Medium Term Budget Policy Statement

2009

National Treasury

Republic of South Africa

27 October 2009

What is the Medium Term Budget Policy Statement?

The *Medium Term Budget Policy Statement* (MTBPS) is a Cabinet policy statement tabled in Parliament about three months before the annual budget. It sets out the economic context and assumptions that inform the following year's budget, as well as the framework in which the budget is prepared.

The budget framework consists of the fiscal framework, government spending priorities, the division of resources between national, provincial and local government, and a tabulation of the major conditional grants. The budget framework enables national departments, provinces and municipalities to prepare their detailed budgets for the following year. South Africa has a multi-year budgeting process, so the framework covers the present year and the three subsequent years.

The fiscal framework sets out government's revenue projections, spending estimates, borrowing requirements and assumptions concerning debt interest costs over the period. The medium-term expenditure framework is government's broad three-year spending plan. The MTBPS also provides a report on spending for the first six months of the fiscal year in which it is tabled.

Parliament plays a critical role in the budget process and is responsible for approving all appropriations, following any amendments. Government departments can only spend money that is appropriated by Parliament for a specific purpose.

Parliament conducts public hearings on the MTBPS. These hearings cover the economic forecasts, the fiscal framework, revenue assumptions, spending priorities and the division of revenue. Section 6 of the Money Bill Amendment Procedure and Related Matters Bill regulates the process by which the MTBPS is processed in the legislature. Parliament can recommend changes to the division of revenue.

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The *Medium Term Budget Policy Statement* is compiled using the latest available information from departmental and other sources. Some of this information is unaudited or subject to revision.

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Foreword

Nobel Laureate Chief Albert Luthuli, who contributed so much to our freedom, envisioned a united, democratic South Africa "where human relations shall rest on the firm foundation of equality, friendship and respect for human dignity". His vision finds expression in our Constitution, which enjoins us to "improve the quality of life of all citizens and free the potential of each person" as we build a nation based on democratic values, social justice and human rights.

The values of our Constitution must be applied to how we run our economy. As recent experience has shown, economic paradigms that do not place human beings and their well-being at the centre can be destructive, particularly to the poor. Inefficiency and corruption in the public sector mean that fewer people will have access to clean water, decent education or quality health care.

We have made much progress since the advent of democracy, yet much more remains to be done. The new administration recognises that despite the challenges we face, it is still within our grasp to realise the vision of our Constitution. This government is taking firm steps to implement our five key priorities: jobs, health, education, rural development, and fighting crime and corruption. In today's difficult economic environment, we must do things differently. Government must make smart spending choices, realise savings, contain costs and reprioritise expenditure for maximum effect.

We *have* to do things differently, because over the past 14 months, the world has faced the most intense economic crisis since the Great Depression. The crisis is not of our making, yet its impact has been very serious. It began in the financial sector of the developed world, where poor regulation, excessive risk-taking and greed led to an inevitable collapse. The knock-on effects rapidly spread around the world. This crisis has necessitated a coordinated global response that focuses on new approaches to governance, regulation and greater recognition of all players, including developing countries.

Conditions in the global economy have hurt many people in South Africa. When factories close and small farms fail, when people lose jobs, when families struggle to get by on reduced incomes, and when hunger knocks at the door, human dignity and survival are at risk. To give effect to Chief Luthuli's vision of a society based on equality and dignity, we have to address these issues with urgency and determination.

We must face our challenges honestly. That means recognising the long-term impact of the crisis from which we are only now emerging, the need for a more labour-absorbing growth path, the importance of improving public services and the need to do more with less in public finances. It means taking tough decisions. It means building partnerships between government, business, labour and civil society.

The *Medium Term Budget Policy Statement* presents the country's economic forecasts and fiscal framework, and proposes to Parliament the medium-term spending priorities and the division of revenue between national, provincial and local government.

We will not waste this crisis. We will use it to build on the foundation we have laid and change that which must change. In partnership, we will develop an innovative growth path that mobilises our positive energies to create a better country – one dedicated to human dignity and improving the quality of life of all our citizens.

Pravin J Gordhan
Minister of Finance

Contents

TABLES

FIGURES

1

Supporting the recovery, transforming the economy

- The watershed events of the past 14 months provide a timely reminder that economics is ultimately about lives and livelihoods, and the choices that people make. Throughout South Africa nearly half a million people have lost their jobs. Hundreds of thousands of families have been affected by retrenchments. Businesses and households are struggling to adjust to declining incomes and precarious levels of debt.
- South Africa is beginning to emerge from its first recession in 17 years, but the recovery is likely to be slow and uneven, with job creation lagging the return to growth and many households continuing to face hardship. Healthy public finances, and strong partnerships with business and labour, have enabled government to reduce the impact of the crisis.
- This *Medium Term Budget Policy Statement* presents the outlook for economic recovery and discusses government's three-year spending priorities. It also addresses two key policy challenges. The first is to transform our economy to enable a massive expansion of employment alongside faster growth. The second is to create a culture of responsible stewardship and reform the public service, which does not yet meet the legitimate expectations of South Africans. In these circumstances, our social and economic transformation challenge has to be addressed with renewed urgency.

From recovery to inclusive growth

South Africa needs an economy in which more people can find work

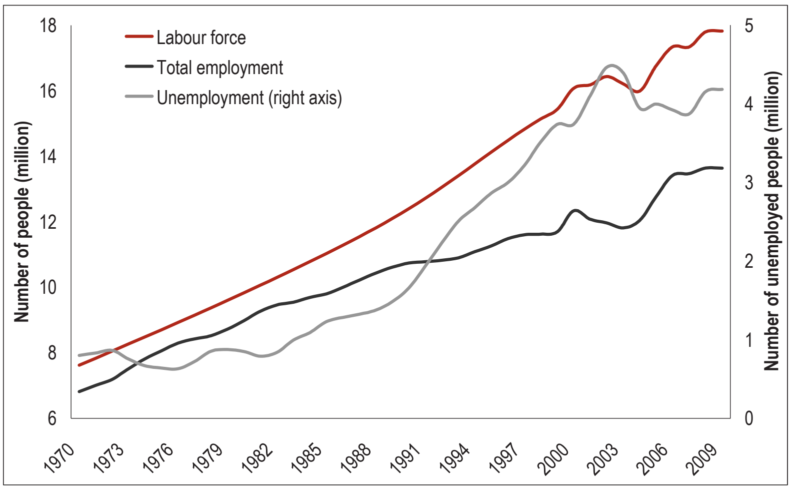
Over the next few years, South Africa faces the related challenges of supporting the nascent economic recovery while transforming the economy so that more people are able to find work. The 2009 *Medium Term Budget Policy Statement* is tabled in a period of opportunity, at the intersection of an economic crisis and a change of administration, to reshape our economy, public finances and the state more generally – and to improve the lives of all South Africans.

Key challenges over the medium term

From the mid-1980s to 2002, South Africa experienced rising unemployment

Too few people in South Africa work, with the result that for millions of citizens, daily life is a struggle with poverty, hunger, frustration and marginalisation. Figure 1.1 shows that unemployment rose rapidly from the mid-1980s to 2002.

Figure 1.1 Labour force, employment and unemployment, 1970 – 2009



The quality of public services, especially in poor communities, is often inadequate

While government has made good progress in increasing access to public services and to household infrastructure, the quality of public services, especially in poor communities, is often inadequate. Too many children cannot read and count, too many women die giving birth, too many people fear for their safety and too many South Africans stand in long queues to receive basic public services. Tackling the twin challenges of employment creation and efficient service delivery is essential to building a cohesive and prosperous nation.

These policy imperatives must be addressed in an international and domestic environment characterised by much lower economic growth rates than those preceding the financial crisis.

A new, sustainable and equitable growth path is needed for South Africa and the world

In recent months the world economy has benefited from a coordinated policy response to the economic crisis. A series of extraordinary fiscal and monetary measures has helped to stabilise the global economy, but the road back to higher employment and rising living standards is likely to be long and bumpy. While some causes of the crisis are being addressed, others merely fester. The challenge remains to find a new, more sustainable and equitable growth path – both for the world economy and for South Africa.

The Group of 20 (G20),[1] of which South Africa is a member, is coordinating the response to the global downturn. The G20 has sought to identify and address causes of the crisis, and has put forward a *Framework for Strong, Sustainable and Balanced Growth*. Our policies are broadly in line with this framework. Yet as a developing country with its own unique challenges, South Africa has an obligation to learn its own lessons from the crisis and address the country's main economic weakness: that too few people work and benefit from economic activity.

The Group of 20 is coordinating the international response

In line with international forecasts, South Africa expects a gradual economic recovery. Gross domestic product (GDP) growth of 1.5 per cent is projected for 2010, with growth only expected to breach the 3 per cent level in 2012. Job creation is likely to be slow, and many households will be forced to get by on reduced incomes, even as the economy recovers. This underlines the need for government to maintain public spending, especially expenditure that assists poor communities, and to accelerate efforts to create jobs.

Job creation is likely to lag return to economic growth

A sound fiscal position has enabled government to sustain public services, and to increase spending on investment that will raise our future growth potential. This has required a higher level of borrowing. As the economy recovers, government will act to reduce the budget deficit from a projected 7.6 per cent of GDP this year, so that the economy is not left with an unsustainable debt burden. Over the next three years, revenue growth is projected to recover gradually, and spending growth will have to moderate to return the public finances to a sustainable trajectory.

As the economy recovers, the budget deficit will gradually reduce

In this challenging fiscal environment, government must shift resources away from lower priorities to higher priorities: job creation, education, health, rural development, and fighting crime and corruption.

The functioning of the public service requires fundamental reform to obtain better value for public money, to do more with less, and to build a culture of responsible stewardship so that citizens trust the institutions of service delivery. The fight against corruption in government, and to prevent the resources of the state from being captured by various interest groups, must be given priority. Corruption hurts the poor most and damages the ability of government to deliver services to the country as a whole. Combating corruption requires steps to improve financial management and to reform state procurement. It also requires greater accountability in the way in which public resources are handled.

To fight corruption, financial management will have to be improved and procurement reformed

[1] The G20 members, representing about 90 per cent of global gross national product, 80 per cent of world trade and two-thirds of the world's population, are: Argentina, Australia, Brazil, Canada, China, the European Union, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States.

Learning from the global crisis

Failure to prevent a new crisis would have devastating consequences

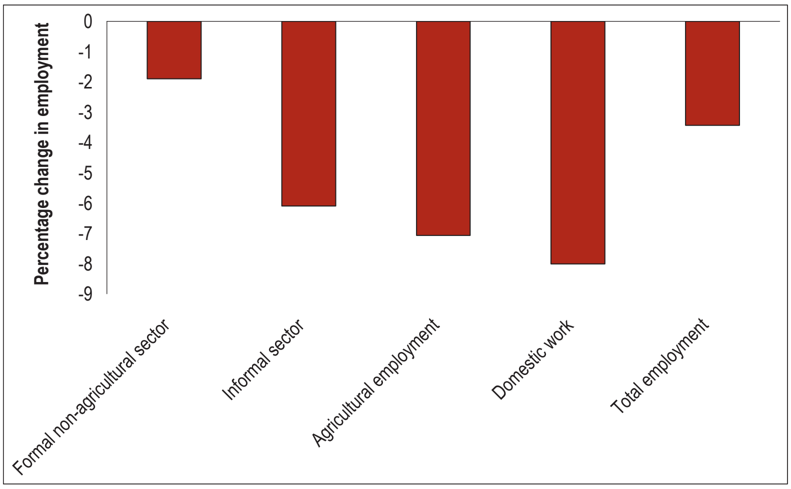
Like the rest of the world, South Africa has to address boom-bust cycles and their effects on the lives of ordinary people. Nouriel Roubini, the New York University economist who warned of the threat posed by the US housing market bubble, states: "The financial, fiscal and economic costs of this crisis are so severe that failing to prevent the next virulent one will lead to a severe backlash against globalisation, free trade and free capital flows." The collapse of global trade that would follow would have devastating consequences, particularly for Africa and the rest of the developing world.

To prevent such an outcome, policy-makers have begun drawing lessons from the most serious economic crisis in more than seven decades.

Macroeconomic stability is required, particularly to reduce the impact of boom-bust cycles on the poor

The first lesson is that boom-bust cycles hurt low-income workers, the poor and the vulnerable more than other sectors of society. This is as true of a developing country like South Africa as it is of major economies. Figure 1.2 shows that aggregate employment fell by 3.4 per cent in the first half of 2009, with the highest ratios of jobs lost in agriculture, domestic work and the informal sector. Government has to act in ways that reduce economic volatility while strengthening job creation and providing adequate social security.

Figure 1.2 Percentage change in employment, first half 2009



Source: Labour Force Survey

Vast economic imbalances are not sustainable

Second, the 21st-century global economy cannot sustain vast imbalances between savings and investment, between earnings and consumption, and between rich and poor:

- Countries cannot invest at a much higher rate than their savings can support on a sustainable basis. For South Africa, this means that savings have to rise to be able to fund a higher level of investment.
- Neither countries nor households can consume more than they earn for prolonged periods of time, because unsupportable debt eventually leads to lower living standards.

- Rising income inequality – both internationally and in South Africa – has negative social effects and leads to economic instability. Policy must focus on reducing inequality by creating more jobs, combating abuse of market power and broadening income security.

Appropriate financial sector regulation is a necessity

Third, appropriate regulation of the financial services sector – the unbridled excesses of which led to the present crisis – is required. Financial services play a vital role in the economy, moving resources from savers to investors. But when financial institutions fail, there are negative consequences, and when such failures take place on a global scale, the consequences threaten the world economy. Sound regulatory frameworks are needed to ensure that the financial sector can continue to play its important intermediary role while minimising the potential for harm to companies, households and economies.

An effective state is needed to support growth and protect the poor

Fourth, government intervention is essential to protect the poor and vulnerable, to help prevent boom-bust cycles, to regulate financial markets and to support growth when demand falls. An effective and capable state is required to achieve these objectives.

While the global crisis precipitated South Africa's recession, domestic factors also played a role. Our economy experienced rapid economic growth between 2003 and 2007, accompanied by rising employment. During this period, however, several imbalances emerged that put the economy on a weaker footing.

A range of factors contributed to overheating the domestic economy

Rising commodity prices, in combination with low interest rates, fed a consumer boom and rising house and asset prices. Business responded by increasing investment, mainly in construction, financial services, telecommunications and transport, contributing to higher employment. However, rising food prices, pressure on wages for skilled employees and rising import costs pushed up inflation. Infrastructure bottlenecks, most notably the lack of adequate capacity to generate electricity, served as visible signs of these imbalances.

Recent experience has reinforced several aspects of policy:

- Fiscal and monetary policy should be used to "lean against the wind", countering cyclical trends when there are signs that the economy is overheating or slowing below potential
- Infrastructure investment is required to sustain high rates of growth over the long term
- Keeping inflation low contributes to both growth and job creation
- Cooperation between the Reserve Bank and the fiscal authorities is essential to counter the effects of asset price bubbles on inflation, and to accumulate reserves to reduce exchange rate volatility.

Supporting the recovery

Striking a balance

Government supports the recovery while avoiding the build-up of unsustainable debt

Over the medium term, economic policy must strike a delicate balance, supporting the recovery through appropriate fiscal and monetary measures while avoiding the build-up of unsustainable debt that will impose costs on future generations. By providing appropriate support to key sectors while enabling economic adjustment to occur – allowing resources to move from industries that can no longer compete to newer, globally competitive ones – government supports a resumption of faster growth and job creation.

Achieving this balance requires sound economic policy, better coordination of policy between departments and well-functioning economic institutions.

The fiscal response

Public-sector borrowing is likely to reach 11.8 per cent of GDP this year

The magnitude of South Africa's fiscal adjustment to the crisis has been among the biggest in the world, with the budget balance shifting from a deficit of 1 per cent in 2008/09 to an expected deficit of about 7.6 per cent in 2009/10. Taking into account the state-owned enterprises, public-sector borrowing is likely to reach 11.8 per cent of GDP this year.

Government will gradually bring the budget back towards a balanced position

South Africa has the fiscal space to be able to run a significant deficit to support the economic recovery. However, over the medium term, a phased moderation of the borrowing requirement will be required.

Low levels of public debt have also enabled a rapid increase in infrastructure spending, much of it supported by government-guaranteed borrowing by state-owned enterprises. Gross fixed capital formation by the public sector increased from 5.9 per cent of GDP in the second quarter of 2007 to 9.4 per cent in the same period of 2009. The public-sector infrastructure programme has helped to sustain investment and employment during a time of declining demand. Higher public-sector investment crowds in private investment.

Private sector and government have developed partnerships to support employment

Public employment has increased during the recession, though the sustainability of this is in question given high real wage increases. The expanded public works programme has accelerated, drawing more people into employment for longer periods. Government has provided support to several sectors through the development finance institutions.[2] Lending by these entities has also helped to boost public investment. Innovative partnerships have been developed between government and the private sector, including the training layoff scheme in which workers agree to forego their normal wage and receive training and an allowance instead of being retrenched. We have been able to take these steps while sustaining public spending on core services, including social security.

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[2] The four major development finance institutions are the Development Bank of Southern Africa, the Industrial Development Corporation, the Land Bank and the National Housing Finance Corporation.

In summary, the steps that South Africa is taking to support the recovery include:

- Sustaining public spending and expanding public employment programmes
- Supporting state-owned enterprises to raise their investment levels
- Assisting sectors affected by the cyclical slowdown and bolstering municipal capital spending through the development finance institutions
- Maintaining expansionary fiscal and monetary policies only as long as is necessary
- Reinforcing the social safety net.

Framework for South Africa's response to the international economic crisis

In February of this year, government, business, labour and community representatives concluded an agreement addressing the impact of the world economic crisis on the real economy. Key elements of this framework, concluded under the auspices of the National Economic Development and Labour Council, include:

- A combination of countercyclical fiscal and monetary policy measures to support economic activity.
- An undertaking to maintain and to expand South Africa's public investment programme, to boost growth and employment, and to crowd in private-sector investment.
- Strategies to help vulnerable sectors, such as clothing and textiles and motor manufacturing, to weather the storm. A national jobs initiative will combine various state resources to finance industrial and special employment measures. As part of this initiative, the Industrial Development Corporation plans to lend more than R6 billion to distressed companies by March 2011.
- Development of investment incentives to create "green" jobs in industries and facilities that will mitigate the effect of climate change.
- Encouraging local procurement of supplies and services to support employment levels.
- Stepping up measures to combat customs fraud and illegal imports.
- Encouraging the financial sector to maintain credit and investment flows to the real economy.
- A pledge by companies to try to avoid retrenchments, and to invest in people and productive capacity. A key agreement in this regard is the training layoff scheme.
- Scaling up the expanded public works programme.

Looking beyond the crisis

South Africa's growth path must become more inclusive

South Africa has to look beyond the present crisis and the short-term recovery. For some years, government and broader society have recognised that if we are to emerge as a prosperous and successful nation, the country's growth path must become more inclusive. While we have made good progress in stabilising the economy since 1994, in putting the macroeconomic and public finance foundations in place for higher growth, and in broadening access to public services and infrastructure, we must address longstanding structural limitations to more rapid and equitable growth.

Informed by active consultation, government will work towards an alternative growth path

Over the period ahead, policy development – informed by active engagement within government and in consultation with business, labour and civil society – will focus on charting an alternative growth path. As a contribution to this process, the *Medium Term Budget Policy Statement* identifies elements required for more rapid and shared growth in the years ahead. The policy statement also recognises that South Africa's peers in the developing world are expected to sustain their focus on economic growth, improving their competitiveness and drawing in investment. Unless we are able to make similar progress, South Africa will be left behind.

For more than a century, South Africa's economic growth has been characterised by heavy reliance on mining exports on the one hand, and a sophisticated but skills-intensive services sector on the other. As a result, too few people work, and too many lack the skills required for the sophisticated services economy.

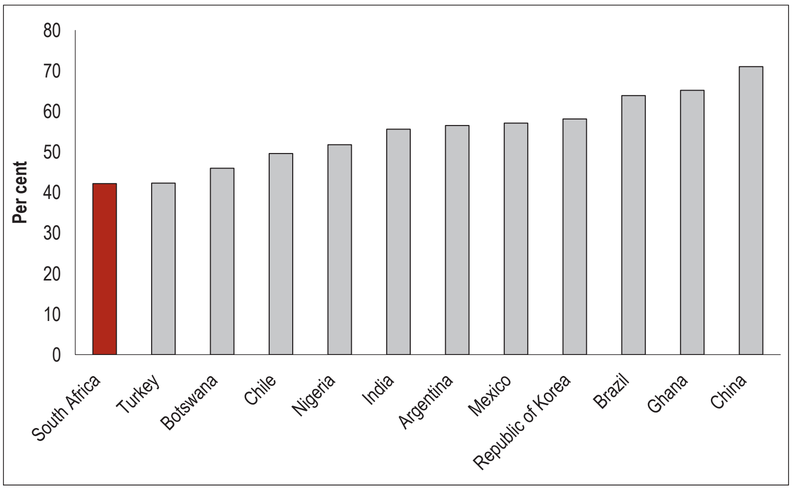
Boosting job creation

All policy choices must be informed by the need to create more jobs

Creating jobs, particularly among millions of relatively unskilled South Africans, is the country's greatest economic challenge. Low employment is the direct cause of our high levels of inequality and marginalisation. Only 42 per cent of the population aged between 15 and 64 are in some form of employment. This compares unfavourably with countries such as Brazil and China, where about two-thirds of the adult population work. In the former homelands, the picture is even bleaker, with fewer than 30 per cent of the adult population working. According to the Labour Force Survey, almost half of young Africans have never worked.

If the country does not find a way to resolve this problem, there will be catastrophic implications for social stability and future growth.

Figure 1.3 Labour-force absorption rates in selected countries, 2008



The jobs crisis has wide-ranging significance for economic and social policy initiatives. Current policy options available to government to boost employment include:

- Expanding services that are labour intensive, such as home-based care, refuse removal, building maintenance, grass-cutting, rural road construction, securing government buildings such as schools, and cleaning up environmentally sensitive areas such as rivers, lakes and wetlands.

- Changing the orientation of industrial incentives to focus on labour-intensive industries.
- Using the tax system to encourage employment. Government can consider using the income tax system to provide incentives to employers to hire staff, lowering the cost of employment without affecting wages. Similarly, government can subsidise social security contributions (such as unemployment insurance) for low-income workers.
- Making greater use of research and development capacity and innovation to support job creation by the private sector. Similarly, responding to the climate-change challenge provides the opportunity to increase investment and employment in "green" technologies.
- Introducing a targeted voucher to help matriculants enter the workforce. Such a voucher could either be used for further education and training, or be presented to an employer willing to hire the school leaver, helping young workers to gain skills and experience.
- Implementing a coherent rural development programme, including support for access to agricultural markets, training and assistance to small farmers. Rural infrastructure projects tend to be labour-intensive, with positive effects for community livelihoods.

Pursuing a competitive real exchange rate and low inflation

The volatility and level of the rand also require attention, particularly because they affect investment in export-led industries. Since 1994, the nominal and real effective exchange rates have depreciated by 60 per cent and 15 per cent respectively, making the rand more competitive today than it was 15 years ago. This long-term trend has supported growth in manufacturing, mining and goods production.

The fiscal and monetary authorities will work to support a more competitive real exchange rate

Mindful of the appreciation of the currency in recent months, the National Treasury and the Reserve Bank will enhance coordination of fiscal and monetary policy to support low inflation and a more stable and competitive real exchange rate. A relaxation of exchange controls is announced (see Chapter 2) to lower the cost of doing business and promote investment. The development of asset prices and their impact on inflation will be the focus of future analytical work.

Inflation rates that are higher than those of our trading partners imply decreasing competitiveness, something that needs to be countered more strongly in the period ahead through various economic policies, not only monetary policy.

The role of countercyclical fiscal policy

Fiscal policy helps to counter the effect of boom-bust cycles

Fiscal policy can play an important role in reducing the occurrence of boom-bust cycles and in supporting a competitive exchange rate. Government has adopted a countercyclical fiscal policy. In practice, this means that spending and tax decisions made when the economy is strong will still be affordable when the economy weakens. In times of economic stress, government is able to borrow to compensate for temporary revenue losses.

Supporting competitiveness, creating jobs through trade policy

South Africa requires higher productivity and greater competitiveness

South Africa's productivity, compared with that of our key emerging-market peers, has deteriorated. Low productivity has contributed to our poor export performance in goods and services – apart from those products, like minerals, which other countries do not have. South Africa needs higher levels of productivity and competitiveness for our economy to grow and employ a greater number of workers. Improving the quality of education, increasing the skills base and raising levels of fixed investment will contribute to higher productivity.

Trade policy is another instrument that can be used to bolster competitiveness and to promote exports. On the basis of specific evidence, government will take steps aimed at raising employment and lowering the costs of products to boost competitiveness.

Tough choices ahead

Funding some priorities means reducing expenditure elsewhere

Transforming the economy and restructuring the public service will require some difficult adjustments. Government, business, labour and civil society will need to give due consideration to these trade-offs and reach consensus on the best way forward.

For example, increasing budgets for labour-intensive public services could mean reducing expenditure elsewhere. Funding a wage subsidy might require higher taxes. Channelling incentives to labour-intensive sectors is likely to take resources away from other sectors of the economy. Such measures imply some discomfort for people and communities, because the options that governments have to reallocate resources are limited. Moreover, the benefits of such resource shifts can be blunted by bureaucratic inefficiency or captured by vested interests.

In summary, key elements of government's strategy to drive more inclusive growth could include:

- Shifting resources to labour-intensive sectors of the economy, helping young workers enter the economy and reducing the barriers to creating jobs
- Trade, industrial and competition policy that contributes to creating jobs through increasing competitiveness, raising productivity and lowering costs for both businesses and households
- Fiscal and monetary policies that promote balanced, sustainable and stable growth, lower inflation, a competitive exchange rate, and higher savings and investment
- Improving the performance of the state, especially in the quality of services it delivers to the poor.

Partnerships are essential to promote better economic outcomes

The budget framework set out in this *Medium Term Budget Policy Statement* balances investment in public services capacity with support for broader development and inclusive growth. While public expenditure plays a key role, partnerships are essential. All actors in the economy, and all those with responsibility for policy, need to pull together to achieve better economic outcomes – a more fair and prosperous society with opportunities for all.

Transforming the public sector

There is public dissatisfaction with the poor quality of service delivery, and high levels of wasteful expenditure and inefficiency in government.

Figure 1.4 Percentage of people satisfied with public services, 2000 – 2009

Source: Development Indicators 2009, The Presidency

To contribute to higher and more inclusive growth, we must also transform the performance of the public sector, which accounts for about one-fifth of consumption and one-third of investment. An efficient public sector means effective resource allocation, better development of human capital and lower costs for business in its interactions with the state.

Government will reprioritise all aspects of public spending over the next three years

Over the next three years government will conduct a phased reprioritisation of public spending. In phase one, the emphasis is on reducing unnecessary and wasteful expenditure. In phase two we will consider rationalising public entities and agencies, shift resources from back-office operations to frontline services, and reform the procurement process to reduce unit costs and corruption. Phase three will include a comprehensive expenditure review. During this phase, government will look at reshaping the way in which public services are delivered and resources are allocated.

The culture of the public service must change

These reforms, as important as they are, cannot substitute for a much-needed change in culture in the public service – one that is premised on respect for citizens, due care and thrift in the management of public funds, and greater accountability. Cabinet oversight of public-sector reform initiatives, planning, and performance monitoring and evaluation will support this process.

Overview of the 2009 policy statement

Economic policy and outlook

Chapter 2 discusses the macroeconomic outlook and provides a perspective on the changes required for higher growth and employment in the context of a much weaker global economy.

Global recovery is likely to be gradual, with job creation lagging growth

A coordinated effort by the major economies to apply large-scale fiscal and monetary stimuli appears to have stabilised the world economy, with tentative signs that output and confidence are beginning to recover. Nevertheless, this recovery is likely to be gradual, with job creation lagging output growth. While some aspects of the systems of economic management, such as the regulation of the financial sector, have received considerable attention, many of the weaknesses that gave rise to the crisis have yet to be addressed. The International Monetary Fund expects the world economy to grow by 3.1 per cent next year, following an estimated output decline of 1.1 per cent this year, driven mainly by growth in emerging markets and a gradual recovery of global trade.

The global crisis led to South Africa's first recession in 17 years. Demand for key exports has fallen. The prices of most commodities, while recovering strongly in recent months, remain below their pre-crisis levels. Employment has fallen, private-sector investment has been curtailed, and industrial and mining output have declined sharply.

Growth of 1.5 per cent expected for South Africa in 2010, rising to 3.2 per cent in 2012

While GDP is expected to decline by 1.9 per cent in 2009, there are signs that the economy is now recovering. Positive GDP growth is anticipated in the fourth quarter of 2009, with growth of about 1.5 per cent projected for 2010, reaching 3.2 per cent in 2012. While public-sector investment will be robust, household consumption, the largest component of GDP, is likely to remain weak as households reduce their considerable debts. Private-sector investment is only likely to recover in 2011. Higher commodity prices should contribute to the recovery.

African prospects buoyed by investment in mining, chemicals, tourism and transport infrastructure

Growth prospects in Southern Africa and Africa in general remain relatively healthy, with growth of 4.1 per cent projected for 2010 due to a recovery in investment in mining, petrochemicals, tourism and transport infrastructure. South Africa is one of the largest investors on the continent and benefits from growing intra-African trade.

Consumer price inflation has fallen from a peak of 13.6 per cent in August 2008 to 6.4 per cent in August 2009, largely as a result of moderating food and oil prices and a stronger rand. However, higher nominal salary increases and rising electricity prices will put upward pressure on inflation.

Table 1.1 summarises the key macroeconomic projections.

Table 1.1 Macroeconomic projections, 2009 – 2012

Calendar year	2008 Actual	2009 Estimate	2010	2011 Forecast	2012
Percentage change unless otherwise indicated					
Final household consumption	2.3	-3.1	0.9	2.3	2.5
Gross fixed capital formation	10.2	3.5	4.4	7.1	6.6
Real GDP growth	**3.1**	**-1.9**	**1.5**	**2.7**	**3.2**
GDP at current prices (R billion)	**2 283.8**	**2 373.8**	**2 560.5**	**2 798.9**	**3 050.0**
CPI inflation	9.9	7.1	6.3	6.0	5.7
Current account balance (% of GDP)	-7.4	-4.9	-5.7	-6.1	-6.9

A key focus of economic policy is to support the recovery. In addition, South Africa's high unemployment rate calls for a bolder response to the jobs crisis. In this regard, Chapter 2 summarises the key findings of several reviews of the South African economy focused on higher employment and faster growth.

Fiscal policy and trends

Sound fiscal policy has prepared South Africa for the global storm

Chapter 3 discusses fiscal policy and revenue trends. South Africa entered the recession in good fiscal health. Low budget deficits and small surpluses during the boom years reduced public debt to about 23 per cent of GDP at the end of 2008/09. Efficient tax administration and sound debt management contributed to a steady reduction in liabilities, reflected in a falling share of spending on debt service.

Strong fiscal response has included rising capital infrastructure investment

A strong fiscal response, complemented by monetary easing, has supported economic growth and prevented further deterioration in consumption, investment and employment. The fiscal stance enabled government to sustain strong growth in public spending during the recession. In particular, rising investment spending by general government and state-owned enterprises helped stimulate short-term activity and raise future potential growth. These investments also have considerable social benefits for the poorest South Africans.

Public-sector employment growth has also increased strongly, especially in services such as education, health and policing. Government has been able to increase borrowing in the face of lower revenue to sustain public spending and investment. A deficit of 7.6 per cent is expected in 2009/10.

As the economy recovers over the next few years, government will act to reduce borrowing gradually as the present deficit level is unsustainable.

Tax revenue is down sharply as a result of the recession

Tax revenue has fallen by about 3.2 per cent of GDP since peaking in 2007/08, with the greatest declines in VAT receipts, company taxes and trade taxes. As the economy recovers tax revenues will rise automatically. However, this will not be sufficient to reduce the deficit to sustainable levels. Other means of increasing revenue, such as broadening the tax base, improving tax compliance and introducing new taxes (such as environmental levies) may have to be considered.

Growth in public expenditure needs to slow given pressure on the fiscus

Over the next several years the rate of growth in public spending needs to moderate. Given the considerable pressures for delivery of more and better public services, the constrained fiscal environment places an obligation on government to do more with less. This implies the need for a new approach to the management of public resources and for spending to be reprioritised towards key areas such as education, health and job creation. Chapter 4 provides a more detailed discussion of efforts to reduce waste and inefficiency in public spending.

Table 1.2 summarises the fiscal framework of consolidated government, taking account of the spending and revenue of national and provincial government, the social security funds and public entities. A consolidated government budget deficit of 7.6 per cent is forecast for 2009/10, declining to 4.2 per cent by the end of the forecast period.

Table 1.2 Consolidated government fiscal framework, 2008/09 – 2012/13

	2008/09	2009/10	2010/11	2011/12	2012/13
R billion	Outcome	Estimate	Medium-term estimates		
Revenue	**692.0**	**657.5**	**743.5**	**833.4**	**921.3**
Percentage of GDP	*29.8%*	*27.3%*	*28.4%*	*29.1%*	*29.6%*
Expenditure	**715.4**	**841.4**	**905.6**	**975.6**	**1 052.8**
Percentage of GDP	*30.8%*	*35.0%*	*34.6%*	*34.0%*	*33.8%*
Budget balance	**-23.4**	**-183.8**	**-162.1**	**-142.1**	**-131.5**
Percentage of GDP	*-1.0%*	*-7.6%*	*-6.2%*	*-5.0%*	*-4.2%*
Gross domestic product	*2 321.2*	*2 405.1*	*2 620.1*	*2 868.7*	*3 111.3*

Medium-term budget priorities and the division of revenue

Following several years of buoyant public expenditure, the medium-term expenditure framework reflects a moderation in spending growth, accompanied by significant reprioritisation of spending.

Procurement reforms are under consideration

Table 1.3 shows consolidated government by function. A deep savings exercise is underway to reduce spending on lower priorities and non-core services, moving resources towards frontline services and higher priorities to enhance the effectiveness of public spending. Reforms to financial management and procurement policy are under consideration.

The main budget priorities, informed by the medium-term strategic framework, are:

- Supporting job-creation initiatives and realigning support to business to enhance employment opportunities
- Enhancing the quality of education and skills development
- Improving the provision of quality health care
- Driving a more comprehensive rural development strategy
- Intensifying the fight against crime and corruption.

These priorities are discussed in more detail in Chapter 4.

Table 1.3 Consolidated expenditure, 2009/10 – 2012/13

R billion	2009/10 Revised estimate	2010/11	2011/12 Budget estimate	2012/13	% Average growth 2009/10–2012/13
General public services	49.2	52.8	55.8	55.8	4.3%
Defence	34.1	36.5	39.3	41.9	7.2%
Public order and safety	77.7	85.9	96.2	101.6	9.3%
Economic affairs	182.9	169.4	155.6	162.8	-3.8%
Environmental protection	5.5	6.4	6.9	7.4	10.4%
Housing and community amenities	69.4	78.9	89.7	98.5	12.3%
Health	89.8	100.8	109.2	115.2	8.6%
Recreation and culture	7.6	5.8	5.4	5.6	-9.5%
Education	144.0	160.2	174.8	184.6	8.6%
Social protection	121.1	132.2	145.2	156.6	8.9%
Contingency reserve	–	6.0	12.0	24.0	
Non-interest expenditure	**781.4**	**834.9**	**890.1**	**954.0**	**6.9%**
State debt cost	60.0	70.7	85.4	98.7	18.1%
Total expenditure	**841.4**	**905.6**	**975.6**	**1 052.8**	**7.8%**

Table 1.4 summarises the division of nationally raised revenue. The fiscal framework makes available an additional R78 billion for allocation to spending programmes. In addition, savings of about R14.5 billion at national level and R12.6 billion at provincial level contribute to financing new priorities. Just over half of the additional amount goes to provinces, mainly for education and health, in part to finance general salary increases and occupation-specific salary dispensations aimed at attracting and retaining skilled professionals.

Further resources for health, education and housing programmes

Resources are also provided to accommodate a higher take-up of antiretroviral treatment, for the rollout of workbooks for the early phases of schooling, and for the housing programme.

About R12.4 billion is added to the local government share, mainly to compensate municipalities for the higher costs of providing free basic services (principally to take account of more expensive electricity). The *municipal infrastructure grant* and other infrastructure programmes also receive additional resources.

Table 1.4 Division of revenue, 2009/10 – 2012/13

R billion	2009/10	2010/11	2011/12	2012/13
National allocations	346.6	356.3	369.0	390.5
Provincial allocations	295.4	321.4	348.7	367.0
Equitable share	*236.9*	*260.6*	*280.3*	*294.4*
Conditional grants	*58.5*	*60.7*	*68.4*	*72.6*
Local government allocations	50.5	59.3	68.0	75.7
Total allocations	**692.5**	**737.0**	**785.7**	**833.2**
Changes to baseline				
National allocations	3.6	3.7	8.2	13.8
Provincial allocations	10.8	11.7	12.8	15.4
Equitable share	*9.0*	*10.3*	*10.9*	*11.5*
Conditional grants	*1.8*	*1.3*	*1.9*	*3.9*
Local government allocations	0.8	1.6	3.0	7.8
Total	**15.2**	**17.0**	**24.0**	**37.0**

The additions factor in the cost of establishing new government departments

Additions to the national share provide for the phased extension of the child support grant, greater investment in rural development, continued growth in spending on the criminal justice sector, and support for industrial development and job creation. The additions also accommodate the cost of establishing new departments.

2

Economic policy and outlook

The world economy is emerging from a deep and synchronised recession precipitated by the financial crisis in developed countries. Recovery is likely to be slow and uneven, with modest global growth projected in 2010. South Africa is also recovering, but at a slower rate. While positive fourth-quarter growth is projected, the economy is expected to contract by 1.9 per cent overall in 2009. Gradual recovery will see the economy realise growth of 1.5 per cent in 2010, rising to 3.2 per cent by 2012.

Government and the Reserve Bank have adjusted fiscal and monetary policies to support domestic demand, while public expenditure on key social priorities and infrastructure investment has been maintained. The recovery will strengthen as business confidence improves, employment stabilises and household incomes start to rise.

Over the next few years, the best-performing emerging-market economies will boost their efforts to increase productivity and competitiveness, and South Africa must do the same or risk being left behind. The crisis provides us with an opportunity to improve the efficiency of public spending, expand investment opportunities for the private sector, and reorient the economy onto a more labour-intensive growth path.

The outlook for growth

The global recession has sharply curtailed trade, investment and employment

The most far-reaching economic crisis since the 1930s was set in motion by the collapse of the "subprime" housing market in the United States. When the bubble burst, the massive exposure of the financial system to bad debt led to a seizure in global credit markets. A systemic collapse of banking systems in developed economies was only averted through large-scale, coordinated government intervention during the fourth quarter of 2008. These events brought on a global recession, sharply curtailing trade, investment and employment.

Financial stabilisation and economic recovery are starting to take root

There are, however, growing signs that financial stabilisation and economic recovery are taking root. The International Monetary Fund (IMF) expects world growth of 3.1 per cent in 2010, after a projected contraction of 1.1 per cent this year.

In South Africa, the global downturn led to the first recession in 17 years. Following a decade of uninterrupted growth, real GDP growth contracted by 2 per cent in the first half of 2009. The world recession coincided with a range of negative domestic developments that contributed to the depth of the present downturn. These included a debt-fuelled consumption boom, followed by a surge in inflation during 2007 and 2008, which reduced competitiveness and pushed up interest rates. In addition, key infrastructure such as electricity generation could not keep up with demand.

Nearly half a million South Africans have been retrenched over the past year

The recession has had a severe impact, with increased hardship felt by millions of South Africans. Nearly half a million people employed before the crisis struck are now without a job, and a growing number have been squeezed between falling incomes and high levels of debt.

Domestic fiscal and monetary policies have been eased substantially over the past year to support communities and bolster demand. The fiscal deficit has increased to 7.6 per cent of GDP, while the repurchase rate has declined by five percentage points since December 2008 to 7 per cent, leaving real interest rates close to zero.

After an estimated contraction of 1.9 per cent in 2009 as a whole, the economy will recover gradually over the medium term, driven by positive investment growth, more stable inventories and slower, but still positive, growth in government consumption. Spending on stadiums and transport associated with the 2010 FIFA World Cup has already boosted growth, and the main event next year will further benefit tourism and tax revenues.

Public-sector investment programme supports growth and medium-term recovery

Real GDP growth of 1.5 per cent is projected in 2010, rising to 3.2 per cent by 2012. In the period ahead, South African producers will benefit from a recovery in global demand and high commodity prices, largely as a result of growth in China and India. Renewed capital flows to emerging markets will also reduce the cost of capital and finance fixed investment. Continuing public-sector investment in economic infrastructure provides crucial support to the recovery and is essential to reduce bottlenecks and draw in private-sector investment. Real fixed investment by public enterprises is projected to grow by about 17 per cent per year over the medium term.

CPI inflation, at 7.1 per cent in 2009, is expected to trend downwards

Low inflation, a more competitive real exchange rate, and rising private-sector investment and employment are important for a stronger recovery. CPI inflation declined gradually to 6.4 per cent in August 2009 as food and petrol prices moderated, but core inflation remains above 8 per cent. CPI inflation is projected to average 7.1 per cent in 2009, trending downward to 6.3 per cent in 2010 and reaching 5.7 per cent by 2012. The primary factors driving inflation next year will be higher electricity tariffs and efforts by producers to recoup profits as demand recovers.

Household consumption will recover gradually. There is limited appetite for new debt and the labour market will remain weak until growth strengthens. Household consumption is projected to grow by 0.9 per cent in 2010 and 2.3 per cent in 2011.

Household consumption recovery will be slow given limited appetite for new debt

The current account deficit will decline to an estimated 4.9 per cent of GDP in 2009 from 7.4 per cent last year. However, the deficit is expected to rise to 5.7 per cent in 2010 and 6.1 per cent in 2011, reflecting stronger growth in domestic expenditure and international investment in domestic markets.

Table 2.1 Macroeconomic projections, 2009 – 2012

	2006	2007	2008	2009	2010	2011	2012
Calendar year		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
Final household consumption	8.3	6.6	2.3	-3.1	0.9	2.3	2.5
Final government consumption	5.1	4.8	5.0	5.4	4.7	3.6	4.2
Gross fixed capital formation	13.2	16.3	10.2	3.5	4.4	7.1	6.6
Gross domestic expenditure	9.1	6.0	3.1	-3.4	1.7	3.3	3.8
Exports	6.0	7.5	1.7	-19.8	3.8	4.5	5.6
Imports	18.9	10.0	2.2	-20.3	4.2	6.2	7.3
Real GDP growth	**5.3**	**5.1**	**3.1**	**-1.9**	**1.5**	**2.7**	**3.2**
GDP inflation	7.3	9.0	10.9	6.0	6.3	6.4	5.7
GDP at current prices (R billion)	**1 745.2**	**1 999.1**	**2 283.8**	**2 373.8**	**2 560.5**	**2 798.9**	**3 050.0**
CPI inflation	3.2	6.1	9.9	7.1	6.3	6.0	5.7
Current account balance (percentage of GDP)	-6.3	-7.3	-7.4	-4.9	-5.7	-6.1	-6.9

Table 2.2 Macroeconomic projections, 2009/10 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Fiscal year		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
GDP at current prices (R billion)	**1 810.7**	**2 067.9**	**2 321.2**	**2 405.1**	**2 620.1**	**2 868.7**	**3 111.3**
Real GDP growth	5.5	4.6	1.8	-1.6	2.0	3.0	3.0
GDP inflation	8.2	9.1	10.2	5.3	6.8	6.3	5.3
CPI inflation	4.0	6.9	9.9	6.5	6.4	5.9	5.7

Prospects and risks in the global recovery

The events of the past year illustrate the dangers of laissez-faire economics, in which financial systems are allowed to operate without prudential supervision and regulation. This leads to boom-bust cycles that do great harm to ordinary people, their livelihoods and savings.

Boom-bust economic cycles do great harm to ordinary people

The world economy contracted by 3.2 per cent in the six months to March 2009, leading to millions of job losses and sharp declines in asset prices. Governments responded with extraordinary measures to stimulate demand by slashing interest rates, expanding money supply and increasing public spending. Although the worst of the crisis appears to be behind us, the world economy is unlikely to return quickly to the preceding period of 5 per cent-plus growth. Soaring household and company debt levels will take considerable time to unwind. The boxes on the following two pages provide a snapshot of the recovery internationally and in South Africa.

The world economy: recovery and risks

The global economy is responding to large-scale stimulus measures and coordinated policy action across major economies. Volatility in equity markets has declined and capital flows to emerging markets have resumed.

Emerging markets and developing countries were drawn into the crisis by the collapse in global trade volumes and a reversal of capital flows. Many emerging markets, particularly China, India and Brazil, are exiting the crisis more quickly. Some major economies, such as Germany and France, have seen output stabilise.

Major economic trends include the following:

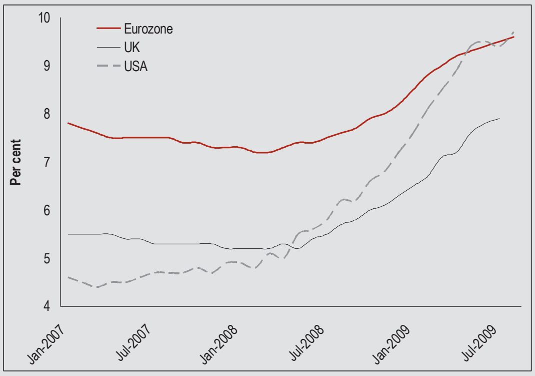
- A contraction in the US economy of 2.7 per cent in 2009 and growth of 1.5 per cent in 2010.
- Real GDP in the Eurozone is expected to contract by 4.2 per cent in 2009 and grow by 0.3 per cent in 2010.
- China is expected to grow by 8.5 per cent in 2009 and 9.0 per cent in 2010. India is expected to grow by 5.4 per cent in 2009 and 6.4 per cent in 2010.
- Emerging markets and developing countries are forecast to grow by 5.1 per cent in 2010, from 1.7 per cent in 2009.
- Growth in sub-Saharan Africa will fall to 1.3 per cent in 2009, rising to 4.1 per cent in 2010.

Much of the present policy stimulus is temporary in nature, and it remains to be seen whether enough has been done to facilitate a lasting recovery. For the recovery to take hold it will require rising real incomes, increasing equity prices, cheaper credit and more stable house prices to outweigh high levels of indebtedness and weak labour markets. The aggregate unemployment rate in advanced economies, which stood at 5.4 per cent in 2007, is projected to be 9.3 per cent in 2010.

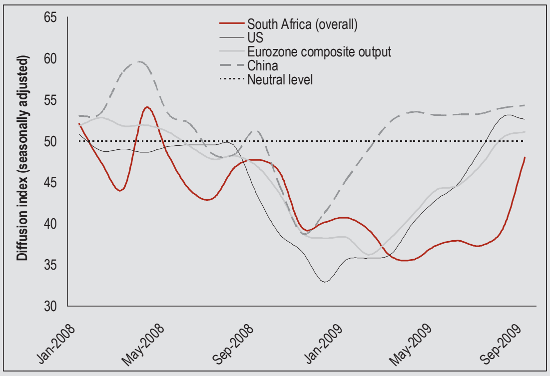
In the longer term, the recovery will be constrained by deteriorating fiscal balances, limiting room for additional stimuli. Higher interest rates could become a factor in the world economy in coming years. The IMF estimates that global fiscal balances will deteriorate by an average of six percentage points in 2009 relative to pre-crisis levels. Debt ratios in advanced economies are projected to rise to 110 per cent of GDP by 2014 from 80 per cent before the crisis.

Short-term efforts to support growth need to be balanced with long-term improvement in fiscal positions and reduced debt.

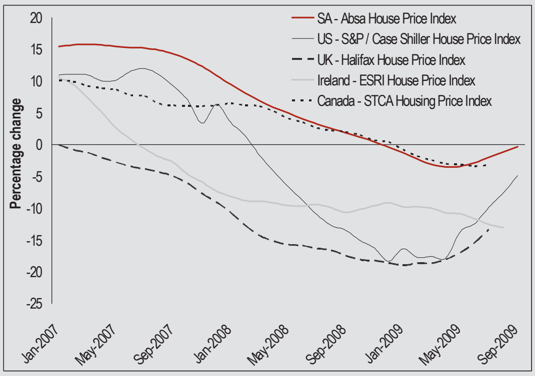
Unemployment rates



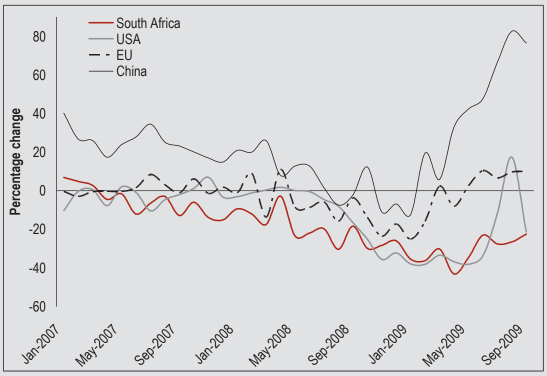
Global purchasing managers' indices



House prices



Vehicle sales



South Africa begins to show signs of a turnaround

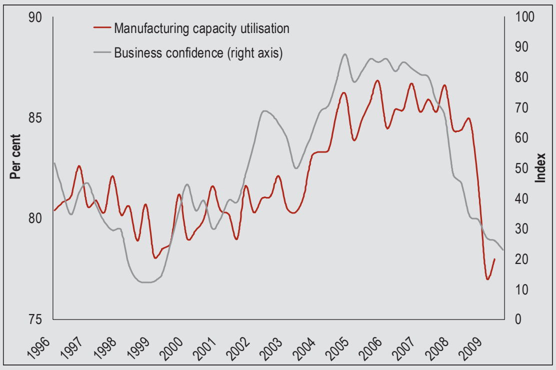
There is mounting evidence that South Africa's economy turned the corner during the third quarter of 2009 in response to improving global conditions, expansionary fiscal and monetary policies, lower inflation and resilient commodity prices.

The composite index of leading business cycle indicators has displayed a gradual upward trend since its lowest point in March 2009. Capacity utilisation by large manufacturers has bottomed out and forward-looking indicators of expectations in the Purchasing Managers Index (PMI) are also more positive.

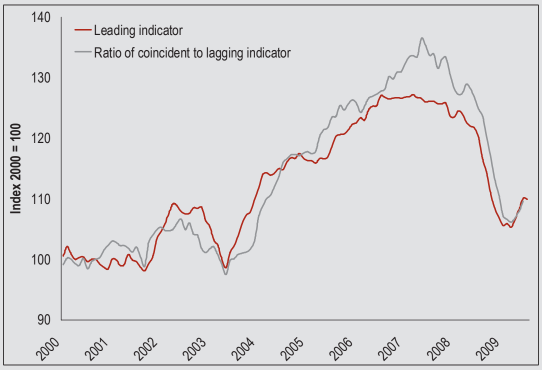
Growth in mining and manufacturing production improved in the three months to August, suggesting benefits from positive global developments, especially high commodity prices. However, competitiveness has been constrained by the appreciating real exchange rate and strong growth in unit labour costs.

South Africa's export prices rose faster than import prices, leading to an improvement in the terms of trade between the fourth quarter of 2008 and the second quarter of 2009, supported by commodity-intensive growth in large emerging economies such as China and India, and gold's reputation as a store of value. Combined with platinum's role in energy-efficient technologies, these factors should provide support to commodity prices over the medium to long term, with positive benefits for mining and minerals exporters. The oil price, however, remains high, with an impact on consumers and businesses.

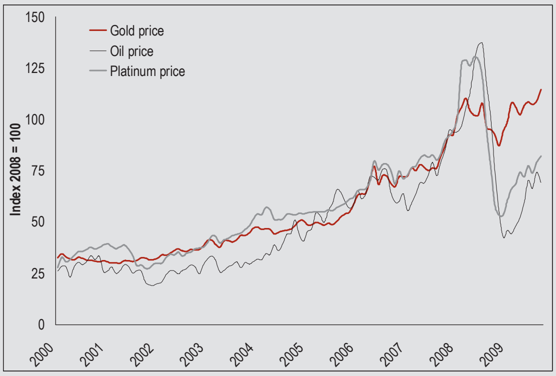
Business confidence and capacity utilisation



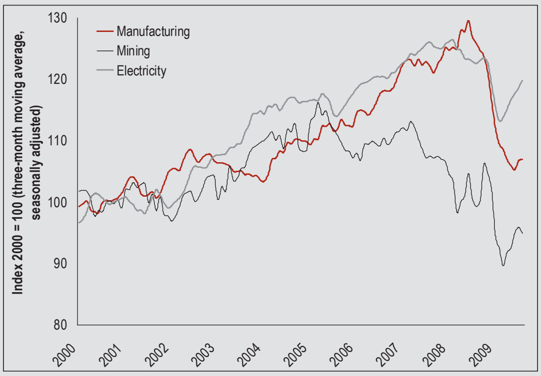
Business cycle indicators



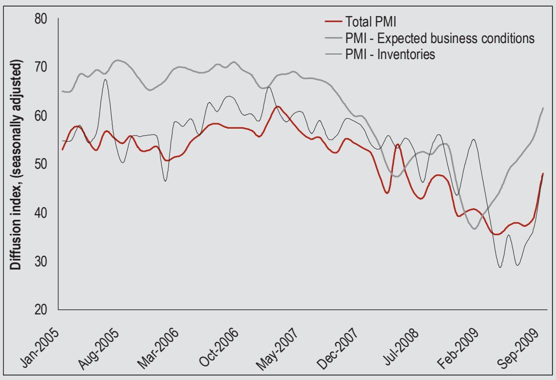
Indices of gold, platinum and oil prices



Mining, manufacturing and electricity output



Components of the PMI



Growth in retail and car sales

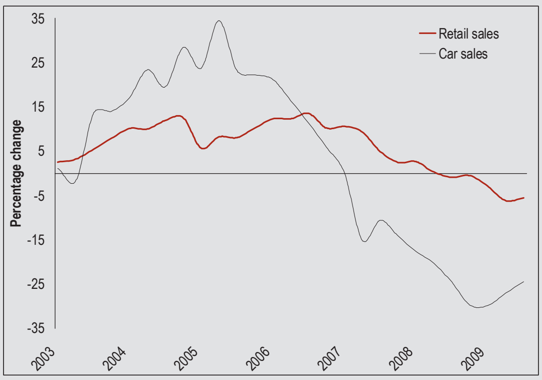


Table 2.3 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2008 – 2010[1]

Region/Country	2008	2009	2010	2008	2009	2010
Percentage	GDP projections			CPI projections		
World	**3.0**	**-1.1**	**3.1**	**6.0**	**2.5**	**2.9**
US	0.4	-2.7	1.5	3.8	-0.4	1.7
Euro area	0.7	-4.2	0.3	3.3	0.3	0.8
UK	0.7	-4.4	0.9	3.6	1.9	1.5
Japan	-0.7	-5.4	1.7	1.4	-1.1	-0.8
Emerging markets and developing countries	**6.0**	**1.7**	**5.1**	**9.3**	**5.5**	**4.9**
Emerging Asia	**7.6**	**6.2**	**7.3**	**7.5**	**3.0**	**3.4**
China	9.0	8.5	9.0	5.9	-0.1	0.6
India	7.3	5.4	6.4	8.3	8.7	8.4
Africa	**5.2**	**1.7**	**4.0**	**10.3**	**9.0**	**6.5**
Sub-Saharan Africa	**5.5**	**1.3**	**4.1**	**11.9**	**10.5**	**7.3**
South Africa[2]	3.1	-1.9	1.5	11.6	7.1	6.3

1. IMF, World Economic Outlook, October 2009

2. National Treasury, October 2009

Supporting the recovery and achieving more rapid growth

Fiscal and monetary measures to support recovery

Policy aims to encourage a recovery without burdening future generations with unsustainable debt

In the near term, economic policies need to encourage a recovery in the domestic economy without burdening future generations with large public debts, high inflation and interest rates, and low growth. For that reason, government has maintained prudent growth in spending on public services and infrastructure development.

Monetary policy adjusted sharply to the decline in demand and output to support growth, with real interest rates now just above zero per cent. However, greater coordination between government, labour and business is needed to mitigate persistent inflationary factors that have built up in recent years and undermined the competitiveness of the real exchange rate. Monetary policy needs to be strengthened and supported by fiscal policy to keep long-term interest rates low. Government will ensure that financial market regulation is appropriately calibrated to maintain macroeconomic stability.

Global lessons for growth

All countries were affected by the crisis, but some emerging markets are faring better than others

All countries were severely affected by the collapse of global trade and demand over the past year. Some emerging markets, however, have bounced back more quickly than others and are in a better position to benefit from the nascent global recovery. South Africa entered the global crisis with large domestic imbalances and relatively low savings, despite having built up a small fiscal surplus during the preceding economic boom. Asian and Latin American economies that enjoyed relatively high savings rates going into the crisis, as reflected in large fiscal and/or current account surpluses, have displayed more resilience. Brazil, which went into the crisis with high savings and low inflation, has weathered the storm particularly well. Countries such as Australia and Korea, where prices and wages have adjusted more quickly to weak demand and rising unemployment, have been able to demonstrate a competitive edge, reflected in their real exchange rates and higher levels of investment.

An opportunity to forge a new growth path that promotes large-scale employment gains

South Africa has the opportunity to use this crisis as a catalyst to forge a new growth path that combines faster economic expansion with large-scale job creation to reduce high levels of poverty and inequality, along with an expansion of public services and a strong social safety net. Improved export performance, sustained investment and robust job creation are essential to those goals.

Over the medium term, government intends to play a greater role in drawing more South Africans into work that complements skills development and enhances service delivery. Measures to help young people make the transition from school to work are also necessary. A greater role for the state in the economy needs to be complemented by efforts to promote private-sector growth. South Africa's macroeconomic framework needs to promote stronger domestic investment, job creation and export activity.

Research has helped to identify core elements of a new growth path

Several recent studies have identified constraints to South Africa's growth. These studies included the work of the International Growth and Advisory Panel (2006-2008), the Organisation for Economic Cooperation and Development's *Economic Assessment of South Africa* (2008), and the Commission on Growth and Development's work on high-growth strategies in 13 economies in the post-World War II period (2008). The five broad lessons that emerge from these studies are summarised below.

Fiscal and monetary policies that promote balanced, sustainable growth

- Savings is the key driver of investment and growth. Countercyclical fiscal and monetary policies that prevent the build-up of large imbalances in the economy bolster savings. Initiatives to promote financial inclusion and literacy are also important to encourage households to save.

Shifting resources to labour-intensive sectors

- In addition to providing incentives to increase labour intensity in public works programmes, governments can boost job creation by facilitating the transition of workers from older, less-productive industries to new, faster-growing ones. Income-support for affected workers, and education and training programmes, are more desirable than efforts to save jobs in uncompetitive industries.

Increasing competitiveness, raising productivity, lowering costs

- Aligning input costs all along the production chain – from capital to labour to transport and finished goods – is necessary to support export and import-competing industries in global and domestic markets.

- Skills development is crucial and reducing red tape is essential. Lowering the cost of hiring young people would improve social inclusion and reduce high rates of youth unemployment. Productivity is central to growth and employment.

Productivity: how South Africa compares

In the view of Nobel Laureate Paul Krugman: “Productivity isn’t everything, but in the long run it is almost everything. A country’s ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.”

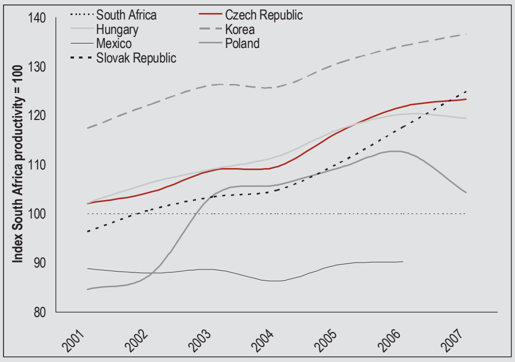
The gap in productivity between South Africa and its emerging-market competitors has grown, requiring us to take steps to raise productivity to support income growth.

South Africa compares reasonably well on indicators of innovation and technology, but educational outcomes are poor, as illustrated by low scores in international tests of literacy, maths and science, which in turn contribute to low enrolment in tertiary education and a low proportion of researchers.

Investment in fixed capital has also lagged other countries. Over the period 1993-2007, our emerging-market competitors invested on average 9 per cent of GDP more each year than South Africa, equivalent to an investment shortfall of R1.3 trillion.

The productivity gap needs to close to boost growth and employment. Greater innovation, technological progress, and more efficient production processes need to be combined with increased investment, and reform of our educational and skills development systems.

Output per worker hour



Productivity indicators

	CEE Average	Korea	Mexico	South Africa
R&D expenditure as share of GDP	0.9	3.2	0.5	0.9
Number of researcher per million inhabitants	2 017	4 162	464	361
Public spending on education as share of GDP	4.8	4.4	5.5	5.4
Primary school enrolment**	98.7	105.0	112.7	103.2
Secondary school enrolment**	96.8	97.5	87.2	95.8
Tertiary school enrolment**	57.3	92.6	26.1	15.4
Rank in international literacy test (PIRLS)	21 out of 45	-	-	45 out of 45
Rank in international science test (TIMSS)	11 out of 45	3 out of 45	-	38 out of 45
Investment as share of GDP	24.5	29.0	23.0	20.0
Investment per worker (PPP US$, Million)	10.3	14.9	8.0	9.3
Manufacturing value added as share of GDP	23.7	29.0	15.8	14.6
Days to start a business	22.0	17.0	27.0	31.0

** Latest available figures unless stated otherwise*

*** As share of relevant school-age population*

Data sourced from the World Bank, UNESCO, UNIDO, WIPO, PIRLS, TIMSS and the Presidency
CEE refers to Central and Eastern Europe

Trade and industrial policies that lower costs and create jobs

- Fast-growing economies are open to trade and fully exploit the global economy by importing ideas, technology and know-how, and exporting goods and services. Foreign direct investment is an important conduit for the transfer of capital, skills and technology.

- In many countries, industrial policy was used successfully to diversify exports and to promote investment in new sectors through special export zones and tax incentives. Such measures should be temporary. “Any profit-seeking activity that needs permanent subsidies or price distortions to survive does not deserve to do so,” notes the Growth Commission. A proposed fund to support industrial development and job creation is discussed in Chapter 4.

- A more stable and competitive real exchange rate is important for growth. Foreign reserve accumulation limits the appreciation of the exchange rate. Reform of exchange controls can facilitate greater two-way flow of capital and help to reduce volatility.
- Government should promote efficient use of energy and water resources by producers and households, alongside measures to mitigate the effects of climate change. Prices that reflect cost and well-structured environmental taxes provide incentives for efficiency improvements and new investment.

Calibrating trade policy

Work on trade policy is focused on providing meaningful support to South Africa's industrial strategy and job-creation objectives. Tariff structures will be reviewed with these objectives in mind.

South Africa seeks a conclusion of the Doha Round based on the original developmental mandate. However, that mandate has been eroded over time, and may result in less ambitious reforms to tariff policies in agriculture that hold back developing-country producers.

At the same time, our status as a middle-income country implies tariff reductions in South African industrial products that we believe to be too large and could have negative effects on employment in some labour-intensive industries.

In line with the objective of building trade relations with key developing economies, South Africa and other members of the Southern African Customs Union (SACU) negotiated and concluded a preferential trade agreement with MERCOSUR in June 2008. The agreement, subject to parliamentary ratification in all signatory countries, provides a sound basis for expanding trade links between Southern Africa and South America.

Improving public-sector performance and service delivery

- Effective and capable public sectors are common to fast-growing economies around the world. Political leadership focused on growth, setting performance standards, enforcing accountability frameworks and resolving tradeoffs in the interest of inclusive growth is also essential.

The beginning of a recovery in the real economy

The collapse in global and domestic demand has had a dramatic impact on all sectors except government services and construction. Real GDP, which began contracting in the fourth quarter of 2008, is expected to decline by 1.9 per cent in 2009 before growing again by 1.5 per cent in 2010 and 3.2 per cent by 2012.

In the first six months of 2009, mining output declined by 9 per cent compared with a year ago, while manufacturing production fell by 16.1 per cent. The ratio of industrial and commercial inventories to GDP fell to a record low of 10.8 per cent of GDP in the second quarter of 2009 from 13 per cent a year earlier as production and demand plunged.

Further relaxation of exchange controls: reducing the cost of doing business

South Africa's financial system proved to be highly resilient during the global financial crisis. Given the strength of our regulatory system and the shift towards a risk-management approach in line with other G20 member countries, government is in a position to announce further reforms to lower the cost of doing business in South Africa, while managing risks in a volatile international environment.

Aligning prudential regulations on financial institutions with G20 commitments

The move to a system of prudential regulation of foreign exposure, supported by a strong financial regulatory framework, contributed to moderating the impact of the global financial crisis on South Africa. The regulations governing foreign exposure of institutional investors were last updated in 2008 and will remain part of the country's framework for financial and macroeconomic stability. Government will, however, take into account appropriate international proposals to strengthen our regulatory framework in alignment with G20 agreements.

Removing red tape on business transactions

Proposed reforms to reduce red tape on business transactions are as follows:

- Promoting regional integration by allowing South African companies to invest in Southern African Development Community (SADC) member states through offshore intermediaries. The relaxation excludes investment in member states that are part of the Common Monetary Area.
- Increasing the current R50 million limit for company applications to undertake outward investment to R500 million. Applications below this limit will be processed by authorised dealers, subject to all existing criteria and reporting obligations.
- Removing the 180-day rule requiring companies to convert their foreign exchange into rand. (South African companies are still required to repatriate export proceeds to South Africa).
- Doing away with the R250 000 limit on advance payments for imports.
- Allowing South African companies to open foreign bank accounts for permissible purposes without prior approval, subject to reporting obligations.
- Replacing the current paper-based monitoring system of exports (Form F178) with a more efficient electronic system in due course.

Further relaxation of limits on individuals

The foreign capital allowance for resident individuals, last adjusted in 2006, has been increased from R2 million to R4 million, and the single discretionary allowance from R500 000 to R750 000.

Removing controls on non-residents

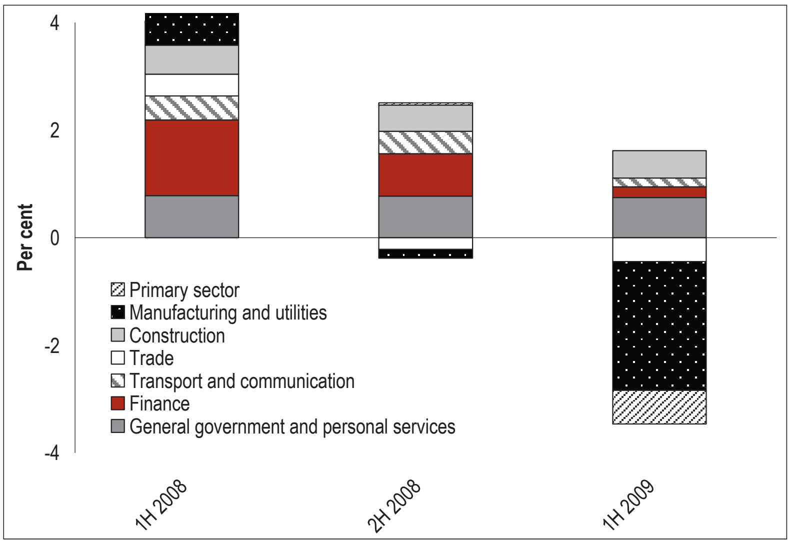
To improve access to domestic credit in the financing of local foreign direct investment (FDI), restrictions on the granting of local financial assistance to affected persons have been further liberalised with the abolition of the 3:1 ratio. This relaxation does not apply to emigrants, the acquisition of residential properties by non-residents, or any other financial transactions – such as portfolio investments, securities lending, hedging or repurchase agreements – by non-residents. In these cases the 1:1 ratio still applies.

The Reserve Bank will provide further details concerning all the above reforms.

Supporting investment and cutting red tape

South Africa continues to welcome foreign direct investment (FDI) and encourages local firms that wish to diversify offshore from a domestic base. Moreover, government recognises the need to modernise the investment framework. In support of these objectives, the National Treasury proposes to improve the current exchange control regulatory framework for approving investments. The key proposals that will form part of the modernised approach will be announced in the 2010 Budget.

Figure 2.1 Sector contributions to real GDP growth, 2008 – 2009



Indicators suggest that the economy turned the corner in the third quarter, although a high degree of volatility remains.

- Mining displayed the first signs of recovery, with production rising strongly in the six months to August. The sector has benefited from a recovery in commodity prices and rising iron ore exports to China.
- Manufacturing production rose at an annualised rate of 3.6 per cent between June and August compared with the previous three months. The improvement has been most noticeable in the motor industry, petrochemicals, and food and beverages.
- Electricity demand has increased since the second quarter of 2009.

Impact on the labour market

Job losses have been concentrated in trade, manufacturing, mining, agriculture and transport

The labour market has been severely affected by the economic crisis, with job losses concentrated in wholesale and retail trade, manufacturing, mining, agriculture and transport. Total employment declined by 3.5 per cent between the fourth quarter of 2008 and the second quarter of 2009, compared with annual growth in employment of 2.4 per cent per year between 2002 and 2008.

The labour market is likely to remain weak over the medium term due to slow recovery in the economy and upward pressure on wages. In addition to job losses, the number of people who are no longer actively seeking employment grew by 409 000 between December 2008 and June 2009. While official unemployment has remained reasonably stable at 23.6 per cent, the broad measure of unemployment has risen to 29.7 per cent from 26.7 per cent in December 2008.

Figure 2.2 Official and broad measures of unemployment, 2008 – 2009

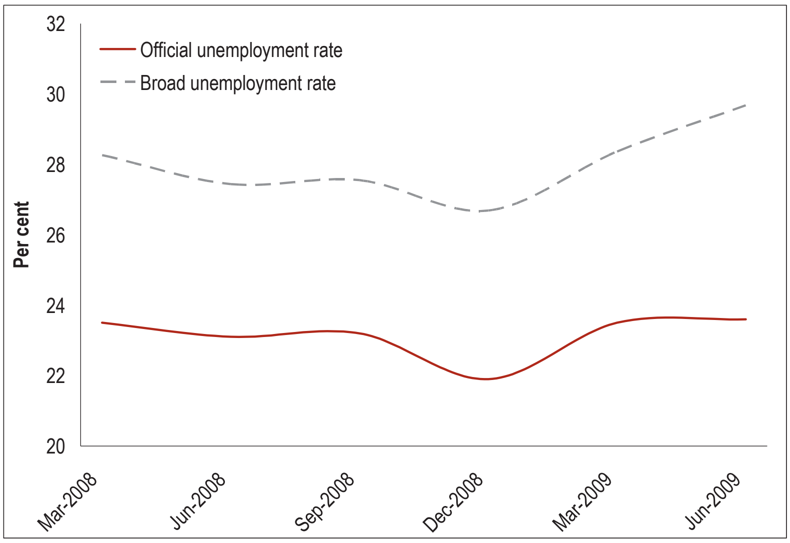


Table 2.4 Formal non-agricultural employment, quarter ended June 2009

	Total employed ('000)	Annual change ('000)	Growth (%, y-o-y)	Change since June 2006 (%)
Mining & quarrying	494	-26	-5.0	7.6
Manufacturing	1 225	-82	-6.3	-8.0
Utilities	59	0	0.0	13.5
Construction	451	-23	-4.9	-1.1
Retail & wholesale trade	1 664	-62	-3.6	0.0
Finance, insurance & real estate	1 827	-80	-4.2	4.7
Transport & communication	357	-7	-1.9	1.4
Community & personal services	2 182	82	3.9	9.0
Total	**8 259**	**-198**	**-2.3**	**2.5**

Source: Statistics South Africa

A gradual recovery in consumption

Gross domestic expenditure declined in the first half of 2009 due to declining household consumption, a sharp contraction in private investment and significant inventory shrinkage. However, government spending and accelerating growth in public investment have contributed positively to growth.

Table 2.5 Contribution to gross domestic expenditure growth

	2006	2007	2008	2009*
Household consumption expenditure	5.3	4.2	1.5	-1.7
Government consumption expenditure	1.0	0.9	0.9	0.8
Gross fixed capital formation	2.3	2.9	2.0	1.3
Change in inventories	0.6	-1.0	-0.8	-2.8
Residual item	-0.1	-0.9	-0.4	–
Gross domestic expenditure	**9.1**	**6.0**	**3.1**	**-2.4**

** First two quarters of the year*

Source: South African Reserve Bank

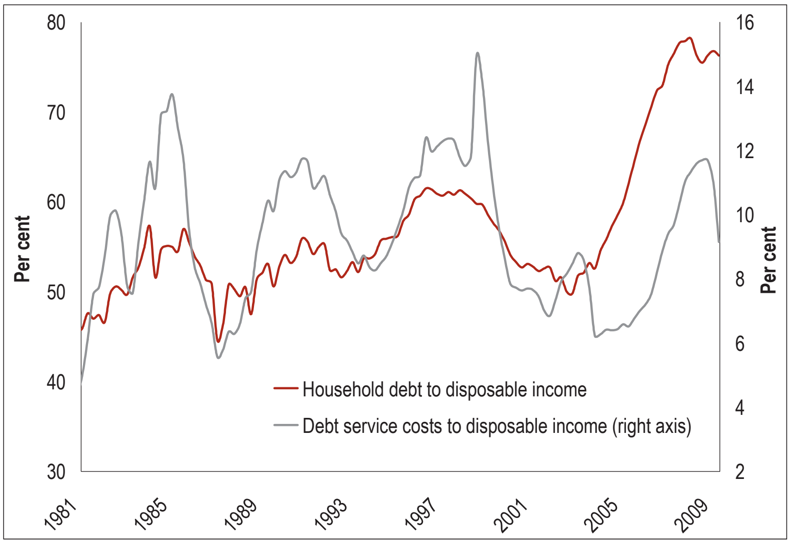
Fiscal and monetary policies have been eased substantially to support demand. However, the full benefit of lower interest rates for consumption and investment will only be seen in time. Banks remain cautious about extending credit and households have been reluctant to take on new debt. Indicators of domestic demand remain weak, with a gradual recovery projected over the medium-term.

Lower interest rates and falling inflation are expected over the period ahead

Household consumption expenditure contracted in the first half of 2009. A sharp rise in inflation in 2008 reduced disposable incomes and spending, and the effects were compounded by tighter credit conditions, job losses and lower house prices accompanying the recession. Although households will benefit from lower interest rates and falling inflation in the period ahead, consumer sentiment will remain muted until greater certainty returns to the labour market and household debt is reduced.

Nevertheless, a gradual improvement in asset prices will help to rebuild household wealth. The ABSA house price index has improved markedly in recent months: prices were only 0.3 per cent lower than a year ago in September after contracting by 3.5 per cent in April 2009.

Figure 2.3 Household debt and debt service costs, 1981 – 2009



Increase in investment by public enterprises helped to offset decline in private-sector investment

Gross fixed investment grew in the first half of 2009, but at a much slower pace of 6.3 per cent compared with growth of 12.6 per cent in the same period in 2008. Private-sector investment fell by 2.5 per cent in the first half of the year, but this decline was partially offset by a sharp increase in investment by public enterprises. The largest declines were in manufacturing, finance and real estate.

Table 2.6 Contribution to overall investment growth

	2005	2006	2007	2008	2009*
General government	0.1	2.4	2.9	1.5	0.4
Public corporation	1.2	1.7	4.1	4.1	7.6
Private enterprises	8.9	9.2	9.3	4.7	-1.7
Total	**10.2**	**13.2**	**16.3**	**10.2**	**6.3**

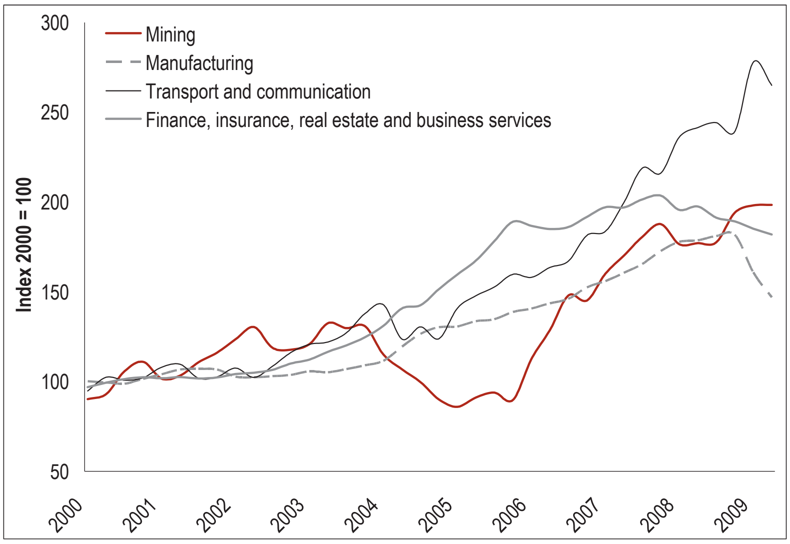
** First half of the year*

Source: South African Reserve Bank

Ratio of gross savings to GDP is rising as a result of weak domestic demand

Weak domestic demand resulted in the ratio of gross savings to GDP rising to 16.5 per cent by the end of June 2009 from 15.2 per cent 12 months earlier, largely due to corporate savings.

Figure 2.4 Real gross domestic fixed investment by sector, 2000 – 2009



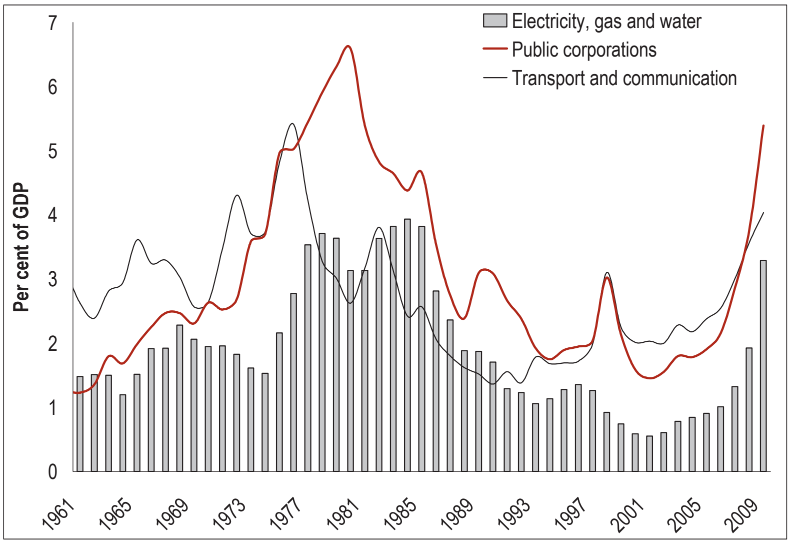
The importance of sustaining public investment

Investment in key infrastructure is part of government's strategy for long-term growth

Public-sector investment, focused on key infrastructure, is a cornerstone of government's strategy to support higher sustainable economic growth in the future. Such expenditure will also help to sustain growth in overall investment and GDP over the medium term.

In the first half of 2009, real fixed investment by state-owned entities increased by 50 per cent compared with the previous year, driven by an 83 per cent rise in spending on electricity, gas and water. Significant investment is also taking place in transport infrastructure, including air, rail, ports and buses. Fixed investment by public corporations rose to 5.4 per cent of GDP in the first half of 2009, a level not seen since the significant capacity expansion of the late 1970s.

Figure 2.5 Investment by public corporations, 1961 – 2009



Data for 2009 is for the first two quarters

Between 2009 and 2012, capital expenditure by Eskom, Transnet and the South African National Roads Agency will total about R441 billion. Higher levels of investment will generally be financed by increased borrowing by state-owned enterprises. In the case of Eskom, the state will provide guarantees where necessary, and tariff increases will be required to align the price of electricity with the cost of generation. Expanded capacity in electricity, rail, ports and roads will help to increase private investment and the potential growth rate of the economy as a whole.

Tariff increases are necessary to align prices with the cost of electricity generation

Development finance institutions are also playing a greater role in supporting companies through the downturn and providing infrastructure finance. The Development Bank of Southern Africa will be supported to leverage its borrowing up to R140 billion. The Industrial Development Corporation intends to invest more than R70 billion in the economy over the next five years, of which R6.1 billion is set aside to assist distressed companies.

Banking sector and credit extension to support recovery

A sustainable economic recovery will require stepped-up credit extension to businesses and households. Although South Africa's financial sector was spared the enormous losses incurred by banks in advanced economies, banking operations have been affected by the downturn and lower house prices. Over the past 12 months, lending growth has slowed sharply across all categories of credit. Growth in private-sector credit extension slowed to only 2.3 per cent in August 2009, with credit extension to the corporate sector 2.4 per cent lower than a year ago. Non-performing loans have more than doubled over the past year from 2.8 per cent of total advances in July 2008 to 5.8 per cent in August 2009.

Stepped-up credit extension is needed to support businesses and households in the recovery

Banks will benefit from the gradual improvement in economic activity. The current stabilisation in the housing market and improved sentiment in financial markets will also reduce pressure on balance sheets. Conditions for raising capital have already improved and banks have taken advantage of this to strengthen their balance sheets. Monetary policy has eased to lower the cost of capital.

Reduced pressure on the current account

The current account has narrowed to a deficit of 5.1 per cent of GDP

Declining domestic expenditure and rising savings have helped alleviate pressure on the current account, which narrowed to a deficit of 5.1 per cent of GDP during the first half of 2009 from 8.1 per cent in the same period in 2008. The trade deficit shrank in the first half of 2009 as imports contracted more sharply than exports, due to weak demand and the rising terms of trade.

Table 2.7 Summary of South Africa's balance of payments, 2004 – 2009

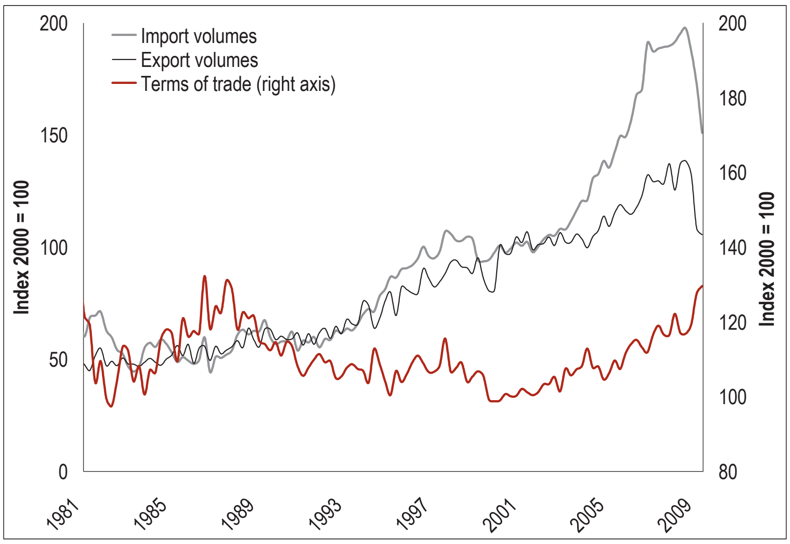
Percentage of GDP	2004	2005	2006	2007	2008	2009*
Trade balance	-0.1	-0.4	-2.3	-2.0	-1.6	-0.6
Net service receipts	-0.3	-0.4	-0.9	-1.1	-1.5	-1.0
Net income receipts	-2.0	-2.0	-2.0	-3.2	-3.2	-2.4
Net dividend receipts	*-1.3*	*-1.6*	*-1.6*	*-2.9*	*-2.5*	*-1.7*
SACU and other current transfers	-0.8	-1.2	-1.1	-1.0	-1.1	-1.2
Net services, income & transfer receipts	-3.1	-3.6	-4.0	-5.3	-5.8	-4.5
Total current account	**-3.2**	**-4.0**	**-6.3**	**-7.3**	**-7.4**	**-5.1**
Current account excl. SACU and other current transfers	-2.4	-2.9	-5.2	-6.3	-6.4	-3.9
Financial account balance	5.9	6.2	8.0	9.7	8.5	5.4
Unrecorded transactions	2.7	1.3	1.9	2.0	4.0	0.7
Change in net reserves due to BoP transactions	**2.7**	**2.2**	**1.7**	**2.4**	**1.1**	**0.8**

** First half of 2009*

Source: South African Reserve Bank

The two largest import categories – capital goods and industrial supplies – have fallen significantly in response to declining manufacturing production and exports. Imports of fuel and lubricant oils have also dropped off.

Figure 2.6 Volumes of exports and imports and the terms of trade, 1981 – 2009



The improvement in the current account is likely to be temporary since demand for imports will rise as domestic demand recovers and inventories are rebuilt. As the economy recovers, income payments to the rest of the world will also rise gradually as foreign holdings of South African assets increase and profit growth strengthens. The current account deficit is expected to rise to 5.7 per cent of GDP in 2010 from an estimated 4.9 per cent in 2009.

The current account deficit is projected to increase to 5.7 per cent in 2010

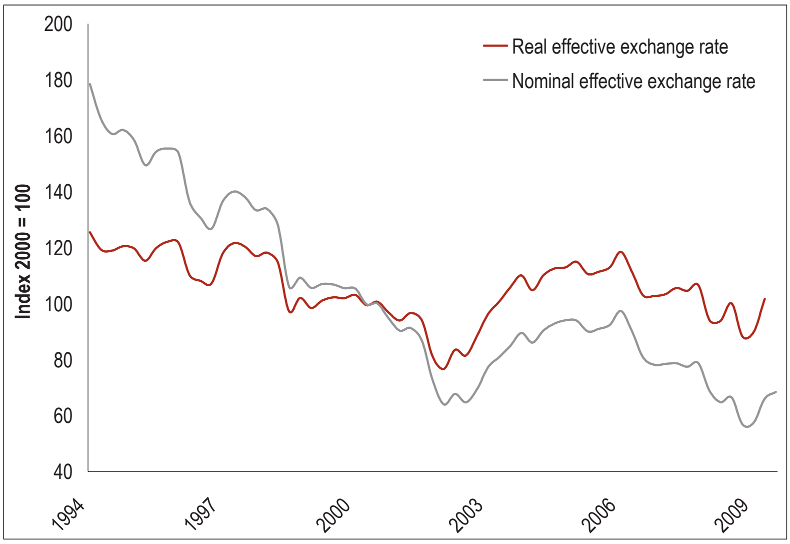
South Africa's overall balance of payments recorded a surplus of R8.9 billion in the first half of 2009. The smaller current account deficit reduced the external funding requirement, but capital inflows also increased strongly as investors purchased more emerging-market assets.

Net purchases of rand-denominated bonds and equities by non-residents amounted to R116 billion in the nine months to September 2009, which is more than the inflows recorded in the same period in 2007. Net inflows of foreign direct investment were also large, at R36.3 billion in the first half of the year.

Strong capital inflows, rising commodity prices, returning risk appetite and a weaker dollar have strengthened the rand to levels last seen before the intensification of the global crisis in September 2008. However, the longer-term trend in the rand is still lower. After a depreciation of more than 40 per cent against the US dollar between January and October 2008, the rand has recovered to pre-crisis levels. In nominal terms, the trade-weighted rand was 27 per cent weaker in September 2009 compared with its peak in February 2006, while the real exchange rate was about 12 per cent weaker over the same period.

Despite the rand's strength in the third quarter of 2009, the long-term trend is lower

Figure 2.7 Nominal and real effective rand indices, 1994 – 2009



Despite strong capital inflows, the squeeze on fiscal resources has limited the Reserve Bank's ability to accumulate more foreign exchange reserves. Gross foreign exchange reserves rose to US$39.1 billion in September 2009 from US$33.7 billion in January, largely due to proceeds from the National Treasury's foreign bond

Gross foreign exchange reserves reached US$39.1 billion in September 2009 issue and the allocation of IMF special drawing rights worth US$2.1 billion. The combination of higher foreign exchange reserves and a smaller current account deficit reduced South Africa's external vulnerability in the second quarter, with reserves adequately covering external obligations.

Conclusion

South Africa's recovery is closely linked to the fortunes of the world economy

The recession has resulted in rising unemployment and business failures, increasing hardship for millions of South Africans. Government has responded to this crisis by sustaining core social expenditure and increasing public infrastructure investment to support higher growth in the future. Interest rates have also declined sharply since the end of 2008 to support growth. South Africa's recovery is closely linked to the fortunes of the world economy, which is expected to improve gradually in the period ahead. Although there are still significant risks to the outlook, the worst of the crisis appears to have passed.

Commodity producers will continue to benefit from strong and sustained expansion in Asia. While many lower-income countries will struggle to manage the aftermath of the global contraction, proximity to better-performing economies, greater regional integration, and improvements to macroeconomic frameworks will tend to support their growth and development. Competitive, well-managed and fiscally sound emerging-market economies are poised to reap the benefits of renewed capital investment flows. Such economies will experience steady increases in per capita incomes.

Over the medium-term, South Africa requires a greater focus on increasing labour absorption in the economy. Reforms to improve competitiveness and to stimulate higher levels of investment, and to foster increased activity by the private sector, are essential to support sustainable employment creation.

Strengthening global financial regulation

The global financial crisis has highlighted the need for a coordinated effort to improve regulation of the financial services industry. To achieve this, the G20 established the Financial Stability Board.

The Financial Stability Board is a high-level forum drawing together policy-makers from important financial centres. It advises on best practice in meeting regulatory standards, and promotes coordination among member countries. South Africa joined the forum 2009. The board has made headway in improving regulation in the following areas:

- Developing a systemic risk ("macro-prudential") approach to financial regulation.
- Raising the quality and level of capital held by banks to improve resilience.
- Reforming the Basel II capital framework to ensure that capital buffers are not procyclical.
- Expanding regulation to reduce risks posed by hedge funds and over-the-counter derivatives.
- Ensuring that banks follow appropriate guidelines for compensating senior executives.
- Strengthening adherence to international standards through a transparent peer review process.
- Improving global accounting standards.

During 2010 work will be undertaken to align South African financial sector policy and regulations with the recommendations of the G20 process.

3

Fiscal policy and trends

Fiscal policy guides government's decisions about revenue, spending and borrowing. South Africa's fiscal policy enables government to deliver on its developmental mandate by providing resources in a manner that is sustainable and that reinforces the stability of the economy.

Prudent fiscal management over the past 15 years has strengthened the public finances, with low debt stock and a broadly balanced budget leading up to the global crisis. As a result, in the face of the downturn and sharply lower budget revenues, government has been able to maintain expenditure on social priorities and support the economic recovery.

Rising expenditure, combined with a largely cyclical downturn in tax revenue, means that the consolidated government budget deficit has increased substantially, to 7.6 per cent of GDP in 2009/10. Higher borrowing to sustain investment in the economy is the correct response to our current economic challenges. Over the medium term, as tax revenues recover and spending growth moderates, the deficit will be lowered to more sustainable levels.

Overview

Healthy public finances enabled government to support growth and spending on social services

Over the past year, as the global economy experienced a sharp contraction, governments around the world have seen revenues fall rapidly, at a time when people and economies require fiscal support the most. South Africa has been similarly affected. The good health of the public finances has enabled government to respond by maintaining spending on public services and stimulating economic growth.

Fiscal and monetary policy have provided significant support to the economy during this recession. The budget deficit has increased from 1 per cent of GDP in 2008/09 to an expected deficit of 7.6 per cent in 2009/10, and interest rates have been reduced by five percentage points. The fiscal easing seen over the past year counts as one of the largest among G20 countries, measured as a percentage of GDP. The fiscus has been able to mobilise resources in support of the economy without compromising future growth or service delivery, and the space remains for government to continue to borrow to reinforce the recovery.

Higher short-term borrowing is necessary, but the deficit must be gradually reduced

Higher borrowing is, however, only a temporary solution. Over the medium term, the deficit will have to be reduced gradually. Failure to do so would mean that a higher proportion of public expenditure would go to service interest payments at the expense of social and economic priorities, or that government would have to raise taxes to meet rising interest costs. Slower growth in expenditure and a recovery in tax revenue due to higher economic growth are expected to support the fiscal recovery, with the budget deficit coming down to 4.2 per cent of GDP by 2012/13.

With this in mind, the fiscal stance is shaped by three goals:

- Ensuring that sufficient resources are available for government to meet its public service commitments, and to provide support to the economy as it moves into its next growth phase.
- Supporting development and alleviating poverty through current expenditure and investments in future capacity.
- Managing an orderly and gradual reduction of the budget deficit towards a sustainable position in a manner that does not compromise the economic recovery. Deficit reduction will result from a combination of automatic adjustments, as tax revenue increases, and a moderation in the growth of government spending.

The proposed budget framework takes into account the consolidated revenue and expenditure of national government, the social security and RDP funds, provinces and various public entities, but excludes local government and the state-owned enterprises.

Table 3.1 Consolidated government fiscal framework, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
R billion	Outcome			Estimate	Medium-term estimates		
Revenue	**546.8**	**634.1**	**692.0**	**657.5**	**743.5**	**833.4**	**921.3**
Percentage of GDP	*30.2%*	*30.7%*	*29.8%*	*27.3%*	*28.4%*	*29.1%*	*29.6%*
Expenditure	**522.9**	**599.1**	**715.4**	**841.4**	**905.6**	**975.6**	**1 052.8**
Percentage of GDP	*28.9%*	*29.0%*	*30.8%*	*35.0%*	*34.6%*	*34.0%*	*33.8%*
Budget balance	**23.9**	**35.0**	**-23.4**	**-183.8**	**-162.1**	**-142.1**	**-131.5**
Percentage of GDP	*1.3%*	*1.7%*	*-1.0%*	*-7.6%*	*-6.2%*	*-5.0%*	*-4.2%*

Contributing to economic stability

Economic stability is essential for creating an environment in which job creation can accelerate, entrepreneurial activity can flourish, and companies and households can invest with confidence. To contribute to stability, and to offset the damaging effects of boom-bust cycles, government maintains a countercyclical fiscal policy. In practice, government expenditure is protected from volatility in the economy by allowing the deficit to expand or contract in response to cyclical changes affecting the budget. This reduces debt levels when times are good and allows government to borrow to finance its expenditure when times are tough. Failure to respond in this fashion would lead to volatility in public spending, larger fluctuations in interest and exchange rates, and lower long-term economic growth.

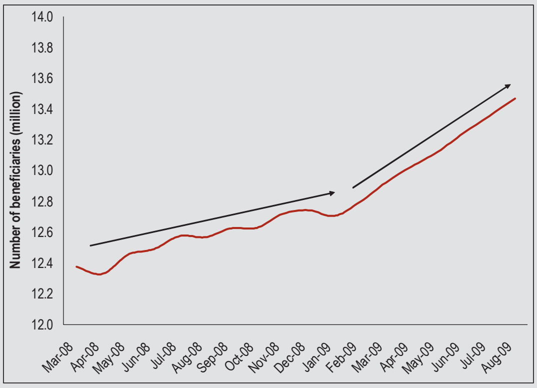
Expenditure trends

Continuing the trend that began in 2003, expenditure rises strongly, reaching 35 per cent of GDP in 2009/10. This rise in government spending during a period of economic contraction stimulates demand and partially offsets the effects of declining growth in other sectors of the economy.

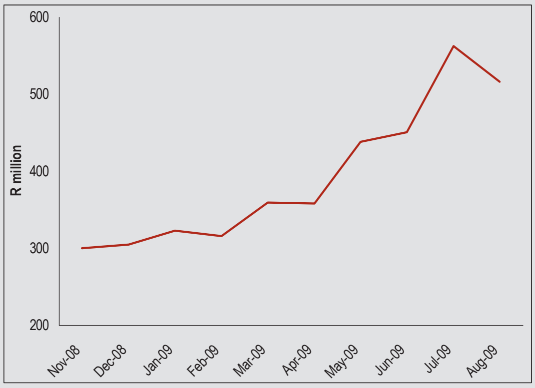
Strengthening social security, creating jobs, building for the future

During the first half of 2009/10, the social grants programme drew in an additional 600 000 people. Most of these were new recipients of the child support grant (475 000) and the older persons grant (86 000). The extension of the child support grant to children aged 14 at the beginning of 2009, and changes to the means test, have resulted in a structural change in the number of social grant beneficiaries.

Total social grant beneficiaries



Total monthly UIF payments



Government is also helping to cushion the newly unemployed from the effects of the downturn. The number of approved Unemployment Insurance Fund (UIF) claims jumped by more than 100 per cent between April 2008 and April 2009. In the first quarter of 2009/10, the UIF paid out R1.3 billion, at an average of R2 400 per payment per month.

Consolidated national and provincial government employment, 2006/07 – 2008/09

	2006/07	2007/08	2008/09
Headcount	1 057 020	1 101 484	1 149 916
Change in numbers		44 464	48 432
% Change		4.2%	4.4%

Public-sector employment has also continued to expand, with national and provincial government creating over 90 000 new positions between 2006/07 and 2008/09.

Public and private investment, year-on-year change

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009
General government sector and public corporations	24.0%	21.0%	20.0%	14.0%	24.0%	29.0%
Private sector	10.0%	8.0%	5.0%	3.0%	-1.0%	-4.0%

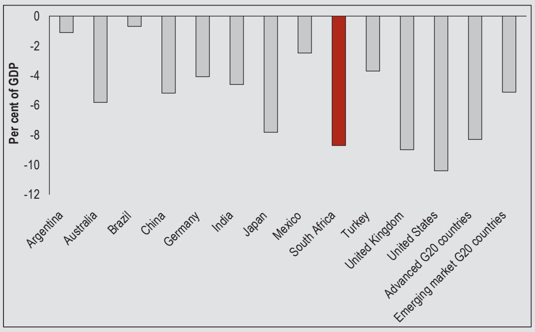
Combined investment for the public sector has continued to grow at over 19 per cent year-on-year in 2009/10, while private-sector investment has declined.

South Africa's fiscal response in a global context

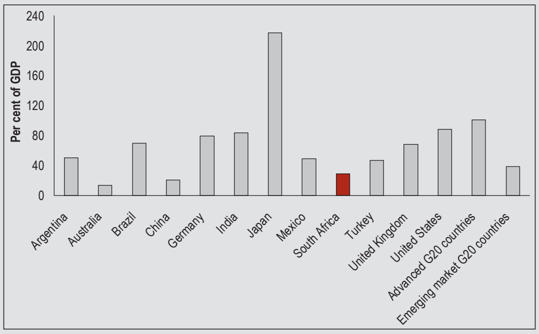
The swing in South Africa's budget balance is among the world's largest, comparable to that of the United Kingdom and the United States.

In contrast to many countries, South Africa entered the crisis with a fiscal surplus and government debt at historic lows. This has put the fiscus in a good position to continue financing the budget deficit without placing excessive pressure on interest rates.

Change in budget balance, 2007 – 2009



Government debt as a per cent of GDP, 2009



Source: IMF World Economic Outlook October 2009 except for South Africa, which is based on National Treasury estimates

As the economy recovers, growth in government expenditure is expected to moderate to more sustainable levels, with consolidated government expenditure stabilising at 34.1 per cent of GDP over the medium term. This allows for additional spending of R78 billion at the main budget level – R17 billion in 2010/11, R24 billion in 2011/12 and R37 billion in 2012/13. Savings and reprioritisation of existing allocations of R14.5 billion at national level, and R12.6 billion at provincial level, increase the amount available to fund new priorities.

Growth in consolidated government non-interest expenditure to average 1 per cent over MTEF

After growing at about 9 per cent a year in real terms over the past three years, real growth in consolidated government non-interest expenditure is expected to average about 1 per cent over the next three years.

Budget revenue trends

Budget revenue is the amount of revenue available to the fiscus to finance expenditure after taking account of tax revenue, other revenue sources and transfers to other members of the Southern African Customs Union (SACU).

Tax revenue is the largest contributor to budget revenue. Because taxes are levied on economic activity, tax revenue is highly cyclical. When the economy is performing well, more tax revenue is available to fund public expenditure, but when the economy is performing poorly, government needs to consider additional financing options.

Over past seven years, tax revenue growth averaged 7.8 per cent a year

Over the past seven years, strong economic growth, improvements in tax administration and compliance, and the broadening of the tax base have resulted in strong growth in tax revenue. While economic growth has averaged 4.2 per cent a year, tax revenue has grown by 7.8 per cent a year in real terms. However, as the economy has slowed, tax revenues have declined and it is expected that total tax revenue for 2009/10 will be R70.3 billion below the forecast presented in the 2009 Budget.

Table 3.2 Consolidated government revenue, 2009/10 – 2012/13

	2009/10				2010/11	2011/12	2012/13
R billion	**Budget**	**Revised**	**Deviation**		**Medium-term estimates**		
Personal income tax	207.5	203.0	-4.5	-2.1%	226.3	264.1	304.5
Corporate income tax	160.0	139.0	-21.0	-13.1%	148.0	163.3	181.2
Value added tax	168.8	138.0	-30.8	-18.2%	157.6	176.5	198.8
Fuel levy	30.1	28.6	-1.5	-5.0%	31.5	33.4	35.4
Custom duties	24.6	17.0	-7.6	-31.0%	18.1	19.9	21.6
Excises - specific	22.6	21.0	-1.6	-7.1%	22.9	23.7	24.8
Other tax revenue	45.7	42.4	-3.3	-7.2%	46.8	52.1	50.4
Gross tax revenue	**659.3**	**589.0**	**-70.3**	**-10.7%**	**651.0**	**732.9**	**816.7**
Percentage of GDP	*26.6%*	*24.5%*	*-2.9%*		*24.8%*	*25.5%*	*26.2%*
Departmental revenue	11.6	9.8	-1.8	-15.3%	10.7	11.3	11.8
Mineral royalties	–	–	–	–	3.5	4.2	4.9
Estimate of SACU payments[2]	-27.9	-27.9	–	–	-19.2	-20.9	-22.5
Other[3]	97.4	86.6	-10.8	-11.1%	97.4	105.9	110.4
Budget revenue	**740.4**	**657.5**	**-82.8**	**-11.2%**	**743.5**	**833.4**	**921.3**
Percentage of GDP	*29.9%*	*27.3%*	*-3.4%*		*28.4%*	*29.1%*	*29.6%*

1. *Includes ad valorem excise, transfer duties, STC, STT, SDL and electricity levy.*
2. *Estimates are based on National Treasury projections. Actual payment will be determined by outcomes of customs and excise revenue collections in line with the revenue sharing formula contained in the SACU agreement.*
3. *Includes provinces, social security funds and selected public entities.*

Most of this decline is the result of lower VAT and company income tax receipts in line with reduced business activity and lower household spending.

As economic growth picks up, tax revenue will begin to recover automatically. Tax revenue is expected to reach 26.2 per cent of GDP by 2012/13, driven by a recovery in household consumption and corporate profits, and supported by measures to broaden the tax base.

South African Revenue Service is increasing penalties for tax evasion

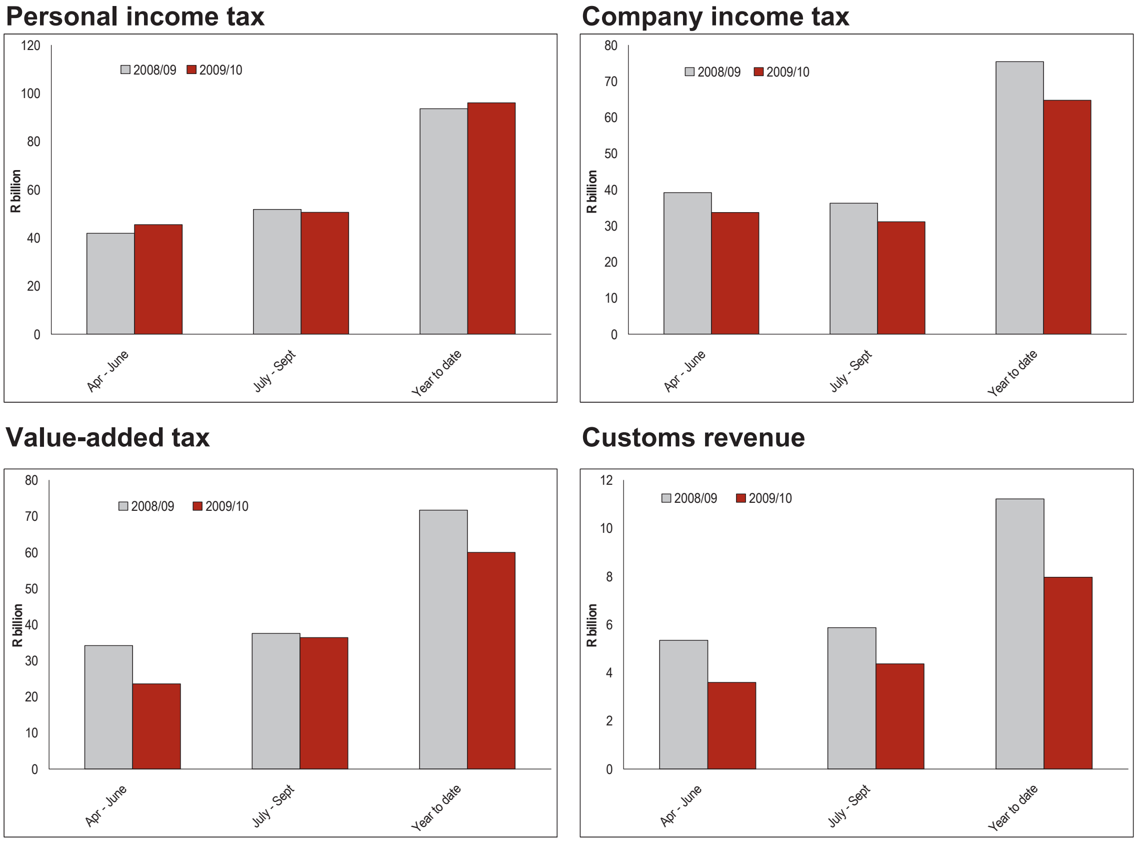
To ensure fairness and equity in the tax system, the South African Revenue Service is increasing penalties for those who do not pay their fair share of taxes. Sustaining the compliance culture built up over the past decade is necessary for government to meet its developmental objectives, and to ensure that the population as a whole believes that the tax system is fair. The present penalty regime is too lax and has been revised, requiring higher penalties on people with higher taxable earnings.

Improved budget revenue partly results from downward revision of estimated SACU transfers

The improvement in budget revenue over the forecast period is supported by downward revisions in the estimates of transfers to South Africa's SACU partners, which share customs revenue. As a result of declining imports, customs revenue was lower than expected in 2008/09 and is also likely to be weaker in 2009/10. This trend will also have a negative impact on Botswana, Lesotho, Namibia and Swaziland. SACU members reliant on customs revenue will have to take into account the impact on their budgets.

The decline in other revenues is mainly the result of lower receipts from departments and interest earned on cash balances.

Figure 3.1 Performance of main revenue categories, year to date



Borrowing trends

Consolidated budget deficit of 7.6 per cent of GDP expected in 2009/10

Government borrows to finance the shortfall between revenue and expenditure. In 2009/10 the increase in expenditure, combined with the decline in budget revenue, results in a projected consolidated budget deficit of 7.6 per cent of GDP. This must be financed through raising debt. The stabilisation of expenditure growth in combination with a recovery in budget revenue is expected to result in the deficit declining to 4.2 per cent of GDP by 2012/13.

Table 3.3 Total government debt, 2006/07 – 2012/13

As at 31 March	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
R billion		Outcome		Estimate		Medium-term estimates	
Domestic debt[1]	471.1	480.8	529.7	709.3	884.3	1 049.1	1 218.6
Foreign debt[1]	82.6	96.2	97.3	100.2	117.1	140.6	167.5
Gross loan debt	**553.7**	**577.0**	**627.0**	**809.5**	**1 001.4**	**1 189.7**	**1 386.1**
Less: National Revenue Fund bank balances	-75.3	-93.8	-101.3	-106.1	-106.1	-106.1	-106.1
Net loan debt[2]	**478.4**	**483.2**	**525.7**	**703.4**	**895.3**	**1 083.6**	**1 280.0**
As percentage of GDP :							
Total net loan debt	*26.4*	*23.4*	*22.6*	*29.2*	*34.2*	*37.8*	*41.1*
of which foreign debt	*4.6*	*4.7*	*4.2*	*4.2*	*4.5*	*4.9*	*5.4*
As percentage of gross loan debt:							
Foreign debt	*14.9*	*16.7*	*15.5*	*12.4*	*11.7*	*11.8*	*12.1*

1. *Forward estimates are based on National Treasury's projections of exchange and inflation rates.*
2. *Net loan debt is calculated with due account of the bank balances of the National Revenue Fund (balances of government's accounts with the Reserve Bank and commercial banks).*

In financing the consolidated government deficit, national government borrowing is projected to reach R175.8 billion in 2009/10, declining gradually to R145.1 billion by 2012/13. As a result, public debt rises from 22.6 per cent of GDP in 2008/09 to 41.1 per cent of GDP by 2012/13. Foreign debt remains a small share of government's debt because South Africa maintains deep and liquid domestic capital markets.

As a result of deep domestic capital markets, foreign debt accounts for a small share of government's debt

Table 3.4 Main budget net borrowing requirement and financing, 2008/09 – 2012/13

	2008/09	2009/10		2010/11	2011/12	2012/13
R million	Outcome	Budget	Revised	Medium-term estimates		
Main budget balance	**-27 715**	**-95 573**	**-181 588**	**-167 635**	**-155 611**	**-145 075**
Extraordinary payments	-4 284	-900	-553	–	–	–
Extraordinary receipts	8 203	6 100	6 297	–	–	–
Borrowing requirement	**-23 796**	**-90 373**	**-175 844**	**-167 635**	**-155 611**	**-145 075**
Domestic short-term loans (net)	**12 225**	**15 400**	**49 700**	**21 000**	**20 000**	**20 000**
Domestic long-term loans (net)	**23 059**	**61 522**	**115 829**	**128 896**	**116 459**	**104 172**
Market loans	42 354	70 500	129 500	142 500	130 000	129 000
Redemptions[1]	-19 295	-8 978	-13 671	-13 604	-13 541	-24 828
Foreign loans (net)	**-3 954**	**3 837**	**11 457**	**14 139**	**15 552**	**17 303**
Market loans	–	9 800	16 098	15 013	17 529	29 364
Arms procurement loan agreements	3 059	3 872	3 845	2 361	1 914	1 360
Redemptions (including revaluation of loans)	-7 013	-9 835	-8 486	-3 235	-3 891	-13 421
Change in cash and other balances[2]	**-7 534**	**9 614**	**-1 142**	**3 600**	**3 600**	**3 600**
Financing	**23 796**	**90 373**	**175 844**	**167 635**	**155 611**	**145 075**

1. Redemption figures are net of anticipated switches, reducing redemptions by R8 billion in 2011/12 and by R35 billion in 2012/13.

2. A negative change indicates an increase in cash balances.

The difference in the financing requirements of consolidated government and national government will be raised by provinces and extra-budgetary institutions.

The significant increase in debt stock means debt-service costs also rise, from 2.3 per cent of GDP in 2008/09 to 2.5 per cent in 2009/10. While the deficit improves over the medium term, debt-service costs continue to rise to 3.2 per cent of GDP by 2012/13.

Debt-service costs rise to 3.2 per cent of GDP in 2012/13

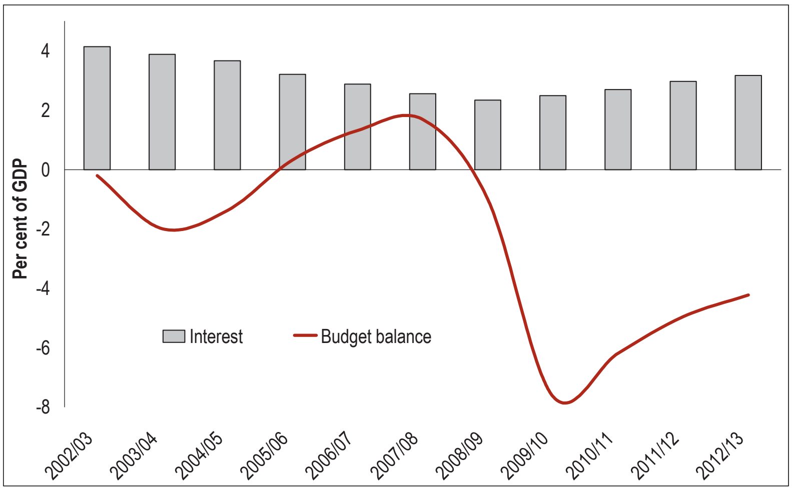
At a broader public sector level, the borrowing of the non-financial public enterprises, such as Transnet and Eskom, is expected to continue to increase in support of their capital expenditure programmes. While the revenues of these enterprises should recover strongly over the forecast period, continued growth in their capital programmes contributes to their high borrowing levels. Eskom will have to borrow about R120 billion over the next three years, though this number may change depending on the level of tariff increases.

Eskom will have to borrow about R120 billion over the next three years

The development finance institutions will expand their role in financing public-sector infrastructure investment. To support this process, government is providing additional support to the major development finance institutions. By increasing the callable capital of the Development Bank of Southern Africa, the bank is able to increase lending by about R102 billion over the next five years. The Land

Bank will be recapitalised to allow it to focus on the extension of development lending.

Figure 3.2 Consolidated government budget balance, 2002/03 – 2012/13



Public enterprises and development finance institutions should be financially sustainable

Both public enterprises and development finance institutions need to operate on a financially sustainable basis. Improving coordination, oversight and governance of these entities, as well as enhanced monitoring of their financial performance and development impact, is a policy priority.

As a result of the higher financing requirement of government and the non-financial public enterprises, the public-sector borrowing requirement is expected to widen to 11.8 per cent of GDP in 2009/10. While government's borrowing moderates somewhat over the medium term, the significant infrastructure programme of the non-financial public enterprises means that public-sector borrowing will average about 9.7 per cent over the next three years.

Table 3.5 Public-sector borrowing requirement, 2008/09 – 2012/13

	2008/09	2009/10		2010/11	2011/12	2012/13
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget balance[1]	**27.7**	**95.6**	**181.6**	**167.6**	**155.6**	**145.1**
Extraordinary payments	4.3	0.9	0.6	–	–	–
Extraordinary receipts	-8.2	-6.1	-6.3	–	–	–
Financing requirement	**23.8**	**90.4**	**175.8**	**167.6**	**155.6**	**145.1**
Other government borrowing[2]	12.0	16.0	11.5	5.5	-1.1	-0.1
General government borrowing	**35.8**	**106.4**	**187.3**	**173.1**	**154.5**	**145.0**
Percentage of GDP	*1.5%*	*4.3%*	*7.8%*	*6.6%*	*5.4%*	*4.7%*
Plus: Non-financial public enterprises	53.2	91.4	97.2	121.3	115.6	115.8
Public sector borrowing requirement	**88.9**	**197.8**	**284.5**	**294.4**	**270.1**	**260.8**
Percentage of GDP	*3.8%*	*8.0%*	*11.8%*	*11.2%*	*9.4%*	*8.4%*
Gross domestic product	*2 321.2*	*2 474.2*	*2 405.1*	*2 620.1*	*2 868.7*	*3 111.3*

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

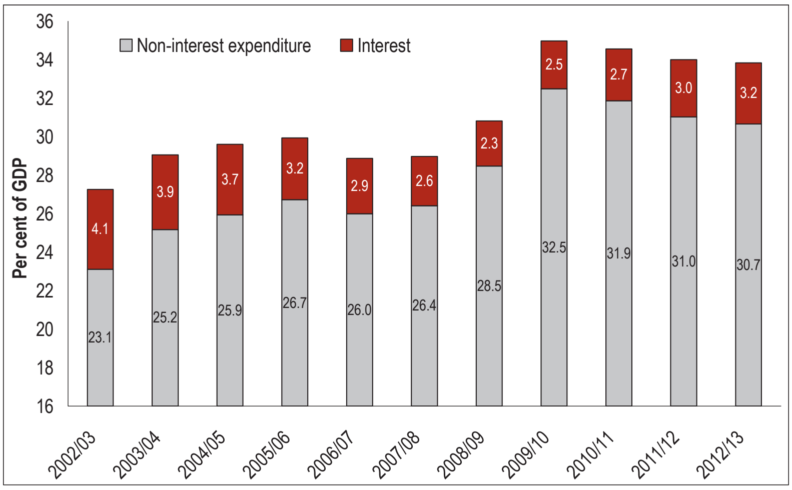
2. Includes social security funds, provinces, extra-budgetary institutions and local government.

Contributing to development

Over the past 10 years government has contributed substantially to social and economic development. Non-interest expenditure by consolidated government is estimated to have grown from 26 per cent of GDP in 2006/07 to 32.5 per cent in 2009/10.

Consolidated government's non-interest expenditure has grown to 32.5 per cent of GDP in current year

Figure 3.3 Consolidated government expenditure, 2002/03 – 2012/13



Growth in expenditure has stimulated economic activity and has been strongly redistributive, contributing to GDP growth and improvements in welfare for all South Africans. The magnitude of this increase was made possible by prudent management of the fiscus, leading to reductions in the deficit, low debt levels and declining debt-service costs.

Strong public spending trend has bolstered economic activity and contributed to welfare

Spending growth has been complemented by reprioritisation of expenditure away from consumption towards welfare transfers and payments for capital assets. In the proposed framework, the compensation of government employees receives a higher proportion of resources than in recent years. To accommodate this expenditure, growth in welfare transfers and capital expenditure moderates, but remains positive.

Growth in government consumption in 2008/09 and 2009/10 is driven by higher public-sector employment, larger salary increases and the introduction of occupation-specific salary dispensations, mainly in education and health. In a constrained fiscal environment these funding pressures are partially offset through slower growth in government employment, savings and reprioritisation of expenditure. The rapid increase in the wage bill in 2009/10 is a permanent cost to the fiscus that cannot be financed through borrowing. If future growth in the wage bill does not moderate, a permanent increase in tax revenue or lower expenditure on other items will be required.

Growth in government consumption is driven by public-sector employment and salary increases

One of government's successes over the past 10 years has been the extent to which it has redistributed resources through transfers to households. These targeted social grants have contributed to the reduction of poverty. Since 2003/04, transfers to households have grown at an average annual real rate of 12.8 per cent, increasing from 3.9 per cent of GDP in 2002/03 to 6.1 per cent in 2009/10.

Consolidated government capital expenditure has been growing by an average real growth rate of 15.6 per cent since 2004/05. Existing capital budgets are now substantially higher than in the recent past, reaching 7.8 per cent of non-interest consolidated government spending in 2009/10. While government capital expenditure stabilises, its contribution to higher levels of investment in infrastructure remains strong.

Investments by Transnet, Eskom expand economy's productive capacity

The non-financial public enterprises – principally Transnet and Eskom – are expected to continue the strong expansion of their capital infrastructure programmes. As a result, expenditure on public sector capital is expected to reach 9.8 per cent of GDP by 2012/13. This represents a considerable investment in the productive capacity of the economy and the ability of the state to provide goods and services. Table 3.6 shows that public infrastructure expenditure remains strong over the medium term, totalling R872 billion. Major funding by government includes further investment in school buildings, public transport, housing, water and sanitation. In addition, non-financial public enterprises continue to invest in power generation, transmission, distribution, transport hubs, freight rail and pipelines.

Public enterprises' capital programmes are financed by own revenue, borrowing and investment

Table 3.6 shows the three-year infrastructure plans of the public sector. Infrastructure projects of government departments and their agencies are budgeted for, while projects of the public enterprises will be financed through their own revenue, borrowing and private investment.

Table 3.6 Infrastructure expenditure estimates, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
R million		**Outcome**		**Estimate**		**Medium-term estimate[4]**	
National departments [1, 2]	4 631	5 712	6 318	8 024	8 709	10 592	10 497
Provincial departments [2]	27 112	29 395	36 094	41 870	48 004	53 434	56 310
Local government	21 084	30 736	39 577	49 950	52 906	57 596	63 787
Consolidated government	**52 827**	**65 843**	**81 989**	**99 844**	**109 619**	**121 622**	**130 594**
Extra-budgetary institutions	3 699	3 726	6 194	7 824	8 216	8 563	8 258
Public-private partnership[3]	1 343	3 857	4 942	2 740	4 553	15 231	13 376
General government	**57 869**	**73 426**	**93 125**	**110 408**	**122 388**	**145 416**	**152 228**
Non-financial public enterprise	25 736	56 765	79 386	127 018	146 070	153 374	152 607
Public sector	**83 605**	**130 191**	**172 511**	**237 426**	**268 458**	**298 790**	**304 835**

1. *Transfers between spheres have been netted out.*
2. *Includes maintenance of infrastructure assets.*
3. *Infrastructure expenditure on PPPs overseen by the Treasury PPP Unit, South African National Roads Agency, Department of Public Works and municipalities.*
4. *National Treasury estimates.*

Efficient implementation of government's infrastructure programme requires improved planning, monitoring and evaluation to ensure that capital budgets are directed towards South Africa's priorities and achieve value for money in the services they produce.

Fiscal sustainability

Sustainability – a core principle of fiscal policy – refers to the ability of government to finance its expenditure over a long period of time. A key indicator of sustainability is debt-service costs. If such costs are expected to rise as a percentage of GDP over the long term, the position is not sustainable. An unsustainable fiscal position can be financed in the short term through higher borrowing. However, pursuing an unsustainable fiscal stance for too long will result in spiralling debt costs – and eventually a costly adjustment through lower spending on service delivery and/or increases in tax rates.

An unsustainable fiscal stance would ultimately result in high debt costs and lower social spending

Figure 3.4 Revenue and non-interest expenditure, 2002/03 – 2012/13

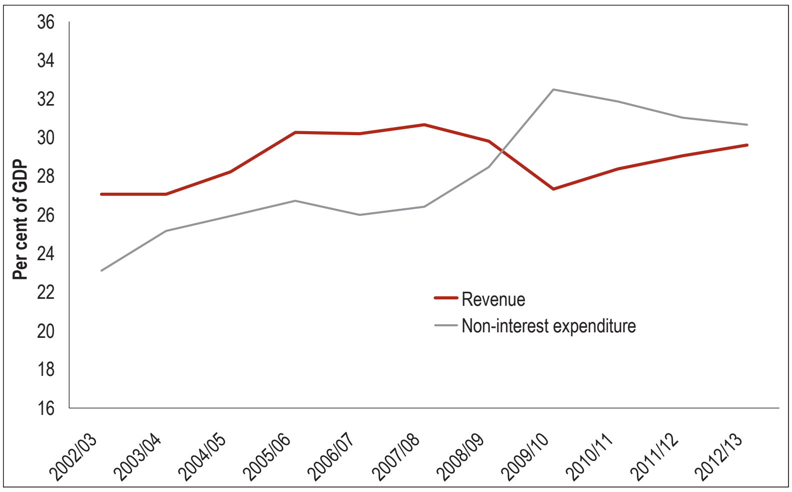


Figure 3.4 shows that strong growth in non-interest expenditure and a decline in budget revenue have resulted in a primary balance deficit. Over the medium term, the stabilisation of growth in non-interest expenditure and rising tax revenue will result in a narrowing of the primary balance deficit.

Primary balance deficit narrows over the medium term

The structural budget balance

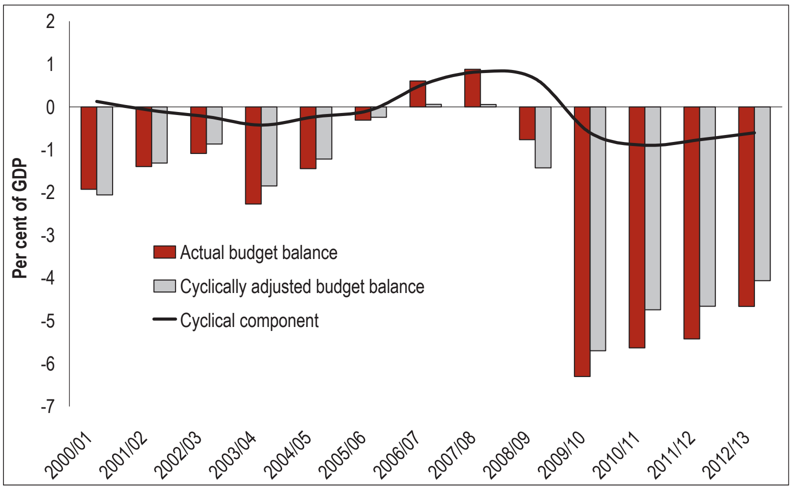
The structural budget balance (also referred to as the cyclically adjusted budget balance) takes account of temporary or cyclical factors that may make the budget deficit (or surplus) appear stronger or weaker than it actually is. In other words, it is an estimate of what the budget balance would be if the economy was performing at its potential growth level for a given set of spending and tax policies.

When the economy is performing above its potential growth level, as occurred between 2004 and 2007, higher revenue is generated and the budget deficit is lower than it would look under normal circumstances. Similarly, during the present recession, revenue has fallen, making the deficit look weaker than it would otherwise appear.

The structural budget deficit is measured at the main budget level, and is projected to be 5.7 per cent of GDP in 2009/10. The increase in the deficit is a result of a permanent increase in some categories of public spending, as well as a recognition that tax revenue is unlikely to

Structural budget deficit is projected to be 5.7 per cent of GDP in 2009/10 recover to pre-2007 levels over the medium term given slower projected economic growth.

Figure 3.5 The structural and main budget balances, 2000/01 – 2012/13



Other means of increasing budget revenue need to be considered in future

Analysis of future trends in the primary and structural budget balance indicates that stabilisation of debt-service costs as a percentage of GDP will require continued improvement in the fiscal balance beyond the forecast period. Combined with the stabilisation in expenditure growth, other means of increasing budget revenue will need to be considered. These include broadening the tax base, improving tax compliance and the introduction of new taxes (such as environmental taxes, to achieve both environmental and revenue objectives). This will permanently raise the level of tax revenue, resulting in a decline in the structural budget deficit and further improvements in the budget balance.

4

Medium-term expenditure framework and division of revenue

While increased public spending over the past decade has had many positive developmental and redistributive effects, the quality of public services in many instances remains poor. Over the next three years South Africa must improve the quality of public spending and, given the pressure on resources, redirect expenditure towards key priorities.

Our country requires a conscientious, efficient public sector that exercises responsible stewardship of public funds. We now have a unique opportunity to rethink and reform the way in which our public finances are managed. Over the medium term, government will aim to improve the efficiency and impact of public spending, reprioritise spending towards key objectives, identify savings and contain costs, reform procurement practices to reduce fraud and exploitation of state resources, and tighten financial management.

Additional resources – including those resulting from a significant reprioritisation exercise – are allocated to five key priorities: education, health, rural development, job creation and fighting crime. The division of available resources maintains a bias towards provincial and local government in recognition of the important services that they deliver.

Policy priorities over the medium term

South Africa has seen a rapid increase in public spending over the past decade

Rapid increases in public spending over the past decade have enabled government to broaden social transfers, increase access to education and health, and deliver housing and basic services such as water and sanitation. Expenditure on economic infrastructure, including public transport and roads, has also risen sharply. The scope of public employment programmes has been broadened.

While access to services has been expanded, quality lags, with far-reaching social consequences

Despite these successes, the quality of many services fails to meet the legitimate expectations of South Africans. Judging by the lack of progress on many of the Millennium Development Goals, South Africa is falling short of its commitments. Too many children cannot read or count; too many women die giving birth; too many people suffer from preventable diseases; too many households fall victim to crime; and too few people are reached by public employment programmes.

Given that South Africa faces a period of lower growth in the next few years, the need to contain state expenditure as a share of GDP implies that the rate of growth in public spending will moderate. Slower revenue growth and rising debt interest costs are expected to feature in the public finances for the foreseeable future.

Government has to do more with less

This means that government has to do more with less. Key elements of this strategy are to:

- Find savings through reduced spending on non-core functions and activities, including shifting resources from administrative components to frontline services
- Rationalise public entities and agencies to save money and improve accountability
- Review public spending to weed out poorly performing programmes, low-priority activities and ineffective policies
- Reform procurement systems to reduce corruption and obtain better value for money, including giving consideration to centralising the procurement of selected goods and services
- Change the culture of the public service to reduce waste and to prevent extravagant spending, shoddy work and corruption.

Jobs, health, education, rural development and fighting crime are the key priorities

The 2010 medium-term expenditure framework (MTEF) expresses government's plans and commitment to deliver on the priorities identified in the medium-term strategic framework (MTSF), while taking into account resource constraints. Over the next three years, government will focus on those priorities that can help to address the impact of the recession and place South Africa on a new developmental path. These priorities are to:

- Support job creation, moving resources towards labour-intensive sectors and the expanded public works programme
- Enhance the quality of education and skills development, focusing on improving foundation-phase literacy and numeracy, and on increasing the number of learners passing grade 12 mathematics and science
- Improve the provision of quality health care, with particular emphasis on reducing infant, child and maternal mortality rates, and broadening access to antiretroviral and tuberculosis treatment
- Carry out comprehensive rural development linked to land and agrarian reform
- Intensify the fight against crime and corruption.

Government also plans to continue investing in the built environment and infrastructure over the next three years to promote access to basic services – such as water, sanitation and electricity – to expand public transport, and to build more schools and hospitals. These investments will support the economy's ability to grow more rapidly in future. To speed up housing delivery, coordination between provinces (which administer the housing grant) and municipalities (which provide bulk infrastructure) is being improved. Responsibility for sanitation is likely to shift to the Department of Human Settlements.

Continuing investment in water, sanitation and electricity infrastructure

The main budget makes available an additional R78 billion for allocation to new priorities or to respond to new pressures over the next three years. This amount is less than in previous years, reflecting the more difficult economic environment.

Budget framework makes an additional R78 billion available

Of the additional resources, 51 per cent go to provincial government, mainly to accommodate higher personnel costs and for spending on education, health and housing. Municipalities receive 16 per cent, the majority of which compensates for the rising costs of providing free basic services and to sustain spending on infrastructure. The national share accommodates growth in the number of social grant beneficiaries, public employment programmes, a step up in funding for rural development and targeted funding to law-enforcement agencies. Support to business and industry will also be considered, with a focus on increasing employment and investment in key export sectors.

While not directly funded through the budget, spending by state-owned enterprises on economic infrastructure continues to rise, albeit at a slower pace.

Finding savings and increasing efficiency

In emphasising its key priorities, government encourages thrift and integrity in the management of public expenditure. Over time, significant increases in spending, combined with weaknesses in financial accountability, have given rise to greater expenditure on low-priority and/or non-essential items.

Departments must reduce expenditure on low-priority and non-essential items

In preparation for the 2010 MTEF, national departments, provinces and municipalities have been asked to thoroughly investigate their baseline budgets to find savings or to identify spending on lower-priority programmes. In some cases, these savings will be retained by departments to fund new priorities; in others, these resources are pooled for allocation to other areas of government for new priorities. While the overall level of spending will be sustained, government is reprioritising medium-term expenditure.

Total net government savings of R14.5 billion at national level and R12.6 billion at provincial level have been identified over three years for reprioritisation. Savings identified at national level will be used to fund additional personnel costs, the phasing in of the child support grant, higher spending on public works programmes and the costs of establishing new departments. Provincial savings will be reprioritised to reduce funding gaps in provinces' education and health budgets

Savings of R14.5 billion at national level and R12.6 billion at provincial level were identified arising from higher-than-budgeted occupation-specific salary agreements.

Substantial savings have been identified in administration and non-essential items

To date, substantial savings have been identified in administration and non-essential items, such as catering, communication, consultants, inventory, stationery and printing, travel and subsistence, accommodation and entertainment. Some savings have also been identified by cutting expenditure from low-priority programmes. In addition, the general level of expenditure on administration programmes across national departments, which has increased by an annual average of 11.7 per cent over the past five years, has been reduced. Government will realise further savings over the medium term by adjusting procurement processes and deferring non-essential purchases.

A high-level task team is reviewing programmes, agencies and public entities to identify cost cuts

A ministerial task team on cost-cutting is reviewing a range of programmes, agencies and public entities as part of government's comprehensive expenditure review. The task team will analyse spending across government and consider rescheduling, rationalising or phasing out certain activities, while ramping up others in support of key priorities. The task team will develop proposals and guidelines to ensure that tangible cost-cutting measures are adopted throughout national, provincial and local government. In a similar vein, a separate ministerial task team has been established to review the operations and finances of state-owned enterprises.

2008/09 outcomes and 2009/10 mid-year estimates

Details of the 2008/09 expenditure outcomes and estimates for the first half of the current financial year for national votes and provinces are set out in Annexure A. Expenditure on national votes (including transfers to provinces) amounted to R636.1 billion in 2008/09, out of a total adjusted appropriation of R637.3 billion. Provincial expenditure amounted to R263.7 billion, compared with the 2008/09 adjusted budget total of R259.5 billion.

Expenditure on national votes in the first half of 2009/10 was 49 per cent of adjusted appropriation

Expenditure on national votes in the first six months of 2009/10 amounted to R368.0 billion, or 49 per cent of the adjusted appropriation for the year, and R66.6 billion more than the spending total for the equivalent period of 2008/09. Expenditure by provinces amounted to R145.3 billion in the first half of 2009/10 or 50 per cent of the main appropriation for the year, and R16.7 billion more than that of last year.

The national adjustments budget is tabled alongside the *Medium Term Budget Policy Statement*, and revised provincial appropriations will be tabled in provincial legislatures before the end of the financial year. Additional spending of R14 billion is proposed in the Adjustments Appropriation Bill, including R5 billion in higher interest costs and R9 billion in higher non-interest spending. More details are provided in the text box below.

Revised expenditure estimates, 2009/10

The Adjustments Appropriation Bill for 2009/10 deals exclusively with necessary amendments in the current financial year. The bill proposes the following changes:

- R1.5 billion in rollovers, arising from commitments related to unspent balances in 2008/09
- R12 billion to cover higher general salary adjustments than provided for in the main budget, and the occupation-specific dispensation agreements
- R562 million for unforeseeable and unavoidable expenditure associated with natural disasters and outbreaks of disease
- R589 million for the establishment of new departments, and the appointment of additional ministers and deputy ministers in line with presidential proclamations
- R116 million for the operational costs of Parliament
- R353 million to address the shortfall in the *devolution of property rate funds grant* to provinces, owing to higher electricity charges
- R509 million to compensate municipalities for the increased cost of providing free basic electricity to poor households
- R524 million to provide workbooks for grades 1 to 6, in the poorest 60 per cent of schools, for the 2010 school year
- R900 million for increased uptake in antiretroviral treatment
- R200 million for the immediate liquidity requirements of the South African Broadcasting Corporation
- R192 million for Airbus's claim against Denel Saab Aerostructures (DSA), subject to verification, for DSA's failure to meet performance targets as part of the 2004 acquisition of eight A400M aircraft
- R144 million to compensate for contractual cost increases as a result of inflation and foreign-exchange losses on the Gautrain Rapid Rail Link conditional grant
- R115 million for community works within the expanded public works programme
- R1 billion for the recapitalisation of the Land Bank
- R731 million refunded to various departments for monies paid directly into the National Revenue Fund from department-specific activities.

Taking into account projected underspending, savings declared by departments and the adjusted state debt cost estimate, the revised estimate of total expenditure in 2009/10 is R752.5 billion. In February 2009 at the tabling of the budget, provision was made for expenditure of R738.6 billion for 2009/10.

Medium-term spending priorities

The key spending priorities are discussed below.

Expanding employment and safeguarding social security

To address unemployment, government will play a role in shifting resources to labour-intensive sectors

The global economic crisis has resulted in large increases in unemployment worldwide. For South Africa, which already faces high levels of joblessness, the challenge is acute. Poverty and income inequality are expected to grow in the immediate future as a result of higher unemployment and reduced incomes. While most jobs are created by the private sector, government plays an important role by shifting resources towards labour-intensive sectors and creating jobs directly in the delivery of public services.

Building skills through the training layoff scheme

As part of its response to the economic crisis, government has introduced the training layoff scheme. Its immediate purpose is to avoid retrenchments while boosting the country's skills base.

The scheme is targeted at companies considering job cuts or closure as a result of the recession. During a temporary suspension of work, employment contracts remain in place, and employers maintain their contributions to the basic social security package, but workers agree to forego their normal wage and receive training and an allowance instead of being retrenched.

The scheme is funded by the National Skills Fund and the Unemployment Insurance Fund with an initial allocation of R2.4 billion. The Commission for Conciliation, Mediation and Arbitration oversees the scheme, while Sector Education and Training Authorities provide training. By 2 October 2009, 24 companies with 3 438 employees had applied to the scheme.

Through the expanded public works programme, government is making a contribution to reducing unemployment and providing incomes to poor communities. In its first phase (2004-2009) the programme provided jobs of varying duration, mainly in infrastructure, for 1.6 million people.

A new phase of the expanded public works programme

Over the next five years, the expanded public works programme aims to create 4.5 million short-term jobs – the equivalent of 2 million full-time low-skilled jobs for unemployed South Africans.

To encourage government departments and municipalities to use funds in their baseline budgets for labour-intensive projects, a wage-based incentive mechanism is being implemented in the infrastructure sector, and for nongovernmental and community organisations providing services on behalf of government. The incentive is a reimbursement of R50 of the daily wage of each person hired, provided that the job target threshold has been exceeded. This subsidy will be extended to projects in the environment, cultural and social sectors.

The community works programme, which operates largely in rural areas, is being rolled out in the current financial year. It aims to provide work to a minimum of 1 000 people per week on each site. The programme targets the creation of 180 000 full-time equivalent jobs by 2014, and receives R114.5 million in the adjustments budget.

Government provides a broad range of incentives, tax breaks and advisory services to help the private sector create jobs, in addition to support offered through the development finance institutions.

Government is considering establishing an industrial development and job creation fund

However, these support measures are not always transparent, and they can be difficult both to access and to monitor. Government is considering establishing a fund to support business with the aim of increasing employment. The fund would be made up largely of existing spending programmes and tax breaks, with clear, measurable job-creation targets.

More than 13 million people now receive social grants

Social grants are a crucial source of income support for poor households. More than 13 million people currently receive benefits. In 2008, government began a phased reduction of men's age of eligibility for the old age grant. In January 2009, poor children up to the age of 15 were accommodated on the child support grant. Over the next three years, the child support grant will be extended to poor children up to their 18th birthday. Once fully phased in, this extension is likely to cost about R7 billion a year.

Other government initiatives, such as the new focus on rural development and the expansion of early childhood education opportunities, will also contribute to greater employment creation.

Improving the quality of education and skills development

Improving education outcomes is essential to support future economic growth and development

The South African education system needs to be constantly improving to broaden access to economic opportunities, and to reduce poverty and inequality. Education has benefited from strong growth in budget allocations over the past decade, mainly focused on improving access to schooling and equity in school funding. Over the next three years, the priorities include improving literacy and numeracy in the early phases of schooling, boosting mathematics and science scores at matric level, and increasing access and quality in further and higher education. School building and teacher training also receive additional resources.

To improve the quality of education, government has refined the occupation-specific dispensation for teachers introduced in 2008. The revised dispensation offers salary improvements for the country's 392 000 teachers, including higher pay for experienced instructors.

To support the teaching of literacy and numeracy in early grades, government intends to provide workbooks to children in poor schools. These classroom aids, together with greater focus on increasing "time-on-task" and teacher training, should contribute to better literacy and numeracy outcomes.

Improving learner performance through workbooks and national assessments

To address South African learners' poor performance in national and international literacy and numeracy benchmark tests, the budget framework proposes to fund workbooks for learners in grades 1 to 7. Some 3.5 million learners will receive workbooks in 2010/11, rising to 5.5 million learners in grades 1 to 7 by 2012.

These educational aids, with daily exercises, will be available in all 11 official languages. The workbook tool will guide teachers on the sequence and pace required to complete the curriculum most effectively, and will benefit learners who do not have textbooks.

Funding is also proposed for national literacy and numeracy assessments to be undertaken in grades 3, 6 and 9. These annual assessments will measure the success of literacy and numeracy interventions. The results will be analysed to provide schools with targeted support.

The Dinaledi schools initiative, introduced in 2004, channels additional resources to 500 disadvantaged schools to increase the number of mathematics and science grade 12 passes. Over the medium term, a new conditional grant will be introduced to provide additional resources, such as science laboratories, textbooks and training for teachers at these schools.

Coverage of school nutrition programme is being expanded and the quality of meals improved

Government will increase the coverage of the national school nutrition programme to reach learners in the poorest 60 per cent of secondary schools, and improve the quality of meals provided. The number of beneficiaries of school feeding programmes will increase from 7.1 million at present to 8.6 million in 2012/13.

The funding of further education and training (FET) colleges is shifting to national government. Government will continue to provide resources for both quality improvements and higher enrolment. However, closer alignment with the funding arrangements contained under the skills development levy is required so that FET colleges can access more of these funds and business can make greater use of the colleges.

Strengthening further education and training colleges

Building on the recapitalisation of FET colleges, government is taking steps to enhance access to these institutions and the quality of courses they provide. The goal is to increase the number of young people and adults accessing continuing education at these technical and vocational centres, in a way that supports an inclusive growth path.

FET attendance and access have improved, but quality requires attention. Government's two core commitments in the period ahead are to consolidate the institutional base for FET colleges in partnership with the skills training system, and to address the gap in the capabilities of school leavers to successfully pursue further education and skills training while improvements are introduced to the basic education system.

Key outputs over the next five years include:

- Increasing participation rates in national curriculum for vocational education (NCV) – the alternative matric offered at FET colleges – to 20 per cent of youth aged 18-24 who are not attending other educational institutions.
- Boosting the number of industrial and related apprenticeships and learnerships in scarce skills areas to a cumulative 350 000.
- Improving NCV subject pass rates to 70-80 per cent and completion rates to 60-70 per cent.

To improve responsiveness to the needs of the economy, programme offerings will be expanded, training partnerships with industry will be funded through SETAs, partnerships with employers will be established and a work-placement programme for graduates of FET colleges will be set up. Quality interventions include initiatives to improve management capacity, materials development and the introduction of formal qualifications for lecturers.

Enhancing the quality of health care

Department of Health has 10-point plan to improve quality of health services

Initiatives to strengthen public health services are important in laying the foundation for a national health insurance system. The Department of Health has developed a 10-point plan to improve the quality of health services. Key elements of this plan include overhauling the management and operation of public hospitals, improving human resource planning, enhancing staffing levels and ensuring more efficient procurement of drugs.

Government also intends to achieve better health outcomes over the next three years by intensifying efforts to fight communicable diseases. The Department of Health has introduced three new vaccines for children. During 2010/11 it plans a mass vaccination campaign to reduce incidence of measles and to raise awareness of the importance of immunisation.

By March 2010, 900 000 people will be receiving antiretroviral treatment

The fight against HIV and Aids is a key priority and treatment uptake will soon exceed more than 300 000 new entrants per year. By the end of March 2010, more than 900 000 people will be receiving antiretroviral treatment, and an estimated 80 per cent of new Aids cases will be entering treatment by 2011/12. Government expenditure on HIV and Aids programmes has increased from R1.1 billion in 2005/06 to R4.4 billion in 2009/10. Additional funding is proposed over the MTEF period for expansion of the programme to accommodate higher numbers of people on antiretroviral treatment.

An occupation-specific salary dispensation was introduced for nurses in 2007. This year new salary scales for doctors, dentists, pharmacists and emergency medical personnel – and a further agreement for physiotherapists, occupational therapists, radiographers, psychologists, and dental therapists – have been concluded, providing for salary increases phased in over two years. These revised dispensations are intended to help the public sector attract and retain skilled professionals. A new quality assurance system will monitor both the quality of care and compliance with norms and standards.

Accelerating public-private partnerships in the health sector

Public-private partnerships (PPPs) can support the expansion of infrastructure and provision of services in public hospitals, while delivering efficiency gains through improved management and supply chain systems. PPPs in the health sector currently include:

- Infrastructure building, upgrading and maintenance (Pelonomi, Settlers and Port Alfred hospitals)
- Co-location, avoiding duplication and optimising unused space (Humansdorp, Universitas and Pelonomi hospitals)
- Medical equipment replacement and maintenance (Albert Luthuli and Western Cape Rehabilitation hospitals)
- Information technology and paperless management systems (Albert Luthuli hospital)
- Catering, cleaning, grounds management and security (various hospitals)
- Pharmaceutical supply chains (Eastern Cape)
- Vaccine production, procurement and distribution (Biovac Institute)
- Delivery of specialised services (Polokwane Renal Dialysis Unit).

Appropriately targeted and costed PPPs can help to improve the relationship between expenditure and patient outcomes in public health.

Rolling out a comprehensive rural development strategy

Two-year pilot project will inform rollout of rural development strategy

The comprehensive rural development programme aims to raise rural income, increase food production, improve the viability of small farms and draw on the economic potential of rural areas. This programme differs from previous initiatives in that it is premised on community participation and planning. A two-year pilot project, launched in Limpopo in August 2009, will inform the rollout of the programme.

Whether they received land through redistribution, restitution or tenure reform, emerging farmers require better access to infrastructure and support services to succeed. The comprehensive agricultural support programme provided support to an estimated 258 830 beneficiaries from its inception in 2004 until the end of 2008/09.

Support to emerging farmers to be increased

Support to the beneficiaries of land restitution and land reform will be stepped up to ensure that farmers are properly skilled and equipped to make productive use of their land. Government is tailoring the programme to improve its impact, and recruiting 1 000 additional extension officers over the next three years, increasing their skills levels and job orientation, and providing them with information and communications technology and administrative support.

Through the *comprehensive agricultural support programme grant*, the *land care programme grant* and the *Ilima/Letsema grant*, R4.1 billion in allocations to provinces support newly settled farmers. These grants include support for local job-creation initiatives and the provision of agricultural starter packs to 140 000 households per year.

At provincial level, total spending on rural development is projected to rise from about R6 billion at present to about R8 billion in 2012/13.

Creating a built environment to support economic growth

Rapid urbanisation has increased demand for land, housing, water, sanitation and transport

A period of sustained economic growth over the past decade, along with increased migration from rural areas, has contributed to significant changes in South Africa's cities. Rapid urbanisation has brought about greatly increased demands for land, housing, water and sanitation, electricity and transport in cities and large towns. Infrastructure and service-delivery functions need to interact effectively to promote efficiency, employment and integrated development.

Housing subsidy is increased to upgrade quality

Government continues to prioritise spending on housing, with the goal of eradicating informal settlements. The baseline budget makes provision for an increase in the housing subsidy and for additional units to be built. Further funding will support the *integrated housing and human settlements grant* in the outer year of the MTEF to sustain rapid growth on this key programme.

Municipalities play an important role in the built environment by expanding basic infrastructure services to households, replacing or rehabilitating assets, and responding to growth in demand for infrastructure. Government has made significant contributions to municipal infrastructure programmes over the past 15 years. The *municipal infrastructure grant* is revised upwards by R2.5 billion to provide more poor households with access to basic services, with the intention of meeting government's target of universal access to services by 2014. This brings the total amount allocated for the rollout of basic infrastructure through this grant to R45.9 billion over the MTEF, augmenting municipal capital budgets.

Further support for township regeneration

The *neighbourhood development partnership grant* will receive additional resources over the three-year period for projects that focus on the regeneration of townships through the development of social and economic infrastructure.

Poor households to get better access to services

Government is committed to providing each poor household with access to a basic level of municipal services. A total of R8.2 billion is added to the local government equitable share over the MTEF period to cater for the increased costs of bulk services such as electricity, and to increase the number of households that receive free basic services. The latest increase in the electricity bulk price for 2009/10 was 31.4 per cent, and further increases over the three-year period are proposed.

A broad-based approach to fighting crime

Fight against crime must include enhancing partnerships

Government is determined to curb the unacceptably high level of crime. We recognise, however, that the police alone cannot resolve high crime levels. The fight against crime must include enhancing partnerships, strengthening social security and creating jobs, along with the review of the criminal justice system. Other public spending priorities, such as health, education, job creation and social security, are essential contributions to creating safer communities.

An additional 22 447 police personnel will be recruited by 2012/13, primarily to strengthen the detective services and crime intelligence. This will increase the number of police personnel from 185 313 at present to 207 760 in 2012/13. The fight against organised crime will be boosted through a proposed additional allocation for the Directorate for Priority Crime Investigation. Staff numbers in this directorate will increase from 350 investigators in 2009/10 to 2 400 investigators by 2012/13. The previous Directorate of Special Operations employed fewer than 500 investigators.

Police reinforcements will strengthen detective services

The implementation of legislation promoting the rights of women and children is being strengthened. The reprioritisation of spending and additional resources over the medium term will enable stepped up staffing levels to support the implementation of the Children's Act (2005), the Child Justice Act (2008), and the Sexual Offences and Related Matters Act (2007).

Consolidated government expenditure

Table 4.1 below shows consolidated expenditure for the period 2009/10 to 2012/13. This consolidation includes national and provincial government, public entities and social security funds. While public spending has increased by close to 9 per cent a year in real terms since 2003, more moderate growth will take place over the MTEF period.

These figures show that expenditure on key priorities such as education, health and infrastructure continues to grow in real terms, while aggregate growth in public spending is more moderate. Major trends include a rising share of spending allocated to education and health and continued strong growth in spending on capital programmes. Personnel costs rise as a share of expenditure as a result of the implementation of the occupation-specific dispensations and above-budget salary increases agreed to in 2009. Some of the higher wage pressures need to be accommodated by finding savings within budgets, reducing the numbers of non-core administrative staff and adjusting other spending items.

Aggregate growth in public spending will moderate over the period ahead

Table 4.1 Consolidated government expenditure, 2008/09 – 2012/13

R billion	2008/09 Outcome	2009/10 Revised	2010/11	2011/12	2012/13	Average annual growth 2009/10 – 2012/13
			Medium-term estimates			
Type of service						
General public services	**44.9**	**49.2**	**52.8**	**55.8**	**55.8**	**4.3%**
Defence	**29.0**	**34.1**	**36.5**	**39.3**	**41.9**	**7.2%**
Public order and safety	**67.3**	**77.7**	**85.9**	**96.2**	**101.6**	**9.3%**
Police services	44.4	50.9	56.3	61.3	65.0	8.5%
Law courts	10.3	11.9	13.3	14.4	15.3	8.5%
Prisons	12.6	14.9	16.3	20.4	21.3	12.8%
Economic affairs	**129.6**	**182.9**	**169.4**	**155.6**	**162.8**	**-3.8%**
General economic, commercial and labour a	23.0	26.9	29.6	30.9	32.0	6.0%
Agriculture, forestry, fishing and hunting	15.9	17.4	18.5	21.0	22.2	8.5%
Fuel and energy	17.3	45.2	34.7	16.2	16.6	-28.4%
Transport	56.0	73.1	65.9	65.4	68.7	-2.0%
Economic affairs not elsewhere classified	17.4	20.3	20.8	22.0	23.3	4.8%
Environmental protection	**5.3**	**5.5**	**6.4**	**6.9**	**7.4**	**10.4%**
Housing and community amenities	**62.4**	**69.4**	**78.9**	**89.7**	**98.5**	**12.3%**
Housing and community development	41.0	45.8	52.8	59.3	66.2	13.1%
Water supply	21.4	23.7	26.0	30.4	32.2	10.8%
Health	**80.7**	**89.8**	**100.8**	**109.2**	**115.2**	**8.6%**
Recreation, culture, and religion	**9.8**	**7.6**	**5.8**	**5.4**	**5.6**	**-9.5%**
Education	**126.2**	**144.0**	**160.2**	**174.8**	**184.6**	**8.6%**
Social protection	**105.8**	**121.1**	**132.2**	**145.2**	**156.6**	**8.9%**
Allocated expenditure	**661.0**	**781.4**	**828.9**	**878.1**	**930.0**	**6.0%**
State debt cost	54.4	60.0	70.7	85.4	98.7	18.1%
Contingency reserve	–	–	6.0	12.0	24.0	
Consolidated expenditure[1]	**715.4**	**841.4**	**905.6**	**975.6**	**1 052.8**	**7.8%**
Economic classification						
Current payments	**421.2**	**480.6**	**529.0**	**581.3**	**617.0**	**8.7%**
Compensation of employees	235.0	272.1	294.7	315.2	330.1	6.6%
Goods and services	128.1	143.8	157.4	171.6	178.7	7.5%
Interest and rent on land	58.2	64.7	76.9	94.5	108.2	18.7%
of which: state debt cost	*54.4*	*60.0*	*70.7*	*85.4*	*98.7*	*18.1%*
Transfers and subsidies	**244.1**	**299.9**	**306.0**	**315.3**	**340.2**	**4.3%**
Municipalities	44.1	53.8	63.0	71.9	79.0	13.7%
Departmental agencies and accounts	23.1	26.2	21.9	23.1	25.6	-0.7%
Universities and technikons	13.9	15.6	17.7	19.2	20.0	8.7%
Public corporations and private	33.1	56.5	42.3	23.6	25.1	-23.7%
Foreign governments and international	1.5	1.9	1.8	2.0	2.1	2.7%
Non-profit institutions	16.4	17.6	20.5	22.1	23.3	9.7%
Households	112.0	128.3	138.8	153.5	165.1	8.8%
Payments for capital assets	**50.0**	**60.9**	**64.6**	**66.9**	**71.6**	**5.5%**
Buildings and other capital assets	37.9	48.0	49.5	51.5	54.9	4.5%
Machinery and equipment	12.1	12.9	15.1	15.5	16.7	8.9%
Total	**715.4**	**841.4**	**899.6**	**963.6**	**1 028.8**	**6.9%**
Contingency reserve	–	–	6.0	12.0	24.0	
Consolidated expenditure[1]	**715.4**	**841.4**	**905.6**	**975.6**	**1 052.8**	**7.8%**

1. *Consisting of national, provincial, social security funds and selected public entities.*

Division of revenue

The division of nationally raised revenue between national, provincial and local government is aligned to MTSF priorities.

The fiscal framework makes available an additional R78 billion over the next three years. Baseline allocations to national departments are increased by R3.7 billion in 2010/11, R8.2 billion in 2011/12 and R13.8 billion in 2012/13. Provincial baseline allocations are revised upwards by R39.9 billion over the MTEF and local baseline allocations are increased by R12.4 billion.

Provincial baselines are revised upwards by R39.9 billion and local baselines by R12.4 billion

The proposed allocation of resources recognises the need for all spheres of government to redirect spending to frontline services and to reduce non-core and ineffective expenditure.

Table 4.2 shows the proposed division of revenue for the 2010 Budget.

Table 4.2 Division of revenue, 2009/10 – 2012/13

R million	2009/10	2010/11	2011/12	2012/13	2010	Average annual growth
	Revised	Medium-term estimates			MTEF	2009/10 – 2012/13
National	**346 642**	**356 350**	**368 986**	**390 531**		**4.1%**
Provincial	**295 353**	**321 369**	**348 720**	**366 983**		**7.5%**
Equitable share	236 878	260 623	280 317	294 386		7.5%
Conditional grants	58 475	60 747	68 403	72 597		7.5%
Local	**50 533**	**59 322**	**67 964**	**75 718**		**14.4%**
Equitable share	24 356	30 468	34 390	37 984		16.0%
Conditional grants	19 377	21 312	25 043	28 776		14.1%
General fuel levy sharing with metropolitan municipalities	6 800	7 542	8 531	8 958		9.6%
Total	**692 528**	**737 042**	**785 670**	**833 232**		**6.4%**
Percentage shares						
National	*50.1%*	*48.3%*	*47.0%*	*46.9%*		
Provincial	*42.6%*	*43.6%*	*44.4%*	*44.0%*		
Local	*7.3%*	*8.0%*	*8.7%*	*9.1%*		
Changes to baseline						
National	**3 565**	**3 730**	**8 200**	**13 788**	**25 718**	
Provincial	**10 834**	**11 670**	**12 800**	**15 412**	**39 882**	
Equitable share	8 995	10 330	10 930	11 530	32 790	
Conditional grants	1 839	1 340	1 870	3 882	7 092	
Local	**835**	**1 600**	**3 000**	**7 800**	**12 400**	
Equitable share	509	1 200	2 500	4 500	8 200	
Conditional grants	326	400	500	3 300	4 200	
General fuel levy sharing with metropolitan municipalities	–	–	–	–	–	
Total	**15 233**	**17 000**	**24 000**	**37 000**	**78 000**	

Funding provincial government

Provinces should reprioritise spending, focusing on education and health

Provincial government delivers education, health, welfare services, housing, agricultural support services, and provincial and rural roads. Additional resources are provided mainly for education, health, housing and rural development.

In line with government's efforts to streamline and prioritise expenditure, provincial governments need to identify savings in non-essential expenditure in their existing budgets to fund core programmes, particularly in education and health. Rising personnel spending strains provincial budgets, especially in labour-intensive services such as education and health. In 2008/09 provinces overspent by R4.2 billion and had a considerable number of unpaid bills.

Of the R39.9 billion added to the provincial baseline over the next three years, R32.8 billion is proposed for the provincial equitable share and R7.1 billion for conditional grants. Transfers to provinces will grow by 7.5 per cent per year, from a revised R295.4 billion in 2009/10 to R367.0 billion in 2012/13.

The funding of FET colleges is shifting from provinces to national government. The equitable share baseline is adjusted by about R3.4 billion a year to reflect this shift. A new conditional grant is created through which funds will flow to FET colleges.

Provincial equitable share

Provincial equitable share adjusted for general salary increases and occupation-specific dispensations

The provincial equitable share is budgeted to grow by an annual average of 7.5 per cent, from a revised R236.9 billion in 2009/10 to R294.4 billion in 2012/13. An adjustment of R29.8 billion is made over the MTEF period to accommodate occupation-specific dispensations and general salary increases. An amount of R18 billion is proposed to accommodate the carry-through costs of this year's higher salary increases. Provision is also made for adjusted salaries in the health and education dispensations.

An additional R1 billion a year is provided to the provincial equitable share for spending on frontline services in education and health, to help accommodate higher salaries for doctors and to enable provinces to strengthen governance and oversight of municipalities.

The calculation of the equitable share is determined by an objective redistributive formula published annually in the *Budget Review* and takes into account various surveys and other data. An adjustment is also made for the shift of Merafong from North West province to Gauteng.

Provincial conditional grants

Conditional grants supplement various programmes partly funded by provinces, such as infrastructure and hospitals, and support specific priority programmes. Conditional grants are expected to grow from a revised R58.5 billion in 2009/10 to R72.6 billion in 2012/13. Revisions to the provincial conditional grant allocations over the medium term are shown in Table 4.3. Conditional grants to provinces appear in Table 4.4.

The *HIV and Aids conditional grant* receives an additional R5.4 billion over the MTEF period and the housing grant is increased by R1 billion in the outer year, sustaining strong growth in this programme.

HIV and Aids grant receives an additional R5.4 billion over the MTEF period

Table 4.3 Revision to provincial conditional grant allocations, 2010/11 – 2012/13

R million	2010/11	2011/12	2012/13	2010 MTEF
	Medium-term estimates			Total
Basic Education	**–**	**70**	**220**	**290**
Dinaledi schools grant	–	70	100	170
National school nutrition programme grant	–	–	120	120
Health	**1 340**	**1 800**	**2 400**	**5 540**
Comprehensive HIV and Aids grant	1 200	1 800	2 400	5 400
Hospital revitalisation grant	140	–	–	140
Human Settlements	**–**	**–**	**1 000**	**1 000**
Integrated housing and human settlement development grant	–	–	1 000	1 000
National Treasury	**–**	**–**	**262**	**262**
Infrastructure grant to provinces	–	–	262	262
Total	**1 340**	**1 870**	**3 882**	**7 092**

Table 4.4 Conditional grants to provinces, 2009/10 – 2012/13

	2009/10	2010/11	2011/12	2012/13
R million	Revised	Medium-term estimates		
Agriculture, Forestry and Fisheries	**974**	**1 117**	**1 437**	**1 509**
Agricultural disaster management grant	157	–	–	–
Comprehensive agricultural support programme grant	715	862	979	1 028
Ilima/Letsema projects grant	50	200	400	420
Land care programme grant: Poverty relief and infrastructure development	51	55	58	61
Arts and Culture	**441**	**494**	**524**	**550**
Community library services grant	441	494	524	550
Basic Education	**2 575**	**3 931**	**5 048**	**5 447**
Dinaledi schools grant	–	–	70	100
HIV and Aids (life skills education) grant	181	188	199	209
National school nutrition programme grant	2 395	3 663	4 579	4 928
Technical secondary schools recapitalisation grant	–	80	200	210
Higher Education and Training	**3 168**	**3 373**	**3 542**	**3 719**
Further education and training college sector recapitalisation grant	3 168	3 373	3 542	3 719
Health	**16 702**	**19 353**	**20 972**	**22 530**
Comprehensive HIV and Aids grant	4 376	5 512	6 433	7 265
Forensic pathology services grant	502	557	590	620
Health disaster response (cholera) grant	50	–	–	–
Health professions training and development grant	1 760	1 865	1 977	2 076
Hospital revitalisation grant	3 370	4 021	4 172	4 381
National tertiary services grant	6 614	7 398	7 799	8 189
World Cup health preparation strategy grant	30	–	–	–
Human Settlements	**12 592**	**15 027**	**17 222**	**17 939**
Housing disaster relief grant	150	–	–	–
Integrated housing and human settlement development grant	12 442	15 027	17 222	17 939
National Treasury	**13 449**	**11 315**	**13 091**	**14 008**
Infrastructure grant to provinces	9 249	11 315	13 091	14 008
Gautrain rapid rail link loan	4 200	–	–	–
Public Works	**1 501**	**1 496**	**1 962**	**2 060**
Devolution of property rate funds grant	1 350	1 096	1 162	1 220
Expanded public works programme incentive grant	151	400	800	840
Sport and Recreation South Africa	**402**	**426**	**452**	**475**
Mass sport and recreation participation programme grant	402	426	452	475
Transport	**6 670**	**4 215**	**4 153**	**4 361**
Gautrain rapid rail link grant	2 977	341	–	–
Overload control grant	10	11	–	–
Public transport operations grant	3 532	3 863	4 153	4 361
Sani Pass roads grant	34	–	–	–
Transport disaster management grant	117	–	–	–
Total	**58 475**	**60 747**	**68 403**	**72 597**

Funding local government

Local government delivers essential household services such as water, sanitation and electricity. Municipalities support social and economic development through infrastructure investment and help to alleviate poverty by providing free basic services to poor households.

Population growth,[1] immigration and urbanisation pose significant challenges for municipalities, and in the context of a weaker economic environment, a balance needs to be struck between expenditure and available revenues.

Given weak revenues in poor municipalities, national support is required to extend basic services

Municipal spending pressures result mainly from the rising cost of bulk services, increasing demand for free basic services, provisions for repair and maintenance of ageing infrastructure, and the costs of governance and administration. Given the weak revenue base of smaller and poorer municipalities, national transfers are needed to support key priorities such as the extension of household services.

Municipalities need to find efficiency savings

Despite the constraints in local government, there is some scope for municipalities to find efficiency savings to reduce budget pressures. Typical savings could include limiting conferences at venues outside municipal offices and spending less on advertising. Local government can also improve revenue collection and avoid the build-up of arrears for services by updating billing systems, maintaining strict credit control measures and improving routine infrastructure maintenance. These measures must be balanced with support to poor households.

Operation Gcina'manzi: water savings in Johannesburg

Johannesburg has managed to save about 4 billion litres of water that would have been lost through poor infrastructure thanks to Operation Gcina'manzi, an initiative of Johannesburg Water. The project involves the repair or replacement of faulty plumbing in households with new fittings free of charge. The water savings for 2008/09 are equivalent to R115.7 million, with cumulative water savings amounting to R258.8 million between 2003 and 2008.

The 2010 MTEF provides for an additional R12.4 billion in the local government budget framework, with R8.2 billion directed to the local government equitable share and R4.2 billion for infrastructure transfers. These increases result in local government's share of nationally raised revenue growing from a revised R50.5 billion in 2009/10 to R75.7 billion in 2012/13. Table 4.5 shows the revised local government allocations for the 2010 framework period.

Local government equitable share

Local government equitable share grows to R38 billion in 2012/13

The primary funding mechanism to support municipal service delivery to the poor is the local government equitable share. This allocation supplements municipal spending to achieve universal access to basic services. It also provides support for basic administration and governance to enhance public participation. Including the *regional service council levies replacement grant* for district municipalities and special support for councillor remuneration, the local government equitable share is budgeted to grow by 16 per cent a year in nominal terms, from R24.4 billion in 2009/10 to R38 billion in 2012/13.

[1] The *2001 Census* indicated that there were 44.8 million people in 11.8 million households, of which 5.5 million households were deemed to be poor. The population grew by 8.3 per cent, to an estimated 48.5 million people in 2007.

Conditional transfers to local government

Municipal capital spending is expected to reach R50 billion in the current financial year

Conditional grants supplement various programmes partly funded by municipalities, such as regional bulk and municipal network infrastructure for electricity, water and sanitation. Municipalities spent R39.6 billion on capital projects in 2008/09 and capital spending is projected to increase to R50 billion in 2009/10, with further increases likely over the three-year period. An additional R2.5 billion is allocated to the *municipal infrastructure grant* and additional resources are allocated for bulk water projects and for the *neighbourhood development partnership grant*. Conditional grants are expected to grow from a revised R19.4 billion in 2009/10 to R28.8 billion in 2012/13. The revised local government infrastructure grants amounts are shown in Table 4.5.

Municipalities are also encouraged to take greater advantage of incentives available to expand public employment programmes, which are essential to address high levels of youth unemployment.

Table 4.5 Local government allocations, 2009/10 – 2012/13

R million	2009/10 Revised	2010/11	2011/12 Medium-term estimates	2012/13
Equitable share	**24 356**	**30 468**	**34 390**	**37 984**
General fuel levy sharing with metros	**6 800**	**7 542**	**8 531**	**8 958**
Conditional grants (direct transfers)	**19 377**	**21 312**	**25 043**	**28 776**
Infrastructure	**17 297**	**19 401**	**22 946**	**26 574**
Municipal infrastructure grant	11 433	12 529	15 069	18 322
National electrification programme grant	933	1 020	1 097	1 151
Public transport infrastructure and systems grant	2 418	4 290	5 149	5 406
Neighbourhood development partnership grant	613	1 030	1 240	1 282
2010 FIFA World Cup stadium development grant	1 661	302	–	–
Rural transport services and infrastructure grant	10	10	11	12
Electricity demand side management grant	175	220	280	–
Municipal drought relief grant	54	–	–	–
Regional bulk infrastructure grant[1]	–	–	100	400
Capacity building and other	**2 081**	**1 911**	**2 097**	**2 202**
Municipal systems improvement grant	200	212	225	236
Financial management grant	300	365	385	404
2010 FIFA World Cup host city operating grant	508	210	–	–
Expanded public works programme incentive grant	202	554	1 108	1 163
Water and sanitation operating grant	871	570	380	399
Conditional grants (indirect transfers)	**2 879**	**2 843**	**3 698**	**4 065**
Infrastructure	**2 744**	**2 843**	**3 698**	**4 065**
National electrification programme grant	1 478	1 769	1 902	1 997
Neighbourhood development partnership grant	80	125	100	105
Backlogs in water and sanitation at clinics and schools grant	350	–	–	–
Backlogs in the electrification of clinics and schools grant	150	–	–	–
Electricity demand side management grant	75	110	120	–
Regional bulk infrastructure grant	612	839	1 575	1 962
Capacity building and other	**135**	**–**	**–**	**–**
Water and sanitation operating grant	135	–	–	–
Total revised allocations (direct)	**50 533**	**59 322**	**67 964**	**75 718**
Total revised allocations (direct and indirect)	**53 412**	**62 166**	**71 662**	**79 783**

1. *The regional bulk infrastructure grant is a grant-in-kind to local government.*

Annexure A

2008/09 outcome and half-year spending estimates for 2009/10

Table A.1 Expenditure by vote, 2008/09 and 2009/10 financial year

	2008/09				2009/10		
R million	Main budget	Adjusted budget	Audited outcome	Over(-)/ Under(+)	Main budget	Adjusted budget	Actual spending April to September
Central Government Administration							
1 The Presidency	290	312	326	-14	325	494	177
2 Parliament[1]	905	914	1 135	-221	974	1 108	460
3 International Relations and Cooperation	4 341	5 570	5 472	98	5 337	5 553	1 548
4 Home Affairs	4 505	4 817	4 667	150	5 051	5 264	2 488
5 Public Works	4 141	4 302	4 197	105	5 298	6 049	2 424
Financial and Administrative Services							
6 Government Communication and Information System	418	440	427	12	482	497	251
7 National Treasury	21 318	31 424	31 312	112	61 676	62 846	32 107
8 Public Administration Leadership and Management Academy	106	106	105	–	119	121	60
9 Public Service and Administration	412	420	412	9	356	430	159
10 Public Service Commission	111	114	114	–	121	132	71
11 Statistics South Africa	1 272	1 323	1 323	–	1 609	1 715	844
Social Services							
12 Arts and Culture	2 117	2 160	2 114	46	2 623	2 632	1 078
13 Education	18 858	19 749	19 709	40	21 287	21 849	16 367
14 Health	15 101	15 851	15 464	387	17 058	18 423	8 857
15 Labour	1 733	1 748	1 643	105	2 126	2 090	1 085
16 Social Development	76 008	76 554	76 097	457	86 408	86 508	45 460
17 Sport and Recreation South Africa	3 496	4 910	4 871	38	2 860	2 884	1 741
Justice, Crime Prevention and Security							
18 Correctional Services	11 672	12 339	12 823	-484	13 239	13 835	6 539
19 Defence and Military Veterans	28 233	27 899	27 801	98	32 024	31 325	13 197
20 Independent Complaints Directorate	98	98	99	-1	115	116	48
21 Justice and Constitutional Development	8 341	8 516	8 434	82	9 658	9 770	4 468
22 Police	40 453	41 492	41 492	–	46 410	47 622	22 510
Economic Services and Infrastructure							
23 Agriculture[2]	–	–	–	–	2 793	–	–
24 Communications	1 724	2 332	2 329	3	2 267	2 470	762
25 Environmental Affairs and Tourism	3 062	3 207	3 199	8	3 481	3 511	1 644
26 Human Settlements	10 587	10 928	10 920	8	13 589	13 605	7 645
27 Rural Development and Land Reform	6 659	6 659	6 655	5	6 099	6 391	3 061
28 Minerals and Energy	3 595	3 786	3 730	56	4 647	4 682	2 585
29 Cooperative Governance and Traditional Affairs	34 194	35 639	35 348	291	35 607	36 527	15 309
30 Public Enterprises	3 008	3 269	3 265	4	3 797	3 991	2 933
31 Science and Technology	3 704	3 722	3 703	18	4 234	4 262	1 641
32 Trade and Industry	5 103	5 127	5 057	70	6 344	6 402	3 046
33 Transport	20 509	24 493	24 839	-346	23 735	24 239	12 928
34 Water Affairs and Forestry[2]	–	–	–	–	7 894	–	–
35 Agriculture, Forestry and Fisheries[2]	2 981	3 431	3 355	76	–	3 764	1 763
43 Water Affairs[2]	6 253	6 544	6 025	519	–	7 774	2 839
Total appropriation by vote	**345 308**	**370 194**	**368 463**	**1 731**	**429 643**	**438 881**	**218 097**
State debt cost	51 236	53 926	54 394	-468	55 268	59 995	28 225
Equitable share	199 377	204 010	204 010	–	231 051	240 046	116 681
General fuel levy sharing with metros	–	–	–	–	6 800	6 800	154
Other direct charges against the National Revenue Fund	9 175	9 175	9 197	-22	9 801	9 801	4 861
Total direct charges against the National Revenue Fund	**259 788**	**267 111**	**267 601**	**(490)**	**302 920**	**316 642**	**149 920**
Unallocated and contingency reserve	6 000	–	–	–	6 000	–	–
Less: Projected underspending	–	–	–	–	–	-3 000	–
Total	**611 096**	**637 305**	**636 063**	**1 241**	**738 563**	**752 523**	**368 017**

1. The audited outcome for Parliament is based on the accrual basis of accounting.

2. Funds appropriated in the main budget shifted to newly created department. Historical numbers were adjusted accordingly.

Table A.2 Expenditure by province, 2008/09 and 2009/10 financial year

R million	2008/09 Main budget	2008/09 Adjusted budget	2008/09 Preliminary outcome	2008/09 Over(-)/ Under(+)	2008/09 Deviation from adjusted budget	2009/10 Main budget	2009/10 Actual spending April to September
Eastern Cape	**38 085**	**39 390**	**39 000**	**390**	**1.0%**	**42 635**	**22 634**
Education	17 810	17 921	17 869	52	0.3%	19 448	10 074
Health	9 746	10 639	10 492	147	1.4%	11 328	6 522
Social Development	1 385	1 397	1 319	78	5.6%	1 434	654
Other functions	9 143	9 434	9 320	114	1.2%	10 425	5 383
Free State	**15 685**	**16 246**	**16 055**	**191**	**1.2%**	**18 374**	**8 649**
Education	6 599	6 721	6 713	8	0.1%	7 407	3 690
Health	4 288	4 469	4 460	10	0.2%	5 169	2 337
Social Development	536	556	540	16	2.8%	667	308
Other functions	4 262	4 500	4 342	158	3.5%	5 131	2 314
Gauteng	**46 672**	**48 605**	**52 063**	**-3 458**	**-7.1%**	**55 259**	**29 429**
Education	16 629	16 678	16 709	-31	-0.2%	18 987	9 505
Health	13 889	14 908	15 679	-771	-5.2%	16 590	9 066
Social Development	1 729	1 742	1 743	-2	-0.1%	1 936	863
Other functions	14 424	15 278	17 932	-2 654	-17.4%	17 746	9 995
KwaZulu-Natal	**51 101**	**53 201**	**55 509**	**-2 308**	**-4.3%**	**60 463**	**29 921**
Education	21 389	22 337	22 983	-646	-2.9%	24 810	12 380
Health	15 043	15 783	17 103	-1 320	-8.4%	17 770	9 103
Social Development	1 198	1 207	1 222	-15	-1.3%	1 377	686
Other functions	13 471	13 874	14 201	-327	-2.4%	16 506	7 752
Limpopo	**29 633**	**30 562**	**30 662**	**-100**	**-0.3%**	**34 476**	**16 145**
Education	14 221	14 544	14 692	-148	-1.0%	16 362	7 839
Health	7 594	7 952	7 960	-8	-0.1%	9 018	4 089
Social Development	726	726	702	24	3.3%	762	333
Other functions	7 092	7 341	7 308	33	0.4%	8 334	3 884
Mpumalanga	**18 740**	**20 436**	**20 068**	**369**	**1.8%**	**22 545**	**11 345**
Education	8 934	9 357	9 361	-4	-0.0%	10 073	5 188
Health	4 242	4 656	4 453	203	4.4%	5 429	2 907
Social Development	662	659	657	2	0.3%	792	296
Other functions	4 901	5 765	5 597	167	2.9%	6 250	2 953
Northern Cape	**6 689**	**7 114**	**7 097**	**17**	**0.2%**	**7 941**	**3 789**
Education	2 601	2 681	2 852	-171	-6.4%	2 979	1 506
Health	1 774	1 857	1 742	115	6.2%	2 214	1 096
Social Development	357	374	363	11	3.0%	408	175
Other functions	1 957	2 202	2 140	61	2.8%	2 340	1 012
North West	**16 938**	**17 724**	**17 587**	**137**	**0.8%**	**19 866**	**9 773**
Education	6 995	7 212	7 179	34	0.5%	8 145	3 978
Health	4 223	4 445	4 485	-40	-0.9%	4 919	2 505
Social Development	608	614	575	39	6.4%	725	286
Other functions	5 112	5 453	5 348	104	1.9%	6 077	3 004
Western Cape	**24 918**	**26 223**	**25 615**	**609**	**2.3%**	**29 034**	**13 630**
Education	9 020	9 206	9 192	14	0.1%	10 346	4 856
Health	8 642	8 871	8 656	215	2.4%	9 893	4 812
Social Development	1 088	1 234	1 215	19	1.5%	1 163	523
Other functions	6 168	6 912	6 551	361	5.2%	7 633	3 439
Total	**248 459**	**259 502**	**263 656**	**-4 153**	**-1.6%**	**290 593**	**145 315**
Education	104 199	106 657	107 550	-893	-0.8%	118 558	59 017
Health	69 440	73 581	75 030	-1 449	-2.0%	82 330	42 437
Social Development	8 289	8 508	8 336	171	2.0%	9 262	4 125
Other functions	66 531	70 757	72 739	-1 983	-2.8%	80 443	39 737

Glossary

Adjustments estimate	Presentation to Parliament of the amendments to be made to the appropriations voted in the main budget for the year.
Appropriation	The approval by Parliament of spending from the National Revenue Fund, or by a provincial legislature from the Provincial Revenue Fund.
Asset price bubble	A condition occurring when a category of assets rises above the level justified by economic fundamentals.
Balance of payments	A summary statement of all the international transactions of the residents of a country with the rest of the world over a particular time period.
Baseline	The initial allocations used during the budget process, derived from the previous year's forward estimates.
Budget balance	The difference between budgeted expenditure and budgeted revenue. If expenditure exceeds revenue, the budget is in deficit – or, if the reverse is true, it is in surplus.
Capital gains tax	Tax levied on the profits realised from the disposal of capital assets or investments by a taxpayer. A capital gain is the excess of the selling price over the original purchase price of a capital asset.
Capital flow	A flow of investments in and out of the country.
Commission for Growth and Development	A commission formed in 2006 and composed of 21 members from government, business and academia to research economic growth and development in a range of countries.
Conditional grants	Allocations of money from one sphere of government to another, conditional on certain services being delivered or on compliance with specified requirements.
Consolidated government expenditure	Total expenditure by national and provincial government, social security funds and selected public entities, including transfers and subsidies to municipalities, businesses or other entities.
Headline consumer price inflation (CPI)	The main measure of inflation, charting the price movements of a basket of consumer goods and services.
Consumption expenditure	Expenditure on goods and services, including salaries, which are used up within a short period of time – usually a year.
Contingency reserve	An amount set aside, but not allocated in advance, to accommodate changes to the economic environment and to meet unforeseen spending pressures.
Countercyclical fiscal policy	Policy that has the opposite effect on economic activity to that caused by the business cycle, such as slowing spending growth in a boom period and accelerating spending in a recession.
Current account (of the balance of payments)	The difference between total exports and total imports, also taking into account service payments and receipts, interest, dividends and transfers. The current account can be in deficit or surplus. See also *trade balance.*
Debt service cost	The cost of interest on government debt.

Deleveraging	The reduction of debt previously used to increase the potential return of an investment.
Depreciation (capital)	A reduction in the value of fixed capital as a result of wear and tear or redundancy.
Depreciation (exchange rate)	A reduction in the external value of a currency.
Division of revenue	The allocation of funds between the spheres of government as required by the Constitution. See also *equitable share.*
Economic cost	The cost of an alternative that must be forgone to pursue a certain action. Put another way, the benefits that could have been received by taking an alternative action.
Equitable share	The allocation of revenue to the national, provincial and local spheres of government as required by the Constitution. See also *division of revenue.*
FIFA	The Fédération Internationale de Football Association – the international governing body of football.
Financial and Fiscal Commission	An independent body established by the Constitution to make recommendations to Parliament and provincial legislatures about financial issues affecting the three spheres of government.
Financial account (of the balance of payments)	A statement of all financial transactions between a country and the rest of the world, including portfolio and fixed investment flows and movements in foreign reserves.
Financial year	The 12 months according to which companies and organisations budget and account.
Fiscal policy	Policy on taxation, spending and borrowing by government.
Fiscal space	The ability of a government's budget to provide additional programme resources without jeopardising fiscal sustainability.
Foreign direct investment	The acquisition of controlling interest by governments, institutions or individuals of a business in another country.
GDP inflation	A measure of the total increase in prices in the whole economy. Unlike CPI inflation, GDP inflation includes price increases in goods that are exported and intermediate goods such as machines, but excludes imported goods.
Gross domestic product (GDP)	A measure of the total national output, income and expenditure in the economy. GDP per head is the simplest overall measure of welfare, although it does not take account of the distribution of income, nor of goods and services that are produced outside the market economy.
Gross fixed capital formation	The addition to a country's fixed capital stock over a specific period, before provision for depreciation. See also *capital formation.*
Inflation	An increase in the general level of prices. See also *headline consumer price inflation.*
Inflation targeting	A monetary policy framework intended to achieve price stability over a certain period of time. The Reserve Bank and government agree on a target rate or range of inflation to be maintained.
International Growth Advisory Panel	A panel of experts drawn from a range of international institutions to make recommendations on growth-enhancing policies for South Africa.
Medium-term Expenditure Committee (MTEC)	The technical committee responsible for evaluating the MTEF budget submissions of national departments and recommending allocations.

Medium-term expenditure framework (MTEF)	The three-year spending plans of national and provincial governments published at the time of the Budget.
Money supply	The change in the total stock of money in an economy.
National budget	The projected revenue and expenditures that flow through the National Revenue Fund. It does not include spending by provinces or local government from their own revenues.
National Revenue Fund	The consolidated account of national government into which all taxes, fees and charges collected by the South African Revenue Service and departmental revenue must be paid.
Nominal exchange rate	The current rate of exchange between the rand and foreign currencies. The "effective" exchange rate is a trade-weighted average of the rates of exchange with other currencies.
Non-interest expenditure	Total expenditure by government less debt service costs.
Organisation for Economic Cooperation and Development (OECD)	An organisation of 30 mainly industrialised countries.
Primary sector	The agricultural and mining sectors of the economy.
Private sector credit extension	Credit provided to the private sector by banks. This includes all loans, credit card balances and leases.
Public-private partnership (PPP)	A contractual arrangement in which a private party performs part of a government function and assumes the associated risks. In return, the private party receives a fee according to predefined performance criteria.
Public sector borrowing requirement	The consolidated cash borrowing requirement of general government and non-financial public enterprises.
Real effective exchange rate	A measure of the rate of exchange of the rand relative to a trade-weighted average of South Africa's trading partners' currencies, adjusted for price trends.
Real expenditure	Expenditure measured in constant prices, i.e. after taking account of inflation.
Repurchase (repo) rate	The rate at which the Reserve Bank lends to commercial banks.
Reserves (foreign exchange)	Holdings of foreign exchange, either by the Reserve Bank only, or by the Reserve Bank and domestic banking institutions.
Seasonally adjusted and annualised	The process of removing the seasonal volatility (monthly or quarterly) from a time series. This provides a measure of the underlying trend in the data.
Southern African Customs Union (SACU) Agreement	An agreement that allows for the unrestricted flow of goods and services, and a sharing of customs and excise revenue, between South Africa, Botswana, Namibia, Lesotho and Swaziland.
Southern African Development Community (SADC)	A regional governmental organisation that promotes collaboration, economic integration and technical cooperation throughout Southern Africa.
Terms of trade	An index measuring the ratio of export prices to import prices.
Trade balance	The monetary record of a country's net imports and exports of physical merchandise. See also *current account.*
Unit labour costs	The cost of labour per unit of output. Calculated by dividing average wages by productivity (output per worker per hour).