Medium Term Budget Policy Statement 2007

National Treasury

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MEDIUM TERM BUDGET POLICY STATEMENT 2007

SPEECH BY MINISTER OF FINANCE

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Madam Speaker

In tabling the 2007 Medium Term Budget Policy Statement, we can affirm that economic growth and investment in public services are steadily bringing a better life to millions of South Africans. We can look back with pride on the course we chose in implementing our Reconstruction and Development Programme, because we can see the fruits of the new Constitutional order we built, of the transformation of policy and service delivery we undertook, of the tough decisions we made and the dedicated efforts of South Africans from all walks of life who have contributed to our social progress and economic renewal.

Today is better than yesterday, and tomorrow will be better than today.

We can assert this confidently because our progress is recorded and measured, and the facts speak louder than any rhetorical flourishes.

Yet the message of today's Budget Statement is not that we have reached our destination or that victory can be claimed. It is that we have advanced to new challenges and another phase in our transformation journey lies ahead.

Economic growth and development challenges

The 2007 Community Survey released last week tells a story of steady progress in public service delivery. In 1996, just over half our people did not have water in their homes. Today, over 88 per cent of people have access to piped water. In 1996, only 64 per cent of our people lived in formal houses. Today, over 70 per cent enjoy this right. In almost every area of public service delivery, from access to schooling and health care to refuse removal, from electrification to access to computers, from roads and street lights to sport facilities, from telecommunication services to access to public transport – we can point to steady progress in living standards. Development is also about access to jobs, security of incomes and redressing past inequalities. We can show measured quantitative progress on these fronts, although we clearly still have more work to do in these dimensions of reconstruction and transformation.

So in tabling the 2007 Medium Term Budget Policy Statement, we also reaffirm our commitment to building a stronger economy, faster job creation, broadening participation and deepening the quality of social and economic opportunities for all.

South Africa is now entering the ninth year of the longest economic upswing since the national accounts have been recorded. National income has risen by 22 per cent per person since 1999, with increases across all income groups. Employment is rising faster than at any point since the 1960s. Fixed investment has increased sharply since 2002, by over 10 per cent a year. These are substantial steps towards our medium term economic goals – growth of 6 per cent a year or more, an unemployment rate of below 14 per cent by 2014, and an aggregate poverty rate half that recorded in 2004. Our commitment is not just an aspiration towards these targets, we intend to measure progress, step by step, in sharing the democratic dividend among all of our people.

We need to understand, Madam Speaker, that the present buoyancy in our economic growth is partly a consequence of favourable global economic conditions. High commodity prices, low interest rates and strong international demand have contributed to the momentum of our income growth and to financing investment through capital inflows. We need to welcome and take advantage of the opportunities of global growth, but we also need to distinguish temporary prosperity from structural progress; we need to ensure that windfall gains are wisely invested and surplus resources are set aside for when markets turn against us in times ahead.

On the domestic front, our economy remains strong, buoyed by rising investment in productive capacity, higher employment and incomes, strong consumer demand and healthy foreign capital inflows. Last week's announcement of a R37 billion investment by the Industrial and Commercial Bank of China in one of our leading banks indicates that international confidence in our economy is high, and perhaps also signals a new place for Africa in the changing patterns of trade and finance flows of the 21st century.

So the healthy economic outlook that we are able to table today is of interest not just to our own people, but also in our region and the wider world. We expect the South African economy to grow by 4.9 per cent this year and 4.5 per cent in 2008, before returning to about 5 per cent a year in 2009 and 2010. The outlook is somewhat less positive than it appeared in February – financial crises in developed markets, global imbalances, high food and oil prices internationally and slowing growth in the US and other developed countries cloud the sky. The advent of the sub-prime mortgage crisis in the US is further evidence of the interconnectedness of our world, and also a reminder of the fact that we must build up our cushion against global volatility.

Our approach to international finance and monetary management has meant an accumulation of over US$30 billion in foreign reserves, which is itself a considerable strength and also a contribution to greater exchange rate and interest rate stability. In the fiscal stance outlined today, we indicate how the public finances are also contributing to the resilience of the economy in the context of both international uncertainty and the future investment requirements of our own economy.

Inflation and capacity utilisation

Madam Speaker, in this regard we are mindful that more rapid economic progress has itself brought new dimensions to the struggle. In the context of increasing oil and food prices globally, rising inflation has re-emerged as a policy concern. And our expanding investment spending has run well ahead of our ability to save, contributing to an increased current account deficit on the balance of payments. This highlights the importance of improved productivity and industrial competitiveness as a condition for the further acceleration in growth and employment creation over the decade ahead.

The recent increase in CPIX inflation to 6.7 per cent has necessitated steps to curb inflation, that have been implemented by the Reserve Bank.

Global price trends present an inflation challenge for all economies at this time. Food and commodity prices have increased sharply in recent years. More recently, the depreciation of the US dollar and continued market pressures have increased oil prices to over US$90 per barrel, an increase of about 23 per cent in the last two months. The global trends have interacted with our own rapid economic growth, agricultural supply conditions, broader supply pressures and skills deficits to push CPIX above the inflation target this year.

The rate of capacity utilisation in the economy is high, and in some sectors demand pressures are generating higher prices.

These price pressures will not abate quickly. Yet addressing them and returning to within the inflation target range is important for our long-term growth. Higher inflation reduces our competitiveness, undermines the real income of rich and poor households alike, and creates greater uncertainty for the investment decisions of firms.

The task of bringing down inflation cannot just be left to the Reserve Bank. Robust investment in capacity is underway and this will reduce some of the price pressures over time. All actors in the economy have a role to play. In particular, an improvement in the fiscal balance will help to moderate inflation and create space for stronger private sector economic activity.

Investment, trade, skills, competitiveness

Because we are determined to make tomorrow better than today, we must carefully analyse our present pattern of growth. For the next two years, somewhat slower growth in household spending will be offset by rising private and public investment. Our increased investment has not been matched by a commensurate increase in domestic production or in savings. Rising inflation and a high current account deficit are signs of both robust domestic growth and that we run a risk of not being able to finance that growth in future. In order to address these imbalances, we need to sharpen our microeconomic policy instruments through lowering the costs of doing business, stepping up our efforts in skills development, increasing trade competitiveness and investing in infrastructure that will support economic expansion.

To grow rapidly, and to sustain that growth, we must increase exports, for they are the source, over time, of the revenue that must pay for our imports. The prices of gold, platinum and other commodities have risen sharply in recent years and this has helped us, but we need to take further and more aggressive steps to diversify our trade capacity. Because of its impact on productivity and innovation, trade policy has a central place in promoting competitiveness. Our approach needs to ensure that competition is fostered through tariff simplification and reform, and that incentives for investment and for research and development are appropriately targeted and effectively administered. Public accountability is critical to the success of such initiatives, so we will seek to publish appropriate reviews and assessments of our progress. In addition, both industrial and labour market policies must focus on raising the labour intensity of the economy so that we can create jobs at an even faster pace. Greater progress in channelling young people into jobs has to be a central policy objective in coming years.

In all of these things, we face intense international competition.

A recent survey of 600 chief executives of multinational companies said a shortage of qualified staff ranked as their biggest concern. No, this survey was not conducted in South Africa. The skills shortage complained about is in Asia. Yes, a region with almost half the world's population is experiencing severe skills constraints. China is battling with severe shortages of lawyers; major Indian companies are complaining about a shortage of IT professionals; everywhere there are difficulties in finding industrial, commercial and managerial expertise. Last week, the European Union announced its intent to recruit 20 million skilled foreigners over the next twenty years. I believe that this kind of parasitic conduct of nations is wrong. But the point we need to debate about South Africa's skills shortages is not whether they exist or not, but how we confront the challenge and deal with it, recognising that everywhere else in the world they are focused on the same thing.

We will continue to place education and skills development at the top of the budget priority list. Building a learning society is partly about improving the quality and content of what goes on the classroom, but it is also about investment by businesses in their employees, about communities taking ownership and responsibility for their schools and about how families communicate values and capabilities to their children. I am aware that the negotiations with educator unions on the occupation specific dispensation have encountered some difficulties. We all know that a better career progression system is needed to retain good teachers and so efforts to unblock these difficulties must enjoy our full support.

The area of skills development is clearly one in which we will make more progress if we address the institutional and financial barriers that stand in the way of aligning resources with needs.

I share with the Minister of Labour a disappointment that financial management has been poor in several of our sector education and training authorities. At the end of last year, our SETAs held over R3.7 billion in cash reserves – effectively levy income that employers had not yet utilised to reimburse training expenses or skills development projects that had not yet been implemented. But other parts of our higher and further education system that are ready to expand enrolment and step up their contribution to human investment, do not have the financial resources to do so. This can’t be right, and so we surely need to explore options for improving the integration of our education and training financing arrangements.

Fiscal policy and the budget balance

For the past five years, public spending has increased by an annual average of 9.4 per cent in real terms. If a comparison is made with expenditure in 1995, it shows that public spending has doubled in real terms since then. Higher spending has been financed by falling debt service costs and rising tax revenues. We must take account that some of the growth in our revenue is cyclical, related to high commodity prices and the consumption boom. It is incumbent upon us to manage these cyclical revenues differently.

In this Medium Term Budget Policy Statement, we introduce the concept of a structural budget balance, sometimes also referred to as the cyclically-adjusted budget balance. The structural balance attempts to calculate the effect of cyclical revenues on our budget balance. This addition to our box of tools allows us to ensure that public spending is protected, even if economic conditions worsen. Revenue that is cyclical must be treated differently. To do otherwise would be reckless. Some of the cyclical revenue should be spent on things that raise our ability to grow faster in the long term, things such as infrastructure, education and institutional capacity. It also makes sense to use some of that cyclical revenue to pay off debt or to save for future needs.

With this in mind, government is proposing to budget for a surplus of about 0.6 per cent of GDP for the next three years so that when economic conditions deteriorate, we have the resources to cushion the economy. When cyclical revenues are removed from our calculations, the structural budget balance indicates a deficit that will rise to about 1 per cent GDP in 2010/11.

The tax burden on the economy has risen since 2004 mainly due to the cyclical windfalls accrued as a result of higher consumption and commodity prices. Rising employment and higher salary increases have also led to a rise in tax revenue. This year, we project to collect about R8.5 billion more than budgeted, mainly due to higher inflation and related salary increases. We expect that over the medium term, main budget revenue will be about 27½ per cent of GDP.

We reaffirm the principle that cyclical revenues should not be used to provide permanent tax relief. However, proceeds from better administration and tax compliance, and the broadening of the tax base may be used to lower the tax burden, as we have done in the past.

Adjustments to the 2007/08 estimates

This year, we have tabled two adjustments appropriations. The special adjustments budget tabled in September dealt with urgent transfers for the following items:

- R1.9 billion brought forward from 2008/09 to fast-track stadium development
- R2.5 billion for the pebble bed modular reactor project
- R700 million for the Land Bank
- R222 million for Denel and R45 million to Alexkor; and
- R500 million to Sentech for wireless broadband infrastructure.

In the adjustments appropriation bill that we table today, we include details of amounts rolled over from last year's budget as well as unforeseen and unavoidable expenditure. These include:

- R654 million for expenditure resulting from fires, floods and other adverse weather conditions
- R400 million for the prevention and treatment of multidrug-resistant tuberculosis
- R744 million to support the restructuring of South African Airways; and
- R1.9 billion to accommodate the higher-than-budgeted cost of the 2007 salary agreement.

Taking into account about R5 billion in under-spending, total spending amounts to R542 billion, about 15.4 per cent more than expenditure in 2006/07. The revised estimate for the budget surplus is R10.8 billion, marginally higher than the R10.7 billion projected in February.

The 2008 Medium Term Expenditure Framework

The proposed budget framework for the next three years makes provision for about R81 billion of additional allocations, allowing for spending on services to rise by 6.4 per cent a year in real terms over the next three years. Of this amount, about R15 billion goes towards funding the higher cost of the 2007 public service salary agreement. A further R2 billion goes towards the occupation-specific dispensations proposed for educators and the envisaged dispensation for social workers. Last year, the budget provided R4.6 billion for occupation-specific adjustments in the health sector.

About R4.3 billion over the MTEF period will go towards compensating pensioners and social grant beneficiaries for rising food prices and other cost-of-living increases.

Of the remaining amounts, municipalities receive about R12.6 billion to accelerate the pace of delivery of water, sanitation and electricity connections. These resources also cover the additional costs of providing poor households with free basic services. Over the next three years, infrastructure transfers to municipalities total R57 billion, reflecting a firm commitment to sharing the fruits of economic development. This includes a further R2 billion for public transport infrastructure and systems.

Provinces receive about R36 billion mainly for targeted interventions to improve the quality of schooling, health care and welfare services. The proposed budget framework provides for growth in the provincial equitable share of 11.9 per cent a year over the next three years. The new estimates of provincial population numbers are taken into account in the allocation of these funds.

Several conditional grant allocations are revised upwards. A further R2.1 billion goes towards funding the comprehensive HIV and Aids programme. Early learning opportunities and the expansion of grade R are also prioritised because these are programmes that improve outcomes in later years. Provision will be made for more places for learners with disabilities and who therefore have particular needs in our schooling system. The school nutrition programme receives a further addition to take account of higher food prices and to feed more children for the full school year.

Earlier this year, the Minister of Education released a report detailing the state of school facilities. It illustrates considerable progress over the past decade, but also signals that more needs to be done. Whereas in 1996, 51 per cent of schools were overcrowded, this figure now stands at 24 per cent. The number of schools without electricity has decreased from nearly 14 000 to 4 300. Schools without adequate water have declined from 8 800 to 3 150. The number of schools with access to computers has increased significantly, but there are still 17 000 without them. With these challenges in mind, a further R2.7 billion is proposed for school building and maintenance over the MTEF period.

National departments receive about R33 billion of the proposed additional expenditure. Much of this will go to economic infrastructure and services, including a substantial rise in funding for industrial development incentives. We will also increase spending on fighting crime, improving service delivery in the Department of Home Affairs and expanding labour-based employment programmes. Higher education will benefit from additional allocations in recognition of rising student numbers and the need to boost financial assistance to students.

Efficiency savings and measuring performance

The 2008 Budget framework favours programmes that induce efficiency savings in other areas of spending. For example, removing unroadworthy vehicles reduces road accidents, taking pressure off our emergency services and trauma health care services. Increasing the number of agricultural extension workers enhances the prospects of successful land reform projects.

Allocating resources to the right areas is only half the battle. The 2008 Budget framework raises the bar in the quest to improve value for money. In line with the Presidency's monitoring and evaluation framework, the Treasury has issued guidelines for the development of performance measures related to each programme. The intention is to assist Parliament and the public to hold departments to account for the delivery of key outputs.

As part of finalising the 2008 MTEF, national departments are asked to make R2.3 billion worth of savings as part of an efficiency programme. National departments are asked to improve their management of expenditure on travel, entertainment, marketing, catering, events and consultants. It is anticipated that provincial treasuries will adopt a similar approach in the finalisation of their budgets. These savings will be reprioritised towards frontline services.

Towards accelerated and shared growth

Madam Speaker, this budget framework and the related economic policy proposals provide a clear platform for investment in the infrastructure and services that are likely to raise our growth path towards 6 per cent. About R20 billion of the additional amounts go towards capital formation, signalling a continuation of the drive towards broadening access to basic services and increasing economic efficiency. Allocations for targeted salary increases are related to performance systems presently being implemented in the public service.

On the basis of sound fiscal and economic policies, we have made significant progress in improving the quality of life of all South Africans, but particularly for those in poverty. With the right policies in place, and through steady improvements in building implementation capacity and monitoring service delivery, we can accelerate progress in transforming the lives of all South Africans.

Ten years of SARS

Madam Speaker, ten years ago this month, the South African Revenue Service Act was promulgated to give effect to a key element of our public finance reforms – the creation of an administratively independent, efficient and effective revenue and customs authority that would be able to fund our spending objectives in a sustainable way.

Since those chaotic days, the Revenue Service has evolved into an organisation respected and admired across the world. SARS has been at the centre of a series of tax, administrative and organisational reforms that have completely changed our relationship with taxpayers. A key element of the social contract between government and citizens is that paying one's fair share of taxes is essential to all of our futures and that revenue collection is as much about a better service to the public as it is about enforcement. It is this virtuous circle which lies at the heart of our fiscal policy and at the centre of SARS's unyielding drive to promote compliance by providing ever higher service levels, greater simplicity and ease of access to honest taxpayers. Madam Speaker, none of us needs reminding of the unrelenting vigour, dedication and passion of Commissioner Gordhan and the 15 000 men and women who work for the revenue service.

Today, as we congratulate the management and staff of SARS for ten years of dedicated service, we must also thank South African taxpayers – individuals and companies – for their contributions to our nation's development. And the Commissioner has asked me to mention that tomorrow is the deadline for tax returns.

Hosting G20 Finance Ministers

Madam Speaker, we are close to the highpoint of our year as host of the G20. In just three weeks, we host the finance ministers from the 19 most systemically significant economies and the EU here in the Cape. This meeting follows a series of consultations dealing with fiscal space, the impact of commodity prices and reform to the World Bank and the International Monetary Fund. We have also used our chairmanship of the G20 to bring African finance ministries into a dialogue with more developed countries on issues of development.

I would like to thank colleagues in Cabinet, and in particular members of the Ministers' Committee on the Budget, for their role in crafting this policy statement. Thanks too to the staff of Statistics South Africa, the Ministry of Finance and the National Treasury.

Madam Speaker, I hereby table the 2007/08 Adjustments Appropriation Bill, the Adjusted Estimates of National Revenue and the Medium Term Budget Policy Statement.

Thank you