BUDGET 2000

Since 1990 the South African economy has been significantly transformed. Market volatility in 1990 led to a slowdown in South African growth, but its impact was muted by prudent fiscal policy responses and sound financial institutions.

But a strong economic recovery is under way and economic growth of 3,6 percent is projected. To reinforce economic confidence and lower inflation expectations, the government has agreed to introduce a formal inflation target. This does not necessarily imply a change in monetary policy, but aims to improve public understanding of South Africa's inflation aims and how the Bank will act to effect them.

This helps create a circle of low inflation expectations and, consequently, low inflation. The measure of inflation that will be targeted is the consumer price index excluding mortgage costs – the CPIX.

A further reduction in exchange controls this year is made possible by the strength of capital inflows.

On the economy

- Growth in GDP of 3,5 percent is expected in 2000, remaining above 3 percent over the medium term.
- After declining in 1999, investment in productive infrastructure is expected to grow by about 5 percent annually over the next three years.
- Price inflation will continue to slow, reinforced by agreement between the government and the Reserve Bank on an inflation target for 2002.

"The 2000 Budget provides for substantially increased spending on defence, public safety, skills development, infrastructure investment, the fight against HIV/Aids and the government's social and economic development priorities. It lowers the overall tax burden, especially for low- and middle-income households. It maintains a sound balance between revenue and spending, contributing to the improved outlook for the broader economy."

International trade and finance

During its transformation, the economy has become more open to trade and capital flows, and exports and imports have both grown strongly. South Africa's trade relations have diversified considerably in recent years, including rapid growth in exports to sub-Saharan Africa and significant expansion into Asian and American markets.

Real exports are projected to grow by over 5 percent a year for the next three years. With the recovery in economic growth, imports will also grow strongly and the current account is expected to remain in deficit. South Africa's improved economic prospects and greater openness to trade and investment should continue to ensure sufficient foreign capital inflows to finance the deficit.

Exchange controls have been substantially removed and many firms have restructured into fully international groups. Foreign direct investment is expected to grow considerably over the next five years and portfolio inflows should also remain strong. This is important because personal saving in South Africa remains weak. Relative to gross domestic product (GDP), South Africa saves significantly less than most comparable nations and foreign investment is crucial to economic growth.

Transforming the public sector

Government's economic goals include restructuring the public sector and refocusing its resources. New regulatory initiatives, competition policy and restructuring of state enterprises are aimed at stimulating investment and expanding employment through gains in efficiency.

Public sector expenditure as a share of GDP has stabilised over the 1990s, with the medium-term goal being to lower government consumption expenditure from about 20 percent of GDP to 19 percent in 2002. Stronger growth in public sector capital formation is projected, reinforced by the investment and service delivery programmes of restructured public utilities. This transformation is accompanied by a new approach to competition policy and independent regulation of utilities to create a more competitive economic environment.

Macroeconomic projections

Growth of more than 3 percent a year is projected over the next three years, supported by final consumption expenditure and a recovery of fixed capital formation.

Consumer inflation of 5,5 percent is projected for 2000/01, falling to 4,7 percent in 2002/03.

Fiscal policy aims to:

- Reduce the burden of tax, to encourage investment and release household spending.
- Provide for social, developmental and infrastructural responsibilities of the state.
- Reduce the budget deficit, contributing to lower interest rates and fiscal sustainability.

The extended budget framework

Stronger economic growth, lower interest on state debt and buoyant revenue collection enable the government to raise spending on public services by more than R8,3 billion a year in 2000/01 and beyond.

The framework now includes the social security funds. These include the Unemployment Insurance Fund, the Road Accident Fund and the compensation funds.

The Budget includes a contingency reserve to provide for unanticipated expenditure and macroeconomic uncertainty. The overall public sector borrowing requirement is expected to be 2,7 percent of GDP in 2000/01.

The government has instituted a national programme of skills creation, funded through a R1,4 billion levy on payrolls in 2000/01, increasing to R3 billion in 2001/02. The Umsobomvu Fund will also begin activities this year, focusing on the employment and training needs of young people.

Structural challenges

The government is implementing a strategic framework for delivering some public services through innovative public-private partnerships. By this approach, payment to the private party is linked to service delivery.

A specialised unit is being established in the treasury to assist departments in implementing public-private partnerships.

South Africa is extending its involvement in regional and international financial coordination. This includes promotion of trade and investment in the SADC region, a review of the Customs Union and engagement with the leading industrial countries as a member of the new G20 group of nations.

Medium-term expenditure estimates

The Budget reflects the nation's social and development priorities and the government's commitment to deliver better services to all. The medium-term expenditure framework (MTEF) enables the government to reprioritise spending and ensure that policy choices are affordable.

The 2000 Budget provides for expenditure of R233,5 billion, divided equitably between national, provincial and local government, after allocations for debt service costs and a contingency reserve. The estimates include provision for the allocation of funds to the National Skills Fund and sectoral education and training agencies.

Government departments are required to budget for their corresponding expenditure on training.

Consolidated expenditure trends

The MTEF comprises the consolidated spending of national and provincial government over the next three years, including the social security funds. Consolidated expenditure is expected to grow by an average 7,6 percent a year over the MTEF period, following growth of 5,9 percent a year over the previous three years.

Education, health, welfare and other social services take up about 56 percent of non-interest allocations in 2000/01, and are projected to grow steadily over the MTEF period. After declining in previous years, defence spending increases sharply to 2002/03 to accommodate the procurement of new equipment. Transport, communications and other economic services also grow strongly after a period of decline.

The consolidated projections indicate growth of 5,2 percent a year in personnel remuneration and 8,6 percent a year in other current expenditure. Capital spending grows by 8,3 percent a year. The budget framework includes a contingency reserve and other unallocated amounts of R2.3 billion in 2000/01, increasing to R8.6 billion in 2002/03.

Provincial and local government finance

Provinces and municipalities receive transfers from the national Budget in line with constitutional requirements.

On the provincial level, the formula governing the division of the equitable share between provinces has been modified slightly:

- the economic activity component has been updated
- the weights of the health and education components have been increased, taking into account expenditure trends in social services.

In addition to their equitable share of revenue, provinces receive conditional grants from national votes for central hospital services, medical training and research, hospital rehabilitation, financial management and an integrated nutrition programme, among others. The Housing Fund subsidy programme is included as a conditional grant to provinces for the first time.

Provincial budgets and accounts have shown aggregate surpluses since 1998/99, reflecting substantial improvements in provincial finances. Provinces are repaying accumulated debt and can begin to address pressing social and developmental service delivery needs.

Provincial spending is projected to rise from R101,1 billion in 1999/00 to R108,4 billion in 2000/01 and by an average of 5,9 percent a year over the next three years. Provinces plan to run surpluses over the next three years to repay overdrafts and other debt. The equitable share and conditional grants account for about 96 percent of provincial revenue.

Social services are the biggest element of provincial expenditure and spending on these programmes has grown steadily, taking up an increasing share of available resources. Over the next three years, however, provinces plan to shift the balance somewhat in favour of roads, agriculture and other functions. Social services will remain over 80 percent of provincial spending.

The share of personnel spending declines moderately over the period, with plans to strengthen other operating expenditure.

Provincial budgets suggest that capital spending will grow to address infrastructural investment and maintenance requirements. Several provinces have set aside funds for infrastructure projects from unallocated reserves. In addition, the department of finance will administer a supplementary infrastructure grant to provinces in 2000/01.

Capital spending looks set to grow by about R1 billion in 2000/01, and at about 5 percent a year thereafter.

On the local government level, municipalities face serious financial challenges. Many are burdened by poor management, cumbersome administrative and budgeting systems, inefficient service delivery, disproportionate wage bills, non-payment for services and high levels of poverty among residents.

A concerted attempt by the government to assist municipalities with the challenges of transformation is reflected in the Budget. It increases provision for local government by R350 million in 2000/01 and R450 million in 2001/02. This brings the total allocation to municipalities to R2,8 billion in 2000/01, increasing to R3,2 billion in 2002/03.

The limit on increases in municipal spending will be set at 5 percent for the financial year July 2000 to June 2001. This will

The Star Jr.... Nr.... P. 8 Dat. 24 Feb 2000

be complemented by systematic reform and capacity building to ensure realistic financial projections and to maintain fiscal discipline during the elections and amalgamation of municipalities.

Municipal operating budgets for July 1999 to June 2000 totalled R44,4 billion, with additional capital budgets of R13,7 billion. The main sources of revenue were electricity, water and sewage charges – R20,7 billion in total.

In 1994 the staff administering certain former homeland towns were transferred to provinces, with the intention to transfer them to local government. A cut-off date of August 31 2000 has been set for transfers, providing an incentive to local government to receive such staff.

The local government support grant provides for a range of management support and capacity building initiatives. It will be increased to R150 million in 2000/01. Two new grants will be introduced, including a restructuring grant for the reorganisation of local government (R300 million in 2000/01) and an additional financial management and capacity building grant.

The equitable share transfers to local government will be R1,9 billion in 2000/01, R2 billion in 2001/02 and R2,1 billion in 2002/03.

Revenue issues and tax proposals

The 2000/01 Budget contains the most extensive tax reforms introduced in democratic South Africa. Like other fiscal reforms, they aim to build an open and competitive economy and to promote the objectives of reconstruction and development.

Changes in indirect taxes

The increase in excise duties are as follows:

- Tobacco excise duties will be increased to maintain the benchmark of 50 percent total tax incidence. This implies a 10 percent real increase in cigarette duty, with higher increases for other forms of tobacco.
- Excise duties on alcohol, with the exception of sorghum beer, will be raised by 5,5 percent, in line with inflation. Sorghum beer and flour duties will remain unchanged.
- Duty on soft drinks and mineral waters will be reduced by a third – from 12c to 8c a litre.
- The fuel levy goes up by 5c a litre on petrol and 3c a litre on diesel.
- Diesel fuel tax bears heavily on the fishing industry and coastal shipping. These industries will therefore receive a diesel tax rebate from May 1.
- In line with international practice, a tax on international air travel of R100 per departure will be imposed as from August 1.

Financial management of state assets

A protocol on corporate governance issued in 1996 provides the point of departure for normalising the financial accounts and tax and dividend policies of state-owned enterprises.

Its principles will be incorporated into regulations issued in terms of the Public Finance Management Act.

Eskom and the Development Bank will in due course become taxpayers and make dividend payments to the state as shareholder. During 1999 the Central Energy Fund consolidated its accounts and paid a first dividend to the exchequer.

The government is adopting an integrated programme for restructuring state assets under the leadership of the public enterprises ministry. The restructuring of the larger public utilities – Telkom, Eskom, Denel and Transnet – will receive priority.

Restructuring proceeds of R6,9 billion have been raised in 1999/00, mainly flowing from the conversion of Sasria into a state-owned company. This has significantly contributed to lowering interest on debt. Proceeds of R5 billion are expected in 2000/01.

Debt management

The South African bond market has matured considerably, creating opportunities for reducing risks and debt-service costs through more active debt management.

In 2000 an inflation-linked bond will be introduced and options for managing financial risks will be explored.

In addition to the budget deficit of R19,7 billion, the government has financed further obligations of R1,5 billion, mainly in debt relating to Transnet Pension Fund shortfalls attributable to South African Airways.

The borrowing requirement has been financed as follows:

- Proceeds from asset restructuring R6,9 billion.
- Short-term loans (net financing) R3 billion.
- Domestic long-term loans (net) R5 billion.
- Foreign loans (net) R3,6 billion.
- Change in cash balances R2,7 billion.

Long-term loans were issued at a discount, amounting to an estimated R3,2 billion compared with R6,2 billion in 1998/99.

The projected net borrowing in domestic government bonds in 2000/01 is R10,1 billion. Foreign borrowing of $1 billion is expected. Of this amount, $300 million will finance the export credit components of the defence procurement programme.

Total government loan debt (net of cash balances) is expected to be R398,3 billion at March 31, or 45 percent of gross domestic product (GDP). It is rojected to fall to 42 percent of GDP by the end of 2002/03.

The Star Jr. Nr. 8 Dat. 24 Feb 2000

Unfunded commitments and other contingent liabilities

These include liabilities relating to public service medical schemes, government pension funds, the Multilateral Motor Vehicle Accident Fund and guarantees to various institutions. The government is also liable for losses incurred as a result of the forward market operations of the Reserve Bank.

During the past year, several international credit rating agencies have acknowledged the positive political and economic developments in the country by confirming the investment grade status of South Africa's domestic and foreign debt.

Income tax reform

The government is returning R9,9 billion a year to taxpayers, mainly at low- and middle-income levels. Individuals will now pay 18 percent of each R1 of taxable income up to R35 000, rising to 42 percent on income in excess of R200 000. The tax payable on taxable income of R30 000 will fall by 19,6 percent and by 12,5 percent on taxable income of R50 000.

Taxpayers over 65 will pay no tax on income below R36 538.

Middle- and upper-income earners also receive some relief. Taxpayers with income between R50 000 to R200 000 will have their tax liability reduced by about 10 percent. The liability of taxpayers with taxable income in excess of R200 000 a year is reduced by about 8 percent.

At present the first R2 000 a year of interest income is exempt from income tax. This exemption will be raised to R3 000 a year, and R4 000 a year for taxpayers aged over 65.

South African income tax is primarily source-based: that is, tax is largely levied on income from a source within South Africa's jurisdiction, irrespective of whether it was earned by a resident or non-resident. The income tax system will be fundamentally transformed to a residence-based income tax from January 1 2001.

From Budget day, dividends accruing to South African residents from sources outside the country will be taxed as ordinary income. The South African Revenue Service has issued a document outlining the details of this proposal, which will yield additional revenue of about R200 million a year.

The capacity of the small business sector to create jobs is especially important, given the high rate of unemployment. A graduated company rate structure is therefore proposed for small businesses. From the new tax year a clearly defined set of small and medium enterprises, especially in production activities, will benefit from lower rates. Only 15 percent company tax will be levied on their first R100 000 of taxable income, down from 30 percent.

Non-profit organisations will benefit from further tax relief. Tax deductibility of donations is to be extended to pre-primary schools, children's homes and organisations focused on HIV/Aids or care for the aged.

Recognising its advantage in protecting the integrity of the personal and corporate income tax bases, the government plans to introduce a tax on realised capital gains. It is proposed that the tax should apply to gains made after April 1 2001. The interim period will allow further research and international consultation, and draft legislation will be made available for comment by interested parties.

On the spending proposals

Significant adjustments from the 1999 Budget include:

- Allocations to the police to improve information systems and extend crime prevention activities
- Provision for the new Directorate of Special Operations and the National Directorate of Public Prosecutions
- Increases in the defence budget to provide for the strategic equipment procurement programme
- Increased allocations to the revenue service to enhance tax collection systems
- Increased provision for post-retirement medical scheme contributions
- Increased allocation to the Independent Electoral Commission for municipal elections
- A supplement to the transport vote for the operating expenditure of the South African Rail Commuter Corporation
- Provision for the costs of the next census
- Increased allocations for international tourism marketing
- Cuts to communications in view of the phasing out of the postal subsidy
- Reductions in the correctional services vote because the expenditure on building prisons has been partially translated into longer-term commitments associated with public-private prison contracts
- Reduced expenditure on government forests associated with the forestry restructuring process.

The 2000/01 Budget also includes a special allocation for an HIV/Aids strategy.

The spending proposals at a glance

- The Budget framework is extended to include the social security funds.
- Increased allocations are made for fighting crime, improving the courts, modernising the defence force, improving hospitals and schools, combating HIV/Aids and for local government elections.
- Lower interest rates and state asset restructuring proceeds bring debt service costs down by R3,3 billion.
- Budget reforms will improve value for money and the quality and scope of public sector services.