Medium Term Budget Policy Statement

2008

National Treasury

Republic of South Africa

21 October 2008

ISBN: 978-0-621-38285-3
RP: 267/2008

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.

To obtain additional copies of this document, please contact:

Communications Directorate
National Treasury
Private Bag X115
Pretoria
0001
South Africa

Tel: +27 12 315 5526
Fax: +27 12 315 5126

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

Foreword

From the first State of the Nation address by President Nelson Mandela, and the first Budget speech delivered in a democratic South Africa, we have made it abundantly clear that budgets are not about markets, bonds or statistics.

Budgets are about people.

This is a timely reminder, because we have just lived through one of the most turbulent months in modern economic history. When a trader presses a button in New York it has an effect on the lives of millions of our people. It is government's responsibility to ensure that what happens in the world economy, and how it happens, is communicated clearly to South Africans. And we must ensure that in periods of global volatility, we have the tools to protect our people – in particular the poor.

The 2008 *Medium Term Budget Policy Statement* is about how we respond in the face of an international storm. The policy statement provides the framework on which the 2009 Budget will be constructed. It is not a budget, nor is it a mini-budget. The statement provides government's assessment of the state of the economy, the fiscal framework, the budget priorities and the division of revenue between national, provincial and local government. And it balances competing claims on the public finances – the need to address immediate priorities with the longer-term requirements of our economy.

Over the past 14 years government has taken some tough decisions on the budget, on spending, on taxation, on exchange controls, on banking regulation and on inflation targeting. So today, as the world faces its sternest economic test in decades, we are prepared. The benefits of taking such difficult decisions early on are reflected in a positive growth forecast, in our low levels of debt and in many other economic indicators.

Liduduma lidlule! The thunder will pass! Storms come and go. Some are more ferocious than others. We must look beyond the storm.

Our challenges are to eliminate poverty, to raise employment, to broaden opportunity and to improve the lives of all, particularly the most disadvantaged among us. We will remain focused on meeting these challenges during the present storm and beyond.

The budget framework presented here gives meaning to these commitments – to strive for faster economic growth, higher levels of investment, rising employment and reduced levels of poverty. Over the next three years we are prioritising education, health care, fighting crime, rural development and extending access to housing, water, sanitation, electricity and public transport.

We reaffirm the commitment of this government to put people first. We will continue to adopt policies that support growth and development, and that ensure more inclusive growth. And most importantly, we will continue to invest in a better life for all.

The thunder will pass!

Trevor A Manuel, MP
Minister of Finance

Contents

TABLES

FIGURES

1

Liduduma lidlule!
The thunder will pass!

As this 2008 *Medium Term Budget Policy Statement* is tabled, a far-reaching global financial crisis is unfolding. While South Africa will unavoidably be affected by these developments, prudent macroeconomic and fiscal policies followed over the past decade mean that the economy is well placed to weather the storm.

Economic growth has averaged 5 per cent a year since 2003. Buoyant investment and favourable terms of trade have contributed to rising incomes and employment. Growth will be slower in 2008 and 2009, held back by domestic supply constraints and the international economic deterioration. However, South Africa's infrastructure investment expansion will continue over the decade ahead, alongside strengthening of initiatives focused on job creation and poverty reduction. Government policy remains focused on long-term growth and broad-based development, founded on a sustainable fiscal and financial framework.

Higher economic growth is dependent on further increasing investment in human and physical infrastructure, boosting domestic savings and improving international competitiveness. Making growth more labour absorbing requires further attention to microeconomic policies, enhancing the effectiveness of competition policy, removing impediments to job creation in the labour market and increasing public spending on infrastructure and labour-intensive services.

Introduction

Amid global turbulence, South Africa is supported by sound policy and healthy public finances

The world is experiencing a financial market crisis on a scale not seen since the 1930s. The prospects for global growth are poor and the short-term outlook is clouded by uncertainty. However, South Africa's longer-term economic expansion rests on sound economic policies, healthy public finances and resilient financial institutions, pursued steadily over the past 14 years. The growing economy, robust regulatory environment and developed capital markets provide favourable conditions for continued investment and growth in the period ahead.

Growth is bumping up against constraints in skills and infrastructure

The strong performance of the domestic economy over the past six years is attributable to both prudent economic policies and a supportive global environment, but the international outlook has deteriorated rapidly in recent months. In addition, six years of robust expansion have seen the economy push up against growth constraints – shortages of skilled labour and aging physical infrastructure. One of the outcomes of these capacity constraints is the rising current account deficit on the balance of payments.

The domestic economy is set to escape the worst effects of the global crisis

While the healthy state of the financial sector will help South Africa escape the worst effects of the financial market crisis, it is also evident that the global downturn will affect domestic growth prospects through lower export demand, financial volatility, exchange rate turbulence and uncertain expectations.

Projections for South Africa's output growth in 2008 and 2009 have been revised downward to 3.7 per cent and 3 per cent respectively. Depending on international developments, GDP growth is expected to recover to above 4 per cent in 2010 and beyond. After rising rapidly during 2008 due to higher food and fuel prices, the inflation outlook has improved.

Economic growth must be more inclusive and create more jobs

In the context of slower growth, employment-intensive development initiatives have to be prioritised. If South Africa is to achieve its target of halving unemployment from its 2004 level of 28 per cent to 14 per cent by 2014, growth must be more inclusive and absorb more labour. Improved social security arrangements also have a key role to play in adapting to a more uncertain economic outlook.

The proposed fiscal framework for the 2009 Budget takes into account both slower economic growth and the need to support continued infrastructure investment and social development in a context of heightened uncertainty. Government will continue to support reforms that reinforce financial-sector stability while encouraging national savings. Medium-term expenditure plans seek to bolster growth, accelerate job creation and broaden economic participation, while improving public service delivery in the following key areas:

- Education
- Health care
- Built environment infrastructure
- Fighting crime
- Improving rural livelihoods.

A discussion of these priorities can be found in Chapter 5.

Higher and more labour-intensive growth

South Africa and the international economy

Tough decisions taken early on are bearing fruit

Early decisions on macroeconomic policy, banking regulation, the gradual approach to exchange control liberalisation, the introduction of inflation targeting and our counter-cyclical approach to fiscal policy have enabled South Africa to benefit from the global environment, while providing a degree of protection from the worst effects of financial contagion.

The commodity price trend has reversed as growth prospects have slowed

Commodity prices have been exceptionally volatile. Oil and food price spikes have increased hardship for the world's poor and driven inflation higher internationally. In recent months, the commodity price trend has reversed as growth prospects have slowed, contributing to downward pressure on global inflation.

South Africa is well placed to adapt to the changed international environment because our financial system is not reliant on foreign banks, but an improved domestic savings performance is needed. Strong investment will continue to drive growth.

Openness to trade needs to be combined with protection in periods of turbulence

The Commission on Growth and Development published its findings earlier this year.[1] It showed that since 1945, those countries that succeeded in sustaining rapid growth and significantly reducing poverty within a generation pursued strategies that leveraged resources from the global economy. However, openness to global trade and finance has to be complemented by institutions that can provide protection during periods of heightened global risk. The fiscal and monetary policies pursued over the past 14 years have been designed to provide such protection, while enabling South Africa to benefit from global markets through trade and financial capital flows.

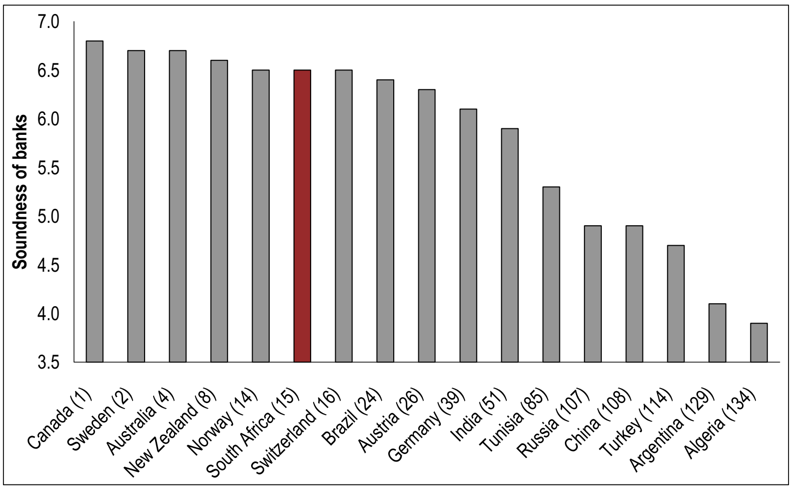
South African banks do not have significant exposures to global deleveraging

In recent months there has been exceptional volatility in the global financial system. Several major financial institutions have collapsed or required large bailouts, and there has been a general loss of confidence between institutions in the banking system. While these developments have important domestic implications, South African financial institutions do not have significant direct exposures to the US housing market or failed banking and credit institutions. As Figure 1.1 shows below, there is a high degree of confidence in South Africa's banking system. Nevertheless, the international credit crisis and the slowing global economy will raise the cost of accessing external finance and limit the growth of trade opportunities.

In countries where the banking crisis is most acute, the first round of policy responses included injecting liquidity and providing guarantees. When these steps failed to inspire confidence, a number of governments also undertook to purchase direct shares in their large banks. It appears that the latest measures are working to good effect, though there remains considerable uncertainty.

1 The Growth Report – Strategies for Sustained Growth and Inclusive Development, Commission on Growth and Development, 2008. (www.growthcommission.org)

Figure 1.1 Soundness of banks (country ranking in brackets)[2]



Soundness is measured between 1 (insolvent and may require a government bailout) and 7 (generally healthy with sound balance sheets).

Government monitors the banking system and will act as the need arises

Given the strength of the domestic banking system, its lack of direct exposure to global deleveraging and the continued efficiency of our interbank market, South Africa has not had to take any such measures. Nevertheless, government is monitoring the banking and financial sector and will take appropriate steps as the need arises.

Domestic economic policy considerations

The South African economy has grown by an average of 5 per cent a year for the past six years. During this period investment increased from about 15 per cent of GDP to more than 22 per cent. The unemployment rate declined from about 29.3 per cent in 2003 to 23 per cent today. Nearly 2 million net jobs were created during this period. Nevertheless, unemployment is unacceptably high, and a critical objective of economic policy over the next five years is to create work opportunities. Rising job creation depends on sustained growth, but also on making growth more labour-intensive. Government's economic policies must tackle these twin challenges.

Faster growth depends on higher productive capacity, savings and exports

During the period ahead, government will work to sustain economic growth by continuing to invest in areas that will boost South Africa's global competitiveness. Improving long-term growth prospects depends on rising investment in productive capacity, moderation of consumption expenditure and improved trade performance.

It is also important to recognise the causes and consequences of South Africa's aging physical infrastructure and poor skills base. Decades of underinvestment in physical infrastructure, from electricity generation to water supply, roads and rail have constrained the economy's ability to grow more rapidly.

Private investment has risen in telecommunications, manufacturing and tourism

Since 2001, both public and private investment have gathered momentum. Public investment in electricity generation, port operations, rail, airports, roads and public transport will support job creation in the short term and add much-needed capacity for higher

2 Source: The Global Competitiveness Report 2008 – 2009, World Economic Forum, Executive Opinion Survey 2007, 2008.

growth in the medium to longer term. Similarly, private investment in mining, manufacturing, telecommunications and tourism has increased the productive capacity of the economy.

Government will strengthen the role of development finance institutions

One of the most critical challenges is to finance investment in a much tougher international financial environment. The budget will continue to support public spending on infrastructure. The large capital programmes of the state-owned enterprises are generally financed through operating surpluses and borrowing on the capital markets. Given more difficult credit conditions, government will support these enterprises in three ways: by continuing to align prices with long-run average costs to provide a suitable rate of return, by strengthening the development finance institutions to support larger infrastructure projects and by providing selective guarantees to the state-owned enterprises to cover their higher borrowing requirements.

South Africa has a strong financial sector and deep capital markets

South Africa's financial sector and deep capital markets have been key strengths in the country's economic development. The banking sector is well regulated and the gradual approach to exchange control liberalisation has enabled an orderly diversification of portfolios.

Earlier this year, the International Monetary Fund released its *Financial System Stability Assessment Report* for South Africa. The report notes that "South Africa's financial system is fundamentally sound and well-capitalised." It observes that the financial system is "diversified and spans a broad range of activities that are supported by an elaborate legal and financial infrastructure and a generally effective regulatory framework". The report also states that the country's major banks are compliant with the Basel II accord – an agreement updating international banking standards, including minimum capital adequacy requirements. Alongside sound financial institutions, however, economic progress requires investment in social and infrastructure development.

Increased resources for education and skills need to be used more effectively

Generations of apartheid education and limited progress in improving the quality of post-1994 education have reinforced skills shortages that inhibit higher growth. The emigration of skilled workers has exacerbated these shortages. South Africa is investing more resources in education and skills development and the 2009 Budget will add further resources in this area. It is important that these resources, and monies raised from the Skills Development Levy, be used more effectively.

A more inclusive growth trajectory has to be more labour absorbing. The 2009 Budget will see further resources allocated to employment-intensive programmes in the public sector, as well as incentives for private employers and non-governmental organisations to use more labour-intensive methods. In addition, rising investment in agricultural services and higher food production are likely to be positive for both employment and rural incomes.

Ways to encourage more energy-efficient production are being considered

Globally, the carbon trading market is maturing and beginning to have the desired effect of moving resources from energy-inefficient producers to more efficient ones. South Africa is exploring the use of similar market-based mechanisms to encourage companies to produce more efficiently. The proposed budget framework contributes to reducing electricity demand by promoting energy efficiency and investment in renewable energy sources, which also helps to limit CO_2 emissions. The proposed electricity levy, delayed until next year, will be broadened to cover other large carbon-producing enterprises.

In the context of heightened uncertainty globally, the key pillars of South Africa's macroeconomic policy provide a stable platform on which to foster more inclusive growth. Inflation targeting will remain the anchor for monetary policy, and fiscal policy will continue to be focused on raising domestic investment and addressing the service and infrastructure backlogs that prevent a more inclusive growth path, within a sustainable framework.

Reforms are required in trade and competition policy and in the labour market

At the same time, South Africa has to raise domestic savings and develop a more export-oriented economy that can take advantage of global opportunities. This requires a series of microeconomic reforms, particularly in areas relating to trade and industrial policy, competition policy and the functioning of the labour market. A more effective and capable state is required to improve the quality of education and health care; to broaden opportunities for the poor by providing access to housing, water, electricity and transport; and to reduce violent crime.

Budget reform

A deeper engagement with Parliament on the budget process

Over the past 14 years the budget process has been substantially improved. The National Treasury has deepened engagement with Parliament, government departments and civil society, and enhanced the quality of published information. Earlier this year, the *Estimates of National Expenditure* included explicit performance measures for each department and, in several cases, for programmes within departments. Efforts to improve the quality of the performance indicators used in the budget process and the data produced in relation to these indicators continue.

What is the Medium Term Budget Policy Statement?

Policy statement defines the parameters for next year's budget

The *Medium Term Budget Policy Statement* is a policy statement issued by the executive that defines the parameters for the following year's budget. It is not a budget, nor is it a "mini-budget". The purpose of the statement is to set out the policy context and direction so that departments, provinces and municipalities can prepare their budget plans for the next three years.

The policy statement sets out the economic context in which the budget is prepared, provides the country with government's official economic forecasts for a three-year period and, based on these factors, outlines the proposed fiscal stance. It sets out the budget priorities over the medium term and provides a division of revenue to finance services provided by national, provincial and local government.

Assessing public finances and accountability

Earlier this year the National Treasury, in partnership with the European Union, conducted a public expenditure and financial accountability assessment. The assessment scores a country on its financial management, budget process, procurement system, quality of published data and the audit process. This assessment is generally done in developing countries and is used by donor countries to assess the capacity of a country to absorb and manage donor aid. In the case of South Africa, where donor aid is a minor part of the budget, the assessment focused on public financial management.

EU body gives high marks for South Africa's public financial management

South Africa received 15 "A" rankings out of a total 28 indicators – the highest number received by any country that has been assessed, including some developed countries such as Norway. The report also identified room for improvement in the procurement system and reporting on donor aid.

Enhancing parliamentary oversight of the budget

Parliament receives extensive information on the budget process

South Africa's Parliament has evolved from a Westminster tradition, where the legislature played little or no role in the budget process. Today, Parliament engages extensively with the process and receives comprehensive information on the finances and performance of departments. Parliament also receives quarterly data on departmental and provincial spending trends.

The Constitution empowers Parliament to establish procedures to amend money bills as part of its role in overseeing the work of the executive. Parliament is presently debating proposals for such a procedure. The executive would still be responsible for drafting and tabling budgets, but Parliament would be empowered to consider and enact amendments to specific provisions of appropriation and revenue bills. In draft legislation, the procedure to amend money bills includes provisions requiring Parliament to take account of government's fiscal responsibilities and the short-, medium- and long-term implications of any changes.

Treasury welcomes enhanced oversight of departmental performance

It is expected that this reform will come into effect in the middle of 2009. It will require Parliament to build up expertise to be able to analyse money bills in greater detail. These reforms are welcomed as they will enhance Parliament's oversight of departmental performance and deepen the quality of engagement on the budget process.

Overview of the policy statement

Economic policy and outlook

Chapter 2 discusses the macroeconomic outlook and provides a perspective on the microeconomic policy changes required for higher growth and employment in the context of global financial market turmoil. In addition, the chapter includes a discussion of forthcoming changes to the consumer price index.

South Africa seeks to grow faster through increasing investment in productive capacity and to promote a more inclusive growth path through expanding employment. Achieving these objectives in a slowing global economy will be more difficult. Nevertheless, South Africa has the policy, institutional and regulatory frameworks to ensure continued economic growth and investment. It is important to further strengthen these frameworks and focus on microeconomic reforms.

Government targets improvements in education, health, and safety and security

The reforms needed to achieve higher and more inclusive growth lie in the areas of trade policy, industrial policy, labour market policy, competition policy and the performance of the state in the areas of education, health, and safety and security. Furthermore, the country needs even higher levels of investment in infrastructure, ranging from power generation to roads and ports.

The performance of the global economy is a key determinant of South Africa's economic performance. Growth in the seven most advanced economies is now projected to be close to zero, with some of these countries dipping into recession. Similarly, measures to curb rising inflation in India and China, as well as slowdowns in their major export markets, mean that growth in these two large trading economies is likely to cool down. Commodity prices have already fallen sharply on expectations of lower Asian demand.

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

Growth prospects in Southern Africa and Africa in general remain robust, with average growth of over 6 per cent projected for 2009 due to rising 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.

A period of slower consumption growth is needed to enable domestic saving to contribute more substantially to meeting the financing requirements of continued investment growth. Following several years of robust household spending, consumption expenditure growth is expected to slow from 2.8 per cent in 2008 to 1.6 per cent in 2009. However, the continued buoyancy of the construction sector in response to rising investments will be supportive of growth going forward. GDP growth is projected to slow from 5.1 per cent in 2007 to 3.7 per cent in 2008 and 3.0 per cent next year. As the global economy recovers and as the benefits of higher investment start to come through, growth prospects strengthen for 2010 and beyond.

In January government will introduce a new headline inflation measure

Consumer price inflation increased rapidly during 2008, driven by rising food and fuel prices. The inflation outlook is more promising, with oil prices falling and food prices moderating. With the introduction of a new basket of consumer prices based on updated consumption trends, the consumer price index will become the targeted measure of inflation. Chapter 2 describes this change in more detail.

Table 1.1 Macroeconomic projections, 2007 – 2011

Calendar year	2007	2008 Estimate	2009	2010 Forecast	2011
Percentage change unless otherwise indicated					
Final household consumption	7.0	2.8	1.6	3.2	3.7
Gross fixed capital formation	14.8	12.6	8.7	8.8	9.3
Real GDP growth	**5.1**	**3.7**	**3.0**	**4.0**	**4.3**
GDP at current prices (R billion)	**1 996.9**	**2 303.6**	**2 538.4**	**2 802.4**	**3 098.2**
CPI[1]	6.5	11.6	6.2	5.3	4.7
Current account balance (% of GDP)	-7.3	-7.6	-7.8	-8.9	-8.8

1. CPIX in 2007 and 2008.

Fiscal policy and revenue trends

Sound fiscal policy has prepared South Africa for the global storm

Chapter 3 discusses fiscal policy and Chapter 4 reviews tax trends. The economic environment has changed radically since the February 2008 Budget. However, sound fiscal policy enables government to adjust the fiscal framework without undue disruption. Fiscal policy will continue to balance mitigating global risks with support for higher investment, better public services and rising employment.

R170.8 billion added to spending plans

Given the fact that revenue growth is slowing, and in particular that corporate tax revenue is likely to fall next year, it is anticipated that the budget balance will revert from a moderate surplus in 2007/08 to a deficit in 2009/10. This budget framework adds R170.8 billion to spending plans for the next three years. A deficit of 1.6 per cent of GDP is expected in 2009/10.

Revenue growth averaged 17 per cent a year over the past four years, but it has slowed in the first six months of 2008/09, despite higher inflation levels. While tax collection is expected to be close to the budgeted figure, revenue as a share of GDP will be lower than expected. The budget framework takes into account that revenue growth is likely to moderate over the next two years in line with corporate profitability.

R60 billion loan to finance Eskom's capital investment programme

Public spending growth will continue to support investment in physical infrastructure, as well as higher investment in education and health. The budget includes R60 billion in loan financing to support capital investment by Eskom. Gross fixed capital formation by general government and public enterprises will continue to rise strongly, by 14.2 per cent a year in real terms. The public sector borrowing requirement increases to 3 per cent of GDP next year, reflecting strong public-sector investment plans. Government will support the investment programmes of its state-owned enterprises by strengthening the role of development finance institutions in financing large infrastructure projects and through targeted loan guarantees. In addition, government recognises that utility prices have to be adjusted to reflect the economic costs of delivering public amenities, while ensuring subsidised support for poor households.

Despite small budget deficit, government continues to be a net saver

Although a budget deficit is anticipated for the period ahead, government will continue to contribute positively to national savings, as growth in capital spending continues to exceed growth in recurrent expenditure.

Table 1.2 Consolidated national government, 2007/08 – 2011/12

	2007/08	2008/09	2009/10	2010/11	2011/12
R billion	Outcome	Estimate	Medium-term estimates		
Revenue	**584.6**	**653.5**	**712.8**	**783.5**	**869.2**
Percentage of GDP	*28.4%*	*27.6%*	*27.4%*	*27.3%*	*27.4%*
Expenditure	**558.0**	**650.3**	**754.3**	**814.5**	**868.6**
Percentage of GDP	*27.1%*	*27.5%*	*29.0%*	*28.4%*	*27.4%*
Budget balance[1]	**26.6**	**3.2**	**-41.5**	**-31.0**	**0.6**
Percentage of GDP	*1.3%*	*0.1%*	*-1.6%*	*-1.1%*	*0.0%*
Gross domestic product	*2 061.9*	*2 366.7*	*2 598.6*	*2 870.2*	*3 170.3*

1. A positive number reflects a surplus.

Medium-term budget priorities and the division of revenue

Continued emphasis on improved public-sector performance

The medium-term expenditure framework emphasises improving the quality of spending and enhancing public-sector performance. Budget priorities for the period ahead are focused on social solidarity and building a more equitable society, and include:

- Improving the quality of education and skills development to broaden employment opportunities and raise productivity.
- Strengthening the public health system, with a particular focus on enhancing human resource capacity and reducing infant and child mortality, maternal mortality, HIV and Aids, and tuberculosis.
- Fighting crime through strengthening the criminal justice sector, especially detective and investigative services, and improving court processes.
- Investing in built environment infrastructure to achieve universal access to water, sanitation, electricity, housing and public transport.
- Reducing rural poverty by taking steps to raise rural incomes and improve livelihoods, including through raising investment in agricultural services and increasing access to arable land.

These priorities are discussed in Chapter 5.

Additional support for the expanded public works programme

Over the next five years government will implement the second phase of its expanded public works programme, which will provide incentives to public institutions, nongovernmental organisations and, in some cases, private companies to use more labour-intensive methods in the delivery of both infrastructure and routine services.

Higher inflation affects the budget framework through higher nominal salaries, adjustments to social grants, increased fuel costs and more expensive medicines, food and textbooks. Adjustments to spending plans over the next three years to compensate for higher inflation amount to R59.0 billion.

Division of revenue reflects shifting priorities in favour of services and municipal infrastructure

The division of revenue between national, provincial and local government, presented in Chapter 6, reflects shifting government priorities in favour of social services and municipal infrastructure. Excluding the transfer to Eskom, the division of revenue indicates a bias towards provinces, given the strong emphasis on education and health spending. Municipalities also benefit from budget increases related to extending municipal and household services such as public transport, water, sanitation and electricity. Additional national spending is mainly for infrastructure, fighting crime, and improving the capacity and performance of the state.

2

Economic policy: beyond the storm

The world economy has entered a period of extraordinary uncertainty. Following several years of persistent imbalances in global trade and finance flows, a banking and credit crisis has emerged in developed economies. While South Africa is well positioned to weather this storm, international and domestic factors will dampen economic growth in the short term. Weaker global conditions will lead to slower export growth, softer commodity prices, reduced investor risk appetite and greater currency volatility.

Sound fiscal and monetary policies enable government to respond flexibly to support the economy in times of stress. South African financial institutions have limited exposure to the underlying sources of the credit seizure, and gradual capital account liberalisation has encouraged companies to diversify offshore while retaining prudent checks on exposure to financial risk.

GDP growth is expected to average 3.8 per cent over the medium term. Despite tougher conditions ahead, the long-term drivers of growth remain intact. Strong public-sector investment will boost productive capacity and reduce growth constraints. Further microeconomic reforms are required to support a higher sustainable rate of growth and to raise employment.

Overview

Government will work to reduce short-term risks to the economy while investing for the future

To build a prosperous and equitable society, government seeks to reduce poverty, create employment and expand opportunity for millions of disadvantaged South Africans. The past five years of strong economic growth have contributed to these goals by increasing employment and financing an expansion of public services. The period ahead, however, is likely to be considerably tougher as international financial and economic conditions weaken. Government will continue to work to reduce short-term risks to the economy, while making investments that can raise future growth rates and improve the lives of all South Africans.

IMF forecasts global growth of 3 per cent in 2009

The present banking and credit crisis, which began in the United States and spread rapidly to Europe and beyond, will have far-reaching repercussions that will play havoc with long-term economic forecasts for all countries. The most recent forecast by the International Monetary Fund (IMF) projects a significant deterioration in global growth to 3.0 per cent in 2009, down from 5.0 per cent in 2007.

Global financial crisis will have implications for domestic economy

How the financial crisis is managed – and the implications for trade and commodity prices – will affect the trajectory of the South African economy.

A possible scenario is that a deep recession and lingering financial uncertainty in the developed economies will result in a reduction in international trade, with a concomitant decline in economic growth in emerging markets and continuing financial volatility. In such an environment, South Africa could expect a prolonged period of much slower growth. Our monetary and fiscal policy framework, strong financial position and appropriate economic policy responses might allow output and employment growth to be maintained, but real income and corporate profits would come under pressure.

In a second and more hopeful scenario, greater international policy coordination and improved regulatory capacity to intervene in poorly performing markets will result in a period of global economic adjustments over the medium term, followed by more balanced growth. While South Africa's fiscal stance and budget proposals are framed to allow for a wide range of possible global trajectories, our current economic forecast reflects this more benign set of assumptions.

GDP forecast and current trends

GDP projected to grow by about 3.8 per cent over medium term

Taking into account South Africa's policy frameworks and the relatively diversified character of the domestic economy, GDP is projected to grow by about 3.7 per cent in 2008 and 3.0 per cent in 2009, before rising to 4.0 per cent in 2010 and 4.3 per cent in 2011. This forecast factors in trends that have emerged during the robust economic performance of recent years, in particular the strong capital expenditure plans of the public sector and private-sector investment momentum.

Since 2004, South Africa has benefited from a stable financial environment and much-improved terms of trade in an expanding world economy. GDP growth averaged 5.1 per cent a year between 2004 and 2007, up from 3.2 per cent in the previous three years.

Rebalancing of domestic growth is taking place as consumption slows

Domestic expenditure in recent years has been robust, but some rebalancing is now taking place. Household consumption has slowed considerably in response to higher interest rates and inflation has eroded consumer purchasing power. Disruptions to electricity supply in the first quarter of 2008 also cut mining and manufacturing output temporarily, dampening GDP growth.

Strong investment supports continued growth over medium term

Strong investment will continue to underpin growth over the next few years. Investment has risen from about 15 per cent of GDP in 2002 to 22 per cent in the first half of 2008. Real growth in fixed investment is expected to remain high, averaging about 9 per cent a year over the medium term, well in excess of overall GDP growth. Household consumption is expected to grow at a slower pace of 1.6 per cent in 2009 before rising to 3.7 per cent in 2011.

Decreasing debt, rising foreign exchange reserves

Fiscal policy has aimed to reduce South Africa's exposure to negative international developments by decreasing government debt and increasing foreign exchange reserves. Over the medium term, the fiscal stance will help to moderate the slowdown in GDP growth by maintaining strong growth in public investment and social spending. A small budget deficit is projected over the next few years.

Rapid growth in domestic expenditure has contributed to an expansion of the current account deficit, which increased from 4.0 per cent of GDP in 2005 to a projected 7.6 per cent of GDP in 2008. This deficit is expected to remain relatively high over the medium term as a result of the projected performance of the economy and lower commodity prices.

Table 2.1 Macroeconomic projections

Calendar year	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
		Actual		**Estimate**		**Forecast**	
Percentage change unless otherwise indicated							
Final household consumption	6.9	8.2	7.0	2.8	1.6	3.2	3.7
Final government consumption	4.8	5.2	5.0	4.5	4.0	4.0	4.0
Gross fixed capital formation	8.9	13.8	14.8	12.6	8.7	8.8	9.3
Gross domestic expenditure	5.7	9.2	6.0	3.6	3.0	5.5	5.2
Exports	8.0	5.6	8.3	2.6	2.9	4.4	6.0
Imports	10.3	18.8	10.4	2.6	3.2	8.9	8.2
Real GDP growth	**5.0**	**5.4**	**5.1**	**3.7**	**3.0**	**4.0**	**4.3**
GDP inflation	5.2	7.2	9.1	11.3	7.0	6.2	6.0
GDP at current prices (R billion)	**1 541.1**	**1 741.1**	**1 996.9**	**2 303.6**	**2 538.4**	**2 802.4**	**3 098.2**
CPIX inflation	3.9	4.6	6.5	11.6	–	–	–
Headline CPI inflation	–	–	–	–	6.2	5.3	4.7
Current account balance (percentage of GDP)	-4.0	-6.5	-7.3	-7.6	-7.8	-8.9	-8.8
Fiscal year	**2005/06**	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
		Actual		**Estimate**		**Forecast**	
GDP at current prices (R billion)	**1 584.7**	**1 808.3**	**2 061.9**	**2 366.7**	**2 598.6**	**2 870.2**	**3 170.3**
Real GDP growth	**4.8**	**5.6**	**4.7**	**3.5**	**3.0**	**4.2**	**4.3**
GDP deflator	5.9	8.0	9.0	10.9	6.6	6.0	5.9
CPI inflation (Metropolitan & urban)	3.5	5.2	8.1	11.6	5.2	5.2	4.7

CPIX inflation rose strongly in the first half of 2008, reaching 13.6 per cent in August 2008, raising inflation expectations and putting upward pressure on wage settlements. Exchange rate volatility may result in higher inflation in the short term, but falling oil prices and lower food costs will help to bring inflation back towards the 3-6 per cent target range. Slower GDP growth will also exert a moderating effect on inflation and the current account deficit.

Interest rate increases have helped to moderate demand

Cumulative interest rate hikes by the Reserve Bank, totalling five percentage points since 2006, have dampened domestic demand and helped to stabilise long-term inflation expectations.

From January 2009, CPIX inflation will be replaced by a new inflation target measure, headline CPI, which is expected to average 6.2 per cent next year and decline gradually over the next three years.

A new target measure of inflation

In 2005, Statistics South Africa (Stats SA) began an extensive review of inflation statistics. The last rebasing of the consumer price index (CPI) occurred in January 2002 and no significant changes were made at that time. A periodic updating of such measures is needed to ensure that the primary measures of consumer price inflation adjust with changes to consumption patterns.

The changes will take effect on 25 February 2009 with the release of the January 2009 CPI statistics. The new CPI series will differ from the old series in the following ways:

- The old CPI series was based on the International Trade Classification. The new series is based on the internationally accepted and widely used Classification of Individual Consumption by Purpose.
- Mortgage interest rates as a measure of housing costs in headline CPI will be replaced with a measure of owner's equivalent rent.
- The CPI will be reweighted based on the Household Income and Expenditure survey of 2005/06.
- The new CPI basket contains 416 indicator products (previously 1 200) broadly classified under commodities (e.g. food, petrol, clothing) and services (e.g. water services, insurance, medical care).

Replacement of mortgage interest rates with owner's equivalent rent is in line with international best practice. Mortgage interest costs were previously excluded from the target measure of inflation (CPIX) because changes in interest rates directly affected that measure of housing costs, resulting in a perverse relationship between headline CPI and monetary policy. The new measure solves that problem, enabling the cost of housing to be represented in the target measure of inflation.

Headline CPI (CPI for all urban areas) will replace CPIX inflation for metropolitan and other urban areas as the official targeted measure of inflation when the changes are implemented in February next year. The Minister of Finance and the Governor of the Reserve Bank have agreed that the target band for headline CPI will remain unchanged at 3-6 per cent.

It is expected that the reweighted and rebased CPI will indicate a somewhat lower rate of inflation in 2008 than the present index, partly due to lower expenditure weights for food and petrol. The extent of the bias will depend on the level of inflation for food, petrol and other components in January 2009.

The current CPI weights reflect expenditure patterns observed in 2000. Significant shifts in spending have occurred since then. The weight of food in headline CPI will fall from 25.7 per cent to 14.3 per cent and the weight for petrol will drop from 5.1 per cent to 3.9 per cent.

Developments in the real economy

About 2 million jobs have been created since 2003

Robust growth in the real economy over the past several years has brought about increased investment and job creation in most sectors. About 2 million jobs were created between March 2003 and March 2008, reducing unemployment from 29.3 per cent to 23.5 per cent. While job creation has been strong, a more rapid reduction in unemployment is required to reduce high levels of poverty. The key economic challenge is to achieve higher sustainable rates of growth that result in increased job creation, broadening economic activity and rising real incomes for all households.

Table 2.2 Key labour market indicators, 2003 – 2008

Thousands	Mar-03*	Mar-07	Mar-08	Jun-08
Employed	11 666	13 326	13 623	13 729
Unemployed	4 843	4 119	4 191	4 114
Total economically active	16 509	17 445	17 814	17 844
Not economically active	11 819	12 763	12 794	12 861
Total aged 15-64 years	28 327	30 208	30 608	30 705
Unemployment rate [1]	29.3	23.6	23.5	23.1
Labour force participation rate [1]	58.3	57.7	58.2	58.1
Labour absorption rate [1]	41.2	44.1	44.5	44.7

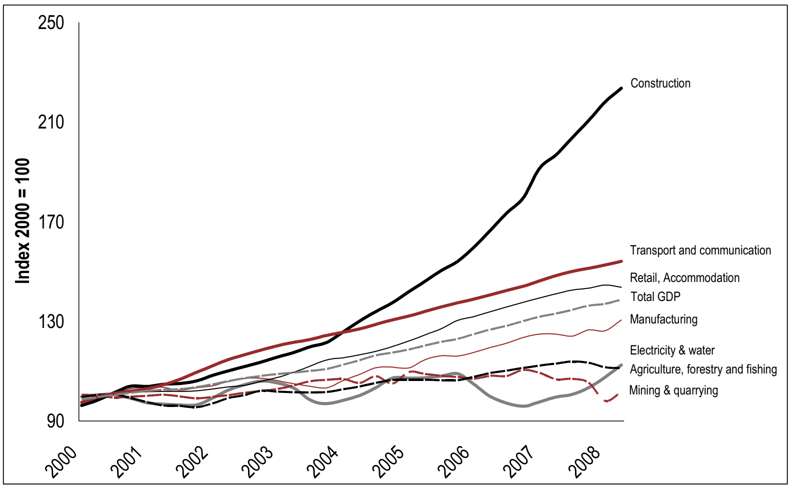
1. Unit is per cent.

** Revised series to make the LFS estimate comparable with the Quarterly Labour Force Survey (QLFS) Q1 data starting 2008*

In the recent period most new jobs have been created in the construction, retail and financial services sectors. In contrast, employment growth in mining, manufacturing and agriculture has been slow.

Job creation has been strongest in construction, retail and financial services

Figure 2.1 Sectoral drivers of GDP growth, 2000 – 2008



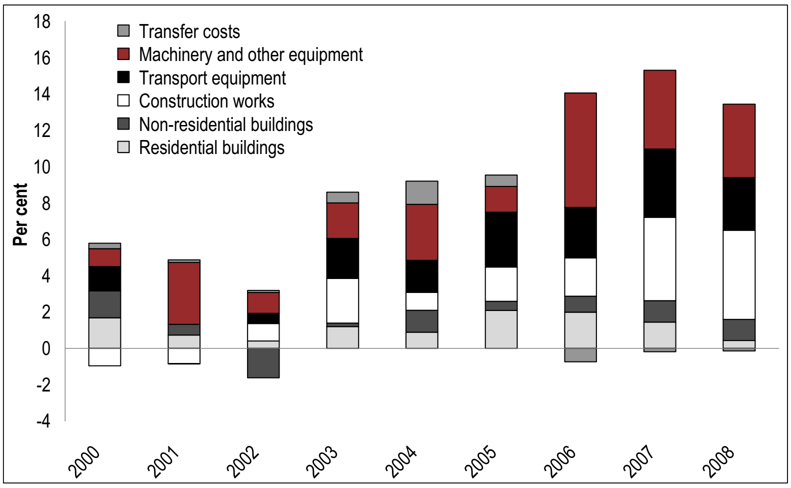
Data for 2008 is for the first half of the year.

Strong investment in machinery, transport equipment and construction should continue to raise productive capacity and long-term potential growth. Real growth in gross fixed capital formation has averaged 11.1 per cent a year since 2003, driven by capacity expansion in manufacturing, electricity and transport. The financial sector invested heavily in information technology expansion. By the end of the second quarter, fixed investment accounted for 22.4 per cent of GDP, the highest level since 1985.

Robust investment will raise productive capacity and long-term potential growth

Investment growth in 2008 has been strongest in the public sector, with the share of investment by public corporations rising to 15.3 per cent in the first half of the year from 11.3 per cent in 2003. The private sector accounted for about 72 per cent of total investment in the first half of 2008.

Figure 2.2 Gross fixed capital formation, 2000 – 2008

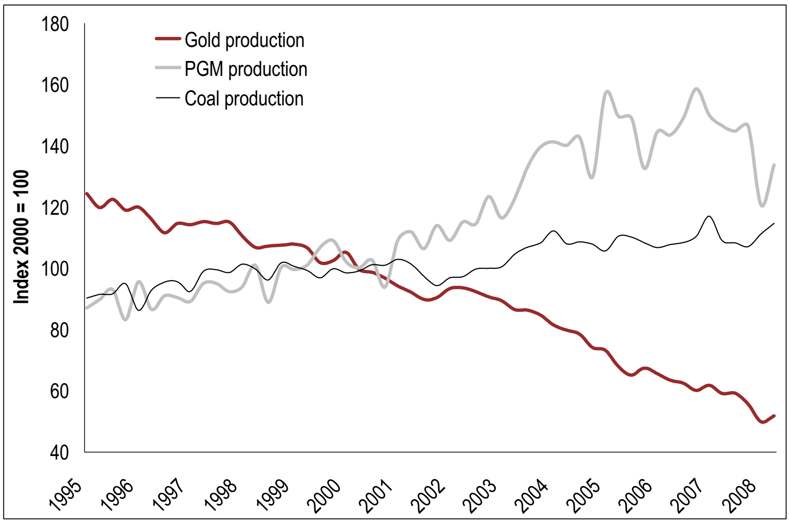


Data for 2008 is for the first half of the year.

Mining exports have stagnated but high prices boosted earnings

The mining sector has faced a number of difficulties in expanding production in 2008, including a period of sharply lower output due to electricity shortages and concerns over mine safety. Some recovery was seen in the second quarter, but total production was still 8.8 per cent lower in the first eight months compared with the same period in 2007. Mining export volumes stagnated in the first half of the year, but export earnings between January and August were 33.7 per cent higher compared with 2007 due to higher commodity prices.

Figure 2.3 Mining production by commodity, 1995 – 2008



Data for 2008 is for the first half of the year.

Agricultural production has responded positively to higher prices

The agricultural sector benefited from a bumper crop and rising food prices during the first half of 2008. Favourable weather conditions and increased plantings raised production of summer crops by at least 47 per cent in 2008. Maize production is likely to be 69 per cent higher in 2008 than in 2007.

Manufacturing output is an important driver of GDP, exports and employment, but the sector's contribution to growth remains uneven. Manufacturing gross value added lagged behind overall GDP growth in the first two quarters of 2008, expanding at an average rate of 3 per cent compared with 2007. Electricity failures in the first quarter of the year constrained output in some subsectors, but the slowdown in global demand has been a more prominent factor in recent months.

Table 2.3 Composition of manufacturing sector growth

	Weights*	Per cent growth (Ave Jan-Aug)	Growth contribution	
			Percentage points	Per cent
Petrochemicals	22.5%	10.5	2.4	71.9
Basic iron and steel	22.4%	-1.4	-0.3	-9.7
Food and beverages	16.4%	3.0	0.5	14.8
Wood and paper	11.0%	1.0	0.1	3.5
Motor vehicles and accessories	8.6%	-1.6	-0.1	-4.1
Furniture	5.8%	4.2	0.2	7.4
Textiles, clothing, leather and footwear	5.4%	1.8	0.1	2.9
Glass and non-metallic mineral products	3.9%	1.1	0.0	1.3
Electrical machinery	2.7%	13.3	0.4	10.9
Radio and TV	1.3%	2.5	0.0	1.0
Total**	**100.0%**	**3.1**	**3.1**	**100.0**

** Weights are based on the large sample manufacturing survey of 2001*
***Columns may not add up due to rounding*

Export imbalance leaves South Africa exposed to developed-country demand

A more competitive real exchange rate will make South African goods cheaper in international markets, although these gains may be offset by weaker global demand and rising production costs. About 36 per cent of South Africa's manufactured goods exports are sold to the Group of Seven (G7) industrialised countries. In contrast, only about 5 per cent of such exports go to Brazil, Russia, India and China. This export imbalance leaves producers sharply exposed to a reduction in developed-country demand.

The global economic environment

Trends in the world economy

Financial crisis is likely to impact on real growth in most developed countries

The world economy is slowing rapidly and many developed countries – including the United States, United Kingdom and Eurozone member states – face a downturn. Global growth is forecast at 3.9 per cent in 2008 and 3 per cent in 2009, down considerably from 5 per cent in 2007.

The deflation of the US housing market bubble, which began in August 2007 in the subprime mortgage market, has developed into a full-blown global crisis, severely undermining confidence in the banking systems of many developed economies and precipitating massive losses in financial markets. The erosion of bank balance sheets due to falling asset prices, combined with reduced market liquidity, has led to a number of high-profile bank failures in the US and Europe, with an associated loss of confidence and a drying up of credit.

Table 2.4 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2007 – 2009[1]

Region/ Country	2007	2008	2009	2007	2008	2009
Percentage	GDP projections			CPI projections[2]		
World	**5.0**	**3.9**	**3.0**	**4.0**	**6.2**	**4.6**
US	2.0	1.6	0.1	2.9	4.2	1.8
Euro area	2.6	1.3	0.2	2.1	3.5	1.9
UK	3.0	1.0	-0.1	2.3	3.8	2.9
Japan	2.1	0.7	0.5	0.0	1.6	0.9
Emerging markets and developing countries	**8.0**	**6.9**	**6.1**	**6.4**	**9.4**	**7.8**
Emerging Asia	**9.3**	**7.7**	**7.1**	**4.9**	**7.3**	**5.8**
China	11.9	9.7	9.3	4.8	6.4	4.3
India	9.3	7.9	6.9	6.4	7.9	6.7
Africa	**6.3**	**5.9**	**6.0**	**6.2**	**10.2**	**8.3**
Sub-Saharan Africa	**6.8**	**6.1**	**6.3**	**7.1**	**11.9**	**9.5**
South Africa[3]	5.1	3.7	3.0	6.5	11.6	6.2

1. IMF, World Economic Outlook, September 2008 for GDP growth and CPI inflation projections.

2. For South Africa, CPIX inflation in 2007 and 2008, and headline CPI in 2009.

3. National Treasury, October 2008.

While it is too early to judge the success of bailout and recapitalisation programmes using public funds, such steps will impose considerable pressure on governments, whose balance sheets may be subject to fiscal deterioration as expenditure rises and debt increases.

A period of slower global growth lies ahead

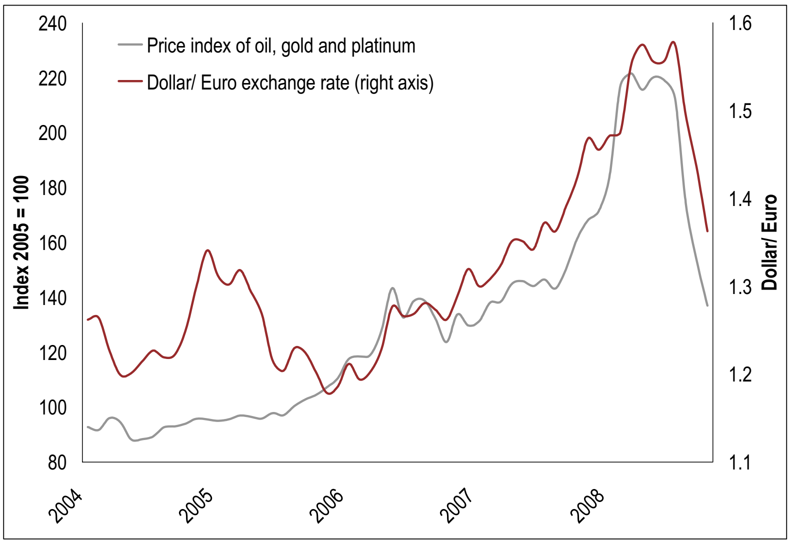
Emerging markets are not immune from this financial and economic imbroglio. Capital flows into equities and bonds have dropped sharply, contributing to declining share prices and more volatile exchange rates. Developing economies will continue to grow, but at generally lower levels.

Key trends in the global economy include the following:

- US economic performance has deteriorated significantly and is expected to grow by 1.6 per cent in 2008 and 0.1 per cent in 2009. The unemployment rate rose to 6.1 per cent in September from 5.0 per cent at the end of 2007. House prices have fallen by 16.3 per cent over the past 12 months.
- The Eurozone is expected to grow by 1.3 per cent in 2008 and 0.2 per cent in 2009.
- The UK is likely to endure a period of slower growth, characterised by a contracting housing market and high inflation.
- China’s economic growth, which registered almost 12 per cent in 2007, is expected to slow to 9.7 per cent in 2008 and 9.3 per cent in 2009, as exports to the US, Europe and Japan weaken.
- Economic growth in Sub-Saharan Africa remains strong. While falling commodity prices may pose risks to current projections, commodities have not been the only sources of growth. In much of the continent, greater economic activity has been supported by improved governance and the opening up of undeveloped markets. Sub-Saharan Africa is expected to grow by 6.1 per cent in 2008 and 6.3 per cent in 2009.

- After soaring to record levels in the first half of 2008, commodity prices declined substantially in anticipation of slowing global demand. Gold and platinum prices reached highs of US$1 003/oz and US$2 254/oz respectively in March 2008, but subsequently fell back sharply to current levels of about US$820 and US$900. Investor demand for gold surged in September as global markets deteriorated and investors sought refuge.
- The price of oil, which peaked at US$145 a barrel in early July, fell below US$70 in October. The decline was driven by a sharp appreciation of the dollar exchange rate and declining demand, especially in developed markets. The fall in commodity prices is illustrated in Figure 2.4.

Figure 2.4 Commodity prices and the dollar, 2004 – 2008



2008 represents data up to and including the first half of October 2008.

South Africa and the world financial crisis

Sound banking regulation, gradual capital account liberalisation bolster resilience of economy

While the endpoint of the global credit crisis does not lend itself to accurate predictions, South Africa appears set to avoid the worst consequences of these developments. The domestic financial sector has been relatively unscathed because it has limited exposure to subprime assets and the frenetic round of deleveraging in major economies. Banking sector regulation has been sound and gradual capital account liberalisation has encouraged companies to expand offshore in a responsible manner that has minimised the build-up of risky investments.

Government, together with the Reserve Bank, continuously monitors the domestic banking and financial system. While there are no signs of stress in the domestic financial sector, the authorities will remain alert to any undue strains and take appropriate action should the need arise.

Prudent macroeconomic decisions taken over the past 14 years will stand South Africa in good stead in the tougher times ahead and provide a platform for accelerated growth in the future.

The global financial crisis and the real economy

The international financial crisis now unfolding is of a scale not seen since the 1930s. Global financial and banking systems have been undermined as financial institutions with large exposures to high-risk assets are unable to raise sufficient capital to offset the loss in value of those assets. While the upheaval has been concentrated in the US and Europe, the inclusion of subprime mortgage-backed securities and derivatives in investment vehicles sold across the world has led to a global contagion.

Since early September the financial market landscape has been irrevocably changed as large financial institutions have failed and governments intervened on an unprecedented scale, attempting to bail out large insurance companies and banks, and to unblock credit markets.

Uncertainty regarding the solvency of individual banks has paralysed the interbank lending market and raised overnight and short-term lending rates to prohibitive levels. Central banks have coordinated action to stabilise markets by injecting billions of dollars, euros, pounds and yen into short-term money markets and cutting interest rates. While this has helped to alleviate liquidity constraints, interbank lending remains severely constrained as banks continue to hoard cash. A number of governments have announced plans to take direct stakes in major banks.

Financial distress affects the real economy through channels such as falling asset prices (house prices and equities) and reduced confidence. An insolvent banking system will provide less credit to the economy, which will ultimately lower investment, consumption and economic growth, leading to businesses closing and rising unemployment.

The real-economy impact of the current financial crisis is evident in a range of recent economic data releases in G7 countries portraying weak manufacturing output, low business and consumer confidence, reduced spending and rising job losses – all of which points to recessionary conditions in developed economies and slower growth in emerging markets. Commodity prices have declined sharply due to fears of a global recession. Exchange rates have also been volatile, with the global funding squeeze benefiting the dollar and emerging-market currencies falling due to increased risk aversion.

Fiscal stance maintains strong growth in investment and social spending

Inflation targeting helps to manage long-term inflation expectations by providing an appropriate anchor for monetary policy. In recent years fiscal policy has worked to reduce South Africa's exposure to negative international developments by decreasing government debt and increasing foreign exchange reserves. Over the medium term, the fiscal stance will help to moderate the slowdown in GDP growth by maintaining strong growth in public investment and social spending. A small budget deficit is projected over the next few years.

Government is steadily building foreign reserves

Government's policy stance of building foreign reserves has reduced the vulnerability of the economy to external shocks. While a period of general risk reduction by global investors will reduce capital flows to emerging markets, countries such as South Africa, with strong financial systems and growth-oriented policies, are better placed to retain investor confidence. Over the short-term a growing interest rate differential between South Africa and developed economies will be another factor supporting capital inflows.

Financing the current account deficit

South Africa's mismatch between savings and investment is reflected in the deficit on the current account, which rose to 8.1 per cent of GDP in the first half of 2008 compared with 6.7 per cent in the same period in 2007. Although the gap between savings and investment was adequately financed in the first half of the year, capital inflows slowed considerably in the third quarter as investors liquidated asset holdings in emerging markets, resulting in a weaker rand exchange rate.

Table 2.5 Summary of South Africa's current account, 2004 – 2008

Percentage of GDP	2004	2005	2006	2007	2008*
Trade balance	-0.1	-0.4	-2.4	-2.0	-2.1
Net service receipts	-0.3	-0.4	-0.9	-1.1	-1.6
Net income receipts	-2.0	-2.0	-2.1	-3.1	-3.3
Net dividend receipts	*-1.3*	*-1.6*	*-1.6*	*-2.9*	*-2.6*
SACU transfers	-0.8	-1.2	-1.1	-1.0	-1.1
Net services, income and transfer receipts	-3.1	-3.6	-4.0	-5.3	-6.0
Total current account	**-3.2**	**-4.0**	**-6.5**	**-7.2**	**-8.1**
Current ex SACU transfers	-2.4	-2.9	-5.4	-6.2	-7.0
Financial account balance	3.2	5.1	6.0	8.1	7.9
Unrecorded transactions	2.6	1.2	2.2	1.5	0.5
Change in net reserves due to BoP transactions	**2.7**	**2.2**	**1.7**	**2.4**	**1.1**
Total current account (R million)	**-44 631**	**-62 179**	**-112 346**	**-145 016**	**-179 553**

** First half of 2008, annualised*

Surplus capital inflows fully financed current account during first half of 2008

The trade deficit has stabilised at about 2 per cent of GDP over the past year as returns to commodity-based exports have outweighed the impact of rising oil prices. But the increase in foreign capital required to finance the current account deficit since 2003 has contributed to deterioration in the income account due to rising dividend, service and interest payments to international investors. The deficit on the income account explains a large part of the rise in the current account deficit. Some moderation in dividend payments can be expected in the period ahead as economic activity slows.

Depth of South Africa's capital markets is a significant advantage

As state-owned enterprises increase capital investment spending, they are likely to require additional domestic and international borrowing. The cost of borrowing abroad has risen significantly in the past month due to tight credit conditions in developed-country capital markets. A year ago, South Africa was able to borrow at a spread of 0.65 percentage points above the rate of the US government, but today the spread has increased to more than four percentage points. The depth and resilience of the rand-denominated capital market, and government support for the borrowing programmes of state-owned enterprises, are therefore significant advantages in present circumstances.

South Africa's flexible exchange rate helps to reduce the impact of commodity and capital flow shocks on the real economy. Public and private-sector liabilities are mostly rand-denominated, which means less potential adjustment costs from a weaker exchange rate and a generally more resilient economy. The nominal effective rand exchange rate declined by about 18 per cent between January and the first half of October, while the real effective exchange rate was 3.7 per cent weaker between January and July.

Foreign exchange reserves reached US$34.4 billion in September 2008

Higher foreign exchange reserves also provide an important buffer. Gross gold and other foreign exchange reserves reached US$34.4 billion at the end of September 2008 from US$30.5 billion at the end of September 2007. This was US$26.7 billion higher than the level of foreign exchange reserves at the end of 2000. In the first half of 2008, foreign exchange reserves almost fully covered the value of South Africa's short-term liabilities, including the current account deficit, with the external vulnerability ratio standing at 115 per cent down from 136 per cent in 2000. A lower ratio suggests that South Africa has become less vulnerable to external shocks.

Policy challenges: driving higher growth

Reducing poverty and unemployment remain key goals of economic policy

The unforgiving global economic climate highlights the need for South Africa to address its primary economic policy challenges – reducing unemployment and poverty – in a more concerted way.

Declining foreign demand, weaker commodity prices and potentially lower portfolio investment from abroad suggest that to sustain a more rapid economic expansion, South Africa requires consistently stronger growth in productivity, and more efficient and lower-cost logistics and communications. Innovation and competition are essential to sustain a long-term rise in productivity, along with investments in human capital, plant and equipment, and infrastructure. Alongside continued efforts to reduce the vulnerability of the economy to global contagion, these areas should be the primary targets of economic policy.

Increasing employment and enhancing competition

International reports underline importance of exports for South Africa

During 2007 and 2008 the country's economic policies were subject to two international assessments. The International Growth Advisory Panel and the Organisation for Economic Cooperation and Development (OECD) both released their reports and recommendations on South Africa.

The International Growth Advisory Panel identified the creation of employment through higher exports as the central challenge, pointing out that export industries tend be more labour intensive than industries focused on domestic consumption. The panel's proposed policy measures included:

- Increasing support for export-oriented manufacturing sectors
- Raising domestic savings
- Introducing a targeted wage subsidy for school leavers
- Reducing barriers to employment creation.

Labour productivity gains are essential to open up new job opportunities

The OECD summarised the key economic challenge as follows: "Although in the long-run sustained increases in living standards and convergence to the levels enjoyed by advanced countries will only be achieved via growth in labour productivity … the near-term priority should be given to creating jobs for the millions of primarily low-skilled South Africans currently wanting work".

Addressing this dual challenge requires removing impediments to higher levels of investment and innovation, especially those arising from the dominance of several key economic sectors by a small number of companies. It is difficult for new firms to break into these sectors, where the incumbents enjoy high profit margins. This can be addressed in part by more effective competition policy and reducing external barriers to trade.

Linking education to the world of work is one area that deserves attention. Practical steps could include designing curricula for better alignment with market requirements, practical work experience, improving the employability of graduates and providing career paths for young people leaving the system. This includes greater attention to vocational training, and improved alignment between companies and Sector Education and Training Authorities.

To reduce unemployment, education should be more linked to the world of work

Raising investment

Over the past six years, strong economic activity has exposed the consequences of historic underinvestment in critical infrastructure. While the electricity crisis was the most glaring example, constraints to faster growth can be seen in the ports and rail sector, on the roads and in the refining of petroleum.

Government, often in partnership with the private sector, has embarked on a significant expansion of economic infrastructure. Public-sector capital investment of more than R600 billion is planned over the next three years. Over the medium term, capital formation is on average forecast to add about one percentage point to GDP growth.

Public-sector investments to exceed R600 billion over next three years

In addition to capital investments by Eskom, Transnet and the Airports Company of South Africa, which are well under way, the Gauteng freeway improvement programme and investments by several municipalities in bus rapid transit systems are raising spending on infrastructure. These investments in municipalities complement 2010 FIFA World Cup projects.

Financing these needs during a period of reduced access to global credit is a challenge. South Africa’s well-developed domestic capital markets will be important sources of finance. Through targeted guarantees and support for borrowing programmes, government assists several state-owned enterprises to access capital markets at a lower cost. Government is also exploring ways of using its development finance institutions, such as the Development Bank of Southern Africa, to support public investment.

The budget framework provides considerable support to Eskom to finance its large investments. However, the correct pricing of services is crucial to balancing supply and demand, and generating the resources required for higher investment. The realignment of electricity tariffs will encourage more efficient consumption of energy by residential and business users, and provide an incentive for investment in new production capacity.

Correct pricing of services will help balance supply and demand

Public investment in economic infrastructure crowds in private-sector investment, with significant expansion plans in agriculture, mining and manufacturing in anticipation of greater capacity in the key utilities. For example, construction of the De Hoop Dam unlocks new mining opportunities; new power stations generate both demand for coal supplies and greater opportunities for industrial development; and improvements in transport networks contribute to export growth and the mobility of goods and workers.

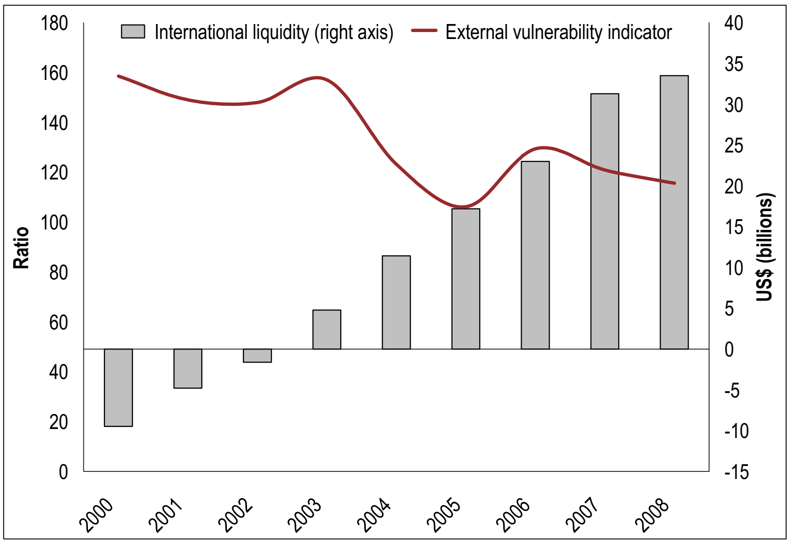
Public investment serves to crowd in private investment

Reducing external vulnerability

Policies and institutions act to cushion economy in a period of global volatility

South Africa has maintained a range of policies and institutions that help to cushion the economy against global volatility. The inflation-targeting framework allows the currency to absorb changes in the prices of commodities and key imports while limiting the impact of these fluctuations on the real economy.

Figure 2.5 Net reserves and external vulnerability, 2000 – 2008

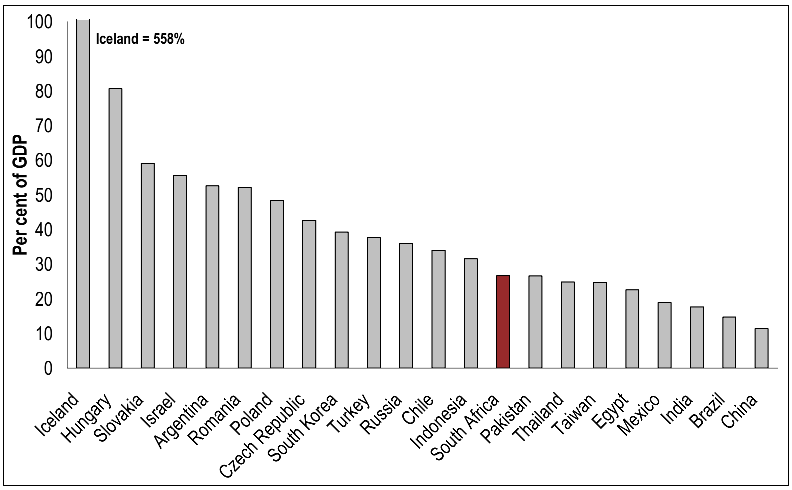


2008 represents data up to and including September 2008.

South Africa's external vulnerability has declined

Financial vulnerability has declined. The prudent fiscal stance has increased government savings and lowered debt (in particular foreign debt) and debt-servicing costs. Exchange controls, prudential regulations and banking supervision have allowed for a responsible expansion of South African financial institutions abroad. Rising foreign exchange reserves have provided further protection.

Figure 2.6 Country comparison of foreign debt levels, 2007



Includes domestic currency debt held by foreigners.

A degree of risk, however, is associated with the large current account deficit. The policy response to mitigating this is as follows:

- Strengthening supportive measures already in place, especially in relation to prudential supervision of the banking system
- Increasing domestic savings to reduce reliance on foreign savings
- Improving net trade performance to generate greater resources for investment.

Household savings are now on the increase

While the institutional capacity to do the first is well advanced, achieving the latter two is likely to be harder. A period of slowing consumption expenditure will help households improve their savings position. This has already begun, with household savings rising in the second quarter of 2008 for the first time in several years. The implementation of the National Credit Act has also served to limit excessive lending by the banking system.

Yet export growth remains sluggish. The ability of South African companies to compete internationally depends on greater productivity gains, cost reduction and innovation, as well as government programmes that promote skills development, reduce infrastructure bottlenecks and improve logistics affecting transport costs.

Table 2.6 Emerging markets export indicators, 2000 – 2007 average

	Goods exports	Services exports	Total trade	Change in share of world exports: goods	Change in share of world exports: services
	Percentage growth			Per cent	
South Africa	3.5	6.3	6.6	0.7	3.2
China	25.3	16.4	22.2	12.4	8.7
Turkey	15.9	5.1	11.3	5.6	-2.4
Poland	15.2	10.7	10.3	10.6	5.7
Hungary	13.5	7.8	11.7	6.4	6.0
South Korea	12.9	4.3	11.6	1.4	0.4
Brazil	9.9	11.3	8.2	5.0	5.6
India	9.2	18.6	11.5	6.4	14.0
Thailand	9.0	5.5	8.6	0.5	-2.1
Mexico	6.4	2.8	6.8	-2.3	-4.5
Argentina	4.9	16.8	5.6	0.2	-0.6

The bulk of South Africa's export earnings are still derived from commodities, and the mining sector has expanded investment rapidly over the past three years. Although commodity prices have fallen sharply in recent months, prices remain relatively high and are likely to receive continued support from economic growth in Asia. The potential for higher mining exports in the medium term remains strong.

Energy efficiency of the economy needs to be improved

South Africa's trade surplus in commodities has been significantly reduced by the economy's reliance on imported oil and petroleum products. While lower oil prices will help to shrink the import bill, over the longer term policy must focus on improving the energy efficiency of the economy, expanding domestic production of oil and gas, and shifting to greater use of other energy sources.

Expanding small-scale agriculture will boost food security and employment

Agricultural investment and production have increased in response to higher prices, and this will support the trade balance. In 2008 South Africa reverted to being a net exporter of maize, but much more needs to be done to boost small-scale agriculture to improve food security and ensure that producers can benefit from higher prices.

Industrial development depends on simplified import tariffs and a lower overall level of trade protection, together with improved coordination of sectoral strategies, skills development, logistics networks and industrial infrastructure investment. Significant tax incentives for the manufacturing sector – to be managed by the Department of Trade and Industry – will also contribute to industrial investment and employment growth over the period ahead.

Conclusion

Through its impact on world growth and appetite for risk, the global financial crisis poses a challenge for commodity-producing countries and those with external funding needs.

Sound macroeconomic management will stand South Africa in good stead in the period ahead, cushioning the economy and households against shocks and providing a platform for higher long-term growth.

The flexible exchange rate, a well-capitalised and prudently regulated banking system, low external debt, deep domestic capital markets, higher foreign exchange reserves, sustainable fiscal policy and ongoing commitment to inflation targeting provide key anchors for improved economic performance. A period of slower growth in consumption in the year ahead will help to replenish household savings. Public-sector investment and capacity additions, in combination with government's efforts to reduce constraints to more rapid economic expansion, will support higher sustainable growth in the future.

3

Fiscal policy: stability and growth

Government has steadily strengthened the overall fiscal position in recent years, mindful of the risks associated with growing global economic and trade imbalances. The public finances are therefore capable of withstanding the strains of the present crisis, while continuing to address South Africa's development challenges. In the context of a sharp slowdown in the world economy and domestic supply constraints, the fiscal stance supports sustainable economic growth by increasing public spending on government's social and economic priorities, and boosting capital investment to increase long-term productive capacity.

Strong growth in capital spending relative to current expenditure ensures that government savings remain positive. The budget posts a modest deficit over the medium term due to growth in government expenditure and lower projected revenue.

Medium-term allocations protect the value of public spending on core programmes in the face of higher inflation. A loan of R60 billion is provided to Eskom for its capital investment programme. Funding for infrastructure expansion, which will contribute to accelerated economic growth in the future, is increased. Rising employment and targeted salary increases in certain categories of the public service aim to strengthen service delivery.

Overview

Fiscal policy ensures that public spending is sustainable

The sound fiscal stance adopted over the past decade enables government to address risks to the economy associated with a volatile global environment. Fiscal policy provides a necessary balance between reducing external vulnerability by supporting domestic savings, and investing in infrastructure and public services that will contribute to higher growth and a broadening of opportunities in the future.

The fiscal stance outlined in this policy statement reaffirms government's commitment to increase spending on infrastructure, public services and job creation, while making the necessary adjustments in a tougher global and domestic environment.

In the period ahead, the fiscal stance is shaped by three goals:

- Bolstering the ability of the economy to grow sustainably through efficient investment and improved service delivery
- Contributing to economic stability by limiting the inflationary and current account effects of government spending in a supply-constrained environment
- Minimising short-term risks to continued investment financing.

Over the past six years the fiscus benefited from rising commodity prices in the form of higher tax revenues. Over the medium term, revenue growth – in particular corporate tax collection – is expected to decline as a share of GDP.

Increase in spending and weaker revenue projections result in a moderate deficit

The 2008 *Medium Term Budget Policy Statement* makes provision for additional allocations totalling R170.8 billion. Of this amount, R50 billion forms part of the R60 billion loan to Eskom and R59 billion consists of adjustments to spending programmes to accommodate higher inflation. This increase in spending, in combination with a weaker revenue projection, results in a moderate budget deficit.

Low debt position helps cushion fiscus from effects of global volatility

Government's moderate debt position and low foreign debt level help to cushion the fiscus from the effects of global financial volatility. Continued positive savings ensure that government is able to finance its current expenditure without placing an excessive burden on the economy or future generations, while the fiscal space created over the past 10 years ensures that the deficit is sustainable.

The structural budget balance introduced last year gives an indication of the fiscal position adjusted for cyclical variables, which have played a strong role in South Africa's growth over the past five years. There is some weakening in the structural budget balance next year, mainly due to higher expenditure, though the balance remains broadly stable over the medium term.

Fiscal trends in the broader public sector

Fiscal policy involves spending by the entire public sector, including national government, state-owned enterprises, local government and extra-budgetary public institutions. Table 3.1 summarises the fiscal indicators of general government using national accounts data, which differ from government financial statistics data used in the budget.

Spending on social welfare grants has increased rapidly, but will show a slower growth trend

Transfers to households consist mainly of social welfare grants and payments by the social security funds. Transfers grew rapidly in the past four years due to the significant increase in recipient numbers. This trend is expected to moderate over the medium term.

Government consumption expenditure has grown relatively rapidly in the past four years, driven primarily by increases in personnel spending for additional employment – especially in health and policing – and higher spending on complementary inputs such as medicines and school books. Over the next three years general government consumption expenditure will continue to grow, but at a more moderate pace.

New and upgraded public infrastructure – including power generation and transmission, rail, ports, roads and pipelines – is needed to boost growth potential and expand private investment. Some of this capital spending has a high import intensity, which will put upward pressure on the current account. Over the long term, however, these investments will help to unwind economic imbalances by lifting the growth potential of the economy.

General government investment spending accelerates

Real growth in general government investment gathers pace over the medium term, averaging 7.3 per cent a year. Increased capital budget allocations reflect government's priorities, with more funds flowing to public transport, education, health, social development, justice and protection services and housing. In addition, a number of new prisons are being constructed through public-private partnerships.

State-owned enterprises are playing a bigger role in driving investment

Public enterprises are shouldering a large share of the capital investment programme. Having grown by an average of 15.9 per cent in real terms over the past four years, investment by public enterprises will accelerate and is expected to average about 20 per cent a year over the medium term. Eskom's infrastructure programme (R340 billion over five years) accounts for the largest share of this expansion, followed by Transnet (R80 billion), the Central Energy Fund (R30 billion) and the Airports Company of South Africa (R17 billion). Investment spending by the large water boards also contributes to rising public-sector capital spending.

Table 3.1 Fiscal trends and projections

Calendar year	2003 – 2007		2007 – 2011
Average annual real growth			
Gross fixed capital formation			
General government[1]	3.8%		7.3%
Public corporations	15.9%		19.7%
Government consumption expenditure			
Compensation of employees	2.5%		2.5%
Non-wage	9.2%		5.6%
Government transfers to households	15.8%		5.6%
Fiscal year	**2003/04**	**2007/08**	**2011/12**
Percentage of GDP			
Interest on public debt	4.0%	2.8%	2.0%
General government savings	-2.0%	0.8%	1.0%
Public sector borrowing requirement	2.0%	-0.3%	2.6%
General government tax revenue	25.6%	28.8%	28.0%

1. General government refers to the accounts of national, provincial and local government, the social security funds, extra-budgetary institutions, adjusted to net outflows within government institutions.

Appropriate price-setting for electricity and water services is a pre-condition for sustainable financing of infrastructure investment. In addition, government will support the role of its development finance institutions in infrastructure finance and provide selective support to state-owned enterprises by guaranteeing some of their debt.

Table 3.2 Infrastructure expenditure estimates, 2007/08 – 2011/12

R million	2007/08	2008/09 Estimate	2009/10	2010/11 Medium-term estimate	2011/12
National departments [1, 2]	6 833	7 954	8 125	8 868	13 454
Provincial departments [2]	31 048	33 103	36 074	41 387	48 168
Municipalities	30 736	31 816	32 501	35 871	38 132
Public private partnerships [3]	3 857	9 911	12 511	10 767	11 259
Extra-budgetary public entities	3 076	5 273	6 765	7 144	7 252
Non-financial public enterprises	56 765	78 393	110 139	125 582	138 527
Total	**132 315**	**166 450**	**206 115**	**229 619**	**256 792**
percentage of GDP	*6.4%*	*7.0%*	*7.9%*	*8.0%*	*8.1%*
GDP	2 061 942	2 366 728	2 598 620	2 870 228	3 170 273

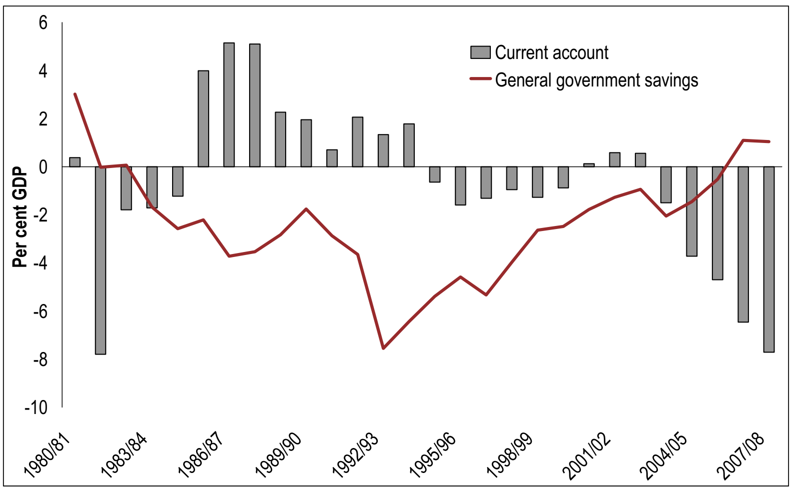
1. *Transfers between spheres have been netted out.*
2. *Includes maintenance of infrastructure assets.*
3. *Infrastructure expenditure on PPPs overseen by the Treasury PPP Unit, South African National Roads Agency, Department of Public Works and at municipal level.*

Revenue growth moderates in line with slower economic activity

As a result of weaker economic activity, tax revenue growth is expected to moderate. Following the buoyancy of recent years, a reduction of gross tax revenue as a percentage of GDP is projected. Much of this decline represents a natural reduction in the cyclical component of revenue, as economic growth and commodity prices retreat from relatively high previous levels. As the economy begins to pick up pace in 2010, the revenue performance should stabilise.

The slowdown in cyclical revenue will put pressure on government savings. This will be partly offset by continued adjustment in the composition of spending, with capital spending growing as a share of total expenditure. The net effect is that government savings are expected to decline marginally, but remain positive.

Figure 3.1 The current account and general government savings, 1980/81 – 2007/08



Investment growth depends on the ability of the economy to finance such expansion, either through domestic or foreign savings. Sound fiscal policy has led to a considerable improvement in government savings. This has helped to offset the widening current account deficit over the past seven years and contributed significantly to the country's economic stability and ability to finance investment.

Improved government savings contribute to economic stability

The public sector borrowing requirement increases, mainly due to the significant increase in borrowings by state-owned enterprises to finance their capital programmes.

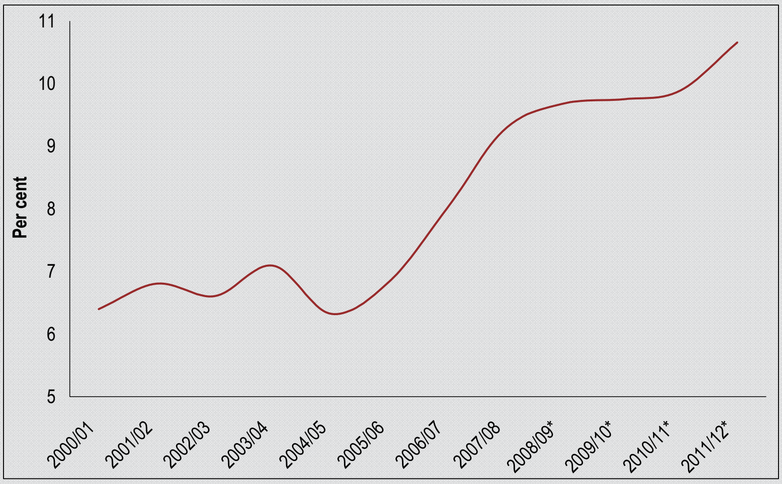
Capital spending: towards higher growth and improved service delivery

Between 1994/95 and 2003/04, consolidated general government capital spending as a percentage of total expenditure was broadly stable. Since 2003/04, fiscal policy has sought to reprioritise government spending towards capital investment in support of public service delivery and higher economic growth. As a result, government's share of capital spending has been rising since 2004/05. Capital spending as a per cent of total government spending increased from 6.3 per cent in 2004/05 to 9.3 per cent by 2007/08. This rising trend is expected to continue over the medium term, with capital expenditure reaching almost 11 per cent of spending by 2011/12.

There have been four major areas of general government capital spending:

- Built environment infrastructure such as housing, water, sanitation, electrification, roads and public transport, including bulk infrastructure and distribution networks for water and electricity
- Social service infrastructure including schools, further education and training colleges, health facilities and welfare services facilities
- Network infrastructure in the economic services sector, including broadband internet connectivity and signal distribution, and investment in research and development infrastructure
- Improving the capacity of the public service through investing (mainly in telecommunication and IT networks) in Home Affairs, the South African Revenue Service and the criminal justice sector.

Capital spending as a percentage of consolidated government expenditure, 2000/01 – 20011/12



**2008/09 – 2011/12 are based on MTEF estimates.*

The budget framework

The proposed budget framework takes into account the consolidated revenue and expenditure of the social security funds in addition to the main budget.

R170.8 billion added to spending plans over next three years

The main budget allows for additional allocations of R170.8 billion over the next three years. Eskom receives support from government in the form of a R60 billion loan, of which R10 billion flows this year and R50 billion over the next two years. Of the remaining R120 billion in additional allocations, the largest share (R59 billion) is allocated to offset the effects of higher inflation, especially on salaries, social grants, fuel and capital projects.

The expanded public works programme, the school feeding programme and municipal infrastructure also receive significant allocations. Spending priorities financed over the next three years are discussed in Chapter 5.

Table 3.3 Consolidated national government, 2007/08 – 2011/12

R billion / *per cent*	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
		Estimate		**Projections**	
Main budget revenue					
Gross tax revenue	572.9	642.3	699.0	769.2	852.8
percentage of GDP	27.8%	27.1%	26.9%	26.8%	26.9%
plus: other non-tax receipts and payments	11.6	11.3	11.1	10.6	11.0
less: SACU transfers	-24.7	-27.1	-27.3	-28.7	-30.4
Total revenue	**559.8**	**626.5**	**682.9**	**751.1**	**833.4**
Main budget expenditure					
State debt cost	52.9	53.9	52.7	55.1	56.7
percentage of GDP	*2.6%*	*2.3%*	*2.0%*	*1.9%*	*1.8%*
Non-interest expenditure[1]	488.6	581.5	682.2	737.4	787.9
percentage of GDP	*23.7%*	*24.6%*	*26.3%*	*25.7%*	*24.9%*
per cent real growth	*8.1%*	*6.7%*	*11.5%*	*2.7%*	*2.1%*
Of which:					
Increases over 2008 Budget		27.7	60.6	52.5	57.7
Contingency reserve		–	4.0	12.0	20.0
Total expenditure	**541.5**	**635.5**	**735.0**	**792.5**	**844.6**
percentage of GDP	*26.3%*	*26.8%*	*28.3%*	*27.6%*	*26.6%*
Social security funds					
Revenue	24.8	29.5	30.0	32.4	35.7
Expenditure	16.5	17.4	19.4	22.0	24.0
Consolidated national budget[2]					
Revenue	**584.6**	**653.5**	**712.8**	**783.5**	**869.2**
percentage of GDP	*28.4%*	*27.6%*	*27.4%*	*27.3%*	*27.4%*
Expenditure	**558.0**	**650.3**	**754.3**	**814.5**	**868.6**
percentage of GDP	*27.1%*	*27.5%*	*29.0%*	*28.4%*	*27.4%*
Budget balance	**26.6**	**3.2**	**-41.5**	**-31.0**	**0.6**
percentage of GDP	*1.3%*	*0.1%*	*-1.6%*	*-1.1%*	*0.0%*
Gross domestic product	2 061.9	2 366.7	2 598.6	2 870.2	3 170.3

1. Includes transfers to provinces and local government, the National Skills Fund and sectoral skills development funds.
2. Flows between funds are netted out.

Following the exceptional revenue performance of the past six years, tax buoyancy has declined in 2008/09 in response to cyclical factors. Over the medium term, tax revenue growth will begin to correlate more closely with the rate of GDP growth, and is expected to stabilise at just below 27 per cent of GDP.

Excluding the Eskom loan, additional main budget resources of R120 billion over the medium-term expenditure framework (MTEF) period result in real growth in expenditure of about 6 per cent a year.

Social security funds continue to run a surplus

The budget framework makes provision for a contingency reserve totalling R36 billion over the next three years. The contingency reserve allows the fiscus to respond within the agreed resource envelope to unforeseen and unavoidable events. The reserve is also available for partial drawdown to fund new priorities in the outer two years. The social security funds continue to run significant surpluses in aggregate, despite a projected deficit on the Road Accident Fund. The budget framework excludes expenditure of about R1.6 billion a year financed by foreign development assistance.

Debt service costs continue to fall as a share of GDP

Debt service costs have fallen from nearly 6 per cent of GDP in 1998/99 to 2.3 per cent in 2008/09. Declining deficits and fiscal surpluses in recent years have resulted in a particularly pronounced drop in debt service costs. This has created significant fiscal space, enabling government to preserve the real value of previous allocations and make available additional resources to improve the availability and delivery of public services without having to increase taxes. The decline in debt service costs as a percentage of GDP is expected to continue over the MTEF, although at a slower rate.

Budget deficit of 1.6 per cent of GDP in 2009/10

The budget balance of the consolidated national budget for 2008/09 is revised to a surplus of 0.1 per cent of GDP. As the economy slows further next year, the budget balance moves to a deficit of 1.6 per cent of GDP.

Debt management

Given the current volatility in global markets and a high current account deficit, debt management policy is focused on managing external vulnerability. In keeping with this position, government will continue to assist the Reserve Bank to increase the level of foreign exchange reserves and actively manage its portfolio to reduce short-term debt, taking into account market considerations.

Table 3.4 reflects the net and gross debt of national government. Including forward estimates of the impact of exchange and inflation rates on foreign and inflation-linked debt, net loan debt will continue to decline as a share of GDP to 19.9 per cent by 2011/12. Foreign debt is projected to fall to 2.8 per cent of GDP.

Table 3.4 Total government debt, 2005/06 – 2011/12

As at 31 March R billion	2005/06	2006/07 Outcome	2007/08	2008/09 Estimate	2009/10	2010/11 Medium-term estimates	2011/12
Domestic debt[1]	461.5	471.1	479.6	518.7	572.9	626.2	660.9
Foreign debt[1]	66.8	82.6	96.2	87.7	85.2	86.3	88.8
Gross loan debt	**528.3**	**553.7**	**575.8**	**606.4**	**658.1**	**712.5**	**749.7**
Less: National Revenue Fund bank balances	-58.2	-75.3	-94.5	-113.7	-101.3	-104.6	-119.8
Net loan debt[2]	**470.1**	**478.4**	**481.3**	**492.7**	**556.8**	**607.9**	**629.9**
As percentage of GDP :							
Net loan debt	*29.7*	*26.5*	*23.3*	*20.8*	*21.4*	*21.2*	*19.9*
Foreign debt	*4.2*	*4.6*	*4.7*	*3.7*	*3.3*	*3.0*	*2.8*
As percentage of gross loan debt:							
Foreign debt	*12.6*	*14.9*	*16.7*	*14.5*	*12.9*	*12.1*	*11.8*

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).*

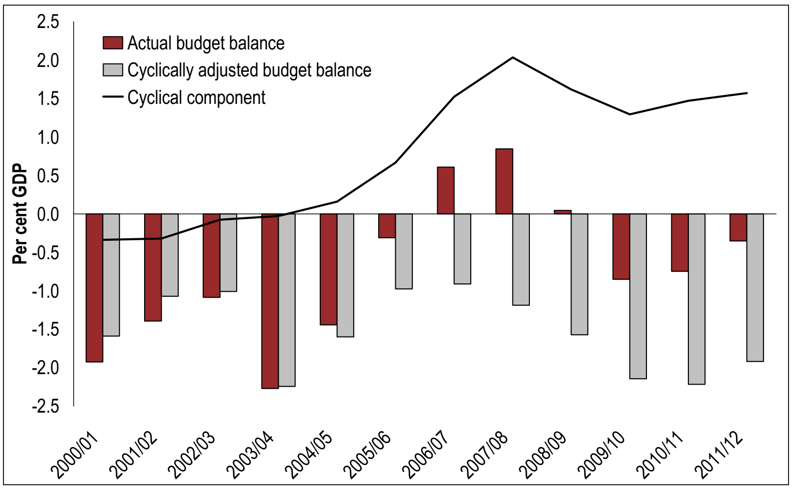
Structural main budget balance

Structural budget balance adjusts fiscal policy for cyclical effects

In 2007, government introduced the concept of a structural budget balance, also called the cyclically adjusted budget balance, to help guide fiscal policy. The aim of this shift is to take account of temporary fiscal developments that do not represent structural changes in expenditure or revenue.

In arriving at the structural budget balance, the main budget is adjusted to take account of cyclical spending and revenue collection, including abnormally high tax on profits when commodity prices are at elevated levels. In the 2009 MTEF, spending is adjusted by removing the Eskom loan – a once-off item that supports investment in infrastructure that will raise potential growth.

Figure 3.2 Main budget and structural budget balances, 2000/01 – 2011/12



Both the actual and cyclically adjusted budget balances have been adjusted for the loan transfer to Eskom.

South Africa's economic cycle is influenced by a range of factors, the most important elements of which are the prices of major exports relative to our imports (often referred to as the terms of trade). Over the period ahead the cyclical adjustment to the budget balance remains positive, signalling that revenue trends are likely to continue to be supported by cyclical factors.

Commodity prices have significant impact on economic cycle

The positive cyclical adjustment is mainly the result of continued favourable terms of trade. Because the prices of imports have fallen by more than the prices of exports, the economy has experienced a positive wealth effect, meaning that South Africa can afford more imports for a given quantity of exports. This feeds through into tax revenue. Such revenue is considered to be cyclical because it does not result from a structural change in the economy and can be expected to unwind as the relative prices adjust.

The structural budget deficit declines from about 1.6 per cent of GDP in 2008/09 to average about 2.0 per cent over the medium term, but remains within an acceptable margin. Over the longer-term, government spending in support of higher GDP growth is expected to contribute to the reduction of the structural budget balance by structurally raising the growth potential of the economy.

Structural budget balance deteriorates slightly, but still within an acceptable margin

Public sector borrowing requirement

The public sector borrowing requirement provides the aggregate cash position of the entire public sector, including state-owned enterprises.

The accelerating capital investment programmes at all levels of the public sector, combined with the more challenging operating environment, result in the cash position of the public sector moving from a surplus in 2007/08 to a borrowing requirement averaging about 3 per cent over the medium term.

Capital spending plans of public enterprises raise public sector borrowing requirement

Table 3.5 Public sector borrowing requirement, 2007/08 – 2011/12

	2007/08	2008/09		2009/10	2010/11	2011/12
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget balance[1]	**-18.3**	**-14.3**	**8.9**	**52.1**	**41.5**	**11.2**
Extraordinary payments	0.8	–	4.9	–	–	–
Extraordinary receipts	-1.8	-0.9	-7.2	-1.4	-0.6	-0.6
Financing requirement	**-19.3**	**-15.2**	**6.6**	**50.7**	**40.9**	**10.6**
Other government borrowing[2]	2.2	4.5	-4.1	-3.8	-2.1	-3.0
General government borrowing	**-17.0**	**-10.7**	**2.6**	**46.9**	**38.7**	**7.5**
Percentage of GDP	*-0.8%*	*-0.5%*	*0.1%*	*1.8%*	*1.3%*	*0.2%*
Plus: Non-financial public enterprises	11.1	37.7	27.9	30.3	53.0	74.9
Public sector borrowing requirement	**-5.9**	**27.0**	**30.4**	**77.2**	**91.7**	**82.4**
Percentage of GDP	*-0.3%*	*1.2%*	*1.3%*	*3.0%*	*3.2%*	*2.6%*
Gross domestic product	*2 061.9*	*2 286.9*	*2 366.7*	*2 598.6*	*2 870.2*	*3 170.3*

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.

The main factors driving the increase in the public sector borrowing requirement are the budget deficit and borrowing by non-financial public enterprises to finance their capital investments. A significant portion of the short-term increase in the main budget borrowing requirement is to support Eskom.

4

Tax policy

While tax revenue collection remains robust, the short-term impact of slower economic activity will reduce the pace of revenue growth. It is estimated that main budget revenue collection during 2008/09 will be R1.2 billion higher than the budgeted amount.

Over the medium term government will continue to promote a progressive, efficient and equitable tax system that broadens the tax base and supports accelerated economic activity. The tax proposals put forward in the 2008 Budget included a reduction in the headline corporate income tax rate to 28 per cent, initial steps to replace the secondary tax on companies with a dividend tax at shareholder level, measures to reduce the compliance costs for micro businesses, improving access to equity finance by small businesses, and incentives to support the industrial policy action plan and low-cost housing. These and other amendments to the revenue laws are currently before Parliament.

Introduction

Government has been able to reinforce the progressive character of the tax system

For several years, revenue growth has exceeded economic growth, with the tax-to-GDP ratio rising by more than three percentage points in five years. The factors behind this strong revenue performance included legislative changes to broaden the tax base and reduce loopholes, and a more efficient revenue service. Through both policy reforms and improved administration, government has increased the efficiency, fairness and progressiveness of the tax system, while reducing the distorting impact of high marginal tax rates.

Over the medium term, as economic growth slows in response to global and domestic factors, tax revenue is expected to moderate to an average of 26.3 per cent of GDP, compared with 27.1 per cent in 2007/08. Slower growth will impact particularly on tax revenues from companies, value-added tax (VAT) and customs duties.

National budget revenue, 2007/08

Audited main budget revenue for 2007/08 was R15.2 billion higher than the budget estimate

The audited main budget revenue outcome of R559.8 billion for 2007/08 was R15.2 billion higher than the original budget estimate in February 2007 and R1.8 billion higher than the revised 2008 *Budget Review* estimate. The main variances from the 2007 estimate were:

- Personal income tax collections R13.4 billion above the estimate
- Secondary tax on companies (STC) collections R4.6 billion above the estimate
- VAT collections R4.6 billion below the estimate.

Table 4.1 National budget revenue, 2007/08 estimates and audited outcome

R billion	Budget estimate	Revised estimate	Audited outcome	Deviation from Budget estimate	Deviation from Revised estimate
Taxes on income and profits	**312.2**	**332.3**	**332.1**	**19.9**	**-0.2**
Persons and individuals	155.3	168.5	168.8	13.4	0.3
Companies	138.5	141.4	140.1	1.6	-1.3
Secondary tax on companies	16.0	20.2	20.6	4.6	0.4
Interest on overdue income tax	2.3	2.0	2.3	-0.0	0.3
Other taxes on income and profits[1]	–	0.2	0.3	0.3	0.1
Taxes on payroll and workforce	**6.5**	**6.8**	**6.3**	**-0.2**	**-0.5**
Skills development levy	6.5	6.8	6.3	-0.2	-0.5
Taxes on property	**11.0**	**12.7**	**11.9**	**0.9**	**-0.8**
Securities transfer tax	3.5	4.2	3.8	0.3	-0.4
Transfer duties	7.1	7.8	7.4	0.4	-0.3
Other taxes on property[2]	0.5	0.8	0.7	0.2	-0.1
Domestic taxes on goods and services	**199.2**	**191.6**	**194.7**	**-4.5**	**3.1**
Value-added tax	155.1	147.0	150.4	-4.6	3.4
Specific excise duties	17.8	18.0	18.2	0.4	0.2
Ad valorem excise duties	1.4	1.6	1.5	0.1	-0.1
Levies on fuel	23.9	24.0	23.7	-0.2	-0.3
Other domestic taxes on goods and services[3]	1.0	1.0	0.9	-0.1	-0.1
Taxes on international trade and transactions	**27.5**	**27.0**	**27.1**	**-0.4**	**0.1**
Customs duties	27.1	26.6	26.5	-0.6	-0.1
Other taxes on international trade and transactions	0.4	0.4	0.6	0.2	0.2
Stamp duties and fees	**0.2**	**0.7**	**0.6**	**0.3**	**-0.1**
State miscellaneous revenue[4]	**–**	**–**	**0.2**	**0.2**	**0.2**
Total tax revenue	**556.6**	**571.1**	**572.9**	**16.3**	**1.8**
Non-tax (departmental) revenue[5]	11.1	11.6	11.6	0.5	0.0
Less: SACU payments	-23.1	-24.7	-24.7	-1.7	–
Main budget revenue	**544.6**	**558.0**	**559.8**	**15.2**	**1.8**

1. Includes tax on retirement funds and small business tax amnesty.

2. Includes estate duty and donations tax.

3. Includes air departure tax, plastic bags levy, mining leases and ownership and the Universal Service Fund.

4. Tax revenue received by SARS that could not be allocated to a specific tax instrument.

5. Preliminary outcome.

National budget revenue estimates, 2008/09

Based on revised macroeconomic projections set out in Chapter 2 and the revenue trends for the first six months of this fiscal year, main budget revenue for 2008/09 is expected to amount to R626.5 billion, or R1.2 billion higher than the February estimate. The gross tax revenue estimate remains unchanged.

Main budget revenue is expected to be R1.2 billion above budget

Table 4.2 National budget revenue, 2008/09 – 2011/12

	2008/09				2009/10	2010/11	2011/12
R billion	Budget estimate	Revised estimate	Deviation	Actual Apr to Sep	Medium-term estimates		
Taxes on income and profits	**369.8**	**380.6**	**10.9**	**178.6**	**416.3**	**457.1**	**511.1**
Persons and individuals	191.0	201.0	10.0	93.6	226.0	252.2	282.2
Companies	156.5	158.9	2.5	75.3	168.7	190.4	212.8
Secondary tax on companies	20.0	18.2	-1.8	8.3	19.0	11.8	13.2
Interest on overdue income tax	2.2	2.3	0.0	1.2	2.5	2.7	3.0
Other taxes on income and profits	–	0.3	0.3	0.2	–	–	–
Taxes on payroll and workforce	**7.5**	**7.9**	**0.4**	**3.5**	**8.4**	**9.3**	**10.3**
Skills development levy	7.5	7.9	0.4	3.5	8.4	9.3	10.3
Taxes on property	**14.2**	**10.3**	**-3.9**	**5.0**	**11.2**	**12.4**	**13.6**
Securities transfer tax	4.7	3.5	-1.2	1.8	3.9	4.3	4.8
Transfer duties	8.6	6.0	-2.6	2.8	6.5	7.1	7.8
Other taxes on property	0.9	0.8	-0.1	0.4	0.9	1.0	1.1
Domestic taxes on goods and services	**218.6**	**215.9**	**-2.7**	**94.3**	**233.5**	**256.5**	**278.7**
Value-added tax	167.0	167.0	-0.0	71.7	180.3	199.8	219.6
Specific excise duties	20.4	20.5	0.1	8.9	21.1	22.1	23.0
Ad valorem excise duties	1.7	1.7	0.0	0.6	1.8	1.8	1.9
Levies on fuel	26.4	25.5	-0.9	12.1	26.3	27.5	28.6
Electricity levy	2.0	–	-2.0	–	2.8	4.0	4.2
Other domestic taxes on goods and services	1.1	1.2	0.2	1.0	1.3	1.4	1.4
Taxes on international trade and transactions	**31.5**	**26.9**	**-4.6**	**11.9**	**29.6**	**33.9**	**39.0**
Customs duties	31.1	26.5	-4.6	11.2	29.2	33.4	38.5
Other taxes on international trade and transactions	0.4	0.4	–	0.7	0.4	0.5	0.6
Stamp duties and fees	**0.7**	**0.6**	**-0.1**	**0.3**	**–**	**–**	**–**
State miscellaneous revenue	**–**	**–**	**–**	**0.6**	**–**	**–**	**–**
Total tax revenue	**642.3**	**642.3**	**0.0**	**294.3**	**699.0**	**769.2**	**852.8**
Non-tax (departmental) revenue[1]	12.0	11.3	-0.7	5.6	11.1	10.6	11.0
Less: Estimate of SACU payments[2]	-28.9	-27.1	1.8	-14.5	-27.3	-28.7	-30.4
Main budget revenue	**625.4**	**626.5**	**1.2**	**285.4**	**682.9**	**751.1**	**833.4**
Percentage of GDP	*27.3%*	*26.5%*			*26.3%*	*26.2%*	*26.3%*
GDP	*2 286.9*	*2 366.7*			*2 598.6*	*2 870.2*	*3 170.3*
Tax/GDP multiplier	*1.11*	*0.82*			*0.90*	*0.96*	*1.04*

1. Preliminary outcome for 2008/09.

2. The revised estimate for 2008/09 includes adjustment payments to Southern African Customs Union member countries.

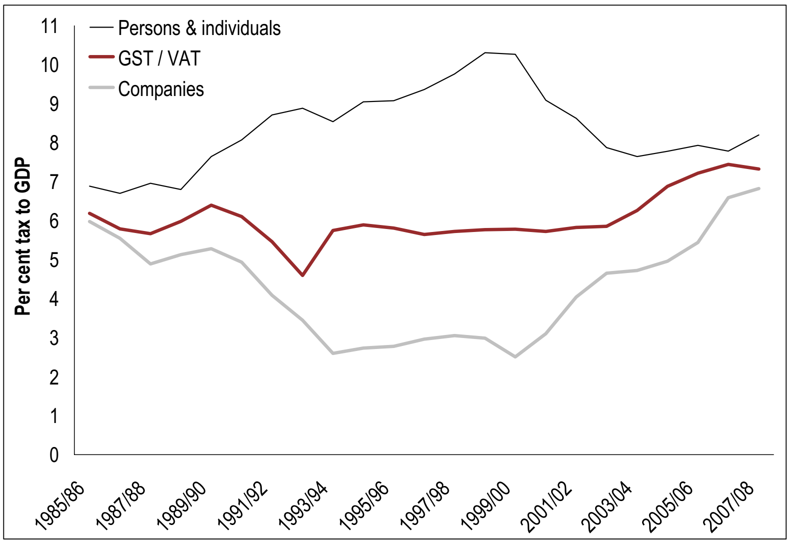
However, the composition of projected revenue has been revised. Taking into account their buoyancy in the first six months of the year, personal income tax and company tax receipts are expected to be R10 billion and R2.5 billion higher for the full year. Revenues from customs duties, transfer duties and STC are expected to be below budget. The estimated R2 billion from the proposed electricity tax will not be collected this year.

Revenue trends and tax reforms

Three taxes account for most government revenue

South Africa's main sources of tax revenue are personal income tax, VAT and corporate income tax. Figure 4.1 illustrates historical revenues from these instruments expressed as a percentage of GDP.

Figure 4.1 Tax-to-GDP ratio, 1985/86 – 2007/08



A decade of significant tax reforms for individuals and businesses

Improved revenue administration and a growing economy have enabled government to make significant tax reforms over the past decade. These included the introduction of capital gains tax, the shift to a residence-based income tax system, the elimination of the regional services council levies and the retirement fund tax, personal income tax relief and reduced transfer duties. Tax reforms currently under way include replacement of STC with a dividend tax. It is proposed that the general fuel levy should be shared with metropolitan municipalities, and further tax instruments to fund local governments are being investigated.

Personal income tax

Tax relief has included full compensation for effects of inflation

Government has granted significant personal income tax relief since 2000/01. Over this period, the income tax brackets and the primary and secondary personal income tax rebates were increased to fully compensate for the effects of inflation, and in a number of years provided relief beyond inflation. In addition, the top marginal personal income tax rate was reduced from 45 to 40 per cent. These reforms have brought relief for individuals across the board, with a bias towards low- and middle-income earners. The taxable income threshold of the bottom personal income tax bracket (at 18 per cent) increased from R40 000 in 2002/03 to R122 000 in 2008/09, and that of the top personal income tax bracket (at 40 per cent) from R240 000 to R490 000 during the same period.

Individuals younger than 65 years with an annual taxable income below R46 000 and those 65 years and older with an annual taxable income below R74 000 during 2008/09 do not pay any income tax.

Reforms have made personal income tax more efficient and more equitable

The net result of the personal income tax reforms – rate reductions, adjustments to brackets, base broadening in the form of capital gains tax, closing of various loopholes and improved enforcements – is a personal income tax regime that is more efficient and more equitable.

The number of people registered for income tax has grown from 3.6 million in 2002/03 to 5.2 million in 2007/08. Four million individuals with annual taxable income below R60 000 per year, who are liable for standard income tax on employees, are not required to register for income tax or to file annual returns.

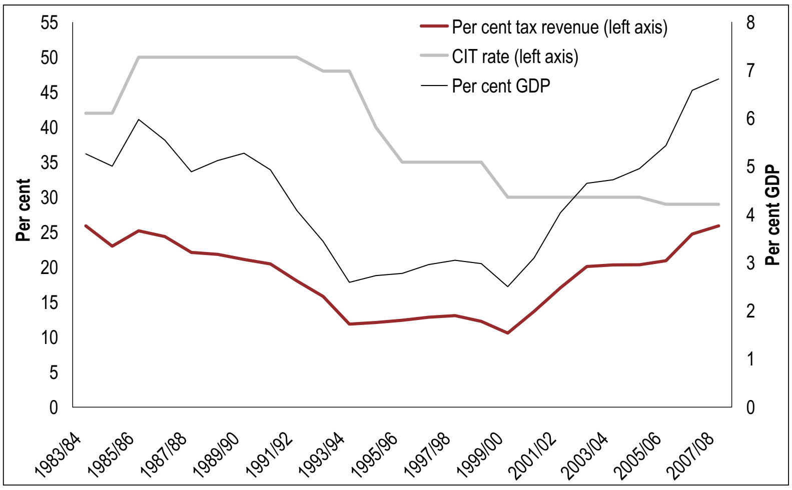
The 2009 Budget will again provide relief for individuals to compensate for the effects of inflation.

Corporate income tax

Corporate income tax rate was reduced but revenues have increased

Figure 4.2 illustrates that although the headline corporate income tax rate has been reduced from 50 per cent in the early 1990s to 28 per cent in 2008/09, corporate tax revenue has increased as a percentage of GDP.

Figure 4.2 Corporate income tax and GDP, 1983/84 – 2007/08



It is apparent that a considerable erosion of the company tax base occurred when the rate was above 40 per cent, while a broadening of the tax base, higher growth and improved compliance efforts have resulted in significant increases in this revenue category since 2000/01. By removing various loopholes and by introducing capital gains tax, the revenue system has become more efficient, increasing the effective tax rate on companies.

Commodity and exchange rate fluctuations make fiscus more vulnerable to revenue shifts

Given the weight of the resources sector in the South African economy, commodity price and exchange rate fluctuations can have a significant impact on corporate profits, making corporate income tax revenue less predictable than personal income tax and VAT revenues.

One consequence of the greater reliance on corporate tax in recent years is that the fiscus is more vulnerable to sudden shifts in revenue. Recognition of this factor contributed to the decision to adopt a cyclically adjusted budget balance, which ensures that revenues that are likely to be of a cyclical nature are not permanently built into the expenditure base or given away in tax relief.

The relative contributions to corporate tax of the main economic sectors and subsectors are indicated in Table 4.3.

Table 4.3 Corporate income tax revenue by sector, 2000/01 – 2007/08

Sector	2000/01	2002/03	2005/06	2007/08
Agencies and other services	2.7%	2.2%	2.7%	2.9%
Coal and petroleum products	9.2%	8.4%	5.5%	5.2%
Construction	0.9%	0.9%	1.6%	2.1%
Financing, insurance, real estate and business services	27.0%	24.8%	26.8%	29.9%
Food, drink and tobacco	5.0%	4.2%	4.8%	3.9%
Long-term insurers	9.2%	6.2%	4.7%	6.3%
Metal	2.3%	3.1%	3.8%	3.3%
Mining and quarrying	14.5%	18.5%	6.2%	10.5%
Retail trade (including mail order)	3.5%	3.4%	6.3%	5.4%
Transport, storage and communication	4.6%	5.3%	11.6%	8.1%
Vehicles, parts and accessories	1.1%	2.6%	4.4%	3.1%
Wholesale trade	3.1%	2.8%	3.3%	2.9%
Other[1]	16.9%	17.6%	18.5%	16.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

1. Includes other sectors.

Value-added tax

Evidence suggests that higher-income groups benefit more than the poor from VAT zero-rating

While the VAT zero-rating of basic foodstuffs and paraffin is intended to assist the poor, higher-income households also benefit from these concessions. Evidence suggests that existing VAT zero-ratings and exemptions, in almost all cases, confer substantially more benefits on middle- and higher-income groups than on lower-income groups. In addition, depending on market structure, producers and suppliers may capture a large percentage of the benefit of VAT zero-rating.

These facts reinforce the case against further VAT zero-rating of goods in a context where public expenditure can provide more effective and targeted relief. Furthermore, revenue lost through the VAT zero-rating of goods and services would have to be made up elsewhere.

Implementation of the 2008 tax proposals

2008 tax proposals aimed to promote economic growth, investment and job creation

The 2008/09 tax proposals supported government's broad macroeconomic policy objectives by promoting economic growth, real fixed investment and job creation. An update is provided below.

Taxation of pre-retirement withdrawals from savings

In 2007, a simplified tax treatment of lump sum payments on retirement was introduced. Forthcoming legislation will extend this reform to include taxation of pre-retirement withdrawals on a cumulative basis. The proposed schedule, to take effect from 1 March 2009, is shown in Table 4.4. Accumulated pre-retirement withdrawals will be taken into account in determining the tax liability on a lump sum at retirement.

Forthcoming legislation to extend reforms

Table 4.4 Proposed rate structure of pre-retirement withdrawals from retirement savings[1]

Lump sum	Tax liability
R 0 – R 22 500	0%
R 22 501 – R 600 000	18% of the amount above R 22 500
R 600 001 – R 900 000	R 103 950 + 27% of the amount above R 600 000
R 900 001 and above	R 184 950 + 36% of the amount above R 900 000

1. Effective from 1 March 2009.

Presumptive turnover tax for micro businesses

A new turnover tax regime for micro businesses with an annual turnover of up to R1 million, effective 1 March 2009, will reduce the compliance burden. Qualifying firms will be allowed to opt out of the income tax and VAT systems. This is complemented by an increase in the compulsory VAT registration threshold to R1 million per year.

New turnover tax regime reduces compliance burden for very small businesses

Table 4.5 Proposed turnover tax for micro businesses[1]

Annual turnover	Tax liability
R 0 – R 100 000	0%
R 100 001 – R 300 000	1% of the amount above R 100 000
R 300 001 – R 500 000	R 2 000 + 3% of the amount above R 300 000
R 500 001 – R 750 000	R 8 000 + 5% of the amount above R 500 000
R 750 001 – R 1 000 000	R 20 500 + 7% of the amount above R 750 000

1. Effective from 1 March 2009.

Venture capital companies

To assist small and medium-sized companies and junior mining exploration firms to overcome the difficulty of accessing equity finance and to encourage entrepreneurship, an incentive to invest in such firms through venture capital companies will be introduced. Investment in a venture capital firm will qualify for a 100 per cent deduction for the initial investment, subject to an annual limit of R750 000 for individuals, with a lifetime limit of R2.25 million.

Incentives support venture capital for small and medium-sized companies

Reform of the secondary tax on companies

The second phase of STC reform is scheduled for late 2009 or early 2010 and entails converting the STC into a dividend tax at shareholder level. Individual and non-resident shareholders will be liable for the dividend tax, while resident corporate shareholders will be exempt, as will institutions such as pension funds and public benefit organisations that are exempt from income tax.

Industrial policy incentives

Incentives support government's industrial policy action plan

An amount of R5.6 billion over five years has been budgeted for tax incentives to support government's industrial policy projects. The tax incentive consists of two elements: an additional deduction for real fixed investment and one for training. The maximum additional deduction for real fixed investment will be R900 million per project and R30 million per project for training.

Low-cost housing

Employers and landlords are encouraged, by way of incentives in the form of accelerated depreciation, to increase the stock of housing units valued at less than R200 000 (excluding land) and apartments valued at R250 000 or less. The purpose of this incentive is to increase access to housing for low- and middle-income families.

Urban development zones

Five-year extension of urban development zone tax incentives

Urban development zones provide accelerated depreciation for new and refurbished buildings. The incentive, which was due to expire in March 2009, will be extended for five years. Depreciation allowances for new buildings in these zones will be enhanced.

Learnership and apprenticeship and artisan training

Amendments to the Income Tax Act (1962) are proposed to make allowances for short-term learnerships and longer-term apprenticeships more equitable, enabling employers to get the full allowance for time-based and competency-based modular-training programmes.

Environmental fiscal reform (an electricity levy)

A step towards a comprehensive carbon emissions tax

To begin addressing the challenges of climate change and to increase energy efficiency given South Africa's electricity supply shortage, a 2c/kWh environmental levy on electricity generated from non-renewable resources, to be collected at source by the generators of electricity, was announced during the 2008 Budget. Electricity produced from renewable sources (e.g. wind, water and solar) will be exempt from the levy, as will power produced through co-generation.

The electricity levy should be seen as the first step towards the introduction of a more comprehensive emissions-based carbon tax. Implementation of the levy has been postponed to 1 July 2009 to coincide with the commencement of the next municipal financial year.

Conclusion

In the context of a global economic slowdown and lower corporate profits, moderate revenue growth is expected over the period ahead. South Africa's sound tax structure and healthy revenue administration enhance government's ability to manage the fiscal challenges ahead and maintain an environment conducive to investment and growth.

5

Public spending priorities and budget policy

Government's spending plans for the period ahead aim to strengthen the quality and effectiveness of public services. The budget gives practical effect to policy commitments focused on growth and employment creation, broad-based development, income security and social cohesion. Improving education and health care, combating crime, investing in infrastructure and speeding up rural development and agrarian reform receive priority in the medium-term expenditure proposals.

Consolidated government expenditure of R839.8 billion is proposed for 2009/10, 14.2 per cent more than the revised estimate of expenditure for 2008/09. In total, about R170.8 billion is added over the medium-term expenditure framework (MTEF), including R58.7 billion for inflation-related adjustments to maintain the purchasing power of existing spending plans. Real increases in medium-term allocations are proposed for schools, hospitals, police, public transport, industrial support, housing, water services and rural development.

The budget policy framework

Strong spending growth promotes broad-based development

The budget policy framework proposed for the next three years provides for strong growth in public spending on infrastructure and services focused on meeting basic needs and promoting broad-based development. Major budget priorities over the MTEF include:

- Enhancing the quality of education
- Improving the provision of health care, particularly for the poor, to reduce infant, child and maternal mortality rates
- Reducing the levels of crime and enhancing citizen safety
- Expanding the built environment to improve public transportation and meet universal access targets in housing, water, electricity and sanitation

- Decreasing rural poverty by taking steps to raise rural incomes and improve livelihoods by extending access to land and support for emerging farmers.

Creating jobs and improving the capacity of the state are crucial to progress

In addition to these priorities, several cross-cutting themes will be reflected in the 2009 Budget. These include support for employment creation, initiatives to improve the capacity of the state and, over the longer term, steps to reduce carbon emissions and mitigate the effects of climate change. The budget framework also includes an unallocated contingency reserve that allows for future spending requirements to be accommodated within the agreed resource envelope.

Alongside departmental spending plans, infrastructure investment by Eskom and Transnet will increase strongly over the period ahead, and the lending activities of the Development Bank of Southern Africa and other development finance institutions will help to sustain the pace of investment spending. Funding of R60 billion to support Eskom's capital programme will be provided by the fiscus.

Core challenges for public expenditure

Increases in public expenditure have improved living conditions

Over the past decade increases in public expenditure have contributed to poverty reduction and improving the living conditions of South Africans, both through direct income support (social assistance grants) and investment in housing, electricity, water and social services. While the global financial crisis and resulting disturbance of trade and investment flows will unavoidably affect economic activity, the fiscal stance and public spending programmes are focused on long-term structural transformation and will continue to support both social development and broadening economic participation. Transfers to provinces and municipalities will increase to enable them to deliver better-quality services and to expand the provision of basic amenities. A key determinant of progress is the ability of national departments, provinces and municipalities to make more efficient use of public funds.

Government aims for more rapid progress in job creation, health and education

Progress since 1994 in key social and economic categories is well illustrated in *Development Indicators 2008*, published by the Presidency.[1] While both economic growth and government services have contributed to rising living standards across a broad range of indicators, high unemployment, shortcomings in the quality of health and education, and high rates of violent crime stand out as challenges.

This chapter summarises the broad trends in public expenditure proposed for the MTEF period. It reflects both the direct income support and service delivery responsibilities of government and the long-term objectives of improving education, skills and infrastructure to grow the economy. It sets out an appropriate balance between immediate objectives and investment for the future.

[1] Available at www.thepresidency.gov.za

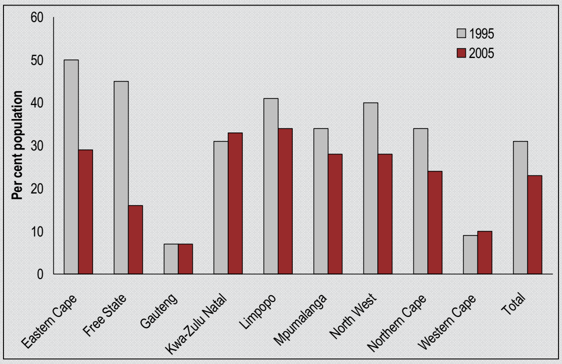
Measuring social and economic progress – South Africa's *Development Indicators*

The *Development Indicators 2008* provides illustrative data on 76 areas of social and economic performance, including growth and transformation of the economy, household living conditions, health, education, social cohesion, safety and security, international relations and good governance. The publication contributes to monitoring progress in all these areas and in meeting the Millennium Development Goals (MDGs), to which South Africa is committed. The MDGs cover eight global challenges:

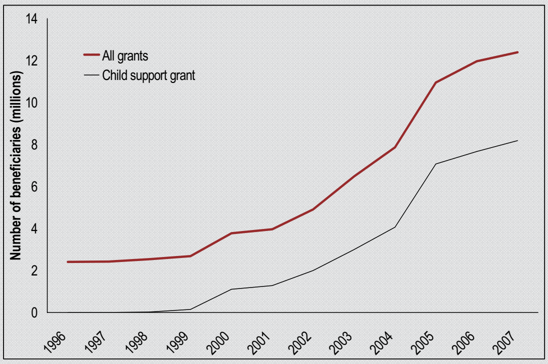
- Eradicating extreme poverty and hunger
- Universal primary education
- Gender equality and empowerment of women
- Reducing child mortality
- Improving maternal health
- Combating HIV and Aids and malaria
- Environmental sustainability
- Global partnership for development.

Trends in poverty reduction, social assistance to households, access to electricity and water, education performance, HIV prevalence and crime reduction are illustrated below.

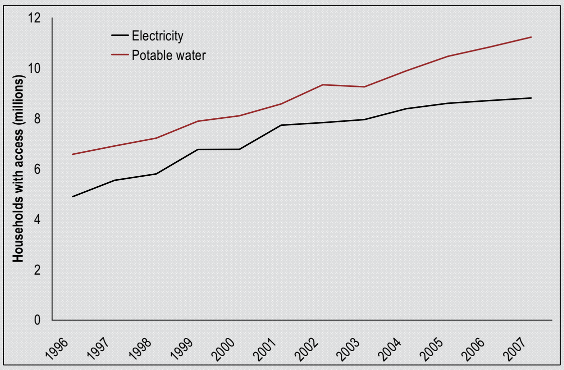
Percentage of households living on less than R250 per person per month (constant 2007 prices)



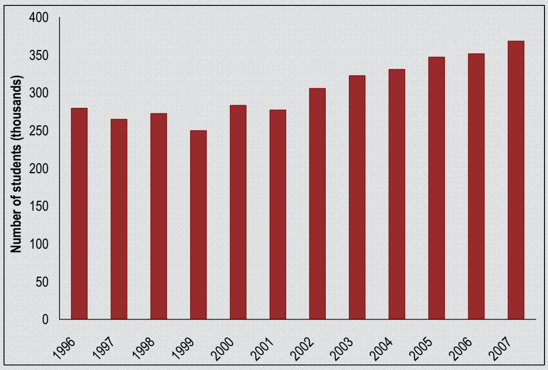
Social assistance grant beneficiaries, 1996 – 2007



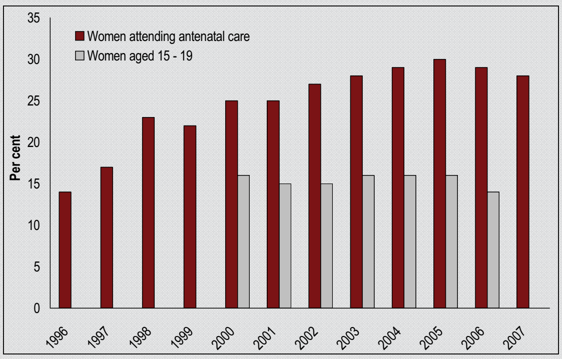
Household access to electricity and potable water, 1996 – 2007



Senior certificate examination passes, 1996 – 2007

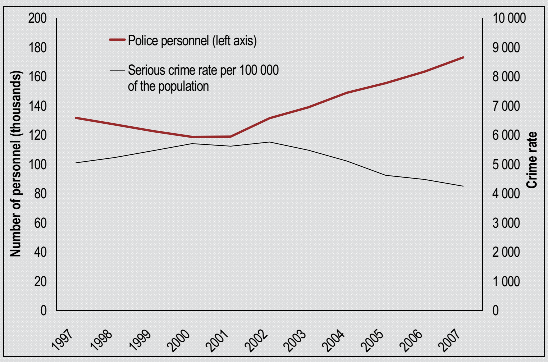


HIV prevalence, 1996 – 2007



Statistics for women aged 15 – 19 unavailable for 2007.

Police personnel and crime rate, 1997 – 2007



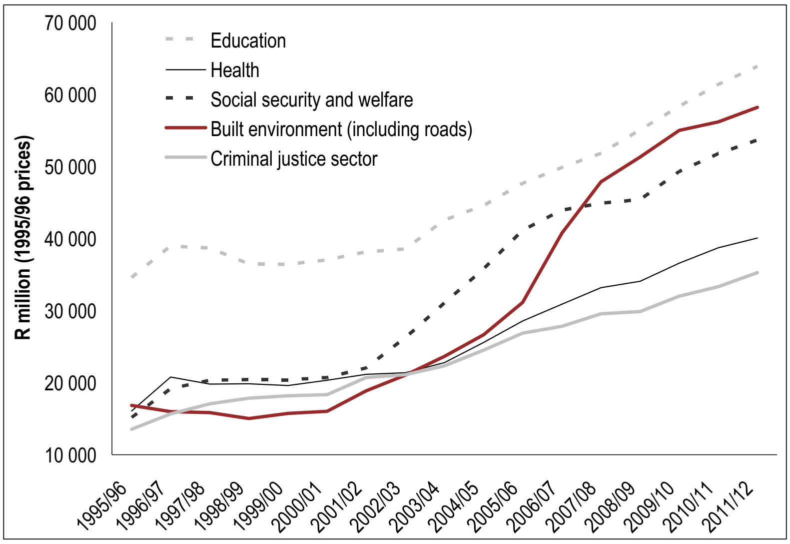
Key spending trends

Social security and welfare spending have increased rapidly

Growth in the main categories of public spending since 1995/96 and for the period ahead is illustrated in Figure 5.1. Following a period of consolidation in the 1990s, real government expenditure increased strongly after 2000/01. Social security and welfare spending has grown rapidly, though education remains the largest category of expenditure. Investment in housing, municipal infrastructure and other built environment programmes has expanded strongly and continues to be a key priority for the period ahead.

The 2009 Budget will maintain the infrastructure focus, targeting spending to alleviate backlogs in delivery of low-cost housing, water, sanitation, roads, public transport, electrification programmes, school buildings and health facilities.

Figure 5.1 Real expenditure trends, 1995/96 – 2011/12



Salary increases targeted to retain key skills in public sector

Government is also steadily improving its investment in human resource capacity. New public service training initiatives are under way, and remuneration scales for several categories of public service employees have been improved, with a view to reward competence and attract skills into government employment. The proposed framework for the 2009 Budget makes provision for further improvements in remuneration of medical doctors and other health professionals, as well as legal professionals, and for the expansion of engineering and technical capacity.

Government seeks ways to cut costs and improve efficiency

Improving the efficiency of government by redirecting spending to priority areas continues to receive emphasis. National departments have been required to identify savings on non-essential expenditure. This year the focus on cost-cutting measures was broadened to include underspending and underperforming areas where spending could be rescheduled or reduced. Total savings of about R1.9 billion were identified over the MTEF period, mainly associated with more cost-efficient administrative support services.

Revised expenditure estimates, 2008/09

The adjusted appropriation bill for 2008/09 proposes the following changes:

- Approved rollovers of R2.4 billion arising from unspent balances in 2007/08
- R7.7 billion to cover costs relating to higher-than-expected inflation, including for personnel and capital projects
- R2 billion for unforeseen and unavoidable expenditure associated with disasters such as adverse weather conditions, fires and animal diseases (R401 million is provided for the same purpose in 2009/10)
- R2.5 billion for the Political Office Bearers Pension Fund
- R107 million for the Kha Ri Gude mass literacy campaign
- R265 million for the school nutrition programme
- R1 billion for the occupation-specific dispensation for nurses
- R50 million for the introduction of new vaccines to combat infant and child mortality
- R1.4 billion for the 2010 FIFA World Cup stadium development grant and R600 million for high-speed internet access between the stadiums and Telkom's national network
- R2.5 billion for the Road Accident Fund
- R500 million of self-financed expenditure
- R180 million for electricity demand management and R20 million for retrofitting government buildings to improve energy efficiency.

Government will loan Eskom R60 billion

Government will also contribute to Eskom's capital investment programme. The Eskom Subordinated Loan Special Appropriation Bill provides for a loan of R60 billion in tranches of R10 billion in 2008/09, R30 billion in 2009/10 and R20 billion in 2010/11.

Taking into account projected underspending, declared savings and the adjusted state debt cost estimate, the revised estimate of total expenditure from the National Revenue Fund in 2008/09 is R635.5 billion. In February 2008, expenditure of R611.1 billion was budgeted for 2008/09.

2007/08 outcomes and 2008/09 mid-year estimates

Details of the 2007/08 expenditure outcomes and estimates for the first half of 2008/09 for national votes and provinces are set out in Annexure A. Expenditure on national votes (including transfers to provinces) amounted to R245.5 billion in 2007/08, out of a total adjusted appropriation of R246.9 billion. Provincial expenditure amounted to R205.8 billion, compared with an adjusted budget total of R205.2 billion.

National departments spent 47.1 percent of allocations in first half of current year

Expenditure on national votes in the first six months of 2008/09 amounted to R301.4 billion, or 47.1 per cent of the adjusted appropriation for the year, and R40.2 billion more than the spending total for the equivalent period of 2007/08. Expenditure by provinces amounted to R127.9 billion in the first half of 2008/09.

Spending trends reflect progress in management of capital spending

Expenditure trends are broadly in line with expectations, and indicate steady progress in government's capacity to manage capital spending and procurement programmes, which have lagged behind allocations in several departments in previous years. Partly because of higher-than-anticipated inflation and salary adjustments this year, personnel spending by both national departments and provinces is higher than the main budget estimates, and will contribute to somewhat higher aggregate spending in the second half of the 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.

Medium-term spending priorities

Improving the quality of education

Education allocations grow strongly over medium term

Education lies at the centre of South Africa's long-term growth and redistribution strategy, and government's commitment is indicated by the strong growth in allocations (provincial and national) as seen in Table 5.1, rising by an average annual growth rate of 10.4 per cent over the next three years.

The initial focus of this expenditure has been to improve access to educational opportunities. In 2007, South Africa had a gross enrolment ratio of 98 per cent for children of school-going age. To ensure that this trend continues, the percentage of children in no-fee schools will be increased from the current 40 per cent of learners to 60 per cent over the medium term.

Spending targets progress in science, engineering and technology

Higher education enrolment grew from 578 134 in 2000 to 741 380 in 2006. Funding for higher education rose from R6.6 billion in 1999 to R13.3 billion in 2007/08 and will receive further support over the medium term. An increasing proportion of higher education funding is channelled to science, engineering and technology. Graduates in these subjects increased from under 24 000 in 1999 to 35 000 in 2006.

In July this year, a new salary structure for teachers was introduced, providing greater career mobility and rewards for both performance and seniority. In addition, more teachers are to be employed to reduce learner:educator ratios in poor schools. To improve learner outcomes and teacher performance and development, government is establishing a unit to evaluate school and teacher performance, and to assess the credibility and reliability of testing and assessment in schools.

School infrastructure receives stepped-up funding

Government will also step up funding for school infrastructure to improve facilities and to enhance safety and security. Construction of libraries, sports fields, laboratories and grade R classrooms, as well as infrastructure for learners with special needs, will be prioritised. A new conditional grant supports the recapitalisation of technical high schools and the purchase of equipment needed to expand the country's skills base.

Mass literacy campaign

Some 4.7 million adults in South Africa cannot read. Government launched the Kha Ri Gude mass literacy campaign on 1 April 2008 to promote increased adult literacy. An allocation of R350 million was made available for the campaign in 2008/09, increasing to R480 million in 2009/10. The campaign set a target of reaching 300 000 illiterate adults with training for the adult basic education and training level 1 qualification for 2008/09. The enrolment target for 2008 has been exceeded by 60 000.

The programme aims to reach more than 1 million illiterate adults over the next three years. A full range of learning materials in the 11 official languages and Braille has been developed. Sign language is also used. Of the 29 000 facilitators who are part of this national initiative, 66 per cent are young people, most of whom were unemployed matriculants prior to joining the campaign. Facilitators are paid a monthly stipend of R1 200.

Transforming the quality of health care

Public health service staff has increased by about 30 000 in past three years

Beginning in the mid-1990s, expanding and improving the primary health care system enjoyed priority in public health policy. Patient visits to clinics and community health centres increased from 80 million in 1998/99 to 104 million in 2007/08. Since 2000/01, revitalisation of hospitals has received increasing attention, and over the past three years the number of staff employed in the public health system has increased by about 30 000.

Recent administrative data indicate that the rate of HIV infection is levelling off. Last year more than 200 000 people began antiretroviral treatment, bringing the total number participating in the Aids treatment programme to more than 500 000. To reduce mother-to-child transmission, the rollout of the improved dual-therapy drug regime will be accelerated.

Government is strengthening measures to tackle communicable diseases, particularly HIV and Aids and tuberculosis (TB). Drug-resistant forms of TB have emerged and require special efforts to identify patients and keep them on appropriate treatment programmes.

New vaccines to be rolled out to reduce infant and child mortality

To reduce infant and child mortality, over the next three years government will introduce three new child vaccines: pneumococcal to prevent the most common type of pneumonia, rotovirus to prevent the most common type of diarrhoea and pentavalent, which incorporates five existing vaccines.

Capacity constraints in the health sector have been exacerbated by a loss of skills. The occupation-specific dispensation for nurses is in place, and dispensations for doctors, pharmacists and other health professionals will be phased in over the next three years. A National Office of Standards Compliance and provincial inspectorates are being introduced to monitor service standards and improve accountability. Research on national health insurance and related reforms is under way.

Strengthening justice, crime prevention and security

By 2011 South Africa will have more than 200 000 police officers

The budget baseline for the Department of Safety and Security grows substantially over the medium term. This will enable an increase in the number of police officers to more than 200 000 by 2011, up from 131 730 in 1997/98. Since 2003, general crime levels have been on a downward trend, with the all-crimes rate falling by a total of

18.2 per cent. Yet reducing crime, particularly violent crime, remains a pressing challenge.

Restructuring for a modern, efficient and integrated criminal justice system

The criminal justice system has experienced coordination failures, poor management and ineffective systems. In partnership with communities and business, government aims to restructure the criminal justice process and establish a more modern, efficient and integrated system. Funding priorities include the rollout of the integrated electronic docket management system, a case management system, upgrading of network and associated infrastructure in all police stations and national fingerprint identification.

New prisons emphasise rehabilitation

The capacity of correctional facilities is being increased. Six new prisons that are more focused on rehabilitating offenders before release are expected to be completed over the next three years. Government will also focus on reducing the number of detainees awaiting trial.

Further increases in the number of policing personnel who specialise in crime prevention, detective work, crime intelligence and forensics will receive priority. Provision for additional expenditure will also be made to cover next year's elections.

Securing South Africa's borders

Government is taking steps to strengthen security at South Africa's borders and ports of entry, increasing patrol capacity and upgrading technology to prevent organised cross-border crime. These efforts are aligned with preparations for the 2010 FIFA World Cup.

The South African Revenue Service will establish a national centre to coordinate all border activities, including emergency response and integrated intelligence. Customs processing will monitor imports, exports, transit, excise and travellers across the region. The Department of Home Affairs will install a passenger information system and establish a port control unit. The passenger system will allow for new pre- and post-departure clearance processes and act as an early warning system.

Investing in the built environment

Public transport infrastructure spending remains a high priority

Investment in modern urban transport systems will gain impetus over the period ahead. The R25.6 billion Gautrain link between Johannesburg's OR Tambo Airport and Tshwane will be completed by the end of 2010. Construction of an improved Gauteng road network has begun. The taxi recapitalisation programme is under way and bus rapid transit networks are being developed for several major metropolitan commuter routes.

The coal haulage road network in Mpumalanga and regional roads in the Lephalale district, the site of one of Eskom's new large coal-fired power stations, will be supported from the national budget. The consolidation of passenger rail service institutions into the South African Rail Commuter Corporation is expected to be completed during 2008/09, and the corporation has increased its upgrading and maintenance programmes, bringing total rolling stock of coaches to 3 500, up from 3 060 in 2006.

Transnet to spend R80 billion, mostly for ports and rail infrastructure

Transnet is undertaking an R80 billion capital investment programme over the next five years, mainly focused on ports, port operations and the freight rail network.

Government has made progress in housing delivery and upgrading informal settlements, though there remain coordination challenges between provinces, which administer the housing grant, and municipalities, which are responsible for planning and bulk services (see Chapter 6). In several areas – notably electricity, water, sanitation and sewage treatment – the bulk infrastructure required to extend services to more households has come under pressure. The 2009 Budget will alleviate some of these shortages, with additional funding for electricity supply and bulk water infrastructure.

Building up South Africa's bulk water infrastructure

The *bulk infrastructure grant* receives R3.1 billion over the next three years. The programme, which began in 2007/08, focuses mainly on regional and district water storage and supply capacity.

Twelve projects valued in aggregate at R113.8 million are under construction across the nine provinces. These include extending existing bulk supply to Cofimvaba to serve new communities in Tsomo (Intsika Yethu) and Amahlathi; augmenting existing bulk supply to Maqassi Hills; a bulk pipeline from Kalkfontein Dam to Lemoenkloof and to Jagersfontein to serve communities in Kopanong; increasing water supply to Lydenburg (Thaba Chweu) to serve 500 stands; and a pipeline from an existing water treatment works to Mbekisburg Ext.2 (Nkomazi) to serve 5 000 stands.

Reservoirs are under construction at Mnafu, Isibanini in Umdoni, Zimele in Uthungulu, Nkadimeng-Sterkfontein and Kareeberg. These range in capacity from 300 kilolitres to 5 million litres. Various pump stations are also being built. Water treatment works and/or wastewater treatment works are scheduled for Jagersfontein (Kopanong) and Mthonjaneni (Uthungulu).

An additional 19 projects valued at R158.8 million are at design stage and 45 at feasibility stage.

Construction update: De Hoop Dam

At 89 metres, the De Hoop Dam wall will be among the five highest in the country. The dam is 20 per cent complete. The rate at which concrete is placed will increase significantly from October 2008. The dam will have a storage capacity of 330 billion litres and serve a population of 800 000 people as well as 23 mines in Limpopo. Funding for the bulk distribution system will partly be met from the fiscus, with the balance financed through 20-year loans to be recovered from mining and commercial users.

Rural development and agrarian reform

Stepped-up support for land redistribution and support for emerging farmers

Sharp increases in world food prices have underlined the need to ensure food security – particularly the ability of the rural poor to obtain adequate and affordable nutrition. Support for emerging farmers will be stepped up over the years ahead, alongside investment in rural infrastructure and land reform programmes.

Accelerated land redistribution over the next three years will be supported by improved alignment and coordination of programmes between responsible departments. Since 1994 the land reform programmes have delivered about 5 million hectares of agricultural land. In anticipation of an increased pace of land redistribution, the *comprehensive agricultural support programme,* which provides emerging farmers with infrastructure, information management, training, and technical and advisory services will receive further support. Increased investment in bulk water infrastructure and irrigation schemes will also strengthen rural development.

Employment creation and social security

The expanded public works programme has created more than 1 million short-term jobs over the past four years in infrastructure construction, environmental services, and social or community services. Over the MTEF period, an additional R4.1 billion is proposed to support the second phase of this programme.

A new phase of the expanded public works programme

From 2009, the expanded public works programme will concentrate on three broad areas of work:

- Longer-term public sector employment, such as in home-based care and community health services, directly funded by departments and supported by targeted training and skills development.
- Project-based employment, including construction, rehabilitation and environmental programmes, supported through performance-based allocations to cover basic wages and to provide incentive for labour-intensive activities financed through provincial and municipal grant programmes.
- A new component of programmes funded or co-funded by government, but managed by non-state actors such as nonprofit organisations, religious and community-based organisations. The Department of Public Works and the Presidency will pilot community-based work programmes.

Estimated full-time equivalent employment on public works programmes, 2004/05 – 2007/08

	2004/05	2005/06	2006/07	2007/08
Economic	286	222	1 222	1 553
Environment and culture	15 944	23 882	26 658	23 075
Infrastructure	52 891	28 188	34 738	77 816
Social services	1 965	10 838	23 083	43 916
Total	**71 086**	**63 130**	**85 701**	**146 360**

South Africa's system of social grants has helped to reduce income poverty. Recent research confirms that access to schools and work opportunities also improves in households benefiting from social grants. Grant recipients grew from 2.4 million beneficiaries in 1996 to nearly 12.4 million in 2007, mainly due to the expansion of the child support grant.

October increases in grants help to protect buying power in face of food inflation

In 2008 this safety net was broadened with adjustments to the means test thresholds, the phased reduction of the qualifying age for men to receive the old age grant and raising the age limit for the child support grant to 15 years in January 2009. In October this year, the old age, war veterans, disability and child support grants will be increased by R20 a month to contribute to protecting their buying power in the face of higher food price inflation.

Industrial development

Four industrial sectors are identified for development programme support

Support is provided to targeted industrial development programmes. Government has identified four lead industrial sectors for support: capital/transport equipment and metals; automotive and components; chemicals, plastic fabrication and pharmaceuticals; and forestry, pulp and paper, and furniture. A revised motor industry development programme has been announced, aimed at expanding employment and output of motor vehicle assemblers and component suppliers. In addition to tax incentives for manufacturing (see Chapter 4), government will continue to expand its investment in export promotion and construction of industrial infrastructure.

A boost for enterprise development and small business countrywide

Following a review of all major incentive programmes in 2007, government initiated the enterprise development programme to succeed the small and medium enterprise development programme. Employment creation in small business will be further supported through the creation of 15 more small business incubators countrywide. Steady progress has been made in raising research and development expenditure, which reached 0.9 per cent of GDP in 2005, up from 0.6 per cent in 1997.

Mitigating global climate change

South Africa needs to reduce its high level of carbon emissions

There is a clear need to reduce South Africa's contribution to climate change, not least because the African continent is likely to be worst affected by global warming. South Africa ranks among the 20 largest CO_2-emitting countries and has one of the highest rates of greenhouse gas emissions per unit of GDP.

Efforts to reduce carbon emissions include improving energy efficiency, increasing public transport capacity, supporting renewable energy sources and improving the technologies used in power generation. In the 2008 Budget, an allocation was announced to subsidise the costs of investment in energy efficiency, which includes electricity demand-side management and renewable energy sources. Over the medium term government will scale up these programmes and support expansion of the renewable energy sector. Measures to reduce greenhouse gas emissions in public transport will be explored.

Administrative capacity and the 2010 FIFA World Cup

Home Affairs turnaround brings about quicker ID book delivery times

The turnaround programme in the Department of Home Affairs is beginning to change the way its services are delivered to the public. It now takes about 60 days to receive a first-time identity document, down from 127 days in June 2007. This has been made possible by improving the fingerprint verification system, upgrading the training of frontline staff and using a single courier service to deliver ID books. SMS verification services and the establishment of a new contact centre to handle queries have improved the client interface.

The South African Revenue Service (SARS) continues to make efficiency gains through its modernisation programme. During 2007 3.8 million individual tax returns were automatically assessed. This year taxpayers will receive pre-completed tax returns to make compliance easier. Continued progress of the modernisation programme will allow SARS to provide an integrated service for taxpayer queries, enabling easier compliance and faster processing.

FIFA is satisfied with the pace of 2010 stadium construction

The 2010 FIFA World Cup preparations remain on course, though costs have escalated beyond the initial budget. Government will provide funding to accommodate part of the cost overruns, with municipalities sharing this burden. FIFA and the 2010 Local Organising Committee concluded a 10-day inspection of the stadiums in early October and expressed satisfaction with the pace of construction to date. Support will also be provided for the migration to digital television to meet international broadcasting requirements.

Consolidated government expenditure

An economic and functional breakdown of consolidated government expenditure, including national and provincial government, the social security funds and public entities is provided in Tables 5.1 and 5.2 below.

Table 5.1 Consolidated government expenditure by type of service, 2007/08 – 2011/12

R billion	2007/08 Outcome	2008/09 Revised	2009/10 Medium-term estimates	2010/11	2011/12	Average annual growth 2008/09 – 2011/12
Social services	**308.5**	**357.6**	**403.6**	**448.0**	**485.7**	**10.7%**
Education	104.0	123.4	137.6	152.3	165.9	10.4%
Health	68.5	78.6	88.8	98.5	106.7	10.7%
Welfare and social security	90.3	101.4	115.6	127.6	138.5	10.9%
Housing and community development	45.7	54.1	61.6	69.6	74.6	11.3%
Protection services	**86.7**	**96.4**	**109.7**	**117.5**	**128.5**	**10.0%**
Defence and intelligence	27.6	29.9	34.6	35.3	37.4	7.8%
Justice, police and prisons	59.0	66.6	75.1	82.2	91.1	11.0%
Economic services and infrastructure	**143.8**	**179.8**	**214.9**	**214.1**	**212.7**	**5.8%**
Water and related services	16.2	16.9	18.8	20.0	22.1	9.3%
Agriculture, forestry and fishing	14.1	15.1	15.2	16.7	18.1	6.1%
Transport and communication	55.2	73.3	78.8	83.1	89.8	7.0%
Other economic services	58.4	74.4	102.1	94.3	82.7	3.6%
Administration	**34.5**	**43.9**	**50.6**	**51.8**	**57.0**	**9.1%**
Total	**573.5**	**677.6**	**778.8**	**831.4**	**883.9**	**9.3%**
Interest	55.8	57.7	57.0	59.6	61.5	2.2%
Contingency reserve	–	–	4.0	12.0	20.0	
Consolidated expenditure	**629.3**	**735.3**	**839.8**	**903.0**	**965.3**	**9.5%**

Table 5.2 Consolidated government expenditure by economic classification, 2007/08 – 2011/12

R billion	2007/08 Outcome	2008/09 Revised	2009/10 Medium-term estimates	2010/11	2011/12	Average annual growth 2008/09– 2011/12
Current payments	**374.1**	**426.4**	**467.4**	**509.7**	**547.0**	**8.7%**
Compensation of employees	200.7	232.0	255.8	277.9	299.6	8.9%
Goods and services	117.5	136.7	154.6	172.2	185.9	10.8%
Interest and rent on land	55.9	57.7	57.0	59.6	61.5	2.2%
of which: State debt cost	*52.9*	*53.9*	*52.7*	*55.1*	*56.7*	*1.7%*
Transfers and subsidies	**212.8**	**251.0**	**304.7**	**312.9**	**318.5**	**8.3%**
Municipalities	39.8	47.9	52.3	60.7	67.3	12.0%
Departmental agencies and accounts	28.7	31.4	38.6	33.6	34.7	3.4%
Universities and technikons	12.0	13.9	15.6	17.9	19.5	11.9%
Public corporations and private enterprises	22.3	32.2	55.5	43.1	25.8	-7.2%
Foreign governments and international organisations	1.2	1.2	1.4	1.4	1.5	7.6%
Non-profit institutions	12.6	16.1	17.6	19.4	20.7	8.8%
Households	96.3	108.2	123.8	136.8	149.0	11.3%
Payments for capital assets	**42.4**	**58.0**	**63.7**	**68.3**	**79.8**	**11.3%**
Buildings and other capital assets	27.0	44.3	46.5	49.9	58.1	9.5%
Machinery and equipment	15.4	13.7	17.1	18.5	21.7	16.6%
Total	**629.3**	**735.3**	**835.8**	**891.0**	**945.3**	**8.7%**
Contingency reserve	–	–	4.0	12.0	20.0	
Consolidated expenditure	**629.3**	**735.3**	**839.8**	**903.0**	**965.3**	**9.5%**

6

Division of revenue and medium-term expenditure estimates

Government's key budget priorities are to improve the quality of education and health, step up investment in built environment infrastructure, reduce crime and support rural development. Provinces and municipalities consequently receive a significant share of the additional resources allocated in this budget framework.

The medium-term expenditure framework (MTEF) allocates R678.2 billion across the three spheres of government in 2009/10. This increases to R767.9 billion by 2011/12. The local share of nationally raised revenue grows from 7.7 per cent in 2008/09 to 8.3 per cent by 2011/12, while the provincial share rises from 42.2 per cent to 43.5 per cent by 2011/12.

The proposed allocations aim to strengthen the ability of provinces and municipalities to deliver better-quality services, particularly in poor communities; to invest in and maintain key infrastructure; and to support labour-intensive delivery of services.

Division of revenue overview

Public spending builds on momentum to deepen programme impact and compensate for inflation

The proposed MTEF builds on the momentum of rising government spending in recent years. Priority is given to allocating additional resources in areas where there is a clear spending impact or to protect buying power in critical areas of service delivery.

National budget priorities and revisions to national allocations are discussed in Chapter 5. Baseline allocations to national departments are revised upwards by R44.7 billion in 2009/10, R36.2 billion in 2010/11 and R29.8 billion in 2011/12.

Provincial baseline allocations are revised upwards by R51.3 billion over the MTEF to strengthen education, health and welfare services. Allocations for infrastructure, including roads, are also stepped up.

Support for expanded access to potable water, sanitation and electricity

Additional allocations to local government of R8.8 billion support expanded community access to housing, potable water, sanitation, electricity and public transport. The majority of these additions are earmarked for municipal infrastructure and programmes aimed at achieving universal access by 2014, providing free basic services in poor communities and assisting 2010 FIFA World Cup host cities.

Table 6.1 shows the proposed division of revenue for the 2009 Budget.

Table 6.1 Medium-term expenditure framework and division of revenue, 2008/09 – 2011/12

R million	2008/09 Revised	2009/10	2010/11	2011/12	2009 MTEF	Average annual growth 2008/09 – 2011/12
		Medium-term estimates				
National	**291 205**	**346 603**	**359 711**	**370 403**		**8.3%**
Provincial	**245 646**	**282 332**	**307 878**	**333 751**		**10.8%**
Equitable share	204 010	233 051	256 170	275 934		10.6%
Conditional grants	41 636	49 281	51 707	57 817		11.6%
Local	**44 689**	**49 306**	**57 808**	**63 780**		**12.6%**
Equitable share	25 560	30 647	36 810	40 197		16.3%
Conditional grants	19 129	18 660	20 998	23 583		7.2%
Total	**581 540**	**678 241**	**725 397**	**767 934**		**9.7%**
Percentage shares						
National	*50.1%*	*51.1%*	*49.6%*	*48.2%*		
Provincial	*42.2%*	*41.6%*	*42.4%*	*43.5%*		
Local	*7.7%*	*7.3%*	*8.0%*	*8.3%*		
Changes to baseline						
National	**17 276**	**44 736**	**36 231**	**29 776**	**110 744**	
Provincial	**7 570**	**14 173**	**14 238**	**22 880**	**51 291**	
Equitable share	4 633	7 585	9 864	14 849	32 298	
Conditional grants	2 937	6 589	4 374	8 031	18 993	
Local	**2 834**	**1 655**	**2 076**	**5 024**	**8 756**	
Equitable share	671	491	614	1 829	2 934	
Conditional grants	2 163	1 164	1 462	3 195	5 822	
Total	**27 680**	**60 565**	**52 545**	**57 680**	**170 790**	

Revisions to transfers to provincial and local government in 2008/09

Adjustments include provision for higher inflation

Provinces receive an additional R7.6 billion in the 2008/09 adjustments budget, bringing total transfers to provincial governments to R245.6 billion. Additions to the equitable share include R3.6 billion for inflation adjustments, of which R3 billion is for higher salary increases awarded in 2008. The remainder covers the higher costs of textbooks, medicine and medical equipment, school meals and fuel. The provincial equitable share is increased by R1 billion to help provinces cope with the higher-than-budgeted implementation of the occupation-specific dispensation for nurses and R50 million to introduce three new vaccines for children.

Grants increased to expand number of people on antiretroviral treatment

Provincial conditional grants are increased by R300 million to cater for more people on antiretroviral treatment. The school nutrition programme receives additional resources to feed more children and in response to higher food prices. Provinces also receive R1.1 million to cover the costs of repairing infrastructure damaged in various natural disasters.

The local government equitable share is increased by R671 million to cover the higher costs of providing free basic electricity to poor households. A further R1.4 billion is allocated to municipalities for 2010 FIFA World Cup stadium projects as a result of escalating costs on several projects.

Funding provincial government

Of the R51.3 billion added to the provincial baseline over the next three years, R32.3 billion is proposed for the provincial equitable share and R19 billion for conditional grants. Transfers to provinces will grow by 10.8 per cent per year, from a revised R245.6 billion in 2008/09 to R333.8 billion in 2011/12.

Provincial equitable share

Adjustments protect the real value of personnel spending and critical programmes serving the poor

The provincial equitable share is budgeted to grow by 10.6 per cent annually, from a revised R204 billion in 2008/09 to R276 billion in 2011/12. An adjustment of R17.2 billion is made to the equitable share over the MTEF to protect the real value of civil service incomes and critical programmes targeting the poor, with R15.1 billion for policy adjustments. Robust growth in these allocations provides for the strengthening of social programmes, especially those likely to have a high impact on human development and the quality of life.

At the time of tabling their budgets, provinces were asked to provide for salary adjustments of 7.5 per cent in 2008/09, but actual increases of 10.5 per cent were awarded. An amount of R3 billion is included in the 2008/09 adjustments budget and R23.2 billion is proposed for the next three years for the carry-through costs of higher salary increases and to provide for additional personnel costs in education and health. This amount includes resources to address cost pressures in the health sector as a result of the implementation of occupation-specific salary scales for nurses, and additional resources to provide doctors and medical specialists with a revised salary scale.

Funding for health care accounts for 11.8 per cent of non-interest spending

Funding for health services accounts for 3.4 per cent of GDP and 11.8 per cent of consolidated government non-interest expenditure. Despite increased health spending by provinces, a renewed focus is required to reduce maternal and child mortality, HIV and Aids, and TB. Additional resources are added to expand the range of vaccines provided to children and for stepped-up interventions to address the TB epidemic.

A part of the additional equitable share allocation aims to ensure that the expansion of social welfare services is accelerated to meet the growing welfare needs of communities. The focus over the medium term is on expanding early childhood development.

The provincial equitable share is also increased to accommodate an extension of no-fee schools.

Education for all: no-fee schools

In line with its commitment to ensure universal access to education, government introduced no-fee schools during 2007. Additional resources are allocated through provincial budgets to expand this programme over the medium term. To implement the policy, schools are ranked into five categories. The schools in the lowest 40 per cent (quintiles 1 and 2) are deemed poor and allow learners to enrol without paying fees. In return, government funds expenses that were previously covered by fees.

For the 2008 school year, provinces will spend just under R3.5 billion to ensure that about 5 million learners in 14 264 schools benefit through this programme. The majority of these learners are in Eastern Cape (1.2 million learners), KwaZulu-Natal (1.1 million) and Limpopo (1 million). Over the medium term, government intends to extend no-fee status to 60 per cent of schools.

Table 6.2 shows the proposed equitable share allocations to each province over the MTEF period. The calculation of the equitable share is determined by an objective redistributive formula published annually in the *Budget Review*. Revisions to the formula this year take into account the data from the 2008 Mid-year Population Estimates, 2008 Education Snap Survey, 2007 General Household Survey, 2006 provincial GDP estimates and the 2005 Income and Expenditure Survey. The adjustments will be phased in over three years.

Table 6.2 Provincial equitable share allocations, 2008/09 – 2011/12

	2008/09	2009/10	2010/11	2011/12
R million	Revised	Medium-term estimates		
Eastern Cape	32 113	36 252	39 368	41 887
Free State	12 701	14 359	15 619	16 646
Gauteng	33 833	39 234	43 764	47 826
KwaZulu-Natal	44 250	50 422	55 282	59 394
Limpopo	26 538	30 120	32 889	35 190
Mpumalanga	16 818	19 170	21 024	22 596
Northern Cape	5 465	6 246	6 868	7 401
North West	14 142	16 261	17 989	19 502
Western Cape	18 149	20 987	23 367	25 493
Total	**204 010**	**233 051**	**256 170**	**275 934**

Conditional grants to provinces

Gauteng receives a loan of R4.2 billion for its contribution to the Gautrain

Conditional grants supplement various programmes partly funded by provinces, such as infrastructure and central hospitals, and support specific programmes. Conditional grants are expected to grow from a revised R41.6 billion in 2008/09 to R57.8 billion in 2011/12. About R12.9 billion or 67.7 per cent of additional conditional allocations are proposed for infrastructure-related grants. An amount of R4.2 billion is for a loan to the Gauteng government for its contribution to the

Gautrain rapid link project. Of the total adjustment of R19 billion, R5.9 billion is to provide for inflation adjustments to conditional grants and R13.1 billion for policy adjustments. Table 6.3 shows the revisions to provincial conditional grant allocations.

The *infrastructure grant to provinces* is revised upwards by R4.1 billion to address school infrastructure needs, including extending grade R infrastructure, upgrading schools for learners with special needs, the construction of school libraries, laboratories, sports fields and increased maintenance.

The national school nutrition programme is enhanced

The *national school nutrition programme* aims to ensure that the poorest learners have at least one meal each school day and is allocated an additional R4 billion over the medium term.

An additional R728 million is recommended for the *hospital revitalisation programme* to compensate for the effects of inflation and ensure that hospitals are appropriately equipped and modernised.

Table 6.3 Revision to provincial conditional grant allocations, 2009/10 – 2011/12

R million	2009/10	2010/11	2011/12	2009 MTEF Total revisions
		Medium-term estimates		
Agriculture	**137**	**305**	**527**	**969**
Comprehensive agriculture support programme grant	137	305	527	969
Education	**583**	**1 322**	**2 097**	**4 002**
National school nutrition programme grant	583	1 322	2 097	4 002
Health	**404**	**685**	**804**	**1 893**
Comprehensive HIV and Aids grant	200	325	407	932
Hospital revitalisation grant	124	265	339	728
National tertiary services grant	81	95	58	233
Housing	**711**	**804**	**2 146**	**3 662**
Integrated housing and human settlement development grant	711	804	2 146	3 662
National Treasury	**4 653**	**1 234**	**2 456**	**8 343**
Infrastructure grant to provinces	453	1 234	2 456	4 143
Gautrain rapid rail link loan	4 200	–	–	4 200
Transport	**100**	**23**	**–**	**124**
Gautrain rapid rail link	100	23	–	124
Total	**6 589**	**4 374**	**8 031**	**18 993**

An amount of R932 million is added to the *comprehensive HIV and Aids grant*, bringing the total planned spending on this programme to R12.4 billion over the medium term.

The *national tertiary services grant* is allocated an additional R233 million to deal with inflation-related increases on goods and services purchased in tertiary hospitals.

A boost for agricultural support to ensure food security

To expand the provision of agricultural support services to ensure food security, R969 million is added to the *comprehensive agricultural support programme.*

Between 1994/95 and 2007/08, government spent about R49 billion on housing grants, as a result of which about 2.6 million houses were built or were under construction. Despite the progress made thus far, there are still about 1.8 million families living in informal dwellings.

The target is to eliminate informal housing settlements by 2014. Increased demand for subsidised housing is fuelled by population growth, the decline in average household size (from 4.5 persons per household in 1996 to 3.9 persons per household in 2007) and rapid urbanisation. The *integrated housing and human settlements grant* is allocated an additional R3.7 billion to speed up housing delivery and to raise the value of the housing subsidy to keep pace with higher inflation, taking the total over the next three years to R44.7 billion.

Table 6.4 Conditional grants to provinces, 2008/09 – 2011/12

R million	2008/09 Revised	2009/10	2010/11 Medium-term estimates	2011/12
Agriculture	**898**	**817**	**1 117**	**1 387**
Agricultural disaster management grant	137	–	–	–
Comprehensive agriculture support programme grant	538	765	1 062	1 329
Ilima / Letsema projects	96	–	–	–
Land care programme grant: poverty relief and infrastructure development	127	51	55	58
Arts and Culture	**345**	**441**	**494**	**524**
Community library services grant	345	441	494	524
Provincial and Local Government	**30**	**–**	**–**	**–**
Disaster management grant	30	–	–	–
Education	**2 915**	**2 578**	**3 858**	**4 785**
Education disaster management grant	22	–	–	–
Further education and training college sector recapitalisation grant	795	–	–	–
HIV and Aids (life skills education) grant	171	177	188	199
National school nutrition programme grant	1 927	2 401	3 670	4 586
Health	**14 363**	**15 547**	**18 034**	**19 194**
Comprehensive HIV and Aids grant	2 885	3 476	4 312	4 633
Forensic pathology services grant	605	492	557	590
Health professions training and development grant	1 679	1 760	1 865	1 977
Hospital revitalisation grant	3 060	3 205	3 902	4 194
National tertiary services grant	6 134	6 614	7 398	7 799
Housing	**10 178**	**12 442**	**15 027**	**17 222**
Integrated housing and human settlement development grant	10 178	12 442	15 027	17 222
National Treasury	**7 384**	**13 449**	**11 315**	**13 091**
Infrastructure grant to provinces	7 384	9 249	11 315	13 091
Gautrain rapid rail link loan	–	4 200	–	–
Public Works	**889**	**997**	**1 096**	**1 162**
Devolution of property rate funds grant to provinces	889	997	1 096	1 162
Sport and Recreation South Africa	**294**	**402**	**426**	**452**
Mass sport and recreation participation	294	402	426	452
Transport	**4 340**	**2 608**	**341**	**–**
Gautrain rapid rail link	3 266	2 608	341	–
Overload control grant	9	–	–	–
Sani Pass Roads grant	30	–	–	–
Transport disaster management grant	1 035	–	–	–
Total	**41 636**	**49 281**	**51 707**	**57 817**

Funding local government

Policy priorities and fiscal framework

Considerable success in provision of municipal services to the poor

Government aims to achieve universal access to municipal services such as water, sanitation and electricity by 2014. Tangible progress has been made in both urban and rural areas. Through the *municipal infrastructure grant,* 835 093 household connections have been made for water and 399 662 for sanitation since 2004.

Rapid urbanisation presents new challenges in the funding of municipalities

Government's funding programmes are required to cater for the unique challenges in both urban and rural municipalities. The rapid pace of urbanisation presents new challenges. According to the 2007 Community Survey, the population increased by 8 per cent, from 44.8 million people in 2001 to 48.5 million people in 2007. More than half of the population now resides in the 27 largest municipalities. Much of the new demand for municipal services is from poor households, and their ability to pay for services is limited.

Over the medium term, an additional R5.4 billion is allocated to municipalities as inflation adjustments to the baseline of grants that support operational and capital expenditure programmes. A further R3.4 billion is allocated for the implementation of national policy priorities for the delivery of infrastructure, electricity demand-side management and 2010 FIFA World Cup preparations.

Of the total additional amount of R8.8 billion:

- R2.9 billion is allocated to the local government equitable share for increased costs of basic services, particularly electricity
- R4.3 billion is earmarked for the *municipal infrastructure grant*
- R835 million is proposed for the *public transport infrastructure and systems grant* to finance an integrated public transport network in large municipalities, including 2010 FIFA World Cup cities
- R497 million is allocated for completion of stadiums and to help host cities with operational requirements for hosting of the 2009 Confederations Cup and the 2010 FIFA World Cup
- R194 million is allocated to the *integrated national electrification programme grant* as an inflation adjustment to the baseline.

Additional funding is also provided for in-kind transfers to municipalities.

- The *integrated national electrification programme*, allocated to Eskom, is adjusted for inflation by R331 million over the MTEF
- The *regional bulk infrastructure grant*, which is administered by the Department of Water Affairs and Forestry, is allocated a further R1 billion over the next three years
- R1.1 billion is allocated to an *electricity demand-side management grant*, to be administered by the Department of Minerals and Energy to promote energy efficiency.

The additional R8.8 billion allocated to local government over the MTEF period results in its share of nationally raised revenue growing from a revised R47.2 billion in 2008/09 to R67.8 billion in 2011/12.

A differentiated approach to municipal funding

The service-delivery challenges facing South Africa's large urban municipalities differ considerably from those of poor rural municipalities. While the large metros are experiencing rapid population growth and strong levels of economic activity, many rural municipalities are burdened with the backlogs resulting from previous funding inequities, high poverty levels and weaker economic activity.

In recognition of these factors, government is working to ensure an appropriately structured system of funding local government.

Reforms introduced in the 2008 Budget direct additional funding to weaker municipalities with limited resources, including changing the *municipal infrastructure grant* formula to ensure a minimum R5 million allocation to all municipalities by 2010/11. It is proposed that in the 2009 Budget, the local government equitable share formula be amended to take greater account of the fiscal capacity constraints in poor municipalities. This measure needs to be supported with efforts to improve institutional capacity.

Integrated planning and financing is required between national, provincial and local government to accelerate the eradication of informal settlements, create new communities that have access to services and transport, and put in place infrastructure that will support economic growth. There is, however, a disjuncture at the planning level: various decisions on the built environment are taken by different spheres of government. For example, provinces make decisions about housing, while municipalities make choices about services that are linked to housing, such as water, sanitation and electricity.

The larger urban municipalities are well placed to achieve integration between built environment services. These municipalities have the capacity to raise finance from internal and external revenue sources to supplement grants and possess sufficient technical capacity to deliver. A mix of appropriate interventions will need to be developed to address the range of service delivery challenges in smaller municipalities.

Local government equitable share

Interim grant replaces RSC levy until replacements are introduced

The interim *RSC levies replacement grant* has been put in place until permanent replacements are introduced, including the phasing-in of the sharing of the general fuel levy for metropolitan municipalities from the 2009 Budget and a permanent grant for district municipalities. The latter will take into account the findings of a policy review being conducted by the Department of Provincial and Local Government. The sharing of the general fuel levy with metros will be set off against *RSC levies replacement grant* allocations.

Equitable share supplements municipal own revenue

The local government equitable share is an integral funding instrument to supplement municipal own revenues for the provision of free basic services to poor households. It also provides supplementary support for viable administrations, good governance and public participation. Excluding the *RSC levies replacement grant* and special support for councillor remuneration, the local government equitable share is budgeted to grow 12.2 per cent a year in real terms, from R16.3 billion in 2008/09 to R26.2 billion in 2011/12.

Table 6.5 Revision to local government allocations, 2008/09 – 2011/12

R million	2008/09 Revised	2009/10	2010/11 Medium-term estimates	2011/12
Total local government allocation	**47 173**	**52 354**	**60 915**	**67 764**
Equitable share and related[1]	26 545	31 502	37 380	40 801
Infrastructure[2]	19 732	19 595	22 349	25 853
Capacity-building and other current transfers[2]	896	1 258	1 187	1 109
Changes to baseline				
Equitable share and related[1]	795	491	614	1 829
Infrastructure[2]	1 983	1 202	1 768	4 149
Capacity-building and other current transfers[2]	197	270	414	500
Total	**2 976**	**1 962**	**2 796**	**6 478**

1. *Includes water services operating subsidy grant.*
2. *Includes indirect transfers to municipalities.*

Infrastructure transfers to local government

Infrastructure transfers to local government will amount to R67.8 billion over the next three years. This includes:

- R38.7 billion for the rollout of basic infrastructure in line with a differentiated approach to the funding of large urban cities and largely rural municipalities in the *municipal infrastructure grant*
- R8.2 billion for the electrification of poor households
- R2 billion for stadium refurbishment and construction to enable the host cities to meet 2010 FIFA World Cup requirements
- R12.4 billion for the development of municipal public transport infrastructure and systems, the bulk of which goes to 2010 FIFA World Cup host cities
- R3 billion for the neighbourhood development partnership grant
- R3.1 billion for regional bulk water infrastructure to connect more households to water and sanitation systems
- R500 million to alleviate backlogs in electrification, water and sanitation at schools and clinics.

Support for improved planning and financial management in municipalities

Capacity-building grants assist municipalities with planning, budgeting, financial management and technical skills. The *financial management grant* and the *municipal systems improvement grant* receive total funding of R1.7 billion. Other current transfers to local government include R718 million for the *2010 FIFA World Cup host city operating grant* and R1.8 billion for the *water services operating subsidy grant.*

Annexure A

2007/08 outcome and half-year spending estimates for 2008/09

Table A.1 Expenditure by vote, 2007/08 and 2008/09 financial year

	2007/08				2008/09		
R million	Main budget	Adjusted budget	Audited outcome	Over(-)/ Under(+)	Main budget	Adjusted budget[1]	Actual spending April to September
CENTRAL GOVERNMENT ADMINISTRATION							
1 The Presidency	255	272	264	8	290	312	161
2 Parliament	836	836	902	-66	905	914	451
3 Foreign Affairs	3 856	4 119	4 070	49	4 341	5 570	2 339
4 Home Affairs	3 315	3 521	3 242	279	4 505	4 817	1 721
5 Public Works	3 693	3 759	3 402	357	4 141	4 302	1 710
FINANCIAL AND ADMINISTRATIVE SERVICES							
6 Government Communication and Information System	376	384	381	3	418	440	212
7 National Treasury	19 708	19 748	18 966	782	21 318	31 424	9 950
8 Public Service and Administration	357	384	370	14	412	420	164
9 Public Service Commission	105	108	108	–	111	114	57
10 Public Administration Leadership and Management Academy	71	131	131	–	106	106	62
11 Statistics South Africa	1 100	1 157	1 057	100	1 272	1 323	565
SOCIAL SERVICES							
12 Arts and Culture	1 608	1 608	1 586	22	2 117	2 160	1 148
13 Education	16 001	16 387	16 241	145	18 858	19 749	14 509
14 Health	12 655	13 091	12 763	328	15 101	15 851	7 503
15 Labour	2 033	2 038	1 949	89	1 733	1 748	786
16 Social Development	67 232	67 229	67 191	38	76 008	76 554	37 197
17 Sport and Recreation South Africa	3 157	5 067	5 048	19	3 496	4 910	2 877
JUSTICE AND PROTECTION SERVICES							
18 Correctional Services	10 742	11 384	11 122	262	11 672	12 339	6 115
19 Defence	25 922	26 292	25 180	1 112	28 233	27 899	11 672
20 Independent Complaints Directorate	81	81	81	–	98	98	46
21 Justice and Constitutional Development	7 278	7 539	7 374	165	8 341	8 516	3 832
22 Safety and Security	35 917	36 386	36 386	–	40 453	41 492	19 821
ECONOMIC SERVICES AND INFRASTRUCTURE							
23 Agriculture	2 281	3 473	3 328	145	2 535	2 938	1 172
24 Communications	1 424	1 924	1 912	13	1 724	2 332	661
25 Environmental Affairs and Tourism	2 591	2 791	2 789	2	3 062	3 207	1 742
26 Housing	8 878	8 982	8 586	396	10 587	10 928	5 346
27 Land Affairs	5 679	5 924	5 897	27	6 659	6 659	3 518
28 Minerals and Energy	2 966	2 975	2 947	28	3 595	3 786	1 118
29 Provincial and Local Government	28 844	30 037	30 030	7	34 194	35 639	12 327
30 Public Enterprises	1 064	4 605	4 604	1	3 008	3 269	1 580
31 Science and Technology	3 142	3 144	3 127	17	3 704	3 722	2 069
32 Trade and Industry	4 846	5 479	5 295	184	5 103	5 127	2 417
33 Transport	15 858	16 544	16 332	212	20 509	24 493	11 541
34 Water Affairs and Forestry	5 306	5 863	5 385	477	6 699	7 037	2 985
	299 178	**313 264**	**308 048**	**5 216**	**345 308**	**370 194**	**169 374**
State debt cost	52 916	52 937	52 877	60	51 236	53 926	28 120
Equitable share	171 271	172 862	172 862	–	199 377	204 010	99 689
Other direct charges against the National Revenue Fund	7 508	8 311	7 712	599	9 175	11 675	4 194
Unallocated and contingency reserve	3 000	–	–	–	6 000	–	–
Less: Projected underspending	–	–	–	–	–	-4 339	–
Total	**533 873**	**547 374**	**541 499**	**5 875**	**611 096**	**635 466**	**301 377**

1. Includes Special Adjusted Appropriation Act.

Table A.2 Expenditure by province, 2007/08 and 2008/09 financial year

R million	2007/08 Main budget	Adjusted budget	Preliminary outcome	Over(-)/ Under(+)	Deviation from adjusted budget	2008/09 Main budget	Spending April to September[1]
Eastern Cape	**31 009**	**30 609**	**30 287**	**322**	**1.1%**	**38 085**	**19 157**
Education	14 726	14 498	14 486	11	0.1%	17 810	8 519
Health	8 143	8 069	8 013	56	0.7%	9 746	5 464
Social Development	952	883	880	2	0.3%	1 385	630
Other functions	7 188	7 160	6 907	252	3.5%	9 143	4 544
Free State	**13 309**	**13 428**	**13 304**	**124**	**0.9%**	**15 685**	**8 145**
Education	5 692	5 718	5 797	-79	-1.4%	6 599	3 385
Health	3 643	3 744	3 841	-97	-2.6%	4 288	2 403
Social Development	453	453	426	27	6.0%	536	244
Other functions	3 520	3 512	3 239	273	7.8%	4 262	2 113
Gauteng	**40 312**	**42 144**	**41 406**	**738**	**1.8%**	**46 672**	**25 520**
Education	14 543	14 646	13 829	816	5.6%	16 629	8 250
Health	12 052	12 446	13 085	-640	-5.1%	13 889	7 240
Social Development	1 404	1 370	1 352	18	1.3%	1 729	806
Other functions	12 312	13 682	13 139	543	4.0%	14 424	9 224
KwaZulu-Natal	**43 515**	**44 538**	**44 803**	**-265**	**-0.6%**	**51 101**	**27 330**
Education	18 577	18 837	18 729	108	0.6%	21 389	11 639
Health	13 413	13 925	14 959	-1 034	-7.4%	15 043	8 662
Social Development	1 000	1 065	1 015	50	4.7%	1 198	625
Other functions	10 525	10 710	10 099	611	5.7%	13 471	6 403
Limpopo	**25 312**	**25 125**	**24 715**	**410**	**1.6%**	**29 633**	**14 633**
Education	11 948	11 930	11 815	115	1.0%	14 221	7 203
Health	6 096	6 171	6 132	40	0.6%	7 594	3 825
Social Development	439	417	416	1	0.1%	726	286
Other functions	6 829	6 607	6 353	255	3.9%	7 092	3 319
Mpumalanga	**16 211**	**16 846**	**16 270**	**576**	**3.4%**	**18 740**	**9 738**
Education	7 956	8 118	7 823	295	3.6%	8 934	4 791
Health	3 595	3 718	3 662	56	1.5%	4 242	2 161
Social Development	498	498	459	38	7.7%	662	325
Other functions	4 163	4 513	4 325	188	4.2%	4 901	2 461
Northern Cape	**5 663**	**5 999**	**5 934**	**65**	**1.1%**	**6 689**	**3 611**
Education	2 267	2 287	2 287	–	0.0%	2 601	1 512
Health	1 460	1 580	1 557	23	1.5%	1 774	921
Social Development	304	310	304	6	1.9%	357	167
Other functions	1 632	1 822	1 786	36	2.0%	1 957	1 010
North West	**14 412**	**15 558**	**15 264**	**294**	**1.9%**	**16 938**	**8 223**
Education	5 324	6 096	6 206	-110	-1.8%	6 995	3 328
Health	3 755	3 917	3 847	69	1.8%	4 223	2 194
Social Development	608	491	438	52	10.6%	608	230
Other functions	4 726	5 055	4 773	282	5.6%	5 112	2 470
Western Cape	**20 717**	**21 682**	**21 525**	**158**	**0.7%**	**24 908**	**11 576**
Education	7 685	7 823	7 738	85	1.1%	9 020	4 356
Health	7 095	7 427	7 498	-71	-1.0%	8 642	4 060
Social Development	892	902	901	–	0.0%	1 088	461
Other functions	5 045	5 531	5 388	143	2.6%	6 158	2 697
Total	**210 460**	**215 929**	**213 508**	**2 421**	**1.1%**	**248 449**	**127 933**
Education	88 719	89 952	88 710	1 241	1.4%	104 199	52 986
Health	59 252	60 997	62 594	-1 597	-2.6%	69 440	36 931
Social Development	6 550	6 388	6 194	194	3.0%	8 289	3 775
Other functions	55 940	58 592	56 009	2 583	4.4%	66 521	34 241

1. *Preliminary numbers for September 2008.*

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.
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)	A measurement of the price increases of a basket of consumer goods and services. From 2009, this replaces CPIX as the main measure of inflation.

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.
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 costs	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 resources for a desired programme without jeopardising fiscal or debt 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 rates	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 in South Africa and the countries included.
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).