the productive capacity of the economy, and protecting society's most vulnerable. In short, a better life for all.

Our challenge is to seek more effective and efficient ways of implementing them. The presentation of the MTBPS to Parliament is part of how we seek to address that challenge. In this spirit I would like to invite Parliament, and the nation, to participate in laying down the frameworks for South Africa's development over the 2003 MTEF.

Trevor A Manuel, MP
Minister of Finance

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Introduction and overview

The 2002 Medium Term Budget Policy Statement sets out the macroeconomic context and fiscal policy considerations against which the 2003 Budget will be framed. It outlines developments in tax policy and the main spending priorities for the next three-year MTEF period.

The proposed budget framework provides for real growth in expenditure on public services averaging 4,7 per cent a year, with particular emphasis given to social services provided by provincial departments and to enhancing basic municipal infrastructure and services.

Introduction

Improved growth outlook, while inflation expected to decline

The South African economy has seen a steady improvement in real economic activity over the past year, accompanied by a marked increase in the inflation rate. In its proposals for the 2003 Budget, Government seeks to reinforce a broad range of national, provincial and local development priorities, aimed at sustaining the momentum of economic growth and extending opportunities and targeted assistance to those whose livelihoods are most vulnerable. Over the medium term, the impetus of growth is expected to improve steadily while inflation will return to a more moderate trend.

Social and economic rights promoted within a sound fiscal framework

This sixth Medium Term Budget Policy Statement reasserts Government's commitment to the progressive realisation of social and economic rights envisaged in our Constitution, within a sound fiscal and budgetary framework. The foundations of budget policies are firmly embedded in the bedrock of our democratic and economic order:

- The Reconstruction and Development Programme informs public spending priorities and Government's broader social and developmental policy agenda.
- The Constitution provides a division of functions between national, provincial and local government and serves as the

point of departure for cooperative arrangements between the spheres of government.

- Organising economic principles include active promotion of human rights, an open, competitive economy, empowerment of historically disadvantaged individuals and communities, and a robust balance between market-based institutions and a developmental state.

Sustainable debt position and competitive economic policies

Following a period of fiscal restructuring between 1996 and 2000, South Africa's public debt has stabilised as a share of GDP and the budget deficit is affordable and sustainable. South African industry is increasingly competing successfully on international markets and the financial sector has undergone a wide-ranging transformation.

Robust tax administration and sound public finances

Tax administration has been modernised and income tax policy has undergone a thorough overhaul. Public spending reforms include the introduction of a medium term expenditure framework and ongoing reprioritisation towards infrastructure investment and social development.

The 2002 Medium Term Budget Policy Statement explains how these and other elements in the progressive development of South Africa's public finances will be taken forward in 2003 and beyond.

Developments in the international and domestic economy are reviewed in Chapter 2. Fiscal policy considerations and the budget framework are set out in Chapter 3. Revenue trends and aspects of tax policy are discussed in Chapter 4. The medium term expenditure framework for the 2003 Budget is summarised in Chapter 5 and local and provincial finances are discussed in Chapter 6.

Budget reform and service delivery improvement

Budget reform aims to improve service delivery

Improved financial management and budget reforms continue to be firmly focussed on improving service delivery and transformation across a wide range of public administration functions and systems.

Departmental annual reports enhance accountability

A significant reform this year has been the publication of departments' annual reports, including financial statements, within six months of the end of the fiscal year, as required by the Public Finance Management Act. In addition to enhancing the capacity of Parliament and provincial legislatures to exercise due oversight of departmental services and expenditure, this provides detailed and timely information to assist treasuries, Cabinet and Executive Councils in reviewing service delivery progress and assessing budget priorities and spending pressures.

Measurable objectives for all programmes in 2003

Next year, departments are obliged to table “measurable objectives” associated with the main divisions (“programmes”) of their budget vote. For the national budget, these will be published in the Estimates of National Expenditure, building on the output and service delivery indicators that have been included in this document in the past two years.

Provincial treasuries have also adopted budget formats that facilitate a meaningful comparison of spending estimates with service delivery targets and indicators. In future years, these will form the basis for reporting on performance and outcomes in departments’ annual reports.

PFMA principles extended to local government

Another milestone has been reached this year with the tabling in the National Assembly of the Municipal Finance Management Bill and its careful consideration by the Portfolio Committee on Finance. This extends to the local government sphere the broad principles and framework that govern national and provincial finances. Recognising the critical role of local government in promoting social and economic development and building better livelihoods for the poor, this is a key step in Government’s public finance reform programme.

Further challenges in budget reform and financial management

For the years ahead, several further challenges remain:

- Integrating the planning, budgeting and reporting processes of departments, agencies and extra-budgetary institutions within the wider general government
- Refinement of measurable objectives, outputs and service delivery indicators
- Enhancement of governance structures and procedures in support of improved accountability, procurement management and institutional oversight
- Adoption of generally recognised accounting practice and improved quality of financial and service delivery reporting.

Progress in these and other aspects of efficient and effective public finance management will remain key performance areas for the national and provincial treasuries in 2003 and beyond.

Overview of the MTBPS

Macroeconomic developments

Uncertain global prospects

The 2002 Medium Term Budget Policy Statement is presented against a background of considerable uncertainty about global economic prospects. Steep declines in equity prices on stock markets signal deteriorating expectations about growth and trade in the major economies. While strong growth continues to be recorded in several emerging markets, there has been a marked retreat of international finance from developing economies. High oil prices and risks of diplomatic failure to resolve international tensions contribute to the unfavourable outlook.

Deepening food security challenges in Southern Africa

Within the Southern Africa region, drought and the commercial farming crisis in Zimbabwe have combined to bring about a food security challenge that threatens the livelihoods of several million people. South African grain production has remained robust, and our infrastructure and surplus production are important assets in the collaborative international response to the region's needs. For South Africa itself, there is not an aggregate food shortage, but rising grain prices add to the vulnerability of families and communities affected by unemployment, illness or income insecurity.

Broad-based economic growth expected

Chapter 2 of the MTBPS explains how the depreciation of the rand late last year contributed to the rising inflation trend this year. However, the depreciation has also provided a stimulus to growth and job creation in manufacturing and tourism-related industries. Strong export growth has been recorded in the first half of 2002.

Despite the poor international outlook, the South African economy is expected to grow by 2,6 per cent this year and an average of 3½ per cent a year over the next three years. Growth is likely to be broad-based, including sustained expansion in production for export markets and output growth in agriculture, manufacturing and services in response to rising prices and robust domestic demand.

Robust growth in investment, together with steady expansion in consumption expenditure

The improved outlook for the economy is described in some detail in Chapter 2. Robust private sector capital formation and a turnaround in government investment expenditure underpin the strengthening of productive capacity in the economy. Private consumption expenditure rose by about 3 per cent a year in the first half of this year, supported in part by tax reductions in the 2002 Budget. Spending on government services is also growing steadily in real terms now. Together with incentives for training and small business development, this is expected to contribute to moderate growth in employment in the years ahead.

Inflation target to remain 3-6 per cent in 2004

The rise in inflation this year is a setback for the inflation reduction objectives agreed between the Government and the Reserve Bank. The CPIX index is expected to rise by an average of 9,6 per cent this year, well outside the 3 – 6 per cent target.

Inflation is expected to decline steadily next year as the effect of the depreciation dissipates. However, the inflation target for 2002 and 2003 will be missed, and the CPIX average is unlikely to fall within the target range again until the last quarter of next year. Under the circumstances, the Minister of Finance and the

Governor of the Reserve Bank have agreed that the inflation target should remain 3 – 6 per cent for 2004. The 3 – 5 per cent target falls away until further notice.

Fiscal policy and tax considerations

Fiscal stance focused on sustainable growth and development

Government's fiscal stance remains focused on enhancing growth and development within a sound and sustainable budget framework. Priority is given to programmes and policies that foster job creation and infrastructure investment, while improving the quality of public services and addressing poverty and inequality.

Real spending growth of 4,7 per cent a year

The budget framework outlined in Chapter 3 provides for real expenditure growth of 4,7 per cent a year over the next three years. New allocations amounting to R4,7 billion this year and R57,1 billion over the 2003 MTEF period are added to national, provincial and local baseline spending plans. In addition, adjustments for higher inflation amounting to R3,4 billion in the current year and R27,8 billion over the next three years are proposed.

Stable tax burden relative to GDP

General government tax revenue is projected to remain about 27 per cent of GDP, with national budget revenue stabilising at 24½ per cent of GDP. A budget deficit of 2,2 per cent of GDP is projected for 2003/04, falling to 2,0 per cent in 2005/06.

Provision is made for forward losses of R28 billion

The budget framework takes into account financing arrangements to settle foreign exchange forward market losses incurred in recent years by the Reserve Bank, which are for the account of the fiscus. Government bonds amounting to R7 billion have been issued to the Bank this year, and provision is made in the budget framework for further issues of R7 billion a year over the next three years.

These extraordinary payments raise future interest costs above the levels projected in the 2002 Budget, but debt service costs are still projected to decline steadily to just under 4 per cent of GDP by 2005/06.

Robust revenue collections this year

National budget revenue collection this year is running ahead of target, offsetting in part both the adjustments to expenditure proposed and the costs of compensating the Reserve Bank for forward losses.

Implementation of 2002 tax reforms

Following the far-reaching reforms to the income tax structure in recent years, tax policy is presently in a consolidation phase. Reforms announced in the 2002 Budget – including introduction of a learnership allowance, further relief for public benefit organisations, accelerated depreciation allowances for manufacturing assets and extended tax relief for small businesses – have been dealt with in this year's Revenue Laws Amendment Bills. Incentives in terms of the new strategic investment programme have to date been awarded to five projects, entailing investment of R2 billion and an estimated 10 573 new jobs.

Targeted personal income tax relief under consideration

Robust revenue growth allows for a moderate real reduction in the personal income tax burden again next year, concentrated on lower and middle-income earners.

A thorough review of the taxation of retirement savings is under way, with a view to legislative overhaul in 2004. In keeping with the provisions of the Minerals and Petroleum Resources Development Bill, a royalty regime will in due course be introduced, bringing the tax treatment of our extractive industries in line with international best practice. The National Treasury is also studying the possible role of taxes and charges in addressing environmental aspects of long-run sustainable development.

The MTEF and division of revenue

Broad consultative process underpins budget policy framework

The medium term expenditure framework is the outcome of an extended consultative process in which national departments, provincial treasuries and representatives of local government review their policies and programmes and table spending plans for consideration.

The President's State of the Nation Address in February serves as a platform for the development of budget priorities.

This year's budget process was enhanced by an extended assessment of priorities and evaluation of policy options by Cabinet at its July lekgotla, supplemented by in-depth reviews by the Ministers' Committee on the Budget, the Budget Council and joint MinMEC discussions of education, health, social development and local government issues.

Additional allocations for key social and economic priorities

Building on the focus on poverty reduction and infrastructure investment in the 2001 and 2002 Budgets, next year's MTEF will allocate substantial additional resources to social security, health, education and the provision of basic water, electricity and other household services.

Provinces will receive an additional R49,8 billion over the next three years, national departments R28,7 billion and local government R6,4 billion. Compensation for higher inflation comprises about one-third of the increases.

Provision of R400 million for emergency food relief

Beginning this year, an amount of R400 million a year is set aside for emergency relief for those facing desperate circumstances as a result of food shortages and food price rises.

Supplementary allocations to provinces will support the broadening and deepening of social services:

Education, health and social development to benefit from increased provincial funding

- Social grants will continue to be adjusted to compensate for inflation, together with a marked rise in child support and disability grant beneficiaries
- A progressive roll-out of HIV/Aids prevention and treatment programmes will be financed, together with a renewed focus on sexually transmitted infections, TB and malaria treatment
- Investment in hospital buildings and facilities, schools and clinics will continue to be enhanced
- Spending on learning support materials in schools and medical supplies in health facilities will be stepped up
- Steady increases in investment in the provincial road network will be supported.

Key national functions to be reinforced

The proposed budget framework will enhance services and aid restructuring in several areas of national responsibility:

- Universities and technikons undergoing institutional mergers
- The land restitution and land reform programmes
- Administration of the courts
- Expansion of capacity in safety and security services
- Home Affairs services to citizens and the national identification system
- Support for research and development to advance growth and technology
- Support for the African Union and NEPAD and enhanced international representation.

Municipal infrastructure and basic services to be supported further

Allocations to local government will continue to be focused on municipal infrastructure investment, which complements provincial spending on housing projects, and the broadening of access to free basic water and electricity services. Government rural development and urban renewal strategies provide a coordinating framework for creating jobs and extending development of communities.

Conclusion

The 2002 MTBPS sets out the economic context for the 2003 Budget and outlines the fiscal policy considerations, tax policy and expenditure priorities that underlie Government's budget proposals for the next three years.

The MTBPS aims to encourage informed debate in Parliament and engagement throughout civil society with the social, economic and developmental challenges that the Budget must address.

Comment on this Statement and the proposals set out for the 2003 Budget can be emailed to tipsfortrevor@treasury.gov.za, or posted to:

“Tips for Trevor”
Ministry of Finance
Private Bag X115
Pretoria
0001

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Economic policy and outlook

Robust private capital formation and a turnaround in government investment expenditure is set to raise the productive capacity of the economy, providing further impetus to medium term growth prospects.

Currency weakness towards the end of 2001 and sharp increases in food prices have rendered the inflation targets unattainable for 2002. The time frame for reaching the target has been revised, protecting the domestic economic recovery, while retaining Government's commitment to low and stable inflation in South Africa.

Gross fixed capital formation and rising exports contribute to solid growth in 2002.

Overview

Growth forecasts revised upward over medium term

Building on steadily improving performance in 2002, and on growing competitiveness, South Africa's growth prospects remain firm over the medium term, despite uncertain prospects in the world economy.

Economy expands 3,1 per cent in second quarter

In the first two quarters of 2002, South Africa experienced a broad-based expansion of the domestic economy, with growth of 3,1 per cent recorded in the second quarter on a seasonally adjusted and annualised basis. Spurred by exceptional export performance, local firms have expanded productive capacity by raising investment expenditure considerably in the first half of the year compared with the first half of 2001.

Trade account surplus of 5 per cent of GDP in second quarter

Firm commodity prices (especially for gold and platinum group metals) and increased competitiveness have led to surpluses on the trade account, and ultimately the current account. A modest current account surplus is expected for 2002.

Rapid expansion of productive capacity

Investment in productive potential of the economy has been particularly robust over the first half of the year, with real gross fixed capital formation rising by 6 per cent in the first quarter and 7,3 per cent in the second quarter, on a seasonally adjusted and annualised basis.

The depreciation of the currency towards the end of 2001 raised profit margins of exporting firms, while also encouraging domestic production in response to higher import prices. This was supported by steady growth in consumption expenditure by over 3 per cent a year in the first half of 2002.

Depreciation leads to higher inflation

Cost pressures associated with the depreciation of the rand have contributed to a marked divergence of CPIX from the official target of 3 to 6 per cent. CPIX reached 11,8 per cent in September, up from a target-consistent level of 5,8 per cent in September 2001. Food prices, which rose by 20,2 per cent in the year to September 2002, have been amongst the main drivers of inflation.

Inflation target of 3 – 6 per cent in 2004

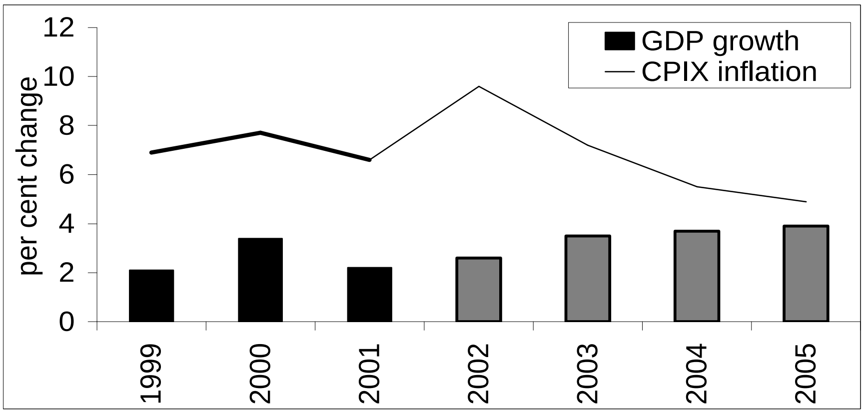
Under the circumstances, the Minister of Finance and the Governor of the Reserve bank have agreed that the inflation target should remain 3-6 per cent for 2004. The 3-5 per cent target falls away until further notice.

Higher growth in the medium term

Economic growth is expected to rise to 3,5 per cent in 2003 from 2,6 per cent in 2002. Given the medium term outlook, growth is expected to rise further to 3,7 per cent in 2004 and 3,9 per cent in 2005. Growth in CPIX is forecast to slow to 7,2 per cent in 2003, 5,5 per cent in 2004 and 4,9 per cent in 2005.

Figure 2.1 sets out GDP growth rates and CPIX inflation rates from 1999 – 2005.

Figure 2.1: Percentage growth in GDP and CPIX, 1999-2005 (year on year)



Global developments and the balance of payments

Growth in the world's industrialised economies has been weaker than anticipated in 2002, with emerging markets enjoying mixed fortunes.

Modest growth trends in major economies

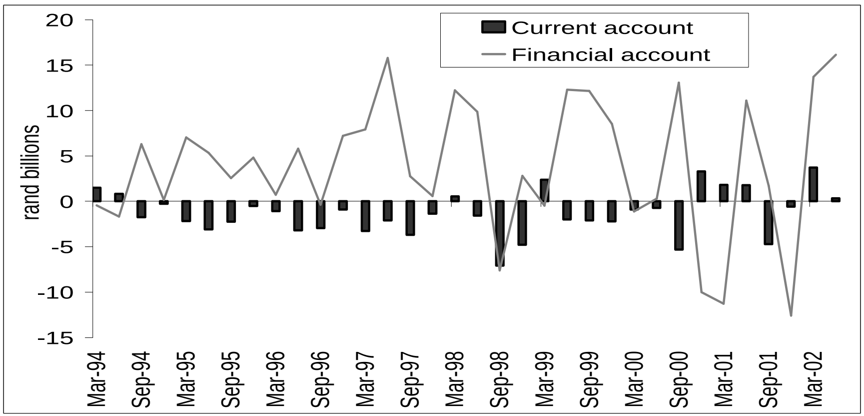
On a seasonally adjusted and annualised basis, growth in the United States dropped to 1,3 per cent in the second quarter, and has averaged 1,4 per cent in the European Union over the first half of this year. Japan grew by 2,6 per cent in the second quarter of 2002, recovering from its third recession in a decade.

Mixed emerging market performance

The experience of emerging markets over the first half of 2002 has been mixed. East Asian economies have recovered, while regional contagion from the Argentine default has created instability in Latin America.

Against this background, South Africa recorded an impressive current account performance and has seen healthy inflows on the financial account of the balance of payments this year. Figure 2.2 illustrates developments in the balance of payments since 1994.

Figure 2.2: Balance of payments, 1994 – 2002



Current account

Strong trade performance supports current account

For the first half of 2002, the surplus on the current account was 0,3 per cent of GDP and a surplus is expected for the full year, which will be the first since 1994. This was largely driven by the strong trade account performance, with surpluses of 3,7 per cent and 5,0 per cent of GDP recorded for the first and second quarters of 2002.

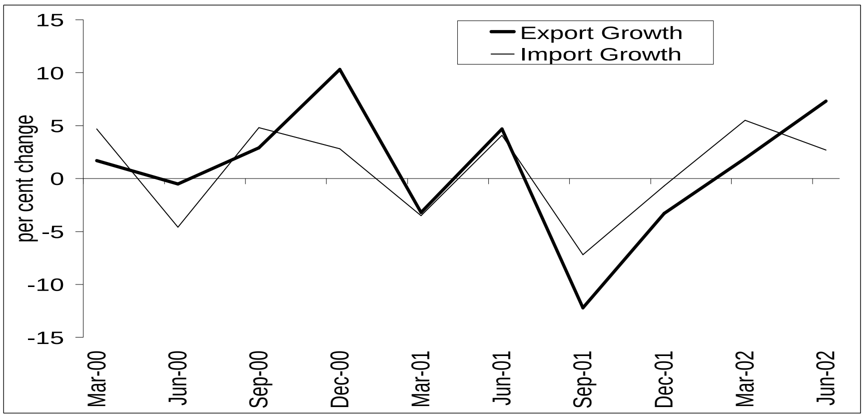
Growth in exports and imports since 2000 is set out in figure 2.3.

Merchandise export volumes expanded by 3,9 per cent in the first half of 2002, a substantial improvement on the 1,6 per cent increase recorded in 2001.

Rising vehicle exports underpin export performance

South Africa's manufactured exports rose to 36,2 per cent of total exports from 35,4 per cent in 2000. Motor vehicle exports increased in the first half of 2002 by 39 per cent and are expected to exceed 133 000 units for the year as a whole.

Figure 2.3: Imports and exports growth, 2000 – 2002 (year-on-year)



Machinery, transport equipment and electrical equipment exports have also performed well. Mining products experienced good growth and higher mineral prices contributed to an improvement in South Africa's terms of trade.

Rising tourism share of export growth

The growing significance of South African merchandise trade as a share of GDP has been accompanied by even faster growth in the services sector, which was boosted in 2002 by rising expenditure of foreign tourists.

Import expenditure up 6,4 per cent

Import demand rose in response to strong growth in domestic capital formation, despite the depreciation of the currency. The volume of merchandise imports increased by 6,4 per cent in the first half of 2002.

Financial account

Capital flows were strongly positive for the first half of 2002. Net capital inflows totalled R29,8 billion in the first half of 2002, compared with a net outflow of R11 billion in 2001 as a whole.

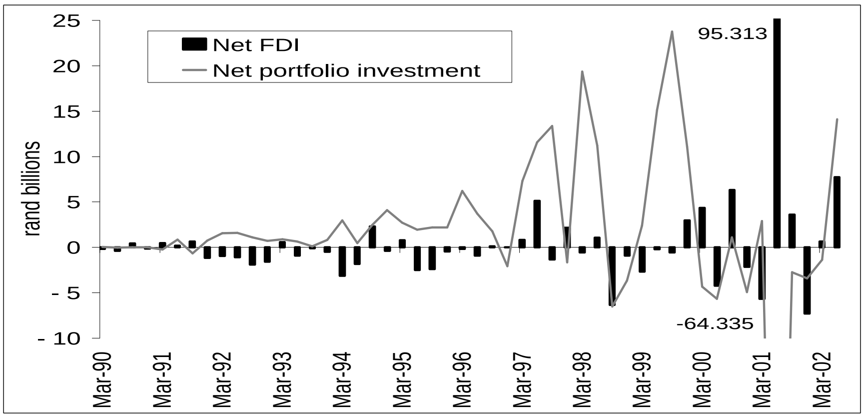
R8,3 billion in FDI supports local economy

Healthy levels of net foreign direct investment of R8,3 billion have been achieved in the first half of 2002, reflecting continued inward investment by foreign multinationals and the repatriation of offshore investments by South African companies.

In the second quarter of 2002, non-residents acquired an impressive R15,7 billion of South African portfolio assets. However, rising concerns regarding emerging markets resulted in rapid outflows in July and August.

As a result of the surpluses on the current and financial accounts, the overall balance recorded a surplus of R21,7 billion in the first half of 2002.

Figure 2.4: Net FDI and portfolio investment, 1990 - 2002



Exchange rate

The performance of the rand has seen a significant turnaround since the depreciation of 2001.

Sharp depreciation of the currency in 2001

During 2001, the nominal effective exchange rate of the rand declined by 34,4 per cent, the bulk of which occurred in the second half of the year. Against the US dollar, the rand depreciated by 37,4 per cent.

Among the factors responsible for the depreciation were the global slowdown and reduced demand for emerging market assets. The initial depreciation was exacerbated by technical factors, such as the delayed repatriation of exporter earnings and advance payments for imports in anticipation of further declines in the value of the rand.

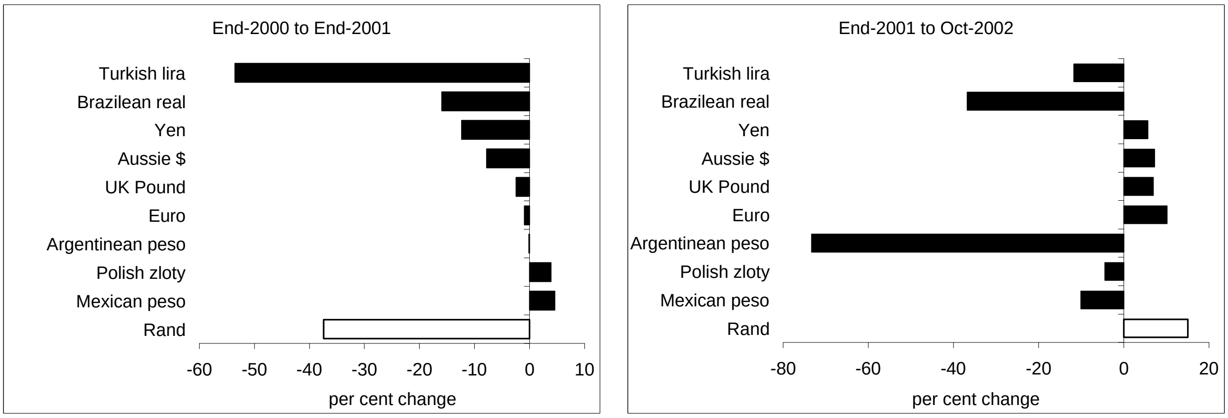
14,4 per cent appreciation against the US dollar to September 2002

However, in 2002 the rand has strengthened considerably. The real effective exchange rate of the rand gained 8,6 per cent in the first four months of 2002 and over the first six months, the nominal effective exchange rate gained 8,4 per cent. Against the US dollar, the rand gained 14,4 per cent up to September 2002, making it one of the top performing currencies against the dollar.

This turnaround can be ascribed to various factors, including:

- The surplus on the current account of the balance of payments
- Strong capital inflows during the first half of 2002
- Firm commodity prices
- Positive investor sentiment towards the credibility of macro-economic policies
- Technical factors, including the repatriation of export proceeds that had been deferred during the rand's sharp decline.

Figure 2.5: Currency performance against the US$, 2000 - 2002



The gradual unwinding of the net open forward position (NOFP) of the Reserve Bank, stabilising capital account inflows, continued implementation of the privatisation process and falling inflation will contribute to stability in foreign exchange markets over the medium term.

Further steps in exchange control liberalisation

No changes to exchange control regulations were announced in the 2002 Budget, pending the outcome of the Commission of Inquiry into the rapid depreciation of the exchange rate of the rand and related matters (the Rand Commission).

The findings of the Rand Commission supported Government's gradual approach to exchange control liberalisation.

As part of South Africa's commitment to NEPAD, Government is particularly supportive of investment by South African firms in Africa. In order to facilitate expanded investment in Africa, the following new exchange control limits apply with immediate effect:

- The allowance governing South African corporates' use of South African funds to finance new approved foreign direct investment in Africa is increased from R750 million to R2 billion.
- The allowance for the use of South African funds is expanded from just the financing of new approved foreign direct investments to also include "top-up" funding for the financing of new approved expansions of existing, prior exchange control approved, foreign direct investments in Africa.

Details will be provided by the South African Reserve Bank.

Foreign reserves and the NOFP

Reserves remain constant

Gross official reserves have remained stable in 2002 at approximately US$7,5 billion. The Reserve Bank's approach has been to not intervene in the foreign exchange markets in order to build up foreign reserves or contract the NOFP. Only proceeds from Government's foreign borrowing and privatisation were used to reduce the NOFP.

NOFP reduced to US$1,7 billion

The NOFP has been reduced to around US$1,7 billion, from US$4,8 billion at the end of 2001, principally through the National Treasury's drawdown of US$1,5 billion on a syndicated loan and the issuance of approximately US$1 billion in foreign denominated debt.

Real output and expenditure trends

Domestic output

Buoyant domestic output growth

Growth in domestic output has been buoyant over the first part of 2002, despite the weaker than anticipated recovery in the global economy.

Total value added at basic prices grew at a seasonally adjusted and annualised rate of 2,3 and 3,1 per cent in the first two quarters of 2002, compared with 1,4 and 1,8 per cent in the same quarters of 2001.

Structural changes across the economy have raised the efficiency of production, better enabling industries to compete in global markets. The depreciation of the currency contributed to this, with firms raising production to take advantage of price competitiveness.

Figure 2.6 sets out the growth performance of the main sectors of the economy.

Figure 2.6: Sectoral GDP Growth, 1997 – 2002 (year on year)

Agricultural output up 6,1 per cent in second quarter

Output growth was particularly robust in the agricultural sector, with seasonally adjusted and annualised real growth rates of 4,5 per cent and 6,1 per cent in the first two quarters of 2002. This reflects the sector's response to higher prices, particularly in the production of maize.

Poor contribution of mining to GDP

Growth in output in the mining sector continues to be weak, although the sector has enjoyed higher margins from firm international mineral prices and the weaker exchange rate.

Manufacturing output grows at 4,1 per cent

Seasonally adjusted and annualised growth of 4,1 per cent in manufacturing output in the second quarter of 2002 contributed to the sound performance of the secondary sector. Growth was especially robust in the more export-oriented subsectors, including clothing and textiles.

Steady growth in tertiary sector

The tertiary sector returned growth rates of 2,4 per cent and 3,0 per cent in output in the first and second quarters of 2002 (seasonally adjusted and annualised) and now contributes around 65 per cent of total output. Within the sector, the transport, storage and communication sub-sectors grew particularly strongly, expanding at an average of 5 per cent in the first half of the year. The finance, real estate and business services sub-sectors also contributed positively to overall growth, growing by 3,6 per cent over the period.

Domestic expenditure

Aggregate real domestic expenditure grew at a year on year rate of 3,8 per cent in the second quarter of 2002, up from 3,6 per cent in the first quarter. This compares favourably with average growth of 1,7 per cent in 2001.

Steady growth in household expenditure

Growth in real final consumption expenditure by households continued steadily at a year on year rate of 2,6 per cent in the first quarter and 3,1 per cent in the second quarter of 2002. Real spending in the second quarter was underpinned by increases in real disposable income of households following the tax cuts announced in the 2002 Budget.

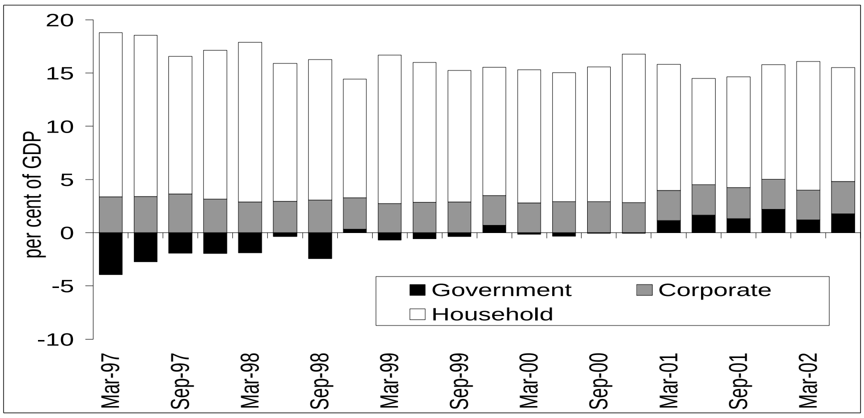
Saving and investment

Saving

Domestic saving rise in first half of 2002

Gross saving as a percentage of GDP increased slightly to 15,8 per cent in the first half of 2002 from 15,2 per cent in 2001. The composition of gross domestic saving is set out in figure 2.7.

Figure 2.7: Gross domestic saving, 1997 - 2002



Private saving remains weak

Private saving, which comprises corporate and household saving, remains weak. The decline in corporate saving reflects in part rising net dividend payments, domestically and abroad. Gross household saving, however, rose modestly from

2,8 per cent of GDP in the first quarter of 2002 to 3,1 per cent in the second quarter.

Government saving improves further

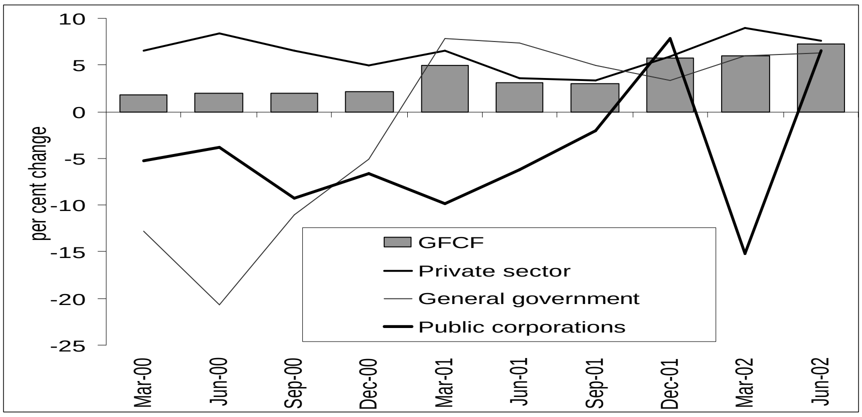
Government is now contributing positively to saving, with gross government saving rising from 1,2 per cent of GDP in the first quarter to 1,8 per cent in the second quarter. This reflects continued progress in the efficiency of tax collection and improved expenditure allocation.

Investment

Investment up 6,7 per cent

Real gross fixed capital formation increased by an average of 6,7 per cent in the first half of 2002 on a seasonally adjusted and annualised basis. The composition of this growth is set out in figure 2.8.

Figure 2.8: Real gross fixed capital formation (quarter on quarter, s.a.a.r)



The main contributor to this increase has been private sector investment, which grew at a seasonally adjusted and annualised rate of 7,6 per cent in the second quarter of 2002, following firm growth of 9,0 per cent in the first quarter.

This increase in investment was quite broad based, with most sectors recording growth in the first two quarters of 2002. Investment in the manufacturing sector accelerated to a quarter on quarter (seasonally adjusted) growth rate of 8,0 per cent in the second quarter of 2002, following growth of 6,1 per cent in the first quarter, as firms raised capacity in response to new export opportunities.

Firm growth in government investment

Real gross domestic fixed capital formation by public corporations rose by a seasonally adjusted and annualised 6,6 per cent in the second quarter of 2002. Gross capital formation by general government increased by 6,2 per cent in the first half of 2002, mainly due to increased infrastructure expenditure at all spheres of Government.

Labour markets

With the official unemployment rate at 29,4 per cent, creating sufficient jobs for the estimated 4,7 million workseekers currently without jobs remains the most critical economic challenge in South Africa.

Slower decline in formal employment

According to the *Survey of Employment and Earnings in Selected Industries* (SEE) the rate of decline in employment in the regularly surveyed formal non-agricultural sectors of the economy slowed to a rate of 0,1 per cent in the year to June 2002, from 1,4 per cent in December 2001, with private sector employment increasing at a rate of 0,1 per cent in the year to June 2002.

Figure 2.9: Formal employment growth, 1995 – 2002 (year on year)

The wider February *2002 Labour Force Survey* suggests that economic growth is now contributing to the creation of new job opportunities, but much of the increase is in casual and informal employment.

Labour productivity

Manufacturing productivity up 6,5 per cent in second quarter

Output per worker in the formal non-agricultural sector of the economy increased by a steady 3 per cent year on year in the first quarter of 2002. Productivity improvements in the manufacturing sector remain firm, accelerating to a year on year growth rate of 6,5 per cent in the second quarter of 2002.

Higher growth in unit labour costs

Economy-wide nominal unit labour costs rose by 6,4 per cent in the year to the first quarter of 2002 – slightly below the year on year growth in the fourth quarter of 2001, although higher than the 4,8 per cent rate for 2001 as a whole.

Figure 2.10 sets out growth in real wages and productivity improvements across the economy since 1994.

Figure 2.10: Annual labour productivity and wage growth, 1994 – 2002

To facilitate job creation and to expand productivity in the economy, Government has taken a number of decisive steps during 2002, including:

- Reforming labour legislation to improve the functioning of key labour market institutions, to provide further flexibility in key areas and to ensure protection for the most vulnerable workers.
- Intensifying efforts of the Sector Education and Training Authorities to enhance skills capacities in the economy.
- Introducing a tax incentive for employers offering learnerships.
- Extending efforts to encourage the development of small businesses, which provide an important impetus to employment creation.

Money supply and interest rates

M3 up 16,2 per cent in August

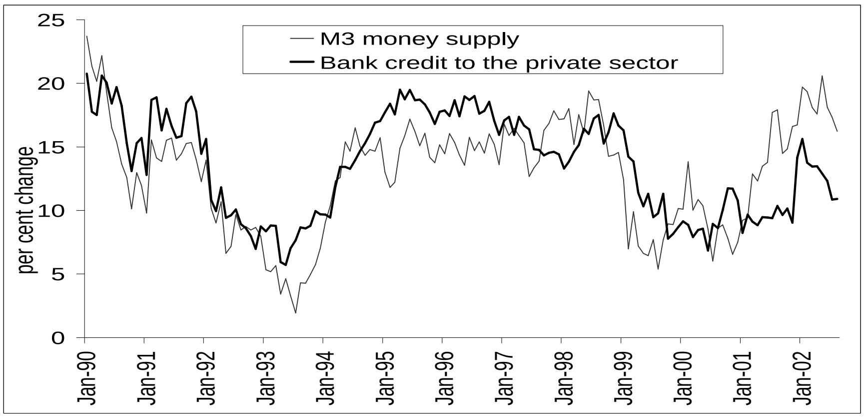
Growth in M3 money supply rose sharply to 20,6 per cent year on year in May 2002, before falling back to 16,2 per cent in August. Growth has been considerably faster than the average year on year growth rate of 14,1 per cent during 2001.

Figure 2.11 illustrates the growth in M3 money supply since January 1995.

Money supply growth moderating

This increase in money supply in 2002 is mainly a result of the repatriation of export proceeds and rising demand for liquid deposits given higher interest rates and the uncertainty in global and domestic share markets.

Figure 2.11: Private credit & money supply growth, 1995 – 2002 (year-on-year)



Growth in credit extension eases in second quarter

Private sector credit extension (PSCE) has also been robust over the first 8 months of 2002. Annual PSCE growth peaked at 15,6 per cent in January, before moderating to 10,9 per cent in August.

In the first quarter of 2002, PSCE was affected by corporate borrowing. When the currency depreciated toward the end of 2001, exporting firms borrowed money to fund their domestic operations, while retaining their export proceeds offshore. As the currency strengthened in the first quarter of 2002, the export proceeds were repatriated and the debt repaid.

In the second quarter, private sector credit growth was higher in the household sector, especially for mortgage rentals and lease finance to purchase motor vehicles. Despite this increase, household debt levels fell to 53,2 per cent of household disposable income during the second quarter of 2002, from 55,8 per cent in the third quarter of 2001. This was in part due to increasing disposable income following the tax cuts announced in the 2002 Budget.

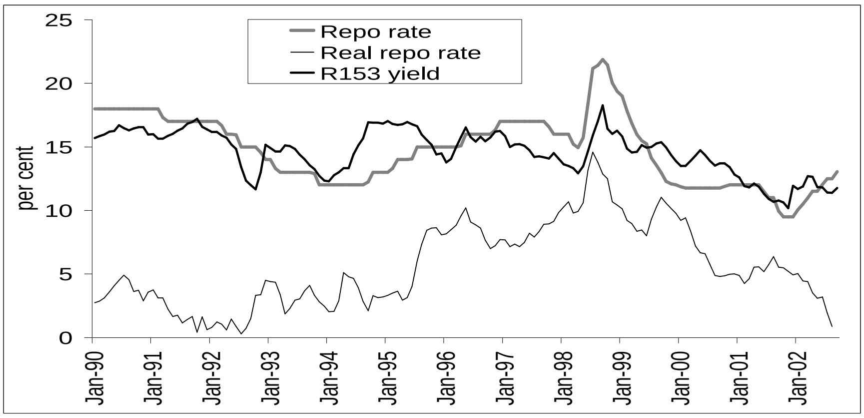
Interest rates

Bond yields rise on inflation concerns

Yields on Government bonds increased by less than the increases in the repo rate over 2002. At the same time long term bonds have continued to trade at significantly lower rates than short term instruments, indicating confidence that inflation will decline in the years ahead. The R153 bond yield increased from an average of 10,2 per cent in November 2001 to 12,7 per cent in March 2002, before falling to 11,8 per cent in September 2002.

Yields on the repo rate and the benchmark R153 are set out in figure 2.12.

Figure 2.12: Interest rates, 1990 – 2002



Inflation

CPIX rises to 11,8 per cent in September 2002

In the course of 2002, CPIX, the inflation rate that defines Government's inflation target, rose by 11,8 per cent in the year to September, from 5,8 per cent in September 2001.

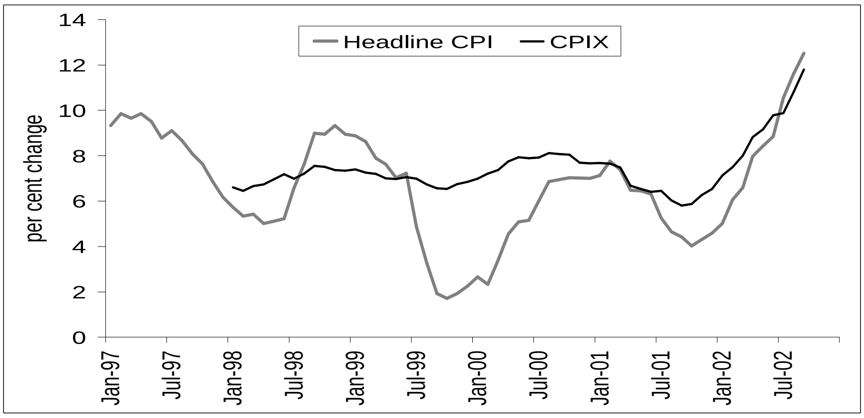
Producer price inflation, which reflects increases in prices of goods used in domestic production, rose by 15,4 per cent in the year to September 2002 from 7,8 per cent in September 2001.

CPIX targets to be shifted outwards by one year

The rise in inflation this year is a setback for the inflation reduction objectives agreed between the Government and the Reserve Bank. The targeted CPIX index is expected to rise by an average of 9,6 per cent this year, well outside the 3-6 per cent target. In response to rising inflation, the Reserve Bank has raised the repo rate four times this year, in effect keeping short-term interest rates broadly stable in real terms.

The increases of CPIX and headline inflation are set out in figure 2.13.

Figure 2.13: Inflation rates, 1997 –2002 (year-on-year)



Food prices contribute 44 per cent to CPIX increases

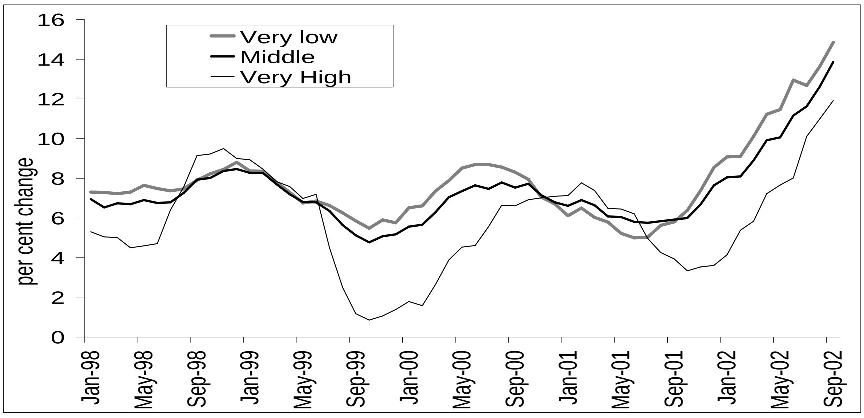
Major contributors to higher inflation in 2002 include food prices, housing, medical services, and transport costs. The monthly average contribution of food prices to increases in the CPIX was 44 per cent between January and September 2002, compared with 16 per cent in the same period in 2001. Regional maize shortages, high international prices, the weak currency and international supply constraints led to significant increases in the price of maize in the domestic market.

Rising oil prices, in combination with the weaker exchange rate, have also exerted upward pressure on domestic prices, with transport costs increasing markedly in line with the price of fuel.

Rising prices affect the poor most

Since lower and middle-income groups spend a significant proportion of their income on basic foodstuff, increasing prices have been felt more powerfully by these groups than by higher income groups, as depicted in figure 2.14.

Figure 2.14: CPI inflation by expenditure group, 1998 – 2002 (year-on-year)



Inflation to decline in the years ahead

Inflation is expected to decline steadily next year as the effect of the depreciation dissipates. It is anticipated that inflation will fall below 6 per cent in the final quarter of 2003, with the average falling within the target range of 3 – 6 per cent in 2004. The inflation forecasts for the medium term are set out in tables 2.1 and 2.2 and depicted in figure 2.1.

Domestic and global outlook

Global Outlook

Global growth and stability impacts on the South African economy through a number of channels, including demand for South African goods and services, in particular commodities, the oil prices, investment flows and exchange rate fluctuations.

Inflation targeting

Mahadeva and Stern (2002) report that between 1990 and 2001, 61 central banks operated some form of explicit inflation target. South Africa is one of 19 countries that they define as 'inflation targeters'.

South Africa first introduced inflation targeting in 2000, with the announcement of a target range of 3 to 6 per cent for CPIX (consumer prices excluding mortgage interest costs). These targets were extended in 2001 to include a target of 3 to 5 per cent in 2004.

The introduction of inflation targeting was born out of a broad consensus that managing inflation and ensuring price stability are of critical importance for long term economic development and poverty reduction.

Reducing inflation is especially important for the poor, who have no ability to hedge against the reductions in purchasing power brought about by rapidly increasing prices.

Furthermore, for small open economies such as South Africa, inflation rates should be kept broadly in line with the rates experienced by the country's major trading partners, and those of its competitors, if global competitiveness is to be maintained.

More broadly, maintaining low and stable inflation rates impacts positively on saving, income distribution, investment levels, the allocation of investment funds and the real value of salaries and wages.

The transparency of an explicit inflation target, based on a firm commitment from Government and the monetary authorities, is of paramount importance in managing inflation expectations.

South Africa's inflation targeting policy recognises the potential for temporary external shocks, which may lead to deviations from the target, and allows for a moderate adjustment path towards the targets in these circumstances. This flexibility is provided for in an 'escape clause', which allows for moderation in the response of monetary policy to certain economic shocks.

The escape clause provides as follows:

It is recognised that there may be some economic supply shocks or extraordinary events impacting on CPIX inflation that are unforeseen and beyond the control or influence of monetary policy. Most of these factors reverse over time. It is not possible to specify in advance all the economic shocks that could affect CPIX inflation, but such factors include a sharp rise in international oil prices, drought, changes in indirect taxes, and international financial contagion which causes major changes in the exchange rate which are unrelated to domestic economic fundamentals and domestic monetary policy. Reacting to such events could result in costly losses in terms of output and jobs. In such circumstances where it is expected that the target for CPIX inflation will not be met, it will be indicated in a monetary policy statement and the Monetary Policy Committee will set out the path and time horizon over which the inflation rate will be brought back in line with the target (MTBPS, 2001).

At the time of South Africa's introduction of the inflation target, and of its subsequent extension, inflation was well on track to meet the 2002 target. In September and October 2001, CPIX was below 6 per cent and the momentum of inflation remained downward.

The rise in inflation this year is a setback for the inflation reduction objectives agreed between the Government and the Reserve Bank. The targeted CPIX index is expected to rise by an average of 9,6 per cent this year, well outside the 3-6 per cent target. Inflation is expected to decline steadily next year as the effect of the depreciation dissipates. However, the inflation target for 2002 and 2003 will be missed, and the CPIX average is unlikely to fall below 6 per cent until the last quarter of next year. Under the circumstances, the Minister of Finance and the Governor of the Reserve bank have agreed that the inflation target should remain 3-6 per cent for 2004. The 3-5 per cent target falls away until further notice.

Mahadeva and Stern (2002) point out that it is not uncommon for countries to miss their inflation targets – as has been the case with Australia, New Zealand and Brazil – especially small, open economies such as South Africa. As in these countries, once the effects of the temporary disturbance have dissipated the inflation trend will return to the more moderate target rates.

The outlook for the world economy remains uncertain, as falling US equity prices, rising oil prices and the possibility of a war with Iraq, create considerable uncertainty.

Modest recoveries expected in the world's largest economies

The September *World Economic Outlook* of the IMF expects US GDP growth to be 2,2 per cent in 2002 and 2,6 per cent in 2003. GDP growth for the Euro area is projected at around

1 per cent for 2002, although growth of 2,3 per cent is anticipated in 2003. Japan's third, and most severe, recession in the past decade seems to be bottoming out, with real GDP projected to stage a modest recovery of 1 per cent in 2003, after falling by 0,5 per cent in 2002.

Rising demand for platinum

Based on rising demand for platinum in catalytic converters used in automobiles and sustained jewellery demand, platinum prices are forecast in a US$540 – 580 an ounce range over the medium term.

Gold price sustained *above $310 an ounce*

The gold price has recovered from around $260 an ounce at the beginning of 2001 to above $310 an ounce. The prospect of a US war against Iraq could lead to a temporary increase in the gold price, though over the medium term a stable gold price of around $315 an ounce is expected.

Firm oil prices in the face of global uncertainty

Lower inventories, seasonal demand and politics should keep the oil price high in the near term. Although OPEC is facing member requests for a higher market share, quotas have been left unchanged for the fourth quarter of 2002. Oil demand is also projected to rise when the global economy recovers in 2003.

Domestic economic outlook

Growth forecasts revised upward

Prudent economic policies should continue to provide an environment for sustained economic growth. GDP growth of 2,6 per cent is projected for calendar 2002, up from the 2,3 per cent expected at the time of Budget 2002.

Growth is expected to maintain its upward trend over the medium term, with rates of 3,5 per cent, 3,7 per cent and 3,9 per cent projected for 2003, 2004 and 2005, respectively. This will be underpinned by improved domestic confidence, real exchange rate competitiveness and continued robust gross fixed capital formation.

Steady household expenditure growth

Household consumption will be supported by the real tax cuts announced in Budget 2002. Further increases later in the forecast period in household consumption (to about 3 to 3,5 per cent) are expected, as consumption responds to lower interest rates, real wage increases and employment creation.

Investment growth raises productive potential

Rising confidence in the domestic and international economy should encourage increased investment levels over the medium term. Investment will also be supported by growth in public corporation outlays. The privatisation process is also expected to inject new capital into the economy.

Further improvement in government capital expenditure

Following brisk growth of around 7 per cent in 2002, fixed capital formation by government is also expected to rise over the forecast period as government departments' capacity to implement capital programmes improves.

Final consumption by government is expected to grow by 2,5 per cent in 2002 and to average 3,6 per cent over 2003 to 2005. Given moderate wage and employment growth, the driving force behind government consumption expenditure is expenditure on non-wage consumption goods, including health and education expenditure, such as textbooks and medicines.

Competitive exchange rate supports export growth

Increased export growth over the medium term will be supported by the competitive real exchange rate, a more liberalised world trade environment and by the anticipated recovery in the global economic environment.

The current account is expected to improve slightly from the deficit of 0,2 per cent of GDP in 2001, to a surplus of 0,1 per cent in 2002, as export performance improves, import growth decelerates, and commodity prices strengthen. However, as domestic demand accelerates over the medium term, import growth will also increase, putting some pressure on the current account.

Inflation should peak in October/November 2002

The effects of the depreciation of the rand have effectively fed through into both producer and consumer prices. Further increases in CPIX inflation could be expected during the course of the year, and CPIX inflation is expected to reach an upper turning point of more than 11 per cent by October/November before subsiding. Inflation is expected to fall sharply during the course of 2003 and should be within the inflation target by the final quarter of 2003.

Table 2.1 Macroeconomic projections (calendar years): 1999 to 2005

	1999	2000	2001	2002	2003	2004	2005
Real growth in demand:							
Final household consumption	1,4%	3,3%	2,8%	3,1%	2,9%	3,3%	3,6%
Final government consumption	-0,7%	0,5%	1,4%	2,5%	3,6%	3,6%	3,8%
Gross fixed capital formation	-7,8%	0,3%	3,3%	6,0%	5,7%	6,2%	6,8%
Gross domestic expenditure	0,0%	2,9%	1,8%	3,1%	3,2%	3,5%	3,8%
Exports of goods and services	1,4%	8,4%	2,4%	3,2%	6,4%	6,6%	6,7%
Imports of goods and services	-7,4%	7,1%	0,4%	5,6%	6,1%	6,5%	6,9%
Real GDP growth	**2,1%**	**3,4%**	**2,2%**	**2,6%**	**3,5%**	**3,7%**	**3,9%**
GDP inflation	6,3%	7,0%	7,5%	9,2%	7,4%	5,3%	4,5%
Gross domestic product at current prices (R billion)	**803**	**888**	**975**	**1 093**	**1 214,2**	**1 325,0**	**1 439,0**
CPI inflation:							
CPIX (Metropolitan and urban areas)	6,9%	7,8%	6,6%	9,6%	7,2%	5,5%	4,9%
Balance of payments:							
Current account balance (% of GDP)	-0,5%	-0,4%	-0,2%	0,1%	-0,3%	-0,6%	-1,1%

Table 2.2 Macroeconomic projections (fiscal years): 2001/02 to 2005/06

	2001/02	2002/03		2003/04		2004/05		2005/06
	Outcome	2002 Budget	Revised	2002 Budget	Revised	2002 Budget	Revised	
Gross domestic product (R billion)	**999,4**	1 082,8	**1 124,0**	1 178,9	**1 240,1**	1 277,5	**1 351,6**	**1 466,1**
Real GDP growth	2,0	2,7	2,9	3,3	3,5	3,6	3,7	3,9
GDP inflation	7,6	6,5	9,3	5,4	6,6	4,6	5,1	4,4
CPI inflation:								
CPIX	6,6	6,7	10,0	5,5	6,5	4,6	5,3	4,8

3

Fiscal policy and the budget framework

Following successful stabilisation after 1996, the growth-oriented fiscal stance set out in the 2001 and 2002 Budgets will continue, with strong expenditure growth and continued tax relief, in the face of adverse global conditions.

Real non-interest spending grows by 6,7 per cent next year, and by an average of 4,7 per cent over the course of the 2003 MTEF, giving priority to improved service delivery, social development and infrastructure development.

Inflation adjustments of R5,6 billion to social security grants over the next three years are proposed in order to take account of the effects of higher food prices on the poor.

The deficit will widen to 2,2 per cent of GDP in 2003/04, declining to 2,0 per cent at the end of the 2003 MTEF, accompanied by debt service costs of 4,1 per cent of GDP, declining to 3,9 per cent over the same period.

Overview

Expansionary fiscal policy to continue

The framework set out in this chapter builds on the growth-orientated fiscal policy stance signalled in the 2001 and 2002 Budgets. Priority is placed on programmes and policies that foster job-creation, investment and growth, while improving the delivery of services and allocating increased resources toward addressing poverty and inequality.

Fiscal prudence has provided for declining debt service costs, which makes possible higher levels of spending under adverse global conditions, without the imposition of a higher tax burden on the economy, nor significant added recourse to the capital markets.

Key features of the 2003 MTEF include:

- Real non-interest expenditure growth of 6,7 per cent next year, with average real growth for the period of 4,7 per cent.

- Prioritisation of expenditure toward infrastructure development, increased allocations towards land restitution, health, education and social welfare.
- Adjustments[1] over the course of the 2003 MTEF of R27,8 billion, in order to cater for the effects of inflation.
- Stabilisation of the tax burden, with main budget revenue targeted at 24,4 per cent of GDP.
- Financing arrangements for losses on the Gold and Foreign Exchange Contingency Reserve Account, managed by the Reserve Bank on behalf of Treasury.
- A main budget deficit of 2,2 per cent for 2003/04, declining to 2,0 per cent in 2005/06, accompanied by debt service costs of 4,1 per cent of GDP, declining to 3,9 per cent over the same period.

Fiscal trends and goals

Table 3.1 sets out a range of national accounts indicators that describes important aspects of South Africa's fiscal policy since 1997, and the projected development of these indicators over the 2003 MTEF.

Table 3.1 shows the following key trends:

- A decline in government consumption expenditure as a percentage of GDP, from 20 per cent in the mid-1990s, to 18 per cent in 2001.

Table 3.1 Fiscal trends and projections

	1997	1998	1999	2000	2001	2002 Forecast	2005 Target
Government consumption expenditure (% of GDP)	19,2	19,0	18,4	18,0	18,0	18,2	18,5
wages	14,1	14,1	13,6	12,9	12,6	12,3	11,6
non-wage	5,2	4,9	4,9	5,1	5,4	5,9	6,9
real growth		*-4,4*	*2,1*	*10,9*	*10,1*	*12,4*	*9,0*
Gross fixed capital formation (real growth)							
general government	7,3	-1,8	-2,0	-6,9	0,1	6,9	5,0
public corporations	9,2	52,8	-29,3	-22,3	-6,1	-0,6	4,0
General government savings (% of GDP)	-4,6	-3,1	-2,4	-2,3	-0,5	-0,8	0,3
Interest on public debt of general government (% of GDP)	6,1	6,4	6,2	5,8	5,5	5,2	4,8
Real yield on long-term government stock (average period)	6,1	8,3	9,6	8,5	5,7	2,5	n/a
General govt tax revenue (% of GDP)	25,4	26,8	27,0	26,1	27,3	26,9	27,0

[1] Note that all adjustments to baseline for the 2003 MTEF assume baseline expenditure growth for 2005/06 of 6 per cent above 2004/05

- Strong real growth rates of non-wage expenditure (capturing spending on goods and services such as medicines, textbooks and maintenance of capital stock), which increased from -4,4 per cent in 1998 to 10,1 per cent in 2001, and are expected to continue into the 2003 MTEF as departments broaden and deepen the quality of service provision.
- A strong increase in gross fixed capital formation by general government, forecast to grow by 6,9 per cent in 2002, and maintaining high levels through the 2003 MTEF, with the delivery of projects initiated as part of the infrastructure expansion announced in the 2001 Budget.
- A modest turn-around in gross fixed capital formation by the public corporations, with the injection of new capital through the privatisation process.
- A sharp decline in general government dissavings, from 4,6 per cent of GDP in 1997 to 0,5 per cent in 2001, and reaching 0 during the 2003 MTEF, driven by containment of consumption expenditure and increases in capital expenditure.
- Falling interest payments on public sector debt, from 6,1 per cent of GDP in 1997 to 5,5 per cent in 2001, declining further to 4,8 per cent towards the outer years of the MTEF.
- Declining real interest rates on government debt, in part due to the decreasing claim of government on the capital markets.
- A stabilisation of the tax to GDP ratio at around 27 per cent over the 2003 MTEF.

The box below sets out key indicators of fiscal sustainability for general government.

2001/02 main budget outcome

The preliminary outcome of the main budget for 2001/02 is set out in table 3.2.

Exceptional revenue performance for 2001/02…

Preliminary outcomes show that the revenue performance for 2001/02 was significantly stronger than expected at the time of the 2001 Budget. Revenue for 2001/02 grew by 15,2 per cent from 2000/01, to R248,3 billion. This is R14,9 billion higher than the original 2001 Budget estimate of R233,4 billion.

… accompanied by marginally higher than forecast expenditure…

On the spending side, preliminary outcomes show main budget expenditure of R262,7 billion, R4,4 billion higher than estimated at the time of the 2001 Budget, and approximately R0,1 billion more than the revised estimate set out in the 2002 Budget.

…leads to lower than forecast deficit

Given the strong revenue performance of 2001/02, the deficit for the year was 1,4 per cent of GDP, lower than the 2,5 per cent announced at the time of the 2001 Budget.

Table 3.2 Main budget outcome: 1998/99 – 2001/02

R billion	1998/99	1999/00	2000/01	2001/02 2001 Budget estimate	2001/02 Preliminary outcome
Total revenue	**184,0**	**198,2**	**215,6**	**233,4**	**248,3**
per cent of GDP	*24,4%*	*24,1%*	*23,7%*	*23,6%*	*24,8%*
per cent increase	*12,6%*	*7,7%*	*8,8%*	*8,3%*	*15,2%*
Total expenditure	**201,4**	**214,7**	**233,9**	**258,3**	**262,7**
per cent increase	*6,0%*	*6,6%*	*8,9%*	*10,4%*	*12,3%*
Budget deficit (-)	**-17,4**	**-16,6**	**-18,4**	**-24,9**	**-14,4**
per cent of GDP (-)	*-2,3%*	*-2,0%*	*-2,0%*	*-2,5%*	*-1,4%*

Indicators of fiscal policy sustainability

Key indicators of the fiscal sustainability of general and national government are set out in the table below. Note that all budget balances are expressed in terms of Government Financial Statistics (GFS) classifications, as opposed to the System of national Accounts (SNA) classifications shown in table 3.1. Due to classification and timing differences, GFS data does not correspond fully to data published in the MTBPS.

The conventional budget deficit, which measures total revenue less total expenditure, shows a steady decline from 5,8 per cent in 1996/97 to 1,0 per cent in 2001/02.

The primary balance is calculated as the difference between revenue and non-interest expenditure. South Africa has been running a primary surplus since 1997/98, which implies that the tax base fully finances spending on public services, and is thus a sign of the sustainability of South Africa's expenditure policies.

The current balance, which measures current revenue less current expenditure, is lower than the conventional deficit. This implies that part of the deficit was incurred by expenditure on capital goods and services.

The table also shows the decline in national government debt as a percentage of GDP over the last six years, which reduces the vulnerability of South Africa to capital market instability, and allows for the prioritisation of government resources to meeting the country's social, economic and development goals.

Key indicators of fiscal sustainability (% of GDP)

	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02
General government						
Conventional deficit	-5,8	-4,4	-2,4	-1,3	-1,9	-1,0
Primary balance	0,0	1,5	3,6	4,3	3,4	4,0
Current balance	-3,1	-1,8	0,0	1,5	0,8	1,8
National government						
Total loan debt[1]	48,5	48,0	48,2	46,4	43,8	43,3

1. Excludes GFECR Account.

The budget framework

Consolidated general government includes the main budget, social security funds, extra-budgetary agencies, provinces and local authorities

The MTBPS publishes projections of the accounts of government at a number of different levels of aggregation. The structure of Government's accounts is set out below.

- The *consolidated national budget* includes the collective revenue and expenditure of the main budget, the RDP Fund (including foreign technical cooperation) and the social security funds. The consolidated national budget is set out in table 3.5. The social security funds are set out in table 3.6.

- The largest part of the consolidated national budget is the *main budget*, which comprises the revenue and expenditure attributed to the National Revenue Fund. The main budget is set out in table 3.3.
- The *consolidated general government account* shows the revenue and expenditure of the main budget, the social security funds, the provinces, extra-budgetary institutions (including universities and technikons) and local authorities.
- The *public sector borrowing requirement* (PSBR), which is set out in table 3.7, is derived from the consolidated general government deficit, the financing requirements of non-financial public enterprises, extraordinary expenditure items and the proceeds of the restructuring of state owned enterprises.

The main budget

Table 3.3 below sets out the revised estimates for the 2002/03 fiscal year and the proposed framework for the 2003 MTEF, taking into account changes to the 2002/03 estimates to be considered by Parliament in the 2002 Adjustments Budget.

Deficit 0,5 per cent below expectations for 2002/03

Revised estimates for 2002/03 show a revenue performance broadly in line with Budget 2002 expectations as a percentage of GDP, higher than forecast nominal non-interest expenditure, and a budget deficit 0,5 percentage points lower than projected at the time of the 2002 Budget.

Strong real non-interest expenditure over the 2003 MTEF, with declining deficit

The 2003 MTEF continues to provide for robust growth in non-interest expenditure over the next three years. Nominal non-interest spending grows by 13,7 per cent next year and by an average of 10,5 per cent a year over the forecast period (6,7 per cent and 4,7 per cent in real terms).

The budget framework provides for additional spending over the forward estimates of R79,0 billion, which, together with the R5,9 billion in unallocated infrastructure money, makes available R84,9 billion above the 2002 Baseline for the three-year period.

The budget deficit declines over the period from 2,2 per cent to 2,0 per cent of GDP.

Estimated outcomes for 2002/03, and projected developments in South Africa’s revenue, expenditure, financing and debt trends are set out in more detail below.

Table 3.3 Main budget framework, 2001/02–2005/06

R million	2001/02 Outcome	2002/03 Estimate	2003/04 Medium-term estimates	2004/05	2005/06
Revenue (National Revenue Fund)					
Tax revenue (gross)	252 424	276 570	306 350	336 052	364 641
Other receipts & repayments	4 043	4 970	5 600	6 100	6 466
Less: SACU transfers	8 205	8 259	9 848	11 814	12 784
Total revenue	**248 262**	**273 281**	**302 102**	**330 338**	**358 323**
per cent of GDP	*24,8%*	*24,3%*	*24,4%*	*24,4%*	*24,4%*
per cent increase	*15,2%*	*10,1%*	*10,5%*	*9,3%*	*8,5%*
Expenditure					
State debt cost	47 571	47 236	51 463	54 599	57 853
Non-interest expenditure	215 103	244 517	277 955	303 825	330 247
Contingency reserve	–	–	*2 000*	*4 000*	*8 000*
Total expenditure	**262 674**	**291 753**	**329 418**	**358 424**	**388 100**
per cent of GDP	*26,3%*	*26,0%*	*26,6%*	*26,5%*	*26,5%*
per cent increase (non-interest expenditure)	*14,6%*	*13,7%*	*13,7%*	*9,3%*	*8,7%*
Real growth (non-interest expenditure)	*7,5%*	*3,4%*	*6,7%*	*3,8%*	*3,7%*
Deficit(-)	**-14 412**	**-18 472**	**-27 316**	**-28 085**	**-29 777**
Percentage of GDP	*-1,4%*	*-1,6%*	*-2,2%*	*-2,1%*	*-2,0%*
Gross domestic product	*999 409*	*1 124 032*	*1 240 156*	*1 351 630*	*1 466 135*

2002/03 revised estimates

R8,1 billion revenue overrun reflects the impact of inflation

Preliminary revenue forecasts based on estimates up to August 2002 suggest a revenue overrun for 2002/03 of R8,1 billion, bringing revenue for the year to 24,3 per cent of GDP – slightly below the target of 24,5 per cent. This anticipated revenue overrun includes R350 million higher revenue on the skills development levy.

This year’s revenue over-run reflects the effects of higher inflation (which boosts nominal tax receipts) rather than stronger collections in real terms. As a percentage of GDP, tax revenue is marginally below the levels forecast in the 2002 Budget.

Taking into account in-year inflation adjustments proposed in the 2002 Adjustments Budget, non-interest expenditure is expected to be R4,1 billion higher in 2002/03 than projected at the time of the 2002 Budget. The Adjustments Budget makes provision for additional allocations of R8,1 billion. This R8,1 billion is sourced from the additional spending of R4,1 billion, the R3,3 billion drawndown from the contingency reserve and R700 million earmarked for infrastructure at the time of the 2002 Budget.

R8,1 billion for allocation in 2002 Adjustment Budget

Revisions to government expenditure set out in the 2002 Adjustments Budget include:

- R3,4 billion to compensate for the sharp increase in inflation that followed the depreciation of the rand in late 2002
- Additional funding to provinces of R2 billion to meet increases in take-up of social security grants and other unforeseen expenditure
- R700 million toward infrastructure development, announced at the time of the 2002 Budget but unallocated to departments at the time
- R400 million toward food security
- R173 million in self-financed expenditure
- R1,4 billion in other unforeseen and unavoidable expenditure at national level.

Inflation-induced lower than projected real expenditure

In real terms, however, non-interest expenditure is lower than projected at the time of the 2002 Budget, reflecting limits to fiscal policy adaptability in the face of unexpected shocks, given long planning and budgeting lead times.

2002/03 deficit at 1,6 per cent of GDP

Debt service costs are R267 million lower than projected, bringing total Government expenditure to R291,8 billion and the deficit to R18,5 billion, or 1,6 per cent of GDP.

Fiscal framework for the 2003 MTEF

The fiscal framework for the 2003 MTEF provides for strong real non-interest expenditure growth averaging 4,7 per cent a year, supported by a stable revenue performance, a continuing decline in debt service costs, and a deficit of 2,0 per cent by 2005/06.

Developments on revenue, expenditure, financing and debt trends over the period are set out below.

Main budget revenue and expenditure

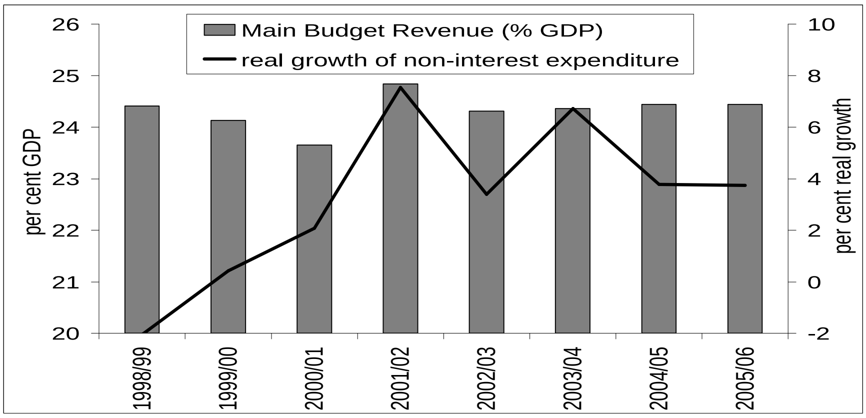
Figure 3.1 illustrates the key MTEF revenue and expenditure trends: revenue as a percentage of GDP and real non-interest expenditure growth.

Main budget revenue comprises gross tax receipts collected by SARS (including the skills development levy), non-tax revenue collected by national government departments, less transfers to our Customs Union partners. Details are set out in Chapter 4.

Main budget revenue constant at 24,4 per cent of GDP

Main budget revenue for 2003/04 is projected at R302,1 billion, rising to R358,3 billion in 2005/06, and remaining constant over the period at 24,4 per cent of GDP.

Figure 3.1: Non-interest expenditure and revenue 2001/02 to 2005/06



4,7 per cent real expenditure growth over 2003 MTEF

The fiscal framework continues to provide robust real growth in non-interest expenditure over the next three years. Total non-interest spending rises from R278,0 billion in 2003/04 to R330,2 billion in 2005/06.

R84,9 billion more to address social and economic needs…

In total, R79,0 billion of new money has been made available above the 2002 allocations, over the 2003 MTEF. Together with R5,9 billion set aside for infrastructure development, which was announced in the 2002 Budget but unallocated until now, the framework makes provision for R84,9 billion over baseline to address social and economic needs.

…taking into account higher inflation…

Of this, R27,8 billion is set aside to cater for the effects of inflation, primarily for social grants and increases in personnel expenditure.

… as well as new policy priorities

A further R57,1 billion is set aside to meet new policy priorities. This includes R5,9 billion in allocations to infrastructure, as part of the infrastructure allocations announced but not allocated at the time of the 2002 Budget.

Key goals for the 2003 MTEF are set out in chapter 5, and include continued emphasis on infrastructure development, increased allocations towards land restitution, recurrent expenditure in the health and education sectors, increased allocation to the restructuring of higher education, improved courts administration, and increases to social grants.

As in previous years, a contingency reserve is set aside for each year of the new MTEF. The purpose of this allocation is to respond to adverse natural or economic occurrences that have the potential to threaten the budget framework. In addition, in future years, half the reserve is drawn for new spending priorities identified by Government.

Contingency reserve back to R2 billion, R4 billion and R8 billion

In the 2002 Budget, R3,3 billion, R5 billion and R9 billion were set aside for the 2002 MTEF, in order to take account of unforeseen inflation. For the 2003 Budget the contingency reserve is lowered to R2 billion in 2003/04, R4 billion in 2004/05 and R8 billion for 2005/06, in line with past practice.

The deficit

Declining debt service costs, and low deficits in previous years have made possible the expansion of fiscal policy under adverse global conditions, without the imposition of a higher tax burden on the economy, nor significant added recourse to the capital markets.

While the main budget deficit in 2002/03 is expected to be 0,5 per cent of GDP below the level forecast at the time of the 2002 Budget, the deficits on the main budget for the 2003 MTEF have been revised upwards in order to accommodate stronger real expenditure over the period.

Deficit of 2,2 per cent of GDP for 2003/04

The deficit rises from R27,3 billion in 2003/04 to R29,8 billion in 2005/06. In percentage GDP terms this represents a steady decline from 2,2 per cent to 2,0 per cent, and remains well within prudent limits.

Financing and debt trends

The National Treasury is responsible for financing the main budget borrowing requirement, which comprises the deficit, adjusted for extraordinary receipts and payments.

Borrowing requirement rises to R33,8 billion in 2005/06

The net borrowing requirement of the main budget, which adds each year to the stock of national government debt, is projected to increase from R29,3 billion in 2003/04 to R33,8 billion in 2005/06.

Stock of debt declines to 37,7 per cent of GDP

The end-of-year stock of total government net loan debt is expected to rise from R475,7 billion to R552,4 billion over the same period, which represents a decline as a percentage of GDP from 38,4 per cent to 37,7 per cent, down from a high of 47,5 per cent in 1998/99, as shown in table 3.4 below.

This percentage decline in debt stock takes into account the revaluation of foreign debt and debt-buybacks. In addition, it makes provision for up to R28 billion in settlement of losses on forward contracts, recorded on the Gold and Foreign Exchange Contingency Reserve (GFECR) Account. The latter is set out in more detail in the box below.

Debt service costs decline to 3,9 per cent of GDP in 2005/06

The addition of R28 billion to government's debt stock would add to the cost of servicing debt. Nonetheless, these costs are expected to continue their decline from 4,2 per cent of GDP in 2002/03 to 3,9 per cent of GDP in 2005/06.

South Africa's foreign debt is moderate by international standards. This serves to insulate the fiscal framework from external shocks, minimising the risk of higher debt service costs in the face of increased financial market instability.

Table 3.4 Total government debt, 1998/99–2005/06

As at end of fiscal year	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
R billion					**Estimate**	**Medium-term estimate**		
Marketable domestic debt	344,9	354,7	365,1	348,5	349,4	373,4	415,7	447,6
Non-marketable domestic debt	2,0	1,0	2,4	2,0	2,2	1,7	1,6	1,5
Total domestic debt	346,9	355,7	367,5	350,5	351,6	375,1	417,3	449,1
Total foreign debt	16,3	25,8	32,0	82,0	96,6	112,6	100,2	109,3
Total gross loan debt	**363,2**	**381,5**	**399,5**	**432,5**	**448,2**	**487,7**	**517,5**	**558,4**
Percentage of GDP	*48,2%*	*46,5%*	*43,9%*	*43,7%*	*41,4%*	*39,3%*	*38,2%*	*38,1%*
Less: National Revenue Fund balance	-5,2	-7,3	-2,7	-6,5	-4,0	-12,0	-6,0	-6,0
Total net loan debt[1]	**358,0**	**374,2**	**396,8**	**426,0**	**444,2**	**475,7**	**511,5**	**552,4**
Percentage of GDP	*47,5%*	*45,6%*	*43,6%*	*43,0%*	*41,0%*	*38,4%*	*37,8%*	*37,7%*

1. The total net government loan debt is calculated after taking account of the cash balances of the National Revenue Fund.

Foreign debt declines to 7,5 per cent of GDP over the 2003 MTEF

Foreign debt as a percentage of gross government debt is projected at 23,1 per cent for 2003/4 declining to 19,6 per cent in 2005/6. As a percentage of GDP, this represents a decline from 9,1 per cent to 7,5 per cent. Total financial guarantees by Government stood at R70,3 billion at the end of financial year 2001, down from R79,0 billion at the end of financial year 2000.

Settlement of losses on the Gold and Foreign Exchange Contingency Reserve (GFECR) Account

The GFECR Account records the cumulative profits and losses of the Reserve Bank from its forward foreign exchange transactions and revaluation of its gold and foreign reserves.

A forward contract is a transaction involving the future sale or purchase of foreign currency at a pre-agreed exchange rate at a certain future date. The Reserve Bank either settles these forward contract at the time that delivery of foreign currency is required, or ‘rolls over’ these contracts – that is, enters into new contracts in lieu of payment.

Historically, the Reserve Bank entered into these contracts in order to provide forward cover to South African importers and exporters, as a form of insurance against currency fluctuations. In terms of these contracts, the Reserve Bank would guarantee the delivery of dollars or rands at a fixed price in the future, and assume the risk of losses or gains should the rand / dollar rate differ from the specified forward rate.

In the past, the Reserve Bank also used forward contracts in order to intervene in the foreign exchange markets, especially in its defence of the rand during the 1997/98 global financial crisis. The forward book – which records the sum of the forward contracts entered into by the Bank - increased from $17,5 billion at the end of April 1998 to $25,3 billion in September 1998.

In 1998, a policy decision was taken to cease using the forward book for foreign exchange interventions, and to reduce the book over time. In particular, it was decided that the excess of the forward book over reserves – or the ‘Net Open Forward Position’ (NOFP) – would be eliminated.

Since 1998, the Reserve Bank has significantly reduced the NOFP, by settling its forward contracts with dollars obtained through capital inflows to South Africa, including privatisation proceeds and increased foreign borrowing by the National Treasury.

At 31 September 2002 the forward book had been reduced to $6,9 billion, while the NOFP stands at $1,7 billion. However, due to the depreciation of the rand, the Reserve Bank has incurred significant losses in settling its obligations on the forward book – that is, the rand cost to the Reserve Bank of buying dollars in order to pay back the parties with which it had entered into forward contracts has been greater than the rand value of the dollars it had initially agreed to receive from the holders of these contracts.

In settlement of losses arising from the Reserve Bank’s reduction of the forward book, the National Treasury issued the Bank with a R7 billion payment of zero coupon bonds in September this year. The fiscal framework makes provision for a maximum of R28 billion in such payments, spread over four years, pending agreement on the total amount that is for the account of the fiscus, in terms of the South African Reserve Bank Act, 1989. A timetable for converting these bonds into fixed income instruments will be negotiated.

The consolidated national budget

The consolidated national budget is summarised in table 3.5. It consists of the finances of the National Revenue Fund, outlined above and set out in table 3.3, the RDP Fund and receipts and disbursements through foreign technical cooperation and the social security funds.

Estimates of receipts on the RDP fund and through foreign technical cooperation remain constant over the course of the MTEF at R800 million, as do disbursements, at R750 million.

In addition to the revenue appropriated in provincial social development votes for South Africa's principle social security benefits (the old age grants, disability payments and family and child grants), mandatory levies and taxes provide revenue for four social security funds - the Road Accident Fund, the Workmen's Compensation Fund, the Mines and Works Compensation Fund and the Unemployment Insurance Fund (UIF).

Table 3.5 Consolidated national budget framework, 2001/02–2005/06

	2001/02	2002/03		2003/04	2004/05	2005/06
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
National Revenue Fund (main budget)						
Revenue	**248 262**	**265 217**	**273 281**	**302 102**	**330 338**	**358 323**
Expenditure						
Interest on debt	47 571	47 503	47 236	51 463	54 599	57 853
Percentage of GDP	*4,8%*	*4,4%*	*4,2%*	*4,1%*	*4,0%*	*3,9%*
Contingency reserve	–	3 300	–	2 000	4 000	8 000
Allocated expenditure[1]	215 103	237 106	244 517	275 955	299 825	322 247
Total	**262 674**	**287 909**	**291 753**	**329 418**	**358 424**	**388 100**
Percentage increase	*12,3%*	*9,6%*	*11,1%*	*12,9%*	*8,8%*	*8,3%*
Surplus (+)/deficit (-)	**-14 412**	**-22 692**	**-18 472**	**-27 316**	**-28 085**	**-29 777**
Percentage of GDP	*-1,4%*	*-2,1%*	*-1,6%*	*-2,2%*	*-2,1%*	*-2,0%*
RDP Fund & foreign technical cooperation						
Receipts & technical cooperation	967	800	800	800	800	800
Disbursements	600	700	700	750	750	750
Social security funds						
Revenue	8 614	9 558	10 483	11 434	11 908	12 823
Expenditure	8 182	9 114	10 045	9 823	10 565	11 702
Consolidated national budget[2]						
Revenue	**257 219**	**275 236**	**284 225**	**314 067**	**342 876**	**371 766**
Expenditure	**270 832**	**297 384**	**302 159**	**339 721**	**369 569**	**400 372**
Percentage of GDP	*27,1%*	*27,5%*	*26,9%*	*27,4%*	*27,3%*	*27,3%*
Percentage increase	*11,8%*	*9,8%*	*11,6%*	*12,4%*	*8,8%*	*8,3%*
Surplus (+) or deficit (-)	**-13 613**	**-22 148**	**-17 934**	**-25 655**	**-26 693**	**-28 606**
Percentage of GDP	*-1,4%*	*-2,0%*	*-1,6%*	*-2,1%*	*-2,0%*	*-2,0%*
Gross domestic product	*999 409*	*1 082 800*	*1 124 032*	*1 240 156*	*1 351 630*	*1 466 135*

1. Includes transfers to provinces and local government, the National Skills Fund and sectoral skills development funds.

2. Flows between funds are netted out.

Table 3.6 Social security funds 1999/00 – 2005/06[1]

R million	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Road Accident Fund							
Income	2 361	2 344	2 628	3 429	3 560	3 707	4 313
Expenditure	2 294	2 655	3 213	3 671	3 970	4 356	5 000
Surplus(+) / Deficit(-)	67	- 311	- 585	- 242	- 410	- 649	- 686
Compensation funds							
Income	1 937	1 910	2 071	2 238	2 429	2 544	2 673
Expenditure	1 140	1 376	1 424	1 732	1 772	1 884	2 117
Surplus(+) / Deficit(-)	796	534	647	506	657	661	556
Unemployment Insurance Fund							
Income	2 778	2 831	3 914	4 816	5 445	5 656	5 836
Expenditure	3 201	3 359	3 544	4 642	4 081	4 326	4 585
Surplus(+) / Deficit(-)	- 423	- 528	370	175	1 364	1 331	1 251
Total social security funds							
Income	7 076	7 084	8 614	10 483	11 434	11 908	12 823
Expenditure	6 635	7 390	8 182	10 045	9 823	10 565	11 702
Surplus(+) / Deficit(-)	441	- 306	432	438	1 611	1 343	1 121

1. Social security numbers do not correspond exactly to SA Reserve Bank figures due to timing differences.

Table 3.6 above sets out the revenue and expenditure of South Africa's social security funds.

RAF continues to show deficit

The Road Accident Fund pays compensation to victims of road accidents caused by third parties, and makes contributions to road safety projects. The Fund continues to show an operational cashflow deficit, expected to widen from R242 million in 2002/03 to R686 million in 2005/06.

Compensation Funds show annual surpluses of around R550 million

The Workman's Compensation Fund and the Mines and Works Compensation Fund pay compensation for injuries, disease or death in the course of employment. Revenues are raised through assessed levies on companies, and are administered by the Department of Labour. The funds show healthy surpluses into the 2003 MTEF of approximately R550 million per year.

UIF reforms to bring R1 billion surpluses

The Unemployment Insurance Fund (UIF) provides for short-term income replacement in the event of unemployment, short-term sickness, death, maternity or adoption of a child.

The UIF has undergone considerable reform in recent years. This year the Unemployment Insurance Act was passed, strengthening the administration of the UIF, targeting benefits towards the poor more effectively and extending the scheme's coverage.

Together with revenue injections, these measures are expected to render the Fund financially viable and self-sustainable. Extension of the fund's coverage will see higher expenditures in 2002/03, with a step-decline in 2003/04 as new regulations curb abuse of the fund. Annual surpluses in excess of R1 billion are forecast for the 2003 MTEF.

Major aggregates constant as a percentage of GDP over the MTEF

All the major aggregates on the consolidated national framework are expected to remain roughly constant as a percentage of GDP over the 2003 MTEF.

Total spending in terms of the consolidated national framework is estimated at R339,7 for 2003/04, rising to R400,4 billion in 2005/06. This represents a marginal decline as a percentage of GDP, from 27,4 per cent to 27,3 per cent.

Total revenue on the consolidated national framework rises from R314,1 billion to R371,8 billion over the MTEF, or 25,3 per cent of GDP to 25,4 per cent.

The deficit on the consolidated framework falls from 2,1 per cent to 2,0 per cent of GDP over the MTEF.

Consolidated general government accounts and the PSBR

The public sector borrowing requirement includes the consolidated general government deficit and the financing requirements of the non-financial public enterprises. It takes into account extraordinary expenditure items and the proceeds from the restructuring of state enterprises.

Table 3.7 summarises these balances since 2001/02 and provides projections to 2005/06.

PSBR at 2,6 per cent of GDP by 2005/06

The PSBR has dropped sharply from its peak, at 4,2 per cent of GDP in 1997/98, to an estimated 1,6 per cent in 2002/03, mainly due to the narrowing main budget deficit. The PSBR is expected to widen to 2,6 per cent at the end of the 2003 MTEF.

The largest contributor to the public sector borrowing requirement is the national budget deficit, which is adjusted for extraordinary payments and receipts and financed through the borrowing activity of the National Treasury.

R13 billion in privatisation receipts over the 2003 MTEF

Extraordinary receipts primarily record the proceeds from the restructuring of state owned enterprises. This is expected to generate R5 billion in both 2003/04 and 2004/05, and R3 billion in 2005/06, reducing the borrowing requirement on the main budget over the 2003 MTEF by a total of R13 billion.

Table 3.7 Public sector borrowing requirement - medium term projections

R billion	2001/02 Outcome	2002/03 Budget	2002/03 Revised	2003/04	2004/05	2005/06
				Medium term estimates		
Main budget deficit	**14,4**	**22,7**	**18,5**	**27,3**	**28,1**	**29,8**
Extraordinary payments	2,1	1,6	8,6	7,0	7,0	7,0
Extraordinary receipts	-4,7	-12,0	-12,0	-5,0	-5,0	-3,0
Main budget borrowing	**11,8**	**12,3**	**15,1**	**29,3**	**30,1**	**33,8**
Other government borrowing[1]	-5,3	3,1	3,1	1,5	2,0	2,5
General government borrowing	**6,5**	**15,3**	**18,1**	**30,8**	**32,1**	**36,3**
per cent of GDP	*0,7%*	*1,4%*	*1,6%*	*2,5%*	*2,4%*	*2,5%*
Plus:						
Non-financial public enterprises	-2,3	-0,5	-0,5	0,3	1,1	1,2
Public sector borrowing requirement	**4,2**	**14,9**	**17,7**	**31,1**	**33,2**	**37,5**
per cent of GDP	*0,4%*	*1,3%*	*1,6%*	*2,5%*	*2,5%*	*2,6%*

1. Social security funds, provinces, extra-budgetary institutions and local government.

Extraordinary payments include provision for annual payments of up to R7 billion to offset losses on the GFECR Account.

General government borrowing constant at approximately 2,5 per cent of GDP

Other government borrowing increases the general government's borrowing requirement by an additional R1,5 billion in 2003/04, rising to R2,5 billion in 2005/06. These projections represent increased capacity in restructured municipalities and a reduction in cash balances in order to finance increased service delivery. Overall, borrowing by general government remains constant over the MTEF at approximately 2,5 per cent of GDP.

Borrowing by the non-financial public enterprises is expected to increase moderately over the course of the MTEF, reflecting increased investment following the sector's negative contribution to gross fixed capital formation in recent years.

Conclusion

Fiscal policy continues to prioritise growth and development within a sustainable budget framework. Emphasis is given to infrastructure development, land restitution, enhanced service-delivery, particularly in the health and education sectors, and to increased social grants.

Robust expenditure growth serves to bolster the economy in an uncertain global environment, enhancing the capacity of South Africa to generate jobs and incomes, and redistributing resources to the most vulnerable.

4

Taxation

National revenue this year is expected to exceed the February budget estimate by R8,1 billion. This reflects continued improvements in tax administration, together with the positive revenue impact of higher than anticipated GDP inflation.

The robust revenue trend will allow for further tax relief measures in the year ahead, which in turn strengthens the economic growth outlook. A moderate reduction in the personal income tax burden on lower and middle-income earners will be implemented.

Phased reforms of the taxation of retirement savings and the pension fund industry will be proposed next year. Other tax issues under consideration currently include the introduction of a royalty charge in keeping with the Mineral and Petroleum Resources Development Act, further encouragement of investment and technology advancement and measures affecting the sustainability of environmental development.

Introduction

Revenue buoyancy due to tax base growth

Revenue performance continues to exceed budget expectations, as has been the case for the past six fiscal years. This has partly been due to higher GDP growth and higher incomes than estimated at the time of the budget. In addition, improvements in tax administration and focused compliance measures, supported by base-broadening tax policy proposals, have strengthened revenue buoyancy.

Tax measures to improve economic performance made possible by robust revenue growth

Strong revenue growth has made it possible to lower tax rates for companies and individuals. By lowering marginal income tax rates, particularly in lower and middle income brackets, the distorting effect of tax on work and investment decisions is reduced.

Moreover, tax incentives for manufacturing assets have been introduced to encourage investment projects with significant direct and indirect benefits for the South African economy. The contribution of private sector participation in infrastructure development has been recognised by the introduction of internationally attractive depreciation rates for assets of a permanent nature.

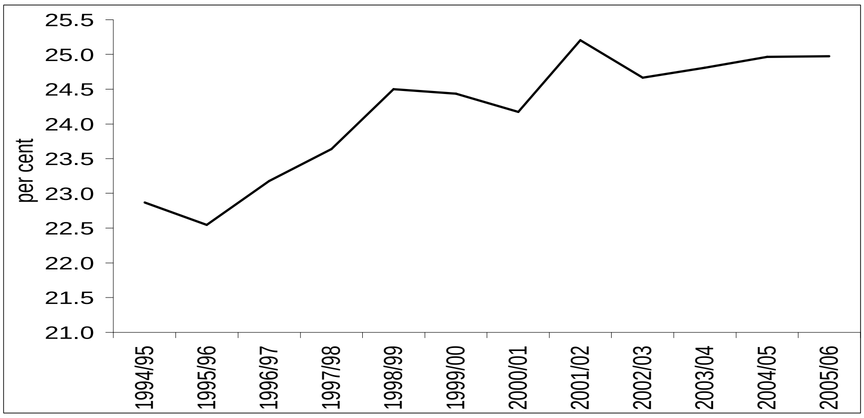
Revenue trends and projections

General government tax to GDP ratio of 27 per cent

As set out in Chapter 3, South Africa's overall tax to GDP ratio – including tax receipts of social security funds, provinces and local government – is stable at approximately 27 per cent of GDP.

Figure 4.1 below shows that taxes collected on the national budget (including taxes collected on behalf of other Customs Union members, but excluding non-tax revenue) have increased as a share of GDP since 1994/95, due to improvements in the efficiency of tax collection and the buoyancy of the tax base. The gross tax to GDP ratio is projected to stabilise between 24 and 25 per cent over the MTEF period ahead.

Figure 4.1: Gross tax revenue to GDP ratio 1994/95 to 2005/06



Income tax reforms implemented since 1995 include the following:

Internationally attractive income tax rate reductions

- Personal income tax relief since 1995 totalling nearly R50 billion.
- Reduction of the top marginal tax rate for individuals from 45 per cent in 2000 to 40 per cent in 2002.
- Reduction of the corporate tax rate to 30 per cent in 1999, in line with international trends. In the event of a 100 per cent profit distribution, the combined corporate and secondary tax burden on companies is 37,8 per cent, thereby minimising tax arbitrage between the maximum tax rate on individuals and corporations.

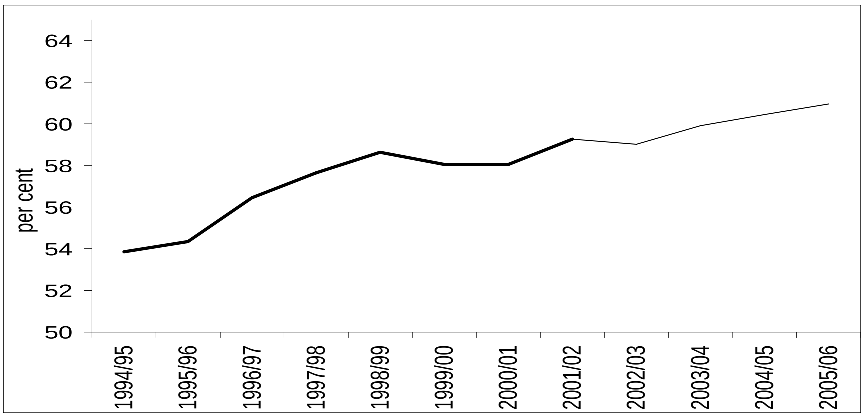
Figure 4.2 below illustrates the increasing contribution of direct taxes as a percentage of total tax revenue. This reflects the rise in revenue collections from the corporate sector from 13,3 per cent in 1994/95 to 16,8 per cent in 2001/02. Revenue from personal income tax decreased to 35,8 per cent last year, and is expected to remain at around 36 per cent of tax revenue over the next three years.

Secondary tax on corporations increased from 1,2 per cent of total tax revenue in 1994/95 to 2,9 per cent in 2001/02 but is expected to stabilise at about 2,6 per cent by 2005/06.

VAT decreased from 25,7 per cent of total tax revenue in 1994/95 to 24,3 per cent of total tax revenue in 2001/02. It is expected to increase to approximately 25 per cent in 2005/06.

Specific excise duties declined from 5,1 per cent of total tax revenue in 1994/95 to 3,8 per cent in 2001/02 and are expected to decline to 3,1 per cent in 2005/06, before adjusting the excise rate structure for inflation. Revenue from the fuel levy declined as a percentage of total tax revenue from 7,3 per cent in 1994/95 to 5,9 percent in 2001/02 and will further decline to 4,5 per cent in 2005/06, in the absence of adjustments for inflation.

Figure 4.2: Direct taxes as a percentage of total tax revenue (1994/95 to 2005/06



National budget revenue, 2001/02

Buoyancy in income tax collections due to high export earnings

In the 2001 Budget, total main budget revenue of R233,4 billion was estimated for 2001/02. A revised estimate of R248,4 billion was published in the 2002 Budget. The preliminary outcome of R248,3 billion was marginally below this, at 24,8 per cent of GDP, compared with the original budget estimate of 23,6 per cent. The R14,8 billion gain in revenue can largely be ascribed to higher profits of export companies as a result of strong world commodity prices and the sharp depreciation of the rand during 2001.

Above expectation corporate profits and dividend distributions

The main deviations from the budget estimates were:

- Company taxes – R12,4 billion higher
- Secondary tax on companies – R2,96 billion higher
- Value added tax – R707 million higher
- Levies on fuel – R387 million lower
- Taxes on international trade and transactions – R748 million lower
- Departmental receipts – R594 million lower.

Table 4.1 National budget revenue, 2001/02 estimates and outcome

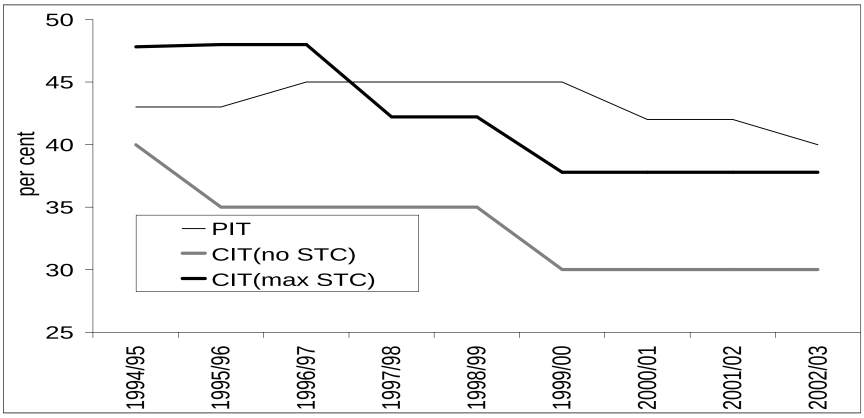
R million	Budget estimate	Revised estimate	Outcome
Taxes on income and profits	**134 382**	**152 350**	**150 028**
Persons and individuals	90 122	91 000	90 390
Companies	29 960	44 000	42 354
Secondary Tax on Companies	4 200	6 700	7 163
Other	10 100	10 650	10 121
Taxes on property	**4 709**	**4 452**	**4 629**
Domestic taxes on goods and services	**86 740**	**84 342**	**86 853**
Value-added tax/sales tax	60 350	58 600	61 057
Specific excise duties	9 802	9 561	9 797
Levies on fuel	15 310	14 988	14 923
Other	1 278	1 193	1 076
Taxes on international trade and transactions	**9 427**	**9 211**	**8 680**
Stamp duties and fees	**1 585**	**1 850**	**1 767**
Miscellaneous[1]	**–**	**–**	**305**
Total tax revenue	**236 843**	**252 205**	**252 261**
Non-tax revenue and repayments	4 800	4 447	4 206
Less: SACU payments	8 205	8 205	8 205
Main budget revenue	**233 438**	**248 447**	**248 262**

1. Receipts not yet classified.

National budget revenue: medium term estimates

The 2002 Budget revenue estimates have been updated to take account of the strong revenue performance in 2001/02, the revenue collection trend during the first two quarters of 2002/03 and the revised macroeconomic forecast set out in Chapter 2. These projections are presented in Table 4.3.

Figure 4.3: Maximum corporate and individual income tax rates



The revised estimate of main budget revenue is R273,3 billion, which is R8,1 billion more than the original estimate. Estimates of total tax revenue are increased by 3,2 per cent to R277,2 billion. This can largely be ascribed to the following:

- Personal income tax is increased by R2,6 billion due to higher than originally budgeted wage settlements.

- Company tax has been raised by R500 million to R51,4 billion and secondary tax on companies has been increased by R700 million to R7,2 billion, reflecting buoyant company earnings and rising dividend distributions.
- Value-added tax has been increased by R3,8 billion to R70 billion, evidencing the higher value of consumption expenditure due to the general increase in prices.
- Departmental receipts have been reduced by R687 million mainly due to lower property income.

Upward revisions to SACU payments

Taking into account growth in trade and revised projections of country imports, projected payments to Botswana, Lesotho, Namibia and Swaziland in terms of the Customs Union agreement have been revised upwards to R9,8 billion in 2003/04 and R11,8 billion in 2004/05.

Table 4.2 National budget revenue - medium term estimates

R billion	2001/02 Outcome	2002/03 Budget estimate	2002/03 Revised estimate	2003/04	2004/05	2005/06
				Medium term estimates		
Taxes on income and profits	**150,0**	**158,7**	**163,1**	**183,7**	**203,3**	**222,5**
Persons and individuals	90,4	90,0	92,6	106,1	118,3	130,2
Companies	42,4	50,9	51,4	56,7	61,8	67,1
Secondary Tax on Companies	7,2	6,5	7,2	7,9	8,8	9,4
Other	10,1	11,4	11,9	13,0	14,5	15,8
Taxes on property	**4,6**	**4,6**	**5,4**	**5,9**	**6,7**	**7,3**
Domestic taxes on goods and services	**86,9**	**92,8**	**96,8**	**105,1**	**113,2**	**121,0**
Value-added tax/sales tax	61,1	66,2	70,0	77,4	84,4	91,5
Specific excise duties	9,8	10,2	10,2	10,6	11,0	11,3
Levies on fuel	14,9	15,2	15,2	15,6	16,2	16,4
Other	1,1	1,3	1,4	1,5	1,6	1,8
Taxes on international trade and transactions	**8,7**	**10,6**	**10,4**	**11,3**	**12,2**	**13,3**
Stamp duties and fees	**1,8**	**1,8**	**1,6**	**1,7**	**2,0**	**2,1**
Miscellaneous[1]	**0,3**	–	–	–	–	–
Total tax revenue	**252,3**	**268,5**	**277,2**	**307,7**	**337,4**	**366,1**
Non-tax revenue and repayments	4,2	5,0	4,3	4,3	4,8	5,0
Less: SACU payments	8,2	8,3	8,3	9,8	11,8	12,8
Main budget revenue	**248,3**	**265,2**	**273,3**	**302,1**	**330,3**	**358,3**
per cent of GDP	*24,8%*	*24,5%*	*24,3%*	*24,4%*	*24,4%*	*24,4%*
Changes from 2002 Budget						
Total tax revenue			8,7	15,8	21,0	
Main Budget Revenue			8,1	13,4	17,1	

1. Receipts not yet classified.

Implementation of 2002 Budget proposals

Wide range of tax relief measures in support of economic growth

The 2002 Budget will be remembered for its significant tax relief, including:

- R15 billion in personal income tax cuts

- Substantial increases in interest income exemption levels for individuals
- Accelerated depreciation allowances for manufacturing assets
- Extension of small business corporations tax relief
- Downward adjustment of the transfer duty rate structure
- Removal of stamp duties on certain financial transactions
- Exemption of certain warrant repurchases from MST and UST
- Increase of certain monetary thresholds to take account of the effects of inflation
- Introduction of discounted fuel levy for environmentally friendly alternative diesel fuel.

During the course of 2002, these policies were refined and set out in the Revenue Laws Amendment Bills tabled before Parliament in June and in October.

Learnership allowance

Incentives for skills training and employment

The learnership allowance was provided for in the 2002 Taxation Laws Amendment Act, in terms of which firms are allowed an additional deduction when they enter into a learnership agreement and when the learner successfully completes the learnership programme. Employers are entitled to the following additional deductions:

- For learnership agreements with "previously unemployed learners":
  - Upon entering the learnership, an amount equal to the allowances paid to the learner, limited to R25 000
  - Upon completion of the learnership, an amount equal to the allowances paid to the learner, limited to R25 000.
- For learnership agreements with learners already employed by the particular employer:
  - Upon entering the learnership, an amount equal to the 70 per cent of the allowances paid to the learner, limited to R17 500
  - Upon completion of the learnership, an amount equal to the allowances paid to the learner, or R25 000.

To date, 285 new learnership programmes have been registered with the Department of Labour covering 24 of the 25 Sector Education and Training Authorities. At the end of August, there were just over 15 000 learners participating in this programme, of which approximately one third were previously unemployed.

Strategic Investment Programme

R3 billion of tax revenue foregone to promote accelerated investment and job creation

In the 2002 Budget, details were provided relating to qualification for the strategic investment programme, which awards for qualifying manufacturing assets an additional capital allowance of 50 or 100 per cent. The incentive programme targets industrial investment projects with significant direct and indirect benefits and linkages in respect of the South African economy.

The Adjudication Committee has considered seven applications for this incentive and has awarded incentives to five projects to date. These projects entail investment of R2 billion, with anticipated revenue foregone over the life of the projects of R425,9 million. It is estimated that these projects will create 10 573 direct and indirect jobs.

Public Benefit Organisations (PBOs)

Significant tax relief for the not-for-profit sector primarily in support of the poor and needy and HIV/Aids infected people

Since the 2000 Budget, Government has sought to privilege fiscally PBO activities that include welfare and humanitarian services, provision of health care, education and development, land and housing, promotion of religion or beliefs, cultural organisations, conservation, environment and animal welfare, research and sport. These activities must primarily benefit the poor or needy, HIV/Aids-affected people, the disabled, the aged, orphaned children and abused persons.

Government has raised the threshold for tax-deductible donations by individuals, has significantly broadened the range of PBOs eligible for tax-deductible donations, and has broadened the list of public benefit activities in which an organisation must be involved to obtain tax-exempt status. SARS has also published a new application form for PBOs wishing to apply for tax-exempt status.

The amended legislation, as well as the expanded list of organisations qualifying for tax exemption and tax deductibility of donations for donors, was published in the Government Gazette of 5 August 2002. The Minister has also signed into law regulations governing the peace parks, bursaries and scholarships.

During 2002, Government received further requests from several organisations seeking to qualify for tax deductibility on donations. A review of applications for inclusion will continue in the period ahead.

Business accommodation and subsistence allowances

The rules for deducting business-related accommodation and subsistence expenses were altered over the course of 2002. As a general rule, all accommodation and subsistence costs can now be deducted only if the taxpayer provides receipts for those expenditures, thereby preventing taxpayers from artificially disguising salary bonuses as accommodation and subsistence allowances.

Effective deeming provisions that seek to minimise administrative and compliance burdens

Strict adherence to the requirement to retain receipts for subsistence and meals, however, is administratively onerous for both taxpayers and SARS, and has unintended incentive effects. Taxpayers who can claim tax benefits from miscellaneous expenses during business travel cannot be expected to economise on such outlays. SARS lacks the administrative wherewithal to review these expenses. In recognition of these concerns, the 2002 October Revenue Laws Amendment Bill contains a deeming provision that dispenses with the need to retain receipts where taxpayers receive advance subsistence and meal allowances. This replaces the prior provision, which had become too restrictive in the light of present price levels. Under this new regime:

- Advanced allowances for subsistence and meals can be provided at US$190 per day for business trips outside South Africa.
- Advanced allowances for subsistence and meals can be provided at R173 per day for business trips inside South Africa.
- Advanced allowances for subsistence (only) can be provided at R53 per day for business trips inside South Africa.

These amounts will be adjusted annually by Ministerial notice in the Gazette.

Company reorganisations

Reorganisations promote more efficient business operations

Company reorganisations are a vital element in evolution of the economy because they promote more efficient business structures. The National Treasury introduced a special dispensation for domestic company reorganisations in October 2001, providing comprehensive rollover relief from the income tax, capital gains tax, secondary tax on companies, and certain financial transaction taxes. The granted tax relief ensures that the South African tax system remains competitive with other international tax systems offering similar tax treatment.

The initial tax rules provided relief for company formations, share-for-share acquisitions, intra-group transfers, unbundlings, and liquidations. This relief, however, was somewhat limited due to the complexity involved and concerns that company reorganisations could be used for unintended tax avoidance. For example, the initial reorganisation regime did not provide relief for financial institutions due to the ongoing banking review.

Expansion of internationally attractive tax preferences in support of reorganisations

After further extensive review, relief for company reorganisations was expanded as part of the 2002 technical corrections process. First and foremost, the exclusion for financial institutions was removed. The banking review revealed that the low effective rate stems largely from preferred share and lease stripping schemes, and transactions in derivatives. None of these schemes require company reorganisations as a prerequisite. Second, the new rollover relief is more comprehensive, covering all tax attributes associated with assets transferred rather than a select few. Third, a series of unnecessary anti-avoidance mechanisms were removed to the extent that these were viewed as superfluous. Finally, on the request of taxpayers, amalgamations have become a tax-free rollover event.

Fuel levy on environmentally friendly fuels

The legislative provisions to implement the 30 per cent concession in respect of fuel levy for bio-fuels, such as bio-diesel, will be incorporated into the October Revenue Laws Amendment Bill, 2002. Several inter-departmental meetings and consultations with the agricultural sector were held during the past eight months to discuss the economics of the production of bio-diesel. In addition, the Departments of Art, Culture and Science and Mineral and Energy have commissioned a study to investigate the viability of producing bio-diesel and to assess the macro-economic benefits of a bio-diesel industry in South Africa.

Tax policy for the 2003 Budget

Personal income tax relief

The 2003 Budget will again provide income tax relief, including moderate reductions in the tax burden on individuals in the lower and middle-income brackets.

Taxation of retirement savings

Wide consultations and industry input

In his 2002 Budget speech, the Minister announced a thorough review of the taxation of retirement savings. A discussion document was accordingly prepared, which served as the basis for a conference held in September 2002. At the conference, industry, academia, and international experts were fully consulted by an official task team with a view to considering various options for reform.

Principles informing review process

In formulating proposals to revise the taxation of retirement savings, the task team – led by the National Treasury – aims to:

- Encourage long-term retirement savings
- Facilitate post-retirement income security

- Enhance equitable distribution of government resources in terms of tax expenditure and social grants to the aged
- Enhance the efficiency and neutrality among the various options for employing domestic savings
- Promote revenue stability and accountability for the provision of tax expenditures.

Proposed legislation will be released for wider consultation in the upcoming year with the expectation of enactment into law during 2004.

Considering tax measures in support of investor confidence

Government's structural monetary, fiscal, financial and trade reforms complement tax measures to support investment

Government recognises the critical role of the tax structure in supporting investor confidence, reducing country risk and encouraging productive capital formation across the economy. Together with monetary and fiscal reforms, development of our financial markets and trade liberalisation since 1994, tax reform has contributed to improving the investment environment and enhancing the growth outlook.

Role of tax measures in support of investment under review

As announced in the 2002 Budget, manufacturing assets acquired between March 2002 and February 2005 now receive the benefit of accelerated depreciation (40 per cent in the first year and 20 per cent in each of the following three years). This has contributed to the stimulation of investment in our increasingly internationally competitive manufacturing sector. With a view to deepening and broadening productive capital formation and extending research and development for technology advancement in South African industry, consideration is currently being given to the possible role of tax measures to support investment in other sectors.

South Africa's Mineral and Petroleum Royalty Bill

Royalties serve as consideration for extraction rights

In line with international practice, it is appropriate that a consideration for the extraction of non-renewable mineral resources should accrue to the state to assist in meeting the government's economic and social development obligations.

Certainty for investors

A draft bill will be published shortly containing a proposed structure and design of a mineral and petroleum royalty system for South Africa. In keeping with the provisions of the Minerals and Petroleum Resources Development Act, it will apply to persons that apply and qualify for new mineral right-holder status. This significant step forward in our tax structure will bring fiscal certainty to the partnership between the state and investors, underpinning the progressive evolution of our mining industry.

Value-added tax

Second most important revenue instrument

In terms of contributions to the fiscus, the broadly based value-added tax (VAT) is the second most important tax instrument in South Africa. The VAT rate has been unchanged at 14 per cent since 1993 and the overall structure of the VAT system has remained stable. The VAT system ensures that all citizens, as consumers, contribute towards the costs of public services, while also providing tax relief through zero-rating an appropriate list of basic household necessities.

More zero-ratings would complicate tax administration and bring little benefit to the poor

Government is mindful of the arguments for further VAT relief, or for a multiple-rate structure aimed at reducing the tax burden on the poor. In practice, however, this is an ineffective approach to assisting people in need and creates both administrative complexity and scope for tax avoidance and evasion. Middle and high-income earners benefit most from VAT relief as their consumption spending exceeds that of poor households. South African experience also indicates that part of the benefit of zero-rating accrues to suppliers and not the final consumer.

Government's approach to poverty reduction and development is accordingly mainly focussed on effective and well-targeted expenditure programmes, discussed further in Chapter 5.

Taxation of alcoholic beverages

Most governments impose excise taxes on alcoholic beverages, both as a means to raise revenue and to discourage excessive consumption. Furthermore, the consumption of alcoholic beverages raises issues of morality, public health, public order, public safety, competition and job creation. The imposition of alcohol taxes therefore aims to strike a balance between revenue generation, internalisation of health and social costs, revenue losses caused by the illicit production of liquor and smuggling, and the international competitiveness of the domestic alcoholic beverages industry.

Responsible consumption of alcoholic beverages can be achieved by higher excise tax burden and stricter enforcement of regulations

The National Treasury undertook an in-depth study of the taxation of alcoholic beverages in South Africa during 2001. The study highlights the increased sale of cheap wine (especially in foil bags) since the mid 1990s, which raises concerns about the effectiveness of regulations of the production and sale of such wine. These concerns must be set against the experience that most wine-producing countries impose relatively lower excise duties on natural wine compared with those on clear beer. The project also confirms that sorghum beer remains largely a traditional rural product, with a declining market share.

Based on the above study, consideration is currently being given to basing the tax burden on alcoholic beverages on targeted fixed percentages of the weighted average retail-selling price of spirits, clear beer and wine.

Fuel levy

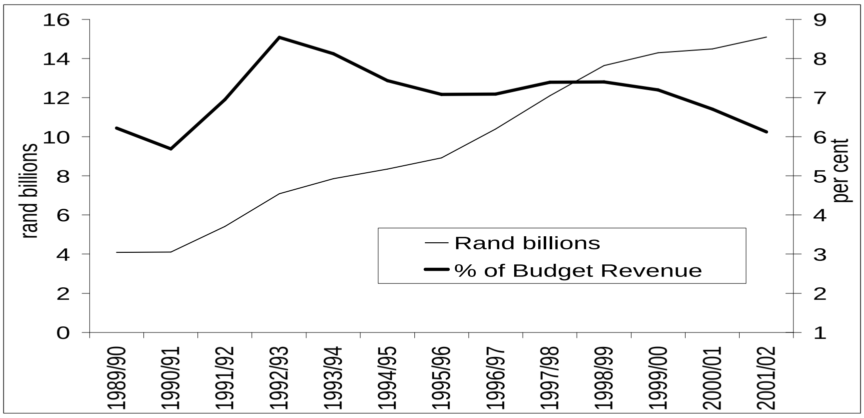
Policy goals informing level of fuel levy

In South Africa, as in other countries, fuel taxes have been imposed to achieve three broad government objectives:

- As a source of revenue for the fiscus to help finance general government expenditure programmes.
- Fuel taxes finance specific government spending, such as the creation and maintenance of road infrastructure and a third party motor vehicle insurance scheme.
- Fuel taxes allow government to achieve certain environmental goals through demand management and the promotion of efficiency in consumption.

Figure 4.4 sets out the trends in revenue collected through the general fuel levy. The declining revenue collection from the general fuel levy as a percentage of total budget revenue is largely a consequence of below-inflation adjustments to the levy. This was intended to mitigate the impact of the higher US dollar price of crude oil and the declining exchange rate on the local pump price.

Figure 4.4: General fuel levy revenue



Fuel taxes must internalise fuels' various efficiency and environmental degradation levels

Transport fuels differ with respect to their energy efficiency and in their impacts on the environment. Internationally, alternative environmentally friendly transport fuels have become increasingly important. For example, low-sulphur diesel has been proven to be environmentally superior to standard diesel, but still falls short of the environmental benefits of renewable alternative diesel fuels, such as bio-diesel and bio-ethanol. The fuel tax regime should also acknowledge that diesel fuel is more efficient than petrol.

Government aims to take appropriate account of the environmental and efficiency qualities of the various transportation fuels in determining the fuel tax structure.

Tax measures in support of sustainable development

The National Treasury has commissioned a study on environmental taxes with a view to developing sound tax policy guidelines for the possible re- alignment of environmental charges or other market-based instruments by Government and provincial and local authorities in South Africa. In broad terms the study will explore the scope for, arguments in favour of and the practicalities of imposing or restructuring environmental charges and other market-based instruments.

Regulatory and market-based instruments in support of the environment

The benefits of environmental protection need to be weighed against possible economic opportunities foregone, including growth or higher living standards, within an appropriate framework of values. Against the background of the World Summit's deliberations on sustainable development, South Africa is well placed to explore these important policy questions and possible options for appropriately aligning our long-run development path. This study aims to inform further consideration of fiscal measures in support of environmental sustainability.

Ad valorem excise duties on new motor vehicles

Ad valorem excise duties on non-essential goods in lieu of a multiple VAT rate

In the post-1994 South African fiscal policy framework, the imposition of *ad valorem* excise duties on certain "luxury" products has served as a practical alternative to an administratively complex multiple VAT rate structure. In keeping with this approach, an *ad valorem* excise duty on the sale of new motor vehicles was introduced in 1995.

High-value cars attract higher excise duty

The current formula links the rate of duty to the value of the motor vehicle, thereby achieving a progressive duty structure for new motor vehicles – higher valued motor vehicles attract a higher rate of duty. However, the current duty arrangement suffers from an element of inbuilt "fiscal drag", which may have to be addressed.

Regional tax cooperation

Southern African Customs Union (SACU)

The SACU Member States of Botswana, Lesotho, Namibia, Swaziland and South Africa concluded eight years of negotiations on a new SACU Agreement in September 2002. This makes provision for the establishment of institutions to manage the Customs Union and determine trade duties in all five member states. The Agreement provides for a new and more equitable revenue sharing formula to distribute customs and excise duties collected in the Union. It is expected that the agreement will be signed by the SACU Heads of State before the end of 2002, and that the new revenue-sharing formula will take effect in 2004/05 .

SADC Tax Subcommittee

Memorandum of understanding on taxation signed

The SADC Tax Subcommittee, chaired by South Africa, was formed in July 1999 to strengthen regional co-operation in tax matters. The Tax Subcommittee has delivered a non-binding Memorandum of Understanding (MOU) on taxation with the aim of realising substantive progress towards tax co-ordination within SADC. After a lengthy period of technical negotiations, the MOU was adopted by the SADC Committee of Ministers of Finance and Investment at its annual meeting in August 2002.

The MOU deals with the development of a tax database, capacity building of tax officials, appropriate use of tax incentives, a common position on tax treaties and the coordination of indirect taxes in support of intra-Community trade. It is intended that a legally binding SADC Protocol on Finance and Investment Matters will in due course include these agreements.

The SADC database project began in May 2002. It will describe in detail the tax systems for all SADC Member States in a publicly accessible web-page format. It will provide an important reference source for tax administrators, policy makers, investors and researchers.

Southern Africa Tax Institute (SATI)

Centre of excellence in advanced learning and tax research

SATI is an independent higher learning and research institute, administratively located at the University of Pretoria. It was officially launched on 23 June 2002. Its overarching goal is to build an independent centre of excellence in matters of tax policy and tax administration. Its key aims are to:

- Provide quality training to the future middle and senior tax policy and tax administration officials in African countries
- Assist revenue authorities with the design of tax training programmes
- Offer specialised short courses in current topical tax issues
- Provide a vehicle for tax-related research
- Establish a forum for the co-ordination and deliberation of tax policy and administration issues among African countries.

The first SATI Winter Programme ran from 24 June until 27 July 2002 and more than 60 participants from 13 countries participated. This initiative gives practical content, in the area of tax coordination, to South Africa’s wider commitment to a New Partnership for Africa’s Development.

5

Medium term expenditure framework

In keeping with our Constitutional mandate, the 2003 Budget will again provide for a progressive advancement of social and economic rights across a broad front. The medium term expenditure framework seeks to consolidate on policy achievements, and to enhance further the quality and effectiveness of service delivery to the poor.

An increase in real spending, with average real growth rates of 4,7 per cent a year over the 2003 MTEF, is proposed, and includes provision for the projected higher rate of inflation.

Looking ahead, the 2003 Budget signals:

- *Poverty reduction and development, addressing the needs of vulnerable groups, through extending social assistance, health and education*
- *Enhanced investment in municipal infrastructure, rural development and urban renewal*
- *Expanded capacity in the safety and security sector*
- *Higher education restructuring*
- *Accelerated land reform and restitution*
- *Re-engineering of services to citizens*
- *Increasing support for research and development*
- *South Africa's growing responsibilities in Africa and international relations.*

Policy priorities and the budget

Strong expansion of public services over the MTEF period

The proposed framework for the 2003 Budget provides for strong real growth in spending on public services, reinforcing Government's investment in people, service delivery and economic growth. Expenditure projections also take account of several developments this year that have increased demands on the fiscus. These include the depreciation of the rand, rising food and fuel prices, and expanding international commitments, including promotion of the New Partnership for Africa's Development (NEPAD).

Poverty reduction remains at the top of Government's development agenda

Progressive realisation of the social and economic rights of South Africa's people, as set out in the Constitution, remains the primary focus of budget plans. Cabinet has reiterated the need to reinvigorate programmes that seek to address the needs of the poor – both through higher rates of economic growth and development, and through appropriate interventions to foster equity and redistribution.

There is consensus on the need to consolidate and deepen existing priorities

The 2003 Budget will build upon the policy priorities laid down in the 2001 and 2002 Budgets. In an in-depth review of the framework for the 2003 Budget at its July Lekgotla, Cabinet agreed on the need to consolidate and deepen existing budget priorities. Hence, the 2003 MTEF will continue to emphasise infrastructure investment and extension of the coverage and quality of social service delivery. Other key elements of the development strategy involve strengthening employment creation incentives, deepening the skills base, reinforcing crime prevention and enhancing the private sector investment environment.

In pursuit of these objectives, the proposed 2003 medium-term expenditure framework prioritises the following areas:

- Extending social assistance, health and education programmes administered by provinces.
- Enhancing investment in municipal infrastructure and basic services in support of the rural development and urban renewal strategies.
- Expanding capacity in the safety and security sector to prevent and combat crime, including a particular focus on the functioning of the courts system.
- Higher education restructuring, including support for institutional mergers and investment in infrastructure.
- Accelerating the land reform and restitution programmes.
- Re-engineering services to citizens provided by the Department of Home Affairs.
- Increasing support for the national research and development strategy to enhance growth and technology advancement.
- A growing international role through increased regional representation, support for the African Union and NEPAD.

Government is driving for better outputs and outcomes from spending

Together, spending on economic infrastructure, human capital and other priorities over the MTEF period will grow by an annual average of 4,7 per cent in real terms.

However, the significant increases in spending will not on their own guarantee better outcomes. Government will continue to strengthen administrative capacity and improve coordination between national and provincial departments and municipalities, to ensure that a higher proportion of spending reaches the intended beneficiaries and that the quality of that spending is improved.

Government is now realising tangible and measurable gains from programmes designed to promote social and economic development. Spending priorities are being translated into better outcomes – as illustrated in several examples provided in this Chapter. Nine years after the inception of the Reconstruction and Development Programme, access to basic services has increased significantly and Government is now seeking to provide a minimum package of free basic services for all. Acceleration and consolidation of social services remains one of the key objectives of socio-economic transformation.

Enhancing the quality and effectiveness of service delivery through targeting high impact initiatives

In order to consolidate and deepen existing budget priorities, Government will target spending towards high impact components and initiatives. For example, increased funding will go to providing learner and support material in schools and medicine supplies in clinics. Additional resources will also go to the police and the courts for addressing crimes against women and children. The child support grant and disability grant programme will be progressively expanded. Enhancing the quality and effectiveness of service delivery remains the central aim of budget reprioritisation and management improvement.

Division of revenue between spheres

Division of revenue is the outcome of policy priority deliberations

The division of revenue set out here is an outcome of Government's policy priority deliberations. It reflects Cabinet's balanced approach to meeting Government's policy priorities over the medium term, taking into account the spending responsibilities and the capacity of national, provincial and local government.

Adjustments to baseline allocations

The preliminary framework proposes R84,9 billion in additional allocations over the baseline amounts

The revised budgetary framework over the next three years is presented in Table 5.1. It shows the revised budget for 2002/03 as per the adjusted estimates, and the additional resources available over the new medium-term expenditure period. The budget framework provides for additional allocations of R84,9 billion over the 2003 MTEF, including infrastructure funds announced but not yet allocated in the 2002 Budget.

The largest adjustments to baseline allocations go to provinces. They receive a further R12,3 billion in 2003/04, rising to R20,8 billion in 2005/06. In relative terms, local government receives the largest increase, at 18,4 per cent over baseline, compared with 9,0 per cent for provincial government and 7,3 per cent for national departments.

Table 5.1 Medium term expenditure framework and division of revenue

R million	2002/03 Revised	2003/04	2004/05	2005/06
		Medium term estimates		
National allocation	98 778	108 977	117 700	125 813
Provincial allocation	136 922	155 122	169 084	182 319
of which				
Equitable share	*123 457*	*140 006*	*152 723*	*164 847*
Conditional grants	*13 465*	*15 116*	*16 361*	*17 473*
Local government allocation	8 818	11 856	13 041	14 115
Total to be shared	**244 517**	**275 955**	**299 825**	**322 247**
Changes from baseline[1]	**8 111**	**21 069**	**28 697**	**35 128**
National allocation	3 371	7 170	9 789	11 704
Provincial allocation	4 502	12 278	16 721	20 814
of which				
Equitable share	*4 005*	*11 540*	*15 634*	*19 532*
Conditional grants	*497*	*738*	*1 087*	*1 282*
Local government allocation	238	1 621	2 187	2 610

1. Baseline allocations comprise the medium term estimates published in the 2002 Budget, together with standard increases of 6 per cent in 2005/06 over the 2004/05 allocations.

This year and over the MTEF period, additional resources are made available to the three spheres of Government to compensate for inflation which has been higher than was anticipated at the time of the 2002 Budget. In 2002/03, the total adjustment for inflation is R3,4 billion, including provision for higher personnel costs, increases in social grants and general inflation adjustments to protect the real value of amounts voted in the 2002 Budget. The provincial allocations includes inflation adjustments for certain conditional grants.

Over the 2003 MTEF period, the proposed inflation adjustment for the three spheres of government amounts to R27,8 billion, of which over half will ensure that the real value of government remuneration is preserved and about 20 per cent will supplement provision for inflation-related adjustments in social grants.

Policy adjustments to provide for enhanced services and new priorities amount to R57,1 billion over the new MTEF period.

Table 5.2 Adjustments to main budget expenditure, 2002/03–2005/06

R million	2002/03	2003/04	2004/05	2005/06
Inflation	**3 400**	**7 970**	**9 540**	**10 290**
Personnel	1 885	3 714	5 042	5 527
Social Security	512	1 811	1 828	1 937
General	1 003	2 445	2 671	2 825
Policy Adjustments	**4 711**	**13 099**	**19 157**	**24 838**
National	2 257	4 905	6 948	8 622
Provincial	2 317	6 744	10 209	13 804
Local	137	1 450	2 000	2 412
Total	**8 111**	**21 069**	**28 697**	**35 128**

Increased spending in 2002/03

The net increase in spending is R3,8 billion in the current year

The total additional funding provided in the 2002/03 Adjusted Estimates amounts to R8,1 billion. However, the net increase in the anticipated expenditure level is R3,8 billion, after taking into account projected in-year savings, lower debt service costs, provision for infrastructure in the main budget and the contingency reserve of R3,3 billion. The adjustments to the 2002 *Estimates of National Expenditure* include the following:

- A supplementary infrastructure allocation of R700 million of which R465 million goes to national departments and R235 million supplements conditional grants to provinces and local government.
- Approved rollovers of R1,2 billion which arise from unspent balances in the previous financial year.
- Adjustments for higher inflation amounting to R3,4 billion.
- Additional allocations of R3,8 billion for unforeseen and unavoidable expenditure, of which R2,3 billion goes to provinces.

A package of assistance to the poor has helped to cushion against inflation

Cabinet has approved a further increase in social grants to vulnerable groups. With effect from October 1, the old-age pension and disability grant is increased by R20, while the child support grant is increased by R10, bringing the total increases in grants this year to R70 (12,3 per cent) for the old age and disability grants and R30 (27,3 per cent) for the child support grant. The R3,8 billion adjustment also includes an amount of R400 million set aside to provide relief to those whose livelihoods are threatened by rising food prices.

Provinces receive a total adjustment of R4,5 billion in the current year

The provinces received a total adjustment of R4,5 billion in the current year, of which R2,2 billion is for unforeseen and unavoidable expenditure. This will assist in meeting spending commitments arising from faster than expected growth in beneficiaries of social grants, stepped-up expenditure in education on learner support materials before the new school year and other unexpected cost increases, particularly in health departments. The additional funds will be distributed between provinces according to the equitable share formula proportions for 2002/03.

The total in-year adjustment to local government budgets is R238 million. Part of this is a general inflation adjustment, in addition to R115 million for infrastructure. The balance of R22,3 million is to meet the costs of the legal settlement with Uthukela, Zululand and Amajuba District Municipalities regarding their equitable share dispute with the National Government. The resulting court action led to an extensive review of the funding needs of the three district councils.

Consolidated spending shares

A moderate reallocation of resources towards provincial and local governments is proposed

The overall impact of these adjustments is a moderate reallocation in the consolidated share of resources away from national government towards the provinces and local government.

Table 5.3 shows the division of revenue across government as proportions of non-interest expenditure, excluding the contingency reserve. There is a marked increase in the share for local government, which rises from 3,6 per cent in the current year to 4,3 per cent next year. The provincial allocation rises gradually from 56,0 per cent to 56,6 per cent in the outer year, while the national share declines by 1,4 per cent over the same period. This partially offsets the rise in the national share in recent years associated with the phasing in of the skills development programme and strategic defence procurements.

Table 5.3 Consolidated shares of national revenue and growth by sphere[1]

Per cent	2002/03 Revised	2003/04	2004/05	2005/06
		Medium term estimates		
National allocation	40,4%	39,5%	39,3%	39,0%
Provincial allocation	56,0%	56,2%	56,4%	56,6%
of which				
Equitable share	*50,5%*	*50,7%*	*50,9%*	*51,2%*
Conditional grants	*5,5%*	*5,5%*	*5,5%*	*5,4%*
Local government allocation	3,6%	4,3%	4,3%	4,4%
Total to be shared	**100,0%**	**100,0%**	**100,0%**	**100,0%**
Average annual change				**2002/03 - 2005/06**
National allocation				8,4%
Provincial allocation				10,0%
of which				
Equitable share				*10,1%*
Conditional grants				*9,1%*
Local government allocation				17,0%
Total				**9,6%**

1. Excludes the contingency reserve which is not allocated to any sphere.

Spending by type of service

Social services accounts for 57,5 per cent of non-interest expenditure

In table 5.4, consolidated national and provincial expenditure trends over the MTEF are presented by type of service. The aggregate spending in the tables that follow includes national and provincial departmental expenditure, transfers to local government and the spending of the social security funds. The envelope is thus somewhat wider than the national budget framework discussed above.

There are four main service groups: social services, protection services, economic services and infrastructure, and administration. Social services account for 57,5 per cent of projected non-interest expenditure next year, protection services 20,2 per cent, economic services and infrastructure 12,3 per cent and administration functions 9,8 per cent.

Table 5.4 Consolidated national and provincial expenditure by type of service

R million	2001/02 Outcome	2002/03 Revised	2003/04 Medium term estimates	2004/05	2005/06
Social Services					
Education	55 395	61 281	69 084	74 647	80 054
Health	31 713	35 653	40 110	44 650	48 458
Welfare	34 072	42 806	46 260	50 222	54 216
Other	8 370	9 932	11 626	12 270	13 231
Protection services					
Defence and intelligence	18 053	21 013	22 586	23 505	24 942
Integrated Justice System	28 840	32 515	36 239	39 500	42 626
Economic services & Infrastructure					
Water and related services	3 555	4 274	4 954	4 803	5 171
Agriculture, forestry & fishing	5 292	6 575	7 043	7 548	8 287
Transport and communication	10 012	11 458	12 471	13 623	14 489
Other economic services	8 134	10 793	11 763	12 710	13 552
Administration	20 981	24 393	28 565	31 960	34 273
Total	**224 416**	**260 692**	**290 702**	**315 437**	**339 299**
Changes from 2002 Budget [1]					
Social Services					
Education		1 483	4 545	6 287	
Health		1 252	2 585	3 818	
Welfare		1 934	3 544	4 275	
Other		144	814	1 183	
Protection services					
Defence and intelligence		423	927	1 149	
Integrated Justice System		745	2 028	2 377	
Economic services & Infrastructure					
Water and related services		72	275	386	
Agriculture, forestry & fishing		415	805	1 025	
Transport and communication		582	880	1 095	
Other economic services		434	960	1 281	
Administration		1 153	2 391	4 163	
Total		**8 636**	**19 753**	**27 039**	

1. Total changes from 2002 budget include additional allocations to all spheres, increased expenditure of the Social Security Funds and a draw-down of provincial reserves in 2002/03.

The largest increases in spending occur in social services

Relative to the baseline figures, the largest increases in spending over the next three years are expected in social services. This reflects the continued emphasis on human capital development, social assistance to households and public health services. The main revisions in the 2003 MTEF are as follows:

- Projected spending on social services is R11,5 billion higher in 2003/04 and R15,6 billion above baseline in 2004/05, resulting in a real average annual increase of 3,6 per cent over the MTEF period. Within education and health, spending on rehabilitation of infrastructure, critical learning materials, equipment and other supplies will be prioritised. Real health spending grows at an average of 5,0 per cent over the period while real spending in education grows at 3,6 per cent.

- The main upward adjustments in economic services and infrastructure relate to land reform and restitution, public transport subsidies and the national electrification programme.
- The integrated justice sector receives an additional R2,0 billion in 2003/04. The main components targeted are court administration and increases in personnel in the Police Service and Correctional Services in the outer MTEF year.
- Increased allocations for administrative services include the increase in the local government equitable share, improvements in services to citizens, strengthening of the Revenue Service and provision for national, provincial and municipal elections in the outer years. The allocations also reflect increased international commitments including NEPAD and the African Union.

Key spending areas

Strong growth in support for municipalities, social services and the administration of justice

Table 5.5 sets out a breakdown of total non-interest expenditure according to service share.

The largest increases in spending over the next three years will occur in Administration, which includes the main local government grants (12,0 per cent a year), health services (10,8 per cent a year) and the integrated justice system, comprising police, prisons and courts administration (9,4 per cent a year).

Table 5.5 Service shares and growth

	2001/02	2002/03	2003/04	2004/05	2005/06	2002/03 to 2005/06
	Outcome	Revised	Medium term estimates			Average annual growth
Per cent						
Social Services						
Education	24,7%	23,5%	23,8%	23,7%	23,6%	9,3%
Health	14,1%	13,7%	13,8%	14,2%	14,3%	10,8%
Welfare	15,2%	16,4%	15,9%	15,9%	16,0%	8,2%
Other	3,7%	3,8%	4,0%	3,9%	3,9%	10,0%
Protection services						
Defence and intelligence	8,0%	8,1%	7,8%	7,5%	7,4%	5,9%
Integrated Justice System	12,9%	12,5%	12,5%	12,5%	12,6%	9,4%
Economic services & Infrastructure						
Water and related services	1,6%	1,6%	1,7%	1,5%	1,5%	6,6%
Agriculture, forestry & fishing	2,4%	2,5%	2,4%	2,4%	2,4%	8,0%
Transport and communication	4,5%	4,4%	4,3%	4,3%	4,3%	8,1%
Other economic services	3,6%	4,1%	4,0%	4,0%	4,0%	7,9%
Administration	9,3%	9,4%	9,8%	10,1%	10,1%	12,0%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**9,2%**

At 57,4 per cent in 2002/03, rising to 57,8 per cent, social services continue to dominate non-interest expenditure, which is consistent with Government's objective of addressing the needs of the poor. The share of protection services declines from 20,5 per cent in 2002/03 to 19,9 per cent in 2005/06, reflecting the fact that both defence and the integrated justice sector have benefited from major increases during previous years. The administrative services share grows substantially over the period from 9,3 per cent in 2002/03 to 10,1 per cent in 2005/06, consistent with the strengthening of local government funding and provision for elections in the outer years. The economic services share falls marginally from 12,7 per cent to 12,2 per cent.

Social Services

Programmes in social services embody Government's core commitment to human capital and social development. In 2003/04, social services expenditure is projected to amount to R167,1 billion. Much of this occurs at the provincial level where primary responsibility lies for delivering social services including school education, primary health care and hospital services, social grants and welfare services.

The increased equitable share provides for enhancement of provincial social services

Key challenges in the sector include expanding the coverage of social grants to vulnerable groups, addressing the impact of HIV/Aids, and improving educational quality and outputs. Substantial upward adjustments in the equitable share allocations to provinces are proposed for next year and beyond in order to maintain the impetus of improved social service delivery.

Social grants have increased substantially this year

Increases in April and October provide for an average increase of 15,2 per cent in social grants in the current year. The largest relative increases were given to the Child Support grant and Grant in Aid. These increases were accompanied by a rapid expansion in the number of beneficiaries, especially of the Child Support grant for which Government intends to extend access even further. At the national level, additional funding has been made available for monitoring and support systems.

Improvements in medical personnel are targeted for poorer provinces

In the health sector, additional spending will provide for both improved compensation of health personnel and expanding employment. Increased allocations are proposed for investment in hospital buildings and equipment, and for the rising costs of medicine supplies. Through the hospital revitalisation programme eighteen additional hospitals will be upgraded and refurbished over the MTEF period.

Stepped up spending on HIV/Aids

It is anticipated that expenditure on the Enhanced Response to HIV/Aids, launched last year, will be stepped up by about R3,3 billion over the next three years. This includes targeted funding on the national department's budget, increased conditional grant amounts as well as increased provincial spending funded through the equitable share. Additional funds will go towards the roll-out of the prevention of mother-to-child transmission, post-exposure prophylaxis and further expansion of appropriate treatment regimes in line with Cabinet's Statement of 17 April 2002. A technical committee is currently reviewing options, costs and affordability to take forward the Cabinet decision.

A focus on learner support materials will enhance quality in schools

In education, the stabilisation of enrolment in recent years, and achievement of near-universal primary enrolment, allow the emphasis to shift decisively to quality-enhancing initiatives. An early childhood development programme has been piloted and will be progressively extended in the years ahead. Adult basic education and training projects will also be enhanced, in part through the new skills development funding arrangement. A key quality-focused aim for the MTEF period is to step up provincial spending on learner support materials and other non-personnel outlays, which are currently just 11,1 per cent of provincial education spending.

Restructuring in higher education will receive supplementary funding over the MTEF

Following Cabinet's approval in May 2002, restructuring in higher education will receive supplementary funding in the years ahead. The programme will involve consolidation of the institutional landscape through the proposed mergers announced by the Minister of Education in May 2002, are which are to be finalised by Cabinet this year. A five year time frame for completing the process is envisaged. It is recognised that the restructuring is costly, and will involve both recapitalisation of individual institutions to ensure their financial stability and substantial direct merger costs.

Alongside the revitalisation of higher education, the budget framework provides for a steady rise in research and development funding in spport of growth and technology advancement. The broader National Skills Development Strategy also seeks to improve the supply of high-quality skills to industry and enhance productivity across the economy.

Protection services

Reversing crime rates remains a major challenge

Strengthening capacity in the safety and security sector is essential to improve the quality of life of citizens, and for the creation of a stable environment for investment and growth.

Recent statistics suggest that crime rates in the country are beginning to stabilise – the challenge now is to reverse the trend. A key initiative is the adoption of more localised policing by the SA Police Service. In order to implement successfully the sector policing strategy, personnel levels will be stepped up in the years ahead. The proposed budget framework extends last year's commitment to increase SAPS personnel by about 5 000 a year into 2005/06.

Court efficiency will be targeted in the IJS cluster to reduce case backlogs

An upward adjustment in funding of the courts is under consideration as backlogs have a negative impact on the rest of the integrated justice system. Semi-automated court centres are being piloted in preparation for fuller court automation. Diversion programmes are under way, in keeping with the Child Justice Bill, to keep juvenile offenders out of jail through rehabilitation. These reforms are also expected to reduce waiting trial periods and thus overcrowding in prisons. Efficiency gains are already evident in courts administration.

Anti-corruption measures have been strengthened in Correctional Services

The Department of Correctional Services is also putting in place measures aimed at tangible efficiency gains and more rigorous controls . In the next two years, the Department will focus on improved management of prisons and support has been given for fighting corruption in prisons. In the third year of the MTEF, there will be a step up in spending when several newly designed prisons will be completed. In the short term however, emphasis is on more effective rehabilitation programmes and strengthening internal systems.

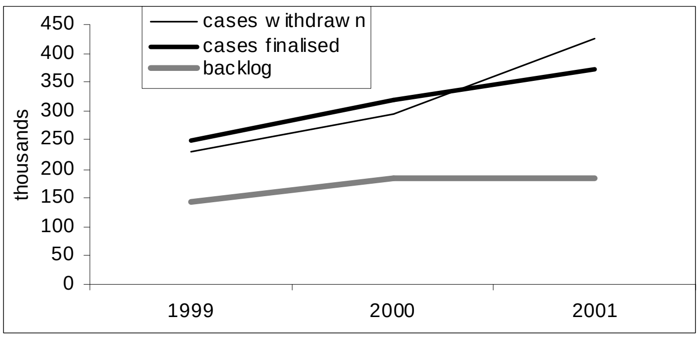
Improved Court Administration

Within the Integrated Justice Cluster, the backlog in court cases has been a major bottleneck with a direct impact on overcrowding in prisons. To address this situation, a series of mutually reinforcing measures have been introduced, specifically aimed at improving court efficiency and reducing court case backlogs.

- Saturday and Additional courts have been introduced as a temporary measure to reduce the number of cases on the court roll.
- A new policy has been introduced which specifies more clearly the criteria applicable for judging if a case is fit for trial. This has led to an increase in the number of cases withdrawn.
- On a pilot basis, 26 semi-automated IJS court centres have been established with a focus on improved management and coordination of court processes.
- The Durban court process project has gone a step further. Full automation has already eliminated the incidence of lost and late dockets which normally comprise 5,8 per cent of court roll cases. Similarly, incidents of lost charge sheets and of wrongful identification of accused persons have been eliminated.
- A Diversion programme provides an alternative sentence for juvenile offenders. This includes more rehabilitative aspects compared to prisons.

The graph below shows that the number of cases finalised by a verdict have increased by 33,5 per cent over the past three years, while the trend in case backlogs is beginning to fall.

Over the same period, the average cost per case has fallen by 14 per cent, suggesting that the above reforms have been associated with efficiency gains in the court system. This analysis is based on a proxy for total costs consisting of personnel and administration expenditure on lower courts, including 82 per cent of the budget of the NPA.



Economic services and infrastructure development

The economic services share of the consolidated budget remains relatively stable over the medium term.

There has been significant progress on infrastructure spending

Over the past few years, spending on infrastructure services has been robust as provinces have increased their capacity to manage capital projects. Provincial capital expenditure on public works, roads and transport reported at the end of March 2002 was an estimated 95 per cent of available funds.

A key infrastructure priority relates to the provision of basic services to communities. This includes extension of water and sanitation infrastructure, improved access to basic electricity services, and promotion of a safe and affordable public transport network.

Poorest consumers will benefit from the free basic electricity

The integrated national electrification programme supports Government's policy on basic service delivery by targeting universal access to basic electricity over a ten-year horizon. Last year, the programme received an additional R350 million per year.

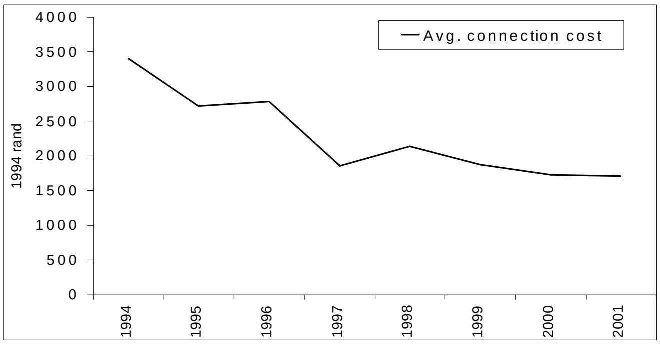
Declining costs in the National Electrification Programme

The government's electrification agenda is a key part of the programme to reduce the backlogs in the provision of infrastructure. Between 1994 and 2002 over R10.5bn has been spent on expanding access to electricity.

The electrification programme has increased the proportion of households electrified from little over 30 per cent to just under 70 per cent. This success that the programme has had in bringing electricity to the people is only half the story. The programme has shown outstanding improvements in efficiency over time.

As the electrification programme has expanded throughout the country, it has covered first those areas that were easier to connect. This made good policy sense as it allowed the highest possible number of households to be connected. Connection costs were expected to increase as electrification reached more remote areas. Instead, the real average cost of connections has fallen from R3 400 in 1994 to R1 700 in 2001.

The reduction in costs has been achieved through effective management, and a number of innovations. Key to the success of electrification has been central coordination of the development of the electricity grid, coupled with the devolution of funds to local electricity distributors to make the final connections. Proper planning has ensured that the electricity network was developed in a coherent and cost effective way, with funds being allocated in accordance with the growth of the network, while the devolution of implementation has ensured that money was spent by those closest in touch with consumers.



The electrification initiative has expanded access to electricity while achieving efficiency gains in making connections, resulting in lower connection costs. Consolidating further on this progress, the 2003 Budget will provide additional support. Grant funding for municipalities is proposed to facilitate the provision of free basic electricity to poor households. The policy aims to underwrite a minimum level of consumption of 50 KwH a month for the poorest 40 per cent of households.

The sanitation programme has been fast tracked after a slow start

The Consolidated Municipal Infrastructure Programme is one of the main vehicles for providing basic infrastructure. It is complemented by the Community Water and Sanitation Programme, which focuses on providing services in rural areas using labour based approaches. For the sanitation programme, a target date of March 2010 has been set to eradicate the estimated backlog of 18 million people.

Initially, progress was slow and targets remained unmet. More recently, management has been revitalised, sanitation delivery has been fast-tracked and the number of VIP toilets built has increased sharply, founded on a community-based approach that emphasises job creation and training, as well as health and hygiene promotion.

Land reform and restitution programmes will be accelerated

Another important element of Government's poverty alleviation strategy is a more equitable distribution of land ownership. The restitution programme will be stepped up considerably during the MTEF period. After a slow start, almost half of the registered land claims have now been settled, and progress is being made with larger rural claims and with the longer term land redistribution programme, complemented by targeted agricultural development initiatives.

Land Restitution Programme: Almost half of land claims now settled

The Land Restitution programme on the Land Affairs vote gives effect to the Government's Constitutional commitment to provide restitution to victims of forced removals under apartheid. Some 68 900 claims were lodged before the 1998 cut-off date, on behalf of about 325 000 households.

Legislative amendments that allow an administrative process under the authority of the Minister of Land Affairs to substitute for the judicial review of claims by the Land Claims Court have contributed to a considerable acceleration of the programme. Over 17 300 claims were dealt with in 2001/02, bringing the total finalised to 29 421.

The larger rural claims are now being dealt with. Recently concluded cases include the Keiskammahoek rural betterment removals claim, in which villagers received R102 million in settlement, and the Amakhoba Land Claim which will benefit some 3 500 households.

The financial cost of these settlements includes compensation to current owners as well as the envisaged settlement and planning grants to be given to the claimants. In addition to an accelerated programme, attention is being given to the process of empowering people to use the land to sustain livelihood. For example, the Makhoba community intends to use a quarter of the land restored for residential development and the balance for commercial purposes, especially in agricultural production. This will enhance the livelihood and the quality of life of this rural community. Under the direction of the Land Claims Commission, the process is being accelerated within a well-defined, transparent legal framework.

Between 1996 and 2002, R591 million was allocated for restitution in settlement of about 30 000 claims. In the current financial year, R323 million is available. As the more complex and larger rural claims are dealt with in the years ahead, spending will be stepped up further.

Administrative services

The HANIS project is a major commitment to modernise systems in Home Affairs

In order to improve basic service delivery, investment in government information systems and improved coordination amongst departments is under way. This includes enhanced capacity to maintain an effective population register and identification system. The Home Affairs National Identification System (HANIS) will receive increased funding over the MTEF period to complete the current digitisation of population records, and to begin the production of an electronically readable card to replace the present ID booklets.

SARS continues to invest in information systems for further efficiency gains

The South African Revenue Service (SARS) continues to build upon its organisational transformation process initiated under Siyakha in 2000/01. To sustain and enhance revenue collections, SARS will continue to rollout the Siyakha program in two more provinces focusing on improvements in taxpayer service, reduction of the tax gap, and better enforcement. To achieve these objectives, SARS will require further investment in technology to build upon the process reengineering that occurred in the first phase. Enhancements in information technology are expected to lead to further efficiency gains.

The national and provincial elections in 2004 and local elections in 2005 will be key spending areas over the MTEF period. Additional funding has been provided for programs in voter education and registration, for infrastructure needs in provinces and to facilitate the local government elections in 2005/06.

International commitments are expected to increase over the medium term

South Africa is playing an increasingly important role in international affairs. Following the successful launch of the African Union, continued involvement in economic cooperation, shared infrastructure projects and joint peace-keeping initiatives must be anticipated. Establishment of several new missions in African countries is planned over the next few years.

Budgetary provision for administration functions includes increased investment in financial management and capacity building, and phasing in of a rising equitable share contribution to local government resources.

Economic classification of expenditure

Table 5.6 sets out a summary of consolidated national and provincial expenditure, excluding debt service costs, by economic category.

Current expenditure accounts for just over 90 per cent of non-interest expenditure in 2003/04, declining marginally over the MTEF period, while capital spending rises from 9,8 per cent in 2002/03 to 10,3 per cent in 2005/06.

Table 5.6 Consolidated national and provincial expenditure – economic classification

R million	2001/02 Outcome	2002/03 Revised	2003/04	2004/05	2005/06
			Medium term estimates		
Current expenditure	**206 440**	**235 069**	**261 095**	**282 405**	**304 508**
Personnel	99 223	108 506	117 640	125 917	134 194
Transfer payments	69 969	84 977	93 521	100 020	107 189
Other	37 248	41 587	49 935	56 468	63 126
Capital expenditure	**17 976**	**25 623**	**29 607**	**33 032**	**34 791**
Transfer payments	7 335	11 363	13 419	14 604	15 380
Acquisition of capital assets	10 641	14 260	16 188	18 428	19 411
Total	**224 416**	**260 692**	**290 702**	**315 437**	**339 299**
Changes from 2002 Budget					
Current expenditure		**6 540**	**16 790**	**23 613**	
Personnel		1 731	3 861	5 090	
Transfer payments		2 701	6 009	8 071	
Other		2 108	6 921	10 453	
Capital expenditure		**2 096**	**2 963**	**3 426**	
Transfer payments		1 181	1 850	2 064	
Acquisition of capital assets		915	1 113	1 362	
Total		**8 636**	**19 753**	**27 039**	

Personnel expenditure

Personnel expenditure will stabilise at 40 per cent of expenditure

Expenditure on personnel is the largest component of current expenditure. However, a gradual relative decline in spending on personnel is underway, from almost 50 per cent of consolidated non-interest expenditure in 1999/00 to a projected 40 per cent in the outer MTEF years.

The allocations provide for a moderate increase in government remuneration in real terms, while steadily improving the balance between personnel costs and purchased inputs in the production of public goods and services.

Remuneration to increase in line with inflation

In the current financial year, public service salaries were adjusted by 9 per cent to cater for inflation. In keeping with the 2001 multi-year salary agreement, the MTEF provides for inflation-related remuneration adjustments each year. In several critical services – including provincial health and schooling, police and justice – the framework anticipates increasing personnel number.

Targeted adjustments for critical scarce skills

Over time, Government seeks to build a more focused public service in which scarce skills are better matched with needs across the country. This will require targeted interventions for certain categories, such as key medical personnel working in rural areas. As implementation of the restructuring agreement signed with organised labour in April 2002 takes effect, the shape and structure of the public service will be aligned more effectively with service delivery needs.

Capital and infrastructure spending

Infrastructure delivery to poorer provinces has been prioritised

Increasing capital and infrastructure spending remains one of Government's key objectives. Infrastructure delivery to poorer provinces that face substantial infrastructure and maintenance backlogs has been prioritised.

In 2003/04 an additional R3,0 billion will be made available for capital expenditure, relative to the 2002 Budget projections. Marked improvements in spending on provincial roads and education and health facilities have been recorded in the past two years, and the rising trend is expected to continue.

Conclusion

Strong real growth made possible by sound fiscal stance

While Government has progressively increased access to social services and basic infrastructure, the challenge to do more remains. A prudent fiscal policy stance since the mid-1990s has effectively contained debt service costs as a share of GDP, allowing for a rising share of resources to be channelled to improving and extending public services.

Key priorities in the years ahead include education, health, land restitution, sanitation, electrification, courts administration and social assistance. Government intends to target much of the additional spending towards initiatives with proven high impact on poverty reduction and development.

2003 Budget will build on the priorities of recent budgets

The 2003 Budget will build upon the policy priorities of recent years, with continued emphasis on infrastructure investment, extension of the coverage and quality of basic service delivery, enhanced economic development and well-targeted interventions to meet critical needs.

Mindful of the need to increase the impact of its spending, Government is seeking greater efficiency gains within existing programmes. Better value for money in the delivery of public services arises from improved management of programmes, more effective use of information systems and technology, targeted spending on critical inputs such as learning materials and medicines, stronger coordination between departments, and closer monitoring of implementation at the national level. On these foundations, a progressive realisation of social and economic rights for all South Africans is underway.

6

Provincial and local government finances

Total transfers to the provincial sphere are set to grow at an annual average real rate of 4,3 per cent over the MTEF period, while transfers to local government will grow by 10,8 per cent.

Additional allocations to the two spheres above baseline reinforce a broad-based development strategy and provide a measured fiscal response to the needs of South Africans in the face of rising costs of living.

Increased allocations to local government will reinforce provision of free basic services to poor households and create jobs through infrastructure development and local services.

Introduction

The division of revenue between spheres is informed by spending commitments, government priorities and the functional responsibilities of each sphere. The proposed division of revenue for the 2003 MTEF seeks to strengthen further the link between policy and budgets. Its focus is on consolidation and deepening services rather than creating new programmes.

The next three years will witness consolidation and deepening of social service quality

Increased spending is intended to reinforce key programmes within social services, provide free basic services and sustain accelerated infrastructure investment. In social services, the main priority is to inject resources into non-personnel supplies and services that impact strongly on improving the quality of public services.

Government continues to prioritise the provision of basic social, economic and household infrastructure. Urban renewal, rural development, labour-based infrastructure development and free services form an integral part of government's poverty alleviation programme.

Funding provincial government

Policy Framework

Priorities in the provincial sphere focus on improvements to the provision of education and health facilities, enhancing the delivery and reach of government's social grants programmes, and investment in public infrastructure.

In the education sector, prioritisation is to be given to increased allocations for learner support materials, expansion of early childhood development programmes, and scaling up of adult basic education.

Education sector to prioritise increased expenditure on learner support material…

Currently, provinces spend an average R124 per child on learner support material, and R220 on non-personnel, non-capital outlays for public schools. This will be progressively increased over the 2003 MTEF, to ensure that sufficient textbooks, stationery and other inputs are available to support effective teaching and learning.

…early childhood development programme…

In 1998, government introduced the Early Childhood Development (ECD) Programme. The programme was run at pilot sites across the nine provincial departments of education and was initially funded through donor support, and subsequently conditional grants. In 2003 it will now be phased into the mainstream provincial budgets and supported as a core provincial responsibility.

… and basic adult education

Continued support for adult basic education and training takes recognition of the importance of increasing basic literacy and numeracy among those to whom educational opportunities have been denied in the past.

Health policy to focus on staffing and equipping of health facilities

In the health sector, substantial funding increases to provinces will seek to ensure that sufficient resources are available to retain, attract and deploy personnel in areas of need. Priority will also be given to equipping the sector with adequate medicines and drugs to implement HIV/Aids prevention and treatment regimes within the policy framework announced by Cabinet in April 2002.

Provinces to enhance effectiveness of social security system

Social development policy will continue to enhance the effectiveness of South Africa's system of social security grants, which is proving to be an effective and well-targeted weapon in the effort to alleviate poverty.

Notable policy developments relating to social security include improved access to grants in general and the introduction of the child support grant, which, in its third year of implementation, reaches over two million beneficiaries.

Social development spending increases by 13 per cent a year since 1999/00

Extending the social security net has substantial implications for provincial finances. As beneficiary numbers and grant values have increased, social development expenditure has risen from R19,4 billion in 1999/00 to R28 billion in 2002/03 – an average annual growth of 13 per cent. This has resulted in the share of social development spending in provinces rising from 17 per cent to over 20 per cent of total provincial spending.

Grant administration is key to effective and efficient delivery of social security

As the types of grants and the range of social development services increase, institutional capacity within the sector needs to be bolstered. In addition to providing for increases in grant values and in the number of beneficiaries, the expanded provincial resource envelope makes provision for enhancing systems and administrative capacity in social development departments, strengthening support for the implementation of norms and standards for social security delivery, the Child Justice Bill, and support for non-governmental organisations.

A range of provincial functions, in particular infrastructure investment, are crucial to enhancing the long-term growth prospects of the economy. The main economic services delivered by provincial governments are agriculture, economic affairs, environmental affairs, tourism and provincial roads.

Provincial infrastructure investment is now rising rapidly…

Provincial investment in public infrastructure has grown strongly over the last three years, rising from R8 billion in 2000/01 to R10,7 billion in 2001/02, which is approximately 10 per cent of total provincial expenditure. Although growth in capital expenditure was initially slow, reflecting weak institutional capacity, levels of expenditure are now catching up with allocations, rising by 33 per cent in 2001/02.

… in part due to the provincial infrastructure grant

While the recovery in capital expenditure cannot be attributed exclusively to the provincial infrastructure grant, the grant has clearly contributed to the upturn. Now that the trend appears sustained, the need for the grant will be reassessed to determine whether it should be phased into the equitable share.

Notwithstanding improvement in the rate of infrastructure delivery, relative to infrastructure needs and to maintenance backlogs, more needs to be done. The increased allocations to provinces will help reinforce further acceleration of infrastructure delivery.

National transfers to provinces

Delivery of social services funded through national transfers

In order to fund pro-poor services, such as school education, health care, social security and housing, provinces rely primarily on transfers from national government. This is for two main reasons. First, the bulk of the services delivered by provinces do not lend themselves to cost recovery and self-funding, because the majority of those who benefit cannot afford to pay for them. Second, relative to expenditure commitments associated with their functional responsibilities, provinces have limited revenue-raising capacity. Table 6.1 sets out the proposed revisions to the provincial budget framework.

National transfers to provinces grow by 4,3 per cent in real terms

Nationally raised revenue transferred to provinces in the form of the equitable share and conditional grants will grow by 4,3 per cent in real terms over the MTEF period. They rise from R155,1 billion in 2003/04, to R169,1 billion in 2004/05 and R182,3 billion in 2005/06.

Table 6.1 Revision to provincial budget framework

R million	2002/03	2003/04	2004/05	2005/06
		Medium term estimates		
Total provincial allocation	**136 922**	**155 122**	**169 084**	**182 319**
Equitable share	123 457	140 006	152 723	164 847
Conditional grants	13 465	15 116	16 361	17 473
Changes to baseline				
Equitable share	4 005	11 540	15 634	19 532
Conditional grants	497	738	1 087	1 282
Total changes to baseline	**4 502**	**12 278**	**16 721**	**20 814**

Additional allocations of R4,5 billion in 2002/03 and R49,8 billion over the MTEF period are proposed. Inflation adjustments account for R19,1 billion for the three-year period.

Equitable share grows by 10,1 per cent a year over MTEF

The provincial equitable share allocation rises by 10,1 per cent a year over the MTEF period. Unlike conditional grants – for which spending is determined by national government and prescribed through the Division of Revenue Act – provinces have discretion over how they allocate the equitable share among the functions they perform, which include concurrent functions. Increased equitable share allocations will give provinces more flexibility in preparing the 2003 budgets.

Horizontal division of revenue

Table 6.2 sets out the revised allocations for 2003/04 and 2004/05 on provincial equitable share division, and new baseline allocations for 2005/06.

Table 6.2 Provincial equitable share division

R million	2002/03 Revised	2003/04	2004/05	2005/06
		Medium term estimates		
Eastern Cape	21 166	23 823	25 986	28 049
Free State	8 270	9 305	10 150	10 955
Gauteng	18 844	21 510	23 464	25 327
KwaZulu-Natal	25 157	28 790	31 405	33 898
Limpopo	16 692	19 029	20 757	22 405
Mpumalanga	8 705	10 049	10 961	11 832
Northern Cape	3 000	3 397	3 706	4 000
North West	10 328	11 624	12 680	13 686
Western Cape	11 294	12 480	13 613	14 694
Total to be shared	**123 457**	**140 006**	**152 723**	**164 846**

The structure of the provincial equitable share formula

The equitable share is divided among provinces by means of a redistributive formula, comprising seven components (weights of each component are included in brackets):

- An education share (41 per cent) based on the size of the school-age population (ages 6-17) and the average number of learners enrolled in public ordinary schools for the past three years.
- A health share (19 per cent) based on the proportion of the population without medical aid or health insurance.
- A social security component (18 per cent) based on the estimated number of people entitled to social security grants – the elderly, disabled and children – weighted using a poverty index derived from the Income and Expenditure Survey.
- A basic share (7 per cent) derived from each province's share of the total population of the country.
- A backlog component (3 per cent) based on the distribution of capital needs as captured in the schools register of needs, the audit of hospital facilities and the share of the rural population.
- An economic output component (7 per cent) based on the distribution of total remuneration in the country and.
- An institutional component (5 per cent) divided equally among the provinces.

The equitable share formula is reviewed annually, taking account of recommendations of the Financial and Fiscal Commission (FFC). The present structure of the formula, a product of collaboration between National Treasury and the FFC, was adopted in 1998/99, and modified to add a backlog component in 1999/00.

Changes to the formula anticipated in the 2004 Budget when Census 2001 data are available

The formula will be retained for the 2003 Budget, with no changes to the weighting of the components. Enrolment data used in the education component will, however, be updated. The decision to keep the structure and weights of the formula unchanged is informed by the need for stability and completion of the phasing in of the present formula. A comprehensive review of the formula is envisaged for the 2004 Budget, after publication of the 2001 Census data.

FFC recommendations on provincial government for 2003-2004

Approach to division of revenue takes account of FFC recommendations

In deciding the division of revenue between spheres and within each sphere, Government takes account of the recommendations of the FFC as required by the section 214 of the Constitution.

For the 2003 MTEF the FFC's recommendations relating to provinces include:

- The Provincial Tax Regulation Process Act, 2001
- Funding of early childhood development, HIV/Aids and a Primary Health Care Package
- Cross cutting equitable share issues, including issues pertaining to disaster management, and allocation of the contingency reserve.

Government's approach to the division of revenue and funding mechanisms in relation to early childhood development and HIV/Aids are broadly in line with the FFC proposals. Both programmes are partly funded through earmarked conditional grants. However, in future, early childhood development will be incorporated into mainstream education funding.

As in previous years, a detailed response to the recommendations of the FFC for 2003/04 will be published in an explanatory memorandum to the Division of Revenue Bill to be tabled alongside the 2003 Budget.

Conditional grants to provinces

Division of Revenue Act improves functioning of conditional grant system

Conditional grants make up about 10 per cent of total provincial transfers, and have been a part of the Budget process since 1998. The current conditional grant system has been shaped by reforms introduced through the various Division of Revenue Acts since 2000. These reforms have contributed to clarifying accountability for grants between spheres. Greater transparency has also helped strengthen parliamentary oversight and sharpen the description of policy objectives and grant outputs, thus resulting in improved use of grants to enhance service delivery.

No changes are envisages to the structure of provincial conditional grants other than phasing out of the financial management grant administered by the Department of Social Development.

Table 6.3 sets out the list of conditional grants to the provinces over the 2003 MTEF, the key features of which are described below.

Main changes to conditional grants occur in Health

The most significant changes to baseline allocations for conditional grants over the MTEF are made to the HIV/Aids, Hospital Revitalisation and the Integrated Nutrition Programme (INP) grants. Adjustments to conditional grants over the MTEF period amount to R738 million, R1,1 billion and R1,3 billion. Total conditional grants increase 17 per cent from R13 billion in 2002/03 to R15,1 billion in 2003/04.

Reconfiguration of health grants balances equity with sustenance of services across the country

Apart from the Integrated Nutrition Programme, health grants are mainly aimed at hospitals, particularly for tertiary health services and training. Following comprehensive research, a new framework for funding tertiary services and health professions training was introduced in the current year. It entails reconfiguring the previous Central Hospitals, the Redistribution of Specialised Services and Health Professions Training grants into two grants – the National Tertiary Services (NTS) grant and Health Professions Training and Development (HPTD) grant. The reconfiguration is aimed at effecting more equity in tertiary health services and funding distribution. The NTS grant amounts to R4 billion in 2003/04, increasing to R4,5 billion in 2005/06.

The HPTD grant now has a new component to employ specified numbers of registrars and medical specialist trainers in provinces with the most severe shortage of medical specialists. The Health Professions Training and Development grant amounts to R1,3 billion in 2003/04, increasing to R1,5 billion in 2005/06.

Eighteen hospitals are earmarked for major upgrading of infrastructure

The Hospital Rehabilitation grant, renamed the Hospital Revitalisation grant, funds major upgrading and replacements in large strategic projects, contributing towards reconfiguration and transformation of the hospital sector. Funding for the Hospital Revitalisation grant increases by R778 million over baseline over the three years to R718 million in 2003/04 rising to R1,0 billion in 2005/06. Over the next three years, the grant will fund improvements in 18 hospitals, two in each province.

A new component introduced into the revitalisation grant for 2003 MTEF is aimed at improving systems for medical equipment and facilitating adoption of modern technology.

Table 6.3 Conditional grants to provinces

R million	2002/03 Revised	2003/04	2004/05	2005/06
		Medium term estimates		
Agriculture				
Poverty relief and infrastructure development	24	38	–	–
	24	**38**	**–**	**–**
Health				
National tertiary services	3 727	3 995	4 273	4 529
Health professional training and development	1 300	1 333	1 434	1 520
Hospital revitalisation	649	718	912	1 027
Hospital management and quality enhancement	126	133	142	150
HIV/AIDS	210	334	482	535
Integrated Nutrition Programme	592	809	950	1 042
Pretoria academic hospital	70	92	–	–
Cholera epidemic (once-off to KZN)	147	–	–	–
	6 821	**7 414**	**8 193**	**8 804**
National Treasury				
Provincial infrastructure	1 550	2 334	2 876	3 056
Flood rehabilitation	400	200	–	–
	1 950	**2 534**	**2 876**	**3 056**
Education				
Financial management and quality enhancement	228	234	248	263
HIV/AIDS	144	117	125	132
Early childhood development	53	88	–	–
	425	**440**	**373**	**396**
Provincial and local government				
Local government support	173	160	144	152
Consolidated Municipal Infrastructure programme	106	111	117	124
	279	**271**	**261**	**277**
Housing				
Housing Fund	3 802	4 246	4 474	4 745
Human Settlement (Urban Development)	106	109	116	122
	3 907	**4 355**	**4 589**	**4 868**
Social development				
Financial management	11	–	–	–
HIV/AIDS	47	64	68	72
	58	**64**	**68**	**72**
Total	**13 465**	**15 116**	**16 361**	**17 473**

The INP is increased substantially to expand the programme and to compensate for food inflation

With spending on the Integrated Nutrition Programme improving, and against the backdrop of rising food prices, funding for the grant is being increased substantially in the next MTEF. It is increased by R894 million over baseline over the three-year period to R809 million in 2003/04, R950 million in 2004/05 and R1 042 million 2005/06.

Further strengthening of the budgetary response to HIV/Aids is made to implement Government's decisions on post-exposure prophylaxis for victims of sexual abuse, the rollout of mother-to-child transmission prevention, strengthening programmes combating sexually transmitted diseases, targeted interventions for commercial sex workers, voluntary counselling and testing.

An additional R270 million is proposed for these initiatives, over the MTEF period.

Housing grant increases by R373 million

The housing subsidy grant receives substantial adjustments aimed at ensuring that price movements do not hamper housing delivery. About R373 million is added to the programme over the next three years growing the grant by 7,7 per cent a year. The grant rises from R3,8 billion in 2002/03 to R4,7 billion in 2005/06.

Provincial infrastructure grant rises to R3,1 billion in 2005/06

Provincial capital spending shows a strong upturn over the current MTEF, partly due to increased funding for the provincial infrastructure grant in the 2002 Budget. The grant rises from R1,6 billion in 2002/03 to R3,1 billion in 2005/06. It is anticipated that current provincial baseline allocations for capital works and infrastructure maintenance, which already show growth of about 17 per cent a year, will be further strengthened over the years ahead.

Provincial Infrastructure Delivery

Government introduced the Provincial Infrastructure grant with an allocation of R300 million a year in the 2000 MTEF. The grant was introduced against the backdrop of very low provincial capital spending, with total provincial spending on capital having dropped to about 6 per cent of total spending in 1997/98. The 2001 Budget increased the allocation to R4,7 billion over the three year period. The grant was intended to serve as a catalyst to turn around provincial capital expenditure in three ways:

- Prioritising accelerated infrastructure delivery, with particular bias to poorer provinces facing substantial infrastructure and maintenance backlogs
- Prioritising increased delivery of provincial social infrastructure (schools, health) roads and rural infrastructure
- Initiating a process for institutionalising good practices in infrastructure planning, project management and monitoring.

Following a period of slow implementation, actual capital expenditure has started to show strong growth, rising from R8,0 billion in 2000/01 to R10,7 billion in 2001/02, with the share of capital in total provincial spending increasing to almost 10 per cent. This is a marked turnaround when compared to the trend in the mid-nineties.

A large share of the growth in capital expenditure is in social services and roads. Capital expenditure in the education and health sectors, which grew strongly between 2000/01 and 2001/02, is set to double in 2002/03, demonstrating Government's commitment to addressing backlogs, and to ensuring that public services are accessible to all South Africans. Spending on roads also increased significantly, rising from R2,3 billion in 1998/99 to R3,6 billion in 2001/02.

Among the most successful capital expenditure programmes to date has been the *Road to Wealth and Job Creation* sector strategy in KwaZulu-Natal, an innovative model that blends the process of meeting infrastructure needs of communities with capacity building and economic empowerment. In terms of this project, communities mobilised through Rural Roads Forums are able to take part in planning and prioritising roads. Through a phased advancement programme and through skills training, emerging contractors are helped to participate in roads construction contracts.

Through a programme called *Zibambele*, households within communities, especially women, are contracted to undertake routine maintenance using labour intensive methods on a specific length of road. The programme has contributed to improved rural roads while injecting cash into poor communities. This programme provides a good example of strategies for addressing road infrastructure needs, while creating meaningful livelihoods in rural areas where poverty and food insecurity are more prevalent.

Funding local government

Policy Framework

Government prioritises free basic services

In the local government sphere, increased allocations of R4,8 billion over three years are aimed at supporting delivery of water, electricity, refuse removal and sanitation as part of government's programme of providing free basic services to households that cannot afford them.

Labour-based infrastructure and services

The local government budget framework also makes provision for labour-based infrastructure investment and services to help stimulate and support economic development. An additional R1 billion over the next three years is allocated for this purpose within the existing municipal infrastructure grant framework.

Focus on strengthening municipal financial management

The programme of supporting municipalities in improving their budgeting and financial management capacity, initiated in the current financial year, continues.

Local government finances

Total municipal budgets are estimated at R65 billion in 2002/03, with municipalities raising R55 billion of this amount through property taxes, RSC levies, fees and user charges.

A significant portion of local government revenue, however, derives from nationally raised revenue, taking into account specific functions rendered by municipalities (water, electricity, refuse removal and municipal infrastructure) and the revenue generating capacity of various municipalities.

Transfers to local government from the national sphere flow through equitable share allocations, infrastructure allocations and capacity building grants. The share of nationally raised revenue allocated to local government has grown steadily over the past few years and is set to grow further over the next MTEF. Table 6.4 sets out the allocations to local government in each of the three categories.

The total allocation to local government grows at an annual average rate of 17 per cent, from R8,8 billion in 2002/03 to R14,1 billion in the outer year of the next MTEF.

Additional allocations to equitable share grow from R1,3 billion to R1,9 billion

Additional allocations to the equitable share and related components grow from R1,3 billion in the first year to R1,9 billion in 2005/06, in order to improve local government capacity to expand free basic services.

About R1 billion of the additional allocation is intended to fund labour-based infrastructure programmes, while R1,4 billion is earmarked for free basic electricity. Additional resources will also be directed towards poorer municipalities to address infrastructure backlogs.

Infrastructure allocations increase by R1,2 billion over the MTEF. The Capacity Building and Restructuring grant – the purpose of which is to assist municipalities in addressing their planning, financial management and technical skills – increases by R300 million above the 2002 baseline.

Table 6.4 Revision to local government allocations

R million	2002/03	2003/04	2004/05	2005/06
		Medium term estimates		
Total local government allocation	**8 818**	**11 856**	**13 041**	**14 115**
Equitable share and related	4 874	7 120	7 896	8 713
Infrastructure	3 397	4 059	4 420	4 640
Capacity building and related	548	677	724	761
Changes to baseline				
Equitable share and related	123	1 322	1 617	1 910
Infrastructure	115	200	470	600
Capacity building and related		100	100	100
Total changes to baseline	**238**	**1 621**	**2 187**	**2 610**

Additional allocations over the 2002 MTEF baseline will enable municipalities to meet key service delivery challenges, like the provision of free basic services to alleviate poverty, and the expansion of household and economic infrastructure.

Since the local government financial year commences in July, work is under way to provide a breakdown of each grant by municipality by February 2003. Government will gazette allocations by municipality close to Budget Day to enable municipalities to table their budgets for the 2003-04 municipal financial year.

FFC recommendations on local government for 2003-2004

Approach to division of revenue takes account of FFC recommendations

In deciding on the division of revenue between the spheres, Government takes account of the recommendations of the FFC as required by section 214 of the Constitution. For the 2003 MTEF, the FFC's recommendations in relation to local government cover:

- The measurement of revenue-raising capacity by municipalities
- The division of powers and functions in non metropolitan municipalities (category B and C municipalities)
- The remuneration of municipal councillors
- Fiscal implications of the restructuring of the electricity distribution industry
- Municipal borrowing and finance markets
- Implementation of the Municipal Finance Management Bill.

Many of these proposals have been taken into account this year and in preparing the framework for the 2003 Budget. However, certain proposals can only be addressed in the medium to long term due to systems and data limitations. A detailed response to the recommendations of the FFC for 2003-04 will be published in an explanatory memorandum to the Division of Revenue Bill to be tabled alongside the 2003 Budget.

Conclusion

Additional allocations to provinces and local governments will give a further boost to the delivery of social services, free water, electricity and sanitation. The increases will ensure that government programmes at sub-national level continue to deliver improved services in the face of rising demand and service costs, thus reinforcing consolidation and deepening of programmes that contribute to human development, poverty reduction and economic growth.

The prioritisation of carefully selected components of spending envisaged in the 2003 MTEF will ensure that in addition to attending to immediate needs of South Africans, public spending also creates a basis for meeting medium-to long-term needs. Increased spending on education, health and social development will enhance human development, while spending on labour-based programmes will create employment opportunities and public assets with a lasting impact on the quality of life over the long term.