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Jobs, growth and development

Towards a new social compact

As the economy continues to recover from recession, there is broad agreement that employment has to be the central focus of South Africa's new growth path. As outlined in last year's *Medium Term Budget Policy Statement*, job creation makes economic growth more inclusive, and is the key to faster poverty reduction and income redistribution.

Employment has to be the focus of South Africa's new growth path

Public debate on economic and social policy options has been given greater impetus in South Africa and elsewhere by the financial market crisis and the severity of the resulting downturn. Confidence in economic models has been shaken, divergent views on policy responses have emerged and the adequacy of financial regulation has come under scrutiny. Unresolved imbalances in global trade and destabilising surges in capital flows have strained international financial coordination efforts.

The policy debate extends beyond macroeconomic and financial challenges. Climate change and associated energy and environmental strategies are the subject of vigorous review. Many countries face difficult adjustments to pension systems because life expectancy is increasing, and to social security arrangements due to high levels of unemployment. Mixed progress towards the United Nations Millennium Development Goals (MDGs) has prompted a reconsideration of both international and national development efforts.

Policy debate precipitated by global crisis extends beyond macroeconomic and financial challenges

Policy debate in South Africa is also focused on our own specific transformation challenges: the structure of wealth, ownership and control of resources, options for empowerment and broadening participation in the economy, access to land, and improving public education and health care.

A new growth path has to address a wide range of needs, from education to service delivery

To meet South Africa's development needs, a new path has to be forged across several frontiers – education and skills development, national health insurance, land and agrarian reform, residential settlements and urban renewal, environmental management, infrastructure investment and maintenance, enterprise development, and public-sector service delivery and management. South Africa's policy discourse is rightly wide-ranging, and invites participation from a broad spectrum of society.

Government is working on a new growth path. Details of its implementation will be developed in consultation with social partners.

Agreeing on a course is one thing; successful implementation is another. Jobs, growth and development are not abstractions: they play out every day in industries, factories, offices and farms across South Africa. In addition, there is considerable complexity in the organisation of public services, in the structure and regulation of markets, and in the coordination of public policy and industrial development.

Job creation requires a range of policy measures and social agreement on price and wage moderation

The *Medium Term Budget Policy Statement* outlines the macroeconomic, fiscal and public-expenditure dimensions of the proposed development path. It emphasises that increased infrastructure investment is needed for faster growth, and that fiscal sustainability requires a reduction in the budget deficit over the period ahead. It highlights the need for better financial discipline in public service delivery, and for improved management of education, health and infrastructure programmes. It stresses that job creation requires a broad range of policy initiatives, and social agreement on price and wage moderation.

Building on these foundations, there is substantial consensus among social partners on broader aspects of a development strategy:

- Strengthening labour-market institutions has to include improved and expanded further education and training opportunities, the reform of job search and placement services, and measures to increase the demand for labour.
- In co-financing economic infrastructure investment, enterprise development, housing and farming support, an expanded role needs to be played by development finance institutions, in partnership with public-service delivery agencies and private-sector funders.
- Industrial development promotion needs to be enhanced, as envisaged in government's industrial policy action plan, together with increased support for small enterprises and local economic opportunities.
- Greater competition is needed in electricity, transport and communications. Eskom's generation and systems operation responsibilities should be separated and independent power producers encouraged.
- South Africa's economic prospects are integrally linked with regional development, including financial and trade networks, transport, communications, energy, water and institutional coordination. Improved economic performance depends on better cooperation between countries in Southern Africa.
- Sustained improvements in public service delivery will depend in part on better financial management, good governance, sound budgeting

and contract management arrangements, and disciplined pursuit of agreed service delivery outputs and targets.

In elaborating a more detailed framework for growth and development, South Africans have a special opportunity to forge a broad-based social compact – a shared social and economic vision – aimed at facilitating effective partnerships between government, business, labour, communities and civil society in pursuit of common goals.

South Africans have an opportunity to forge a broad-based social compact

The *Medium Term Budget Policy Statement* provides a scan of current trends in the economy and the medium-term outlook, an overview of macroeconomic and fiscal considerations, and a summary of government's spending plans for the period ahead. It provides a planning framework within which a better-informed policy debate can proceed.

Progress report on the MDGs

South Africa's recently completed third progress report on the Millennium Development Goals provides a timely reminder of the social and economic challenges ahead.

The MDGs represent a global partnership of 189 countries to address a set of eight interrelated goals, focused on eradicating extreme poverty, promoting universal education and gender equality, addressing critical health challenges and promoting environmental sustainability. South Africa's progress report to the United Nations indicates a number of targets for 2015 that are likely to be reached, others that might be achieved if identified steps are taken, and some that will not be met.

South Africa is poised to reach some goals and fall short of others

MDG 1 is the eradication of extreme poverty and hunger. The evidence shows that South Africa has met the target of halving the proportion of the population living on less than $1 a day. The expansion of income support through social assistance grants has contributed significantly to this outcome. Yet little or no progress has been made in reducing income inequality, or expanding employment opportunities for the poor.

South Africa has reduced poverty levels, yet little progress has been made in reducing income inequality

MDG 2 is universal primary education. South Africa has near-complete primary school enrolment, and is likely to achieve a literacy rate of over 95 per cent for 15-24 year-olds in 2015. Deficiencies are evident, however, in the quality and functionality of the public school system. The progress report sets out several recommendations for improving school infrastructure, teacher education and school effectiveness.

MDG 3 is promotion of gender equality and empowerment of women. South Africa scores well on the targeted gender ratios in education and the share of women in formal employment. Yet there is much more to be done in advancing women's rights and promoting full equity in the workplace.

There is strong progress on gender targets, but more needs to be done to advance women's rights

MDG 4 focuses on child mortality. South Africa's infant and child mortality rates are unacceptably high and far above comparable international norms. Recent progress in immunisation coverage and prevention of mother-to-child HIV transmission will assist in reducing child mortality, but improved nutrition and better primary health care need to be prioritised.

Measuring social and economic progress – *2010 MDG Country Report*

Goals and indicators	Baseline	Current status	2015 target	Target achievability
Proportion of population living on less than $1 a day (%)	11.3 (2000)	5.0 (2006)	5.7	Achieved
Employment-to-population ratio	41.5 (2003)	42.5 (2009)	50-70	Unlikely
Gini coefficient (total income including free services)	0.69 (2000)	0.71 (2006)	0.3	Unlikely
Adjusted net enrolment ratios for primary education, male and female	96.4 (2002)	98.4 (2009)	100	Achieved
Ratio of girls to boys in secondary school	1.1:1 (1996)	1.1:1 (2009)	1:1	Achieved
Under-five mortality rate (per 1 000 births)	59 (1999)	104 (2007)	20	Unlikely
Immunisation coverage of under 1 year-olds	66.4 (2001)	95.3 (2009)	100	Likely
Maternal mortality (per 100 000 births)	369 (2001)	625 (2007)	38	Unlikely
Antenatal care coverage	76.6 (2001)	102.8 (2009)	≈100	Achieved
Incidence of TB (per 100 000)	253 (2004)	283 (2009)	< 253	Unlikely
HIV prevalence in population aged 15-49 (%)	15.6 (2002)	16.9 (2008)	15.6	Unlikely
Proportion of population using an improved drinking water source (%)	61.1 (1996)	92.4 (2009)	81	Achieved
Proportion of population using an improved sanitation facility (%)	58.5 (2001)	72.2 (2009)	79.2	Likely

The country's maternal mortality rate is rising – an alarming trend

MDG 5 is improved maternal health. South Africa has seen improvements in antenatal care coverage and use of modern contraceptive methods, but maternal mortality is high and rising. The prevalence of HIV, together with complications associated with hypertension and deficiencies in obstetric services, has contributed to this trend.

HIV prevalence appears to have stabilised, and the antiretroviral programme is expanding rapidly

Combating HIV, malaria and other diseases is MDG 6. South Africa's HIV prevalence appears to have stabilised, and for the 15-24 year-old population is estimated to have declined from over 10 per cent in 2005 to 8.7 per cent in 2008. South Africa now has the largest antiretroviral therapy programme in the world, though the proportion of those with advanced HIV infection who are on treatment (42 per cent in 2009) is still well below target. Successful completion of tuberculosis (TB) treatment (76 per cent in 2008) is also below the MDG target (85 per cent). Malaria does not pose a widespread health hazard in South Africa, and is effectively combated through an insecticide-spraying programme and medical response capability.

Strategies have been identified to lower CO_2 emissions, but other environmental challenges demand urgent attention

MDG 7 is environmental sustainability. South Africa has made notable advances in improving household access to water, electricity, sanitation and waste removal services. There is well-established scientific and research capacity, and publicly supported institutions committed to promoting biodiversity and environmental management. Mitigation strategies have been identified to contribute to lower carbon dioxide emissions. However, there are large environmental challenges, including overfishing and threatened fish stocks, water resources at risk due to acid mine drainage, overreliance on fossil fuels as a source of energy, poor landfill site management and biodiversity loss.

MDG 8 is global partnership for development. South Africa is well integrated into global finance, trade and technology development, and is a significant contributor to regional integration through the Southern African Customs Union, the Southern African Development Community (SADC) and the African Union.

South Africa makes a considerable contribution to regional integration and development through the SADC and African Union

Several of these MDG commitments now find expression in government's framework for improved delivery of public services, summarised below.

Priority outcomes, outputs and budget planning

In January 2010, Cabinet adopted 12 outcomes within which to frame public-service delivery priorities and targets. Cabinet ministers have signed performance agreements linked to these outcomes and outputs. More detailed delivery agreements have since been developed to extend targets and responsibilities to national and provincial departments, agencies and municipalities.

Government's 12 outcomes form the basis of delivery agreements

The priority outputs have already influenced departmental planning and budgeting, though the full impact will only emerge in the 2011/12 budget cycle. Much of the work of the Ministers' Committee on the Budget concerns the examination of spending plans and programmes, and how they give effect to South Africa's service-delivery priorities.

The outputs for each outcome are set out in the accompanying tables, together with examples of programmes and activities of government departments that give practical effect to these targets. Spending proposals summarised in Chapter 4 take these policy priorities and service delivery goals as points of departure.

Spending proposals give effect to new targets, with focus on jobs, education, health and infrastructure

1 Improve the quality of basic education

Outputs	Key spending programmes (examples)
1. Improve quality of teaching and learning 2. Regular assessment to track progress 3. Improve early childhood development 4. A credible outcomes-focused accountability system	• Increase the number of Funza Lushaka bursary recipients from 9 300 to 18 100 over the 2011 MTEF • Assess every child in grades 3, 6 and 9 every year • Improve learning and teaching materials to be distributed to primary schools in 2011 • Improve maths and science teaching • Eradicate infrastructure backlogs in 3 627 schools by 2014

2 Improve health and life expectancy

Outputs	Key spending programmes (examples)
1. Increase life expectancy to 58 for males and 60 for females 2. Reduce maternal and child mortality rates to 30-40 per 1 000 births 3. Combat HIV/Aids and TB 4. Strengthen health services effectiveness	• Revitalise primary health care - Increase early antenatal visits to 50% - Increase vaccine coverage • Improve hospital and clinic infrastructure • Accredit health facilities • Extend coverage of new child vaccines • Expand HIV prevention and treatment - Increase prevention of mother-to-child transmission • School health promotion (increase school visits by nurses from 5% to 20%) • Enhance TB treatment

3 All people in South Africa protected and feel safe

Outputs	Key spending programmes (examples)
1. Reduce overall level of crime 2. An effective and integrated criminal justice system 3. Improve perceptions of crime among the population 4. Improve investor perceptions and trust 5. Effective and integrated border management 6. Integrity of identity of citizens and residents secured 7. Cyber-crime combated	• Increase police personnel • Establish tactical response teams in provinces • Upgrade IT infrastructure in correctional facilities • ICT renewal in justice cluster • Occupation-specific dispensation for legal professionals • Deploy SANDF soldiers to South Africa's borders

4 Decent employment through inclusive economic growth

Outputs	Key spending programmes (examples)
1. Faster and sustainable inclusive growth 2. More labour-absorbing growth 3. Strategy to reduce youth unemployment 4. Increase competitiveness to raise net exports and grow trade 5. Improve support to small business and cooperatives 6. Implement expanded public works programme	• Invest in industrial development zones • Industrial sector strategies – automotive industry; clothing and textiles • Youth employment incentive • Develop training and systems to improve procurement • Skills development and training • Reserve accumulation • Enterprise financing support • New phase of public works programme

5 A skilled and capable workforce to support inclusive growth

Outputs	Key spending programmes (examples)
1. A credible skills planning institutional mechanism 2. Increase access to intermediate and high-level learning programmes 3. Increase access to occupation-specific programmes (especially artisan skills training) 4. Research, development and innovation in human capital	• Increase enrolment in FET colleges and training of lecturers • Invest in infrastructure and equipment in colleges and technical schools • Expand skills development learnerships funded through sector training authorities and National Skills Fund • Industry partnership projects for skills and technology development • National Research Foundation centres of excellence, and bursaries and research funding • Science council applied research programmes

6 An efficient, competitive and responsive economic infrastructure network

Outputs	Key spending programmes (examples)
1. Improve competition and regulation 2. Reliable generation, distribution and transmission of energy 3. Maintain and expand road and rail network, and efficiency, capacity and competitiveness of sea ports 4. Maintain bulk water infrastructure and ensure water supply 5. Information and communication technology 6. Benchmarks for each sector	• An integrated energy plan and successful independent power producers • Passenger Rail Agency acquisition of rail rolling stock, and refurbishment and upgrade of motor coaches and trailers • Increase infrastructure funding for provinces for the maintenance of provincial roads • Complete Gauteng Freeway Improvement Programme • Complete De Hoop Dam and bulk distribution • Nandoni pipeline • Invest in broadband network infrastructure

7 Vibrant, equitable and sustainable rural communities and food security for all

Outputs	Key spending programmes (examples)
1. Sustainable agrarian reform and improved access to markets for small farmers 2. Improve access to affordable and diverse food 3. Improve rural services and access to information to support livelihoods 4. Improve rural employment opportunities 5. Enable institutional environment for sustainable and inclusive growth	• Settle 7 000 land restitution claims • Redistribute 283 592 ha of land by 2014 • Support emerging farmers • Soil conservation measures and sustainable land use management • Nutrition education programmes • Improve rural access to services by 2014: - Water - 74% to 90% - Sanitation - 45% to 65% - Electricity - 55% to 70%

8 Sustainable human settlements and improved quality of household life

Outputs	Key spending programmes (examples)
1. Accelerate housing delivery 2. Improve access to basic services 3. Improve property market 4. More efficient land utilisation and release of state-owned land	• Increase housing units built from 220 000 to 600 000 a year • Increase construction of social housing units to 80 000 a year • Upgrade informal settlements: 400 000 units by 2014 • Deliver 400 000 low-income houses on state-owned land • Improved urban access to basic services by 2014: - Water - 92% to 100% - Sanitation - 69% to 100% - Refuse removal - 64% to 75% - Electricity - 81% to 92%

9 A responsive, accountable, effective and efficient local government system

Outputs	Key spending programmes (examples)
1. Differentiate approach to municipal financing, planning and support 2. Community work programme 3. Support for human settlements 4. Refine ward committee model to deepen democracy 5. Improve municipal financial administrative capability 6. Single coordination window	• Municipal *capacity-building grants*: - Systems improvement - Financial management (target: 100% unqualified audits) • *Municipal infrastructure grant* • Electrification programme • *Public transport & systems grant* • *Bulk infrastructure & water grants* • *Neighbourhood development partnership grant* - Increase urban densities - Informal settlements upgrades

10 Protection and enhancement of environmental assets and natural resources

Outputs	Key spending programmes (examples)
1. Enhance quality and quantity of water resources 2. Reduce greenhouse gas emissions; mitigate climate change impacts; improve air quality 3. Sustainable environment management 4. Protect biodiversity	• National water resource infrastructure programme • Water management and information - reduce water losses from 30% to 15% by 2014 • Expanded public works environmental programmes - 100 wetlands rehabilitated a year • Forestry management (reduce deforestation to <5% of woodlands) • Biodiversity and conservation (increase land under conservation from 6% to 9%)

11 A better South Africa, a better and safer Africa and world

Outputs	Key spending programmes (examples)
1. Enhance the African agenda and sustainable development 2. Enhance regional integration 3. Reform global governance institutions 4. Enhance trade and investment between South Africa and partners	• International cooperation: proposed establishment of the South African Development Partnership Agency • Defence: peace-support operations • Participate in post-conflict reconstruction and development • Border control: upgrade inland ports of entry • Trade and Investment South Africa: - Support for value-added exports - Foreign direct investment promotion

12 A development-oriented public service and inclusive citizenship

Outputs	Key spending programmes (examples)
1. Improve government performance 2. Government-wide performance monitoring and evaluation 3. Conduct comprehensive expenditure review 4. Information campaign on constitutional rights and responsibilities 5. Celebrate cultural diversity	• Performance monitoring and evaluation: - Oversight of delivery agreements • Statistics SA: Census 2011 – reduce undercount • Chapter 9 institutions and civil society: programme to promote constitutional rights • Arts & Culture: promote national symbols and heritage • Sport & Recreation: support mass participation and school sport programmes

Overview of the 2010 policy statement

Economic policy and outlook

A perspective on how to achieve more rapid growth

Chapter 2 presents the macroeconomic outlook. It also provides a perspective on how to achieve more rapid growth to address South Africa's core development challenge of drawing more people into employment to reduce poverty and inequality.

Expansionary fiscal and monetary policies in major developed and developing economies continue to support a recovery in the world economy. After contracting in 2009, the world economy is expected to grow at a relatively strong pace of 4.8 per cent in 2010 and 4.2 per cent in 2011, driven mainly by fast-growing emerging economies such as China, India and Brazil.

Global outlook improving, but remains fragile

A sharp slowdown in growth momentum since mid-year has highlighted the fragility of the outlook. Employment and demand remain depressed in major developed countries where extraordinary monetary policy measures are being taken to boost liquidity and fight deflation. Most developed economies face the challenge of reducing high levels of bad debt in their banking systems and adjusting fiscal policy to reduce public debt.

South Africa's recovery has gained strength, supported by expansionary fiscal and monetary policies

The recovery in global demand has benefited South Africa by supporting high prices of the country's major commodities. Real GDP growth accelerated to an annualised rate of 3.9 per cent in the first half of the year as household demand strengthened, supported by expansionary fiscal and monetary policies and lower inflation. Sustained investment by state-owned enterprises helped to offset weak business investment.

The labour market remains weak. Total employment declined by more than a million jobs (8.0 per cent) between the fourth quarter of 2008 and the second quarter of 2010, with losses concentrated in the trade, manufacturing and construction sectors. The unemployment rate has reached 25.3 per cent, and labour force participation has fallen sharply because many people have stopped looking for work. Employment and private investment are expected to rise gradually as growth accelerates.

The labour market remains weak and unemployment has reached 25.3 per cent

The pace of GDP growth is expected to moderate in the second half of the year. Growth of 3.0 per cent is projected for 2010 before rising to 3.5 per cent in 2011 and 4.4 per cent by 2013. At these rates of growth it will take some time before the economy reaches full capacity.

Consumer price inflation has declined more than expected this year to 3.5 per cent in August. Headline CPI is expected to remain below 6 per cent over the next three years, supported by moderate increases in food prices and a relatively buoyant exchange rate. This will allow real interest rates to remain low over the medium term.

South Africa has low interest rates owing to low inflation

Like other emerging markets, South Africa is experiencing high levels of capital inflows, which provide an important source of funding. Along with a weak US dollar, these flows also contribute to strengthening the rand exchange rate. Sustained exchange rate appreciation will lead to unbalanced growth, widening the current account deficit and increasing the economy’s vulnerability to shocks. Fiscal and monetary measures are being taken in response to the present strength of the rand. The National Treasury and the Reserve Bank will continue to purchase foreign exchange reserves. Gross foreign exchange reserves stood at US$44.1 billion in September 2010.

Fiscal and monetary measures are being taken in response to the present strength of the rand

Table 1.1 summarises the key macroeconomic projections.

Table 1.1 Macroeconomic projections, 2009 – 2013

	2009	2010	2011	2012	2013
Calendar year	**Actual**	**Estimate**		**Forecast**	
Percentage change unless otherwise indicated					
Final household consumption	-3.1	2.6	3.4	4.1	4.5
Gross fixed capital formation	2.3	0.8	5.6	5.0	5.9
Real GDP growth	**-1.8**	**3.0**	**3.5**	**4.1**	**4.4**
GDP at current prices (R billion)	**2 407.7**	**2 631.4**	**2 867.1**	**3 148.0**	**3 471.9**
CPI inflation	7.1	4.4	4.7	5.0	5.2
Current account balance (% of GDP)	-4.0	-4.2	-4.9	-5.3	-5.8

A key focus of economic policy must be to achieve and sustain faster growth over an extended period of time to significantly increase labour absorption. Chapter 2 sets out elements of what would be required to raise South Africa’s growth rate to create jobs at a scale that would decisively reduce poverty and inequality.

Fiscal policy and trends

A countercyclical fiscal policy stance is central to government’s approach to both long-term growth and sustainability in the public finances. This policy helps to manage demand over the business cycle, thereby containing inflation and allowing real interest rates to remain low.

During the economic downturn in 2008 and 2009, government spending on infrastructure and social assistance expanded strongly, and the budget deficit widened to 6.7 per cent of GDP. As growth improves over the period ahead, spending growth will moderate and the budget deficit is expected to revert to 2.9 per cent of GDP by 2013/14. However, infrastructure investment by Eskom and Transnet will continue to exceed internally generated funds by a substantial margin, bringing the overall public-sector borrowing requirement to about 10 per cent of GDP this year, declining to a projected 6.1 per cent in 2013/14.

Government's real per capita non-interest expenditure has doubled over the past eight years

Chapter 3 notes that in per capita terms, real non-interest expenditure has doubled over the past eight years. This was made possible by buoyant growth and associated revenue trends, and because a reduction in the budget deficit in preceding years led to declining debt-service costs as a share of GDP. The proposed framework for the 2011 Budget provides for real growth in non-interest spending of 2.7 per cent a year over the next three years. Improved efficiency of public service delivery needs to be sought to enable education and health priorities to be addressed, and infrastructure investment and maintenance to be enhanced.

Project management capacity in capital projects requires attention

Government capital spending has increased from 5.2 per cent of total spending in 2002/03 to 7.8 per cent in the current year. However, project management capacity remains a concern, and underspending of capital budgets is evident in both provincial and municipal finances.

A moderation in public-sector infrastructure spending is expected over the next three years, though additional funding will be earmarked for health and education facilities. Over the medium-term expenditure framework (MTEF) period, total infrastructure spending of R811.2 billion is anticipated, of which 40.3 per cent is in the energy sector and 26.1 per cent in transport and logistics.

Development finance institutions need to play a greater role in investing and co-financing projects in South Africa and the region

Government expects its development finance institutions to enhance their investment in and co-financing of economic and social infrastructure, enterprise development, land reform and access to affordable housing. It is also recognised that South Africa's economic prospects are tied to broader regional development progress. The Development Bank of Southern Africa has a key role to play in supporting both municipal infrastructure and services, and investment projects in the SADC.

Table 1.2 summarises the consolidated fiscal framework for the current year and the MTEF period ahead. As outlined in Chapter 3, total gross loan debt of government is expected to rise from 36.4 per cent of GDP at the end of 2010/11 to 40.9 per cent at the end of 2013/14.

Table 1.2 Consolidated government fiscal framework, 2009/10 – 2013/14

	2009/10	2010/11	2011/12	2012/13	2013/14
R billion	**Outcome**	**Estimate**	**Medium-term estimates**		
Revenue	**666.9**	**761.0**	**843.0**	**931.7**	**1 040.2**
Percentage of GDP	*27.2%*	*28.4%*	*28.7%*	*28.9%*	*29.1%*
Expenditure	**832.5**	**904.1**	**977.2**	**1 059.1**	**1 154.2**
Percentage of GDP	*33.9%*	*33.7%*	*33.3%*	*32.8%*	*32.3%*
Budget balance	**-165.6**	**-143.1**	**-134.2**	**-127.4**	**-114.0**
Percentage of GDP	*-6.7%*	*-5.3%*	*-4.6%*	*-3.9%*	*-3.2%*

Medium-term expenditure priorities and the division of revenue

Budget framework highlights need to identify savings and improve efficiency of public services

The proposed expenditure framework for the 2011 Budget is informed by government's 12 agreed outcomes, with priority given to education, health, infrastructure development and job creation. A moderate pace of expenditure growth is possible in the current circumstances, reinforcing the need for identifying savings and opportunities for more effective organisation of public services. Several areas of reform are proposed:

- Excessive administrative capacity, relative to frontline services, will come under renewed budget scrutiny.
- Effective training programmes need to be strengthened across the public service.
- A new approach to budgeting and management of capital projects is proposed to improve planning and reduce underspending.
- Non-departmental agencies and entities will be reviewed, with special focus on governance, remuneration and mandates.
- Strengthened capacity is in place to deal with wrongdoing in government procurement, and improved rules will enhance transparency in the supply chain process.
- Information technology systems and management of consulting services will come under specialised scrutiny within the supply chain regulatory framework.

Table 1.3 summarises consolidated government expenditure by function. These revised baseline estimates reflect current spending priorities in education, health, social protection, transport and health services, and provide for strong growth in housing, water infrastructure, police services and law courts.

Table 1.3 Consolidated government expenditure, 2010/11 – 2013/14

	2010/11	2011/12	2012/13	2013/14	Average annual growth
R billion	Revised estimate	Budget estimate			2010/11–2013/14
General public services	46.7	48.0	49.0	52.9	4.2%
Defence	35.7	40.6	43.6	46.2	8.9%
Public order and safety	86.8	94.2	101.6	108.2	7.6%
Economic affairs	128.4	132.1	137.7	146.3	4.4%
Environmental protection	5.7	6.2	6.8	6.6	5.0%
Housing and community amenities	97.4	110.1	120.0	127.8	9.5%
Health	101.9	111.4	119.0	127.1	7.6%
Recreation and culture	6.4	6.0	6.4	6.7	1.6%
Education	173.2	190.7	201.7	215.8	7.6%
Social protection	134.2	148.4	161.7	174.2	9.1%
Contingency and policy reserve	–	10.4	18.7	35.0	
Non-interest expenditure	**816.5**	**898.3**	**966.0**	**1 046.7**	**8.6%**
State debt cost	67.6	78.9	93.1	107.5	16.7%
Eskom loan	20.0	–	–	–	
Total expenditure	**904.1**	**977.2**	**1 059.1**	**1 154.2**	**8.5%**

Support for job creation, with focus on youth employment initiatives

An amount of R22.1 billion in the contingency reserve over the MTEF period is still to be allocated in the final budget. Part of this policy reserve will be set aside for education, health, infrastructure and job creation, in particular for youth employment programmes.

The draft division of revenue for the 2011 Budget is set out in Table 1.4. Increases to baseline allocations amounting to R67 billion are proposed over the MTEF, of which R40.1 billion goes to provinces, R23.8 billion to national departments and just over R3 billion to municipalities. The local government share grows by 10.1 per cent a year, the provincial share by 7.5 per cent and the national share by 5.8 per cent a year. Rising allocations to municipalities reflect the priority of improving basic services and bulk infrastructure. Allocations to provinces will accommodate higher personnel costs and infrastructure backlogs in education and health.

Table 1.4 Division of revenue, 2010/11 – 2013/14

R billion	2010/11	2011/12	2012/13	2013/14
National allocations	360.6	374.5	401.0	427.3
Provincial allocations	328.1	359.5	382.3	407.7
Equitable share	*265.1*	*289.0*	*305.7*	*323.3*
Conditional grants	*63.0*	*70.5*	*76.6*	*84.4*
Local government allocations	59.3	67.2	74.0	79.0
Total allocations	**748.1**	**801.2**	**857.3**	**914.1**
Changes to baseline				
National allocations	1.5	4.0	7.3	12.5
Provincial allocations	5.3	9.0	13.0	18.2
Equitable share	*4.2*	*8.3*	*10.3*	*11.2*
Conditional grants	*1.1*	*0.7*	*2.7*	*7.0*
Local government allocations	0.5	0.5	1.0	1.6
Total	**7.3**	**13.5**	**21.3**	**32.3**

Chapter 4 sets out broad policy considerations underlying these expenditure proposals, including government's economic and industrial policy framework, the need to strengthen infrastructure maintenance, land and agrarian reform goals, and the challenges of improving police services and administration of justice.

Holding government accountable

South Africa ranks first in the international Open Budget Survey

South Africa has once again achieved international recognition for meeting stringent transparency and accountability standards. The International Budget Partnership (IBP) ranks South Africa first among 94 countries in its 2010 Open Budget Survey. The survey measures the degree to which governments provide sufficient budget documentation to allow for both public participation and oversight in national budget decision-making. The IBP concludes that the comprehensiveness and quality of South Africa's budget documentation "makes it possible for citizens to hold the government accountable for its management of the public's money".

The 2010 *Medium Term Budget Policy Statement*, and the proposed MTEF set out in Chapter 4, are tabled for further consideration in Parliament and its committees, and by all South Africans.

2

Economic policy and outlook

A gradual recovery

The world economy continues to recover from the severe recession precipitated by the global financial crisis. Fiscal and monetary policies in major developed and developing economies support stronger demand, but the recovery is fragile and marked by persistent global imbalances. The costs of the crisis as reflected in higher unemployment and increased public debt will weigh on growth for many years to come. The world economy is expected to grow at a relatively strong pace of 4.8 per cent in 2010 and 4.2 per cent in 2011.

Global growth of 4.2 per cent is projected for 2011

South Africa's economy gained strength during the first half of the year, and the outlook has improved moderately since the 2010 Budget forecast. Stronger spending by households and income from high commodity prices have been supported by expansionary fiscal and monetary policies and lower inflation. Investment by state-owned enterprises has been sustained. Employment and private investment are expected to rise gradually as growth accelerates. Real GDP growth of 3 per cent is projected for this year, followed by 3.5 per cent in 2011 and 4.4 per cent by 2013. Like other emerging markets, South Africa is experiencing high levels of capital inflows, which provide an important source of funding. Combined with US dollar weakness, however, the surge in capital inflows has led to strengthening of the rand exchange rate.

South Africa's economic recovery continues to gain momentum

While the outlook is improving, the pace of growth has not begun to approach the level required to draw millions of people into employment and to sharply reduce inequality. This is South Africa's development gap: the economy needs much faster, more labour-absorbing growth over an extended period to meet the country's core challenges. To achieve this requires a growth strategy that forges partnerships between government, business and labour to raise competitiveness, expand production and create employment through increased investment and trade.

A new growth strategy is needed to drive massive job creation and meet development challenges

The domestic economic outlook

Domestic growth will pick up moderately in 2011

The economic recovery strengthened in the first half of the year, with real GDP growth expanding at an annualised rate of 3.9 per cent compared with the second half of 2009. Growth was stronger than expected in the first six months of 2010 as a result of temporary factors, including an uptick in consumption related to the soccer World Cup and more stable inventories. The pace of GDP growth is likely to moderate in the second half of the year, before picking up in 2011.

Real GDP growth is projected to rise from 3 per cent in 2010 to 3.5 per cent in 2011, 4.1 per cent in 2012 and 4.4 per cent in 2013. While the level of real GDP returned to pre-crisis levels in the second quarter of this year, it will take some time before the economy reaches full capacity.

Table 2.1 Macroeconomic projections, 2007 – 2013

Calendar year	2007	2008	2009	2010	2011	2012	2013
		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
Final household consumption	5.5	2.4	-3.1	2.6	3.4	4.1	4.5
Final government consumption	4.7	4.9	4.7	4.9	4.3	4.2	3.7
Gross fixed capital formation	14.2	11.7	2.3	0.8	5.6	5.0	5.9
Gross domestic expenditure	6.4	3.3	-1.8	4.1	4.2	4.5	4.9
Exports	5.9	2.4	-19.5	4.1	5.7	6.6	7.6
Imports	9.0	1.4	-17.4	8.4	7.8	7.9	8.7
Real GDP growth	**5.5**	**3.7**	**-1.8**	**3.0**	**3.5**	**4.1**	**4.4**
GDP inflation	8.2	9.2	7.3	6.1	5.3	5.5	5.6
GDP at current prices (R billion)	**2 017.1**	**2 283.8**	**2 407.7**	**2 631.4**	**2 867.1**	**3 148.0**	**3 471.9**
Headline CPI inflation	6.1	9.9	7.1	4.4	4.7	5.0	5.2
Current account balance (% of GDP)	-7.2	-7.1	-4.0	-4.2	-4.9	-5.3	-5.8

Table 2.2 Macroeconomic projections, 2009/10 – 2013/14

Fiscal year	2009/10	2010/11	2011/12	2012/13	2013/14
	Actual	Estimate		Forecast	
Percentage change unless otherwise indicated					
Real GDP growth	-1.3	3.5	3.6	4.2	4.5
GDP inflation	7.2	5.6	5.5	5.6	5.8
Headline CPI inflation	6.4	4.1	4.8	5.1	5.2
GDP at current prices (R billion)	**2 455.6**	**2 683.9**	**2 933.5**	**3 227.9**	**3 568.7**

Policy adjustments support recovery

South Africa's countercyclical response during the recession partly offset the sharp reduction in trade, and will continue to support a recovery in private investment and consumption. The projected fiscal deficit for 2010/11 is 5.3 per cent of GDP, and government expenditure will grow by nearly 5 per cent in 2010 to cover the costs of higher real wages and expanding social services. A slower pace of public expenditure growth is projected over the medium term to ensure that government debt levels remain sustainable and to prevent an undue rise in interest rates.

Monetary policy has also adjusted to weak demand, with interest rates declining further this year in response to lower-than-expected inflation. The Reserve Bank reduced interest rates by 1 percentage point between March and August, bringing the repo rate to 6 per cent, the lowest level since it was introduced in 1998. Subdued headline inflation should allow monetary policy to remain supportive of growth over the medium term.

Interest rates have declined in response to lower-than-expected inflation

The rise in output during 2010 contrasts markedly with continued weakness in the labour market. On the present GDP growth trajectory, private-sector employment will only recover to pre-crisis levels by 2014.

Accelerating growth and creating jobs

To achieve its developmental aims, South Africa needs to promote large-scale job creation, increased investment, greater trade, higher savings and a more competitive economy. This requires addressing constraints to growth, including infrastructure bottlenecks, skills deficiencies, state inefficiency and regulatory burdens that act as a disincentive to small business activity. Partnerships between government, business and labour are needed to:

Partnerships between government, business and labour are needed to create jobs, especially for youth

- Rapidly reduce youth unemployment
- Contain price and wage increases to support competitiveness and higher exports
- Make more effective use of development finance institutions to fund domestic and regional infrastructure development
- Promote sustainable use of energy and natural resources
- Support land reform and bolster agricultural productivity to increase food production and rural development
- Remove constraints to mining and industrial investment, including capacity limitations in energy, transport and telecommunications.

Factors in the recovery

South Africa has benefited from the global recovery through higher prices of its major export commodities, lower inflation and the falling cost of capital, supported by large inflows to the domestic bond and equities markets. In combination, these developments should stimulate private-sector credit extension and fixed investment over the medium term.

On the downside, the current scale of capital inflows places upward pressure on the real exchange rate, reducing the competitiveness of manufactured exports and encouraging imports. Sustained exchange rate overvaluation will lead to unbalanced growth, widening the current account deficit and increasing the economy’s vulnerability to shocks.

Fiscal consolidation and lower interest rates are the macroeconomic prerequisites for a more competitive real exchange rate. The combination of tighter fiscal policy and looser monetary policy will support demand while moderating the build-up of imbalances arising from strong capital inflows. Short-term exchange-rate risks can also be mitigated more directly through stepped-up purchases of foreign exchange reserves and reduced restrictions on capital outflows to encourage an increase in foreign assets.

Fiscal consolidation and lower interest rates will support a more competitive rand exchange rate

Monetary policy needs to remain focused on anchoring inflation expectations

Headline CPI inflation is expected to remain below 6 per cent over the next three years, supported by moderate increases in food prices and a relatively buoyant exchange rate. The strong rand currently offsets the impact of high real wage increases on inflation. While inflation is low, underlying inflationary pressures remain. To prevent a resurgence in inflation that could put further upward pressure on the real exchange rate, monetary policy needs to remain focused on anchoring inflation expectations and supporting financial stability to promote growth and employment.

South Africa is building power stations and roads, extending rail lines and modernising ports

Expanding and maintaining network infrastructure is necessary to support competitiveness. Real investment by public corporations is expected to grow by about 12 per cent in 2010 off an already high base. Average growth of 7 per cent per year is projected over the medium term, led by Eskom (power stations), Transnet (rail, ports and a pipeline) and the South African National Roads Agency Limited (SANRAL, national roads). Municipal underspending on capital and infrastructure maintenance is a challenge that needs to be urgently addressed.

Growth in real gross fixed capital formation is expected to rise from an estimated 0.8 per cent in 2010 to 5.6 per cent in 2011 and 5.9 per cent by 2013. Private investment will recover gradually as higher domestic consumption lifts demand, and as capacity utilisation in manufacturing rises in sectors producing for domestic and regional markets. In the electricity sector, clear direction on the terms of long-term price agreements and regulatory clarity will encourage independent power producers to come on-stream, with positive effects for overall investment.

After a sharp narrowing in 2009, the current account is forecast to widen, reaching 5.8 per cent in 2013

Infrastructure spending combined with a recovery in domestic demand will result in faster growth in imports than exports over the next three years. Strong capital inflows and a recovery in corporate profits will also lead to higher income payments to global bond and equity investors. After narrowing sharply in 2009, the current account deficit is forecast to widen to 4.2 per cent of GDP in 2010 and to rise to 5.8 per cent by 2013.

Over the medium term, the strength of South Africa's recovery is greatly dependent on the trajectory of the world economy, though stronger growth can be achieved through appropriate policy measures.

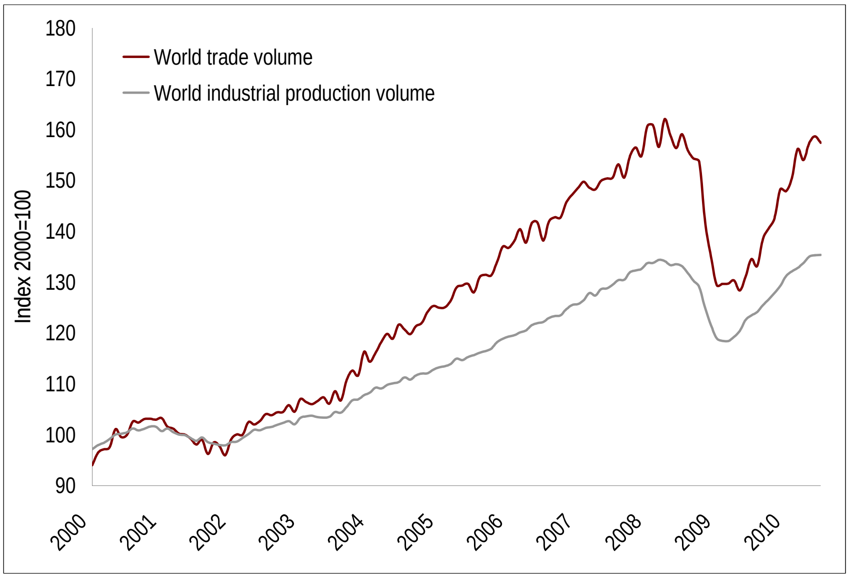
Global recovery: prospects and risks

After contracting by an estimated 0.6 per cent in 2009, global growth has resumed this year, supported by stimulatory fiscal and monetary policies internationally. In the first six months of 2010, world manufacturing and trade rebounded strongly as inventories were rebuilt and investors regained confidence.

China and other emerging economies continue to lead global growth

The IMF forecasts global growth of 4.8 per cent in 2010 and 4.2 per cent in 2011 – a considerable improvement from the nadir of the recession in 2009. Growth continues to be led by emerging and developing economies – such as China, India and Brazil – which are expected to grow by 7.1 per cent in 2010 and 6.4 per cent in 2011.

Figure 2.1 Global manufacturing and trade volumes, 2000 – 2010



Source: Netherlands Bureau for Economic Policy Analysis

Despite positive signs, global economic recovery remains fragile

While the international outlook is more positive, a sharp slowdown in growth momentum since mid-year highlights the fragility of the recovery. Factors weighing on global growth prospects include the following:

- Employment and demand remain depressed in many countries, particularly in the United States, where the impact of stimulus measures is fading.
- Deflation is still a threat in advanced economies due to low levels of capacity utilisation and weak demand. With limited scope for additional fiscal stimulus some governments are taking extraordinary monetary policy measures, such as large-scale purchases of government bonds, to boost liquidity.

Table 2.3 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2010 – 2012

Region / country	2010	2011	2012	2010	2011	2012
Percentage	**GDP projections[1]**			**CPI projections[1]**		
World	**4.8**	**4.2**	**4.5**	**3.7**	**3.1**	**2.9**
US	2.6	2.3	3.0	1.4	1.0	1.4
Euro area	1.7	1.5	1.8	1.6	1.5	1.5
UK	1.7	2.0	2.3	3.1	2.5	1.7
Japan	2.8	1.5	2.0	-1.0	-0.3	0.2
Emerging markets and developing countries	**7.1**	**6.4**	**6.5**	**6.3**	**5.2**	**4.5**
Developing Asia	**9.4**	**8.4**	**8.4**	**6.1**	**4.2**	**3.2**
China	10.5	9.6	9.5	3.5	2.7	2.0
India	9.7	8.4	8.0	13.2	6.7	4.7
Middle East and North Africa	**4.1**	**5.1**	**4.8**	**6.8**	**6.2**	**6.2**
Sub-Saharan Africa	**5.0**	**5.5**	**5.7**	**7.5**	**7.0**	**6.3**
South Africa[2]	3.0	3.5	4.1	4.4	4.7	5.0

1. IMF World Economic Outlook, October 2010.
2. National Treasury forecasts.

- Most of the world's largest economies face the challenge of reducing non-performing banking system assets, boosting productivity, and adjusting fiscal policy to reduce public debt.
- Strong growth in China has prompted concerns that asset bubbles could develop. To prevent overheating of the Chinese economy, the authorities are tightening monetary policy.

Price trends for commodities produced in South Africa are expected to remain favourable

Despite the uncertain global outlook, strong growth in emerging markets has kept commodity prices relatively high. Price trends for commodities produced in South Africa are expected to remain favourable over the medium term:

- Gold has benefited from global uncertainty, maintaining its role as a store of value. The gold price has risen by more than 20 per cent since January to record levels above US$1 300/oz.
- The price of platinum has increased by 14 per cent since January to levels around US$1 700/oz, and the coal price is up by 14 per cent.
- The price of Brent crude oil has averaged US$80/barrel this year.

Exchange rates and global economic adjustment

A rebalancing of global demand is necessary to support sustainable growth. Countries with large surpluses, such as China, Japan and Germany, need to reduce savings and increase the contribution of household consumption to growth. Those running large deficits, such as the US, the UK and Australia, need higher savings and less reliance on credit-fuelled consumption.

Attention has recently focused on China's exchange rate. The US has signalled that it will maintain loose monetary and fiscal policies to support demand, causing the dollar to weaken by 16 per cent against the euro since June. China, in contrast, has tightened monetary and credit policies to prevent overheating and has allowed the renminbi to appreciate marginally (2.8 per cent) against the dollar since June. A relative shift in exchange rates would result in higher net exports from the US and lower net exports from China.

As this rebalancing unfolds, sharp movements in the US dollar have caused the exchange rates of many countries to strengthen appreciably, undermining export competitiveness. In response:

- A range of countries, notably Japan, have countered with their own efforts to weaken exchange rates. Emerging markets such as Korea, Singapore, Brazil, Thailand, Mexico, Colombia, South Africa and Turkey have purchased dollars to sterilise large capital inflows.
- Korea, Indonesia, Brazil and Australia have delayed raising interest rates.
- Where strong capital inflows are fuelling asset bubbles and threatening higher inflation, governments are considering prudential measures such as relaxing controls on capital outflows and taxing inflows.

Inappropriate short-term responses to global currency adjustments, such as competitive devaluations or increased trade protectionism, will entail longer-term costs to economic growth. A coordinated international agreement on currency realignment would help to minimise the negative effects of this rebalancing, especially for developing countries.

Capital flows and currency movements

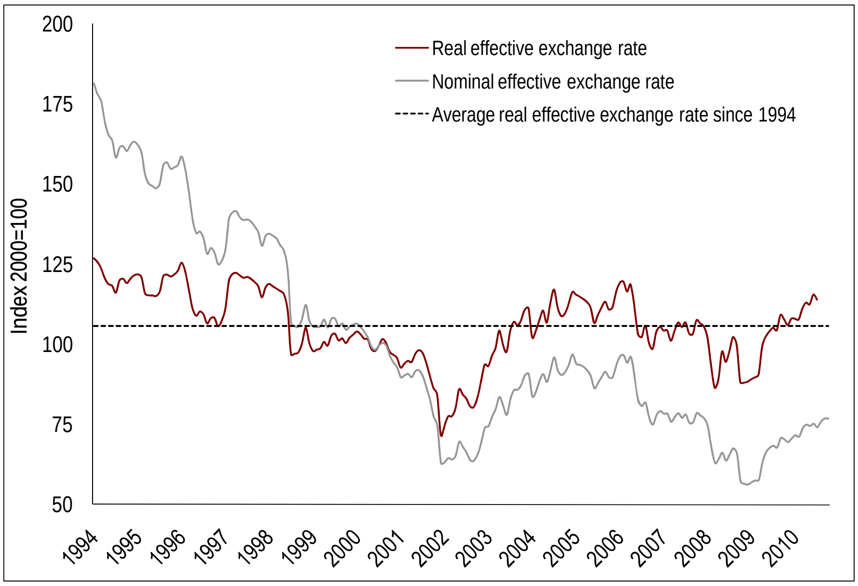
Emerging markets are experiencing massive capital inflows, with both long-term and short-term components

Capital flows to emerging markets have increased steadily over the past decade, supported by favourable growth dynamics, improved credit ratings, greater openness and the development of domestic financial markets. The Institute for International Finance projects that net private capital flows to emerging economies will reach US$825 billion in 2010, up from US$581 billion in 2009. JP Morgan estimates that inflows into emerging-market fixed-income investments will rise to a record US$70-75 billion in 2010. Net capital inflows to South Africa have risen strongly over the past two years, reaching 5.5 per cent of GDP in the first half of 2010 compared with 4.7 per cent in 2009 as a whole.

The investment pattern over the past decade suggests that a structural change is under way in global savings allocations. This shift may result in a long-term rise in levels of fixed and portfolio investments held in well-managed developing countries, providing an important source of funding for private-sector growth and infrastructure development.

A structural change in global savings allocations appears to be underway

Figure 2.2 Trade-weighted rand indices, 1994 – 2010



Source: South African Reserve Bank. Data for 2010 is up to July for the real effective exchange rate and October for the nominal effective exchange rate

At the same time, low interest rates in advanced economies are supporting a short-term investment wave motivated by the prospect of quick gains. These include "carry trades" in which investors borrow money at low interest rates and invest in assets that pay higher interest rates. Such short-term investments are inherently volatile. The policy challenge is how to benefit from these capital inflows while minimising the attendant risks.

The policy challenge is how to benefit from capital flows while minimising the attendant risks

The rand has appreciated by 7.5 per cent against the US dollar since December 2009, and by 6.1 per cent against a trade-weighted basket of currencies (see Figure 2.2). Because South Africa has higher inflation than its major trading partners, the real effective rand exchange rate, which reflects losses or gains in competitiveness, is now about 12 per cent above its average level for the past decade.

Fiscal and monetary policy have adjusted to take account of these circumstances. As a small open economy with low domestic savings and relatively high financing needs, South Africa cannot fully offset the impact of massive global capital flows, barring a much sharper tightening of fiscal policy that diverts resources towards substantially larger reserve purchases. Complementary policies to support sustainable gains in productivity and international competitiveness are also necessary.

South Africa cannot fully offset the impact of massive global capital flows

Towards faster, more labour-absorbing growth

South Africa's present economic growth trajectory cannot meet the country's employment needs. Faster growth is required over an extended period of time to significantly increase labour absorption, reduce high unemployment and achieve a more equitable distribution of income. Modelling work by the National Treasury shows that if South Africa were to sustain 7 per cent growth for 10 years, national income would double and the economy would generate about 5.5 million jobs, leading to a dramatic reduction in poverty and inequality.

To achieve 7 per cent growth, South Africa requires higher productivity and investment

For South Africa to grow at 7 per cent per year, jobs, investment and productivity all need to grow more quickly. Prudent and sustainable macroeconomic and fiscal policies that keep inflation low, reduce real interest rates, moderate government debt levels, support financial stability and maintain a competitive real exchange rate, must form the foundation of a higher growth path. Such policies promote investment and job creation, and help to reduce the severity of boom/bust economic cycles.

G-20 process highlights the need for prudent macroeconomic and fiscal management

The Group of Twenty (G-20) mutual assessment process underscores the need for prudent economic management. This process has identified “growth-friendly” fiscal consolidation for countries with high or rapidly rising deficits and debt levels as a precondition for a balanced and sustainable international recovery. While governments are mindful of the risks of reducing spending too quickly, which could jeopardise growth, there is a general commitment to halve fiscal deficits by 2013.

The desire to raise growth potential among G-20 members has focused attention on microeconomic reforms and complementary measures needed to support higher productivity. These include better-quality education, stepped-up skills development, increased retirement savings, reforms to product and labour markets to promote efficiency and boost employment, greater competition, increased openness to international trade and infrastructure investment.

OECD recommendations for structural reform in South Africa

The Organisation for Economic Cooperation and Development (OECD) has participated in the G-20’s mutual assessment process by providing country-specific recommendations on structural reforms needed to increase global growth. The OECD benchmarks countries against each other and conducts annual surveys to assess progress. The OECD’s 2011 *Going for Growth* publication recommends the following for South Africa:

- Improve the **quality of education** by improving teacher training; addressing teacher underperformance effectively; improving provision of textbooks and teaching materials; and upgrading school infrastructure.
- Enhance **competition in network industries** by removing legal barriers to entry; ending state-owned enterprises’ exemptions from competition laws; moving towards separating generation, transmission and distribution of electricity; and strengthening the independence of the telecommunications regulator.
- Reform the **wage bargaining system** to increase labour absorption.
- Strengthen policies to **tackle youth unemployment** through age-differentiation of minimum wages in sectors where these are set by the state; implementing a wage subsidy; and intensifying placement assistance for young workers.
- Reduce **barriers to entrepreneurship** such as the burden of licenses and permits, and the complexity of rules and procedures; introducing a systematic regulatory impact assessment for significant new regulations; and reviewing existing legislation to reduce administrative burdens for small businesses.

Competitiveness: a prerequisite for growth

More competitive economies have higher productivity, attract more foreign direct investment (FDI) and can grow their export industries. Competition is an essential driver of innovation and productivity growth. FDI enables technology transfer, brings in skills and encourages local companies to become more efficient. FDI is generally higher in countries with a stable and predictable policy environment, which includes legal protection and effective enforcement of investor rights.

While South Africa ranks highly in areas such as soundness of banks, overall competitiveness is declining

South Africa's competitiveness has declined over the past few years relative to our emerging-market peers. The *Global Competitiveness Report* for 2010/11 ranks South Africa 54th out of 139 countries, down from 45th in 2009/10. South Africa still ranks highly in several areas – the soundness of banks, the availability of financial services, the strength of auditing and reporting standards, and the legal system. But these positive rankings are offset by poor performance in other areas, including basic education and health (129th), labour-market efficiency (97th), technological readiness (76th), higher education and skills (75th) and infrastructure (63rd).

Competition, along with low costs of capital and other production inputs, is important for inventing new goods or services and for breaking into new markets. For South Africa to produce goods that are competitive internationally, the costs of production need to be in line with (or even lower than) those prevailing in other countries. Currently, South Africa's prices of transport and communication are higher than those of our major competitors. Containing inflation, and aligning wage costs and productivity, are also important factors in increasing competitiveness.

Industrial policy measures include generous tax incentives and import tariffs to support specific sectors

South Africa has a range of industrial policy measures in place, including generous tax incentives and import tariffs to support sector growth in automobile and components manufacturing, textiles and clothing, and general manufacturing. The benefits of these subsidies to the rest of the economy can be enhanced by refining the conditions attached to state-support to ensure that companies work to increase their productivity and eventually prosper without protection.

Realigning pricing structures to reflect negative externalities such as carbon emissions, or scarcity of resources such as water, can help new industries to emerge. Such realignment will promote investment and employment in "green" businesses that make South Africa's use of natural resources more sustainable.

Deepening regional integration can support innovation and new product development. Expanding infrastructure and transport networks to reduce the cost of trade in goods and services would bolster manufacturing exports while increasing South Africa's role as a market for products from the Southern African region.

Development finance institutions to provide greater support for domestic and regional infrastructure

South Africa can also make more effective use of development finance institutions to finance domestic and regional infrastructure development. Institutions such as the Development Bank of Southern Africa and the Industrial Development Corporation can play a greater role in financing public infrastructure, enterprise development and investments in the built environment.

In some respects, South Africa's weak global competitiveness ranking reflects the country's legacy of social inequality. To bolster competitiveness and improve the living standards of all South Africans, government must reduce backlogs and bottlenecks that impede growth by prioritising spending on social and economic services, including education, health and infrastructure investment. With limited fiscal resources, the quality of spending must also improve.

Support for job creation and skills development

Public-sector initiatives complement private-sector job creation, which accounts for most employment

While social grants provide an important safety net for about a quarter of the population, South Africa's long-term prosperity depends on more people being drawn into work. The private sector accounts for 75 per cent of all economic activity and a slightly higher share of employment, and will remain the primary driver for job creation. The public sector plays a complementary role in this process. Alongside a range of initiatives to increase training and skills development, specific government interventions to raise employment include the following:

- The expanded public works programme supports job creation by increasing the labour intensity of public-sector projects and services. The current phase of this programme aims to create 4.5 million short-term jobs lasting 100 days on average over the 2010-2014 period. A new performance-based incentive grant encourages municipalities and provinces to carry out their work using more labour. The cost-effective community works programme provides useful services such as home-based care, food gardens, environmental services and maintenance of community assets.
- A youth jobs initiative is proposed to provide work experience, on-the-job and vocational training in the public sector. This forms part of a broader strategy to address high levels of youth unemployment, including consideration of a hiring subsidy to help first-time job seekers to gain experience in the formal labour market.

The nexus between education, skills and jobs

Several recent surveys highlight the shortage of skilled workers as a binding constraint for South Africa. The World Economic Forum's *Global Competitiveness Report 2010/11* cites "an inadequately educated workforce" as the second most problematic factor for doing business. The *2010 Grant Thornton International Business Report* found that 34 per cent of all businesses see the availability of skilled workers as the major constraint to business expansion.

There is a clear link between education, skills and employment. Labour market statistics show that among workers with four years of university training or more, unemployment is near zero. In contrast, joblessness among those with some secondary education is more than 30 per cent. During the recent recession, the burden of job losses fell disproportionately on those with lower levels of education.

Increasing the depth and quality of South Africa's skills reservoir will raise the productive potential of the workforce and reduce inequality by increasing job opportunities.

The recovery in the real economy

The economy has continued to grow in the second half of the year, but at a slower pace than in the first half. While business and consumer confidence have nudged higher, output volatility in mining and manufacturing has increased due to fluctuations in global demand, and domestic factors such as increased strike activity, rand volatility and regulatory uncertainty. The latter is also inhibiting growth in private investment.

Measures to reduce regulatory uncertainty in mining

The Minister of Mineral Resources has announced the following measures to reduce regulatory uncertainty in the mining industry and root out corruption in the awarding of mining licenses:

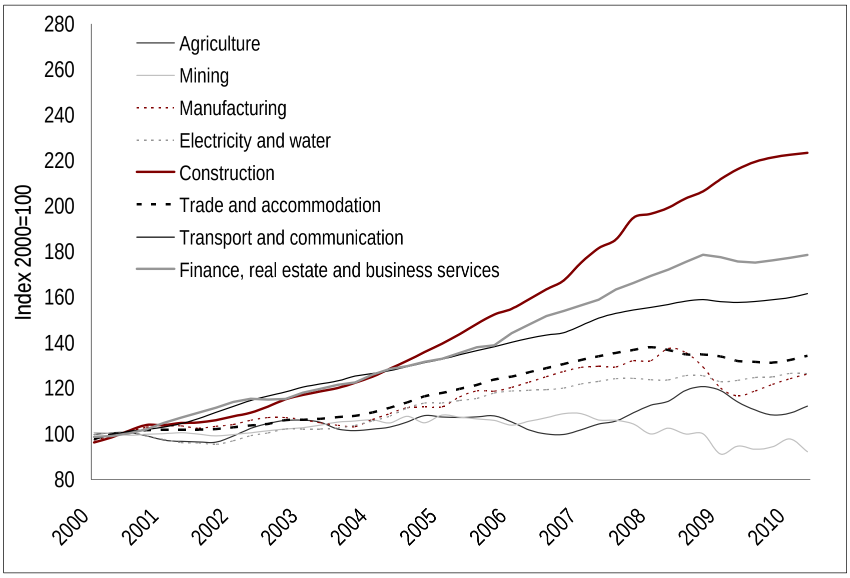
- With effect from 1 September 2010, the Department of Mineral Resources will place information on the status of exploration and mining licenses on its website.
- The department has imposed a moratorium on accepting prospecting applications to allow for a comprehensive audit of licenses granted since the promulgation of the current act.
- The department will develop a new license process tracking system during the course of 2010/11.
- Prospecting rights, previously issued at regional offices, will only be issued from head office.

A task team has identified areas in the legislation that require clarification, including the order of processing applications; the interpretation of regulations on transfer of rights; regulations covering associated minerals; and regulations to prevent the fragmentation of rights. The department will table proposals to Cabinet.

Trends in the real economy include the following:

- In the first six months of 2010, manufacturing value added grew by 5.8 per cent compared with the previous year, driven by increased production of motor vehicles, petrochemicals, and basic iron and steel.
- Growth momentum in manufacturing has slowed in the second half of the year. The purchasing managers' index fell from a peak of 60.4 in February – a level consistent with an expansion of production – to an average level below 50 between June and September.
- Value added in mining increased by only 2.2 per cent during the first half of 2010, despite favourable commodity prices. Output growth jumped from 0.7 per cent in June to 10.3 per cent in August.
- The construction sector continued to grow during the first six months of 2010, but growth during this period was 4.2 per cent compared with 7.8 per cent in 2009.
- Real retail sales were 4.6 per cent higher in August compared with a year earlier, but the pace has slowed since the end of the World Cup.

Figure 2.3 Sector contributions to real GDP growth, 2000 – 2010



Source: Statistics South Africa. Data for 2010 is for the first two quarters of the year

Labour market response to the recovery

While employment levels are stabilising, the labour market remains weak

The labour market was affected severely by the recession and remains weak, despite the pickup in economic activity and signs that employment levels are stabilising after a period of steep job losses.

Total employment declined by more than a million jobs (8 per cent) between the fourth quarter of 2008 and the second quarter of 2010, with losses concentrated in the trade, manufacturing and construction sectors. The unemployment rate has increased by 3.4 percentage points to 25.3 per cent. The rate of labour force participation has fallen sharply because many people have stopped looking for work.

Average wage settlements of 8.3 per cent in the nine months to September 2010 were higher than average CPI inflation of 4.7 per cent between January and August. Average settlements in the public sector, particularly in state-owned enterprises and municipalities, were higher than private-sector settlements. High wage settlements may have reduced the incentive of companies to rehire workers laid off during the recession and to create new jobs. In the past, employment growth has been associated with strong GDP growth and moderate growth in real earnings (see Figure 2.4).

Table 2.4 Total employment per sector, June 2010

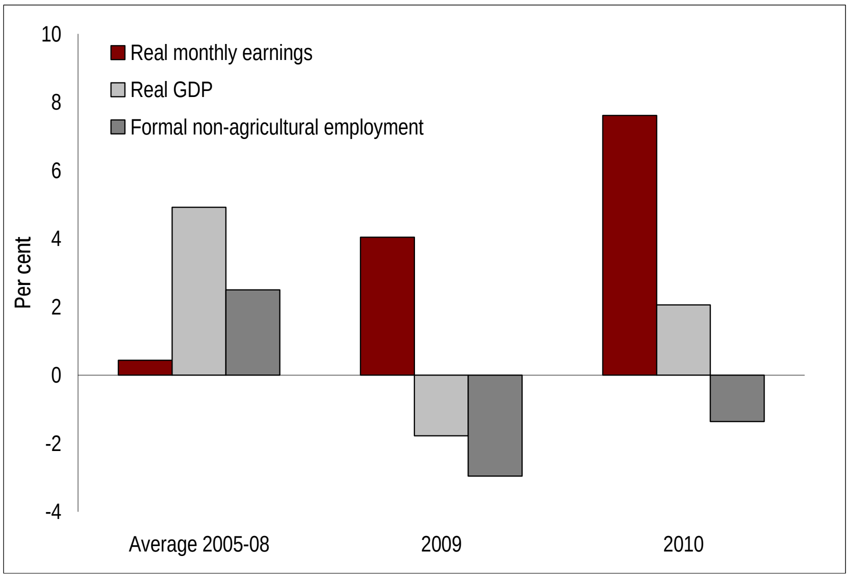
	Total employed (thousands)	% of total	Change since December 2008 (thousands)	% change since December 2008
Agriculture	618	4.9	-146	19.0
Community and personal services	2 659	20.9	-2	-0.1
Construction	1 006	7.9	-185	-15.5
Finance, insurance and real estate	1 670	13.1	34	2.1
Manufacturing	1 656	13.0	-288	-14.8
Mining and quarrying	305	2.4	-16	-5.0
Private households	1 155	9.1	-143	-11.0
Retail and wholesale trade	2 839	22.3	-325	-10.3
Transport and communication	734	5.8	-40	-5.2
Utilities	93	0.7	7	8.1
Total	**12 735**	**100.0**	**-1 104**	**-8.0**

Source: Statistics South Africa

Cooperation is needed to protect workers' rights and to ensure wage-setting flexibility

Cooperation between business, labour and government, including through bargaining councils, is needed to ensure that workers' rights are adequately protected and that the wage-setting process does not undermine employment and new job creation.

Figure 2.4 Growth in formal-sector employment, real earnings, and real GDP, 2005 – 2010



Source: Statistics South Africa. Data for 2010 is for the first two quarters of the year

How government can help small business create jobs

A successful job creation strategy needs to address constraints that make it more difficult to open or expand small businesses. About 20 per cent of employees in South Africa work for microenterprises (fewer than 5 workers) and another 40 per cent are employed in small firms (fewer than 50 workers). The latter account for almost 80 per cent of hiring by companies.

Small and micro businesses face an onerous regulatory burden and limited access to finance. Among businesses with turnover of less than R1 million, the cost of regulatory compliance is about 8 per cent of total turnover, compared with less than 1 per cent for large businesses (over R25 million). Starting a business takes on average 22 days and involves complicated procedures with multiple government departments to obtain trading licences. Rules friendly to small business are needed across all regulations (tax, company registration, labour, zoning, etc) to minimise compliance burdens and costs.

Government communication on issues affecting small business should be in plain language, clear, direct and concise, and made more accessible through advertising campaigns, libraries, post offices and the internet. New laws should be subjected to regulatory impact assessments to review their effect on small businesses.

Source: Stats SA, Quarterly Labour Force Survey (2Q 2010); OECD Economic Assessment of South Africa, 2008.

Consumption resumes as households repair balance sheets

Gross domestic expenditure accelerated in the first half of 2010 due to a recovery in household consumption and growth in government consumption. Fixed investment spending by the private sector also stabilised somewhat after falling in 2009 and the rate of inventory drawdown slowed considerably as production growth strengthened.

Fixed investment spending by the private sector has begun to stabilise

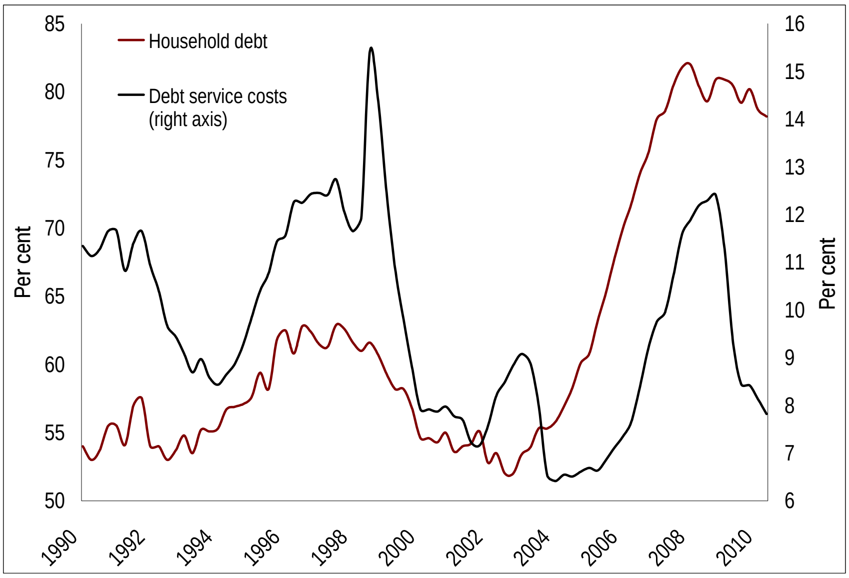
Stimulatory fiscal and monetary policies have combined to support the recovery in demand. Lower-than-expected inflation has allowed the Reserve Bank to reduce the repo rate by one percentage point since March to 6 per cent. The full benefit of lower borrowing costs on consumption and investment will only be seen in time, but banks have already started to increase lending to households. Over the medium term, high household debt levels will moderate credit demand and spending growth.

Table 2.5 Contribution to gross domestic expenditure growth, 2007 – 2010

Percentage	2007	2008	2009	2010[1]
Household consumption expenditure	3.5	1.5	-1.9	0.7
Government consumption expenditure	0.9	0.9	0.9	1.0
Gross fixed capital formation	2.4	2.1	0.5	-0.4
Change in inventories	-0.2	-1.5	-1.6	1.1
Residual item	-0.2	0.3	0.4	0.1
Gross domestic expenditure	**6.4**	**3.3**	**-1.8**	**2.5**

1. First half of 2010 compared to the same period in 2009.
Source: South African Reserve Bank

Figure 2.5 Ratios of household debt and debt-service costs to disposable income, 1990 – 2010



Source: South African Reserve Bank. Data for 2010 is for the first two quarters of the year

Sustaining and financing public investment

Public-sector infrastructure investments will continue to raise the economy's growth potential

Public-sector investment remains the cornerstone of government's strategy to support higher sustainable economic growth, because it reduces bottlenecks in the economy and draws in private-sector investment. Higher levels of public and private investment are necessary over the medium term to raise the economy's growth potential and create employment.

During 2009, overall growth in gross fixed investment was sustained by a strong expansion in spending by public corporations, particularly for capacity expansion in the electricity sector. Private-sector investment contracted by 7 per cent during the year, with the largest declines in manufacturing, finance and real estate as companies cut back purchases of new machinery and equipment, and residential building contracted further.

Table 2.6 Contribution to overall investment growth, 2006 – 2010

Percentage	2006	2007	2008	2009	2010[1]
General government	2.4	2.9	2.1	-0.2	-1.2
Public corporation	2.2	4.0	5.7	7.2	2.7
Private enterprises	7.6	7.2	3.9	-4.6	-3.5
Total	**12.1**	**14.2**	**11.7**	**2.3**	**-2.0**

1. First half of 2010 compared to the same period in 2009.
Source: South African Reserve Bank

To remove bottlenecks and reduce the cost of doing business, the core investment plans of state-owned enterprises remain focused on capacity expansion in electricity, rail, ports and roads with the bulk of spending carried out by Eskom, Transnet and SANRAL.

Capital infrastructure investments will expand electricity, rail, ports and roads capacity

Investment in water sector infrastructure is crucial to address an estimated refurbishment backlog of R10 billion. A review of water pricing is underway to realign prices where necessary. Tariff caps and exemptions in the current pricing strategy impede the efficient allocation of water. Cost-reflective tariffs are necessary to moderate demand, ensure the long-term sustainability of water-related infrastructure and preserve the natural environment. Continuous investment and stronger regulation should reverse current trends and prevent what would otherwise become a crisis in the future.

In the energy sector, the integrated resource plan will provide clarity on committed generation projects and the future direction of power generation technology, such as nuclear and renewable energy. The planned increase in generation capacity from the Medupi and Kusile coal-fired stations will be supplemented by independent power producers.

Integrated energy resource plan is expected to provide clarity on the direction of power generation

Recovery in banking sector lending

While the banking sector has weathered the crisis reasonably well, banks have faced high levels of non-performing loans and reduced margins as a result of falling interest rates. This should improve as economic growth strengthens and bank revenues are boosted by falling impairments. Impaired advances as a percentage of gross loans and advances have stabilised at just below 6 per cent over the past 12 months, more than double pre-crisis levels.

The South African banking sector remains well capitalised. The sector’s “tier one” capital adequacy ratio, which measures the highest-quality assets held in reserve to protect depositors and promote the stability of the financial system, stood at 11.2 per cent in July 2010, well in excess of the Basel III accord’s 7 per cent requirement. Total capital adequacy stands at 14.3 per cent.

Banking sector remains well capitalised, and banks have begun to ease lending standards

Financial sector reform

The global crisis exposed serious weaknesses in financial regulatory systems internationally. South Africa is participating actively in multilateral reform initiatives.

While South Africa's financial system remained sound and stable during the global contagion, there is scope to strengthen domestic financial sector regulation. Government proposes to implement the Basel III accord, which will tighten some banking regulations. In addition, government is committed to modernising exchange controls to reflect a prudential approach, updating regulation 28 in terms of Pension Funds Act, expanding the scope of regulation (to include, for example, credit ratings agencies), reviewing the approach to investment funds regulation and strengthening capital markets regulation.

These measures, together with others aimed at improving market conduct and encouraging access to financial services, are addressed in a discussion document entitled *Strengthening the Financial Sector to Better Serve South Africa.* This document, to be released shortly after the *Medium Term Budget Policy Statement* is tabled in Parliament, sets out a range of National Treasury initiatives.

Credit extension to households has picked up, but credit extension to companies remains weak

Credit extension to households has picked up as banks have begun to ease lending standards, but credit extension to companies remains weak. Growth in private-sector credit extension rose to 3 per cent in August 2010, but bank lending to companies was still 1 per cent lower than a year ago. Corporate cash balances have been rising and private investment rates are low, which may explain weak demand for credit.

Temporary decline in the current account deficit

The current account deficit narrowed from 7.2 per cent of GDP in 2007 to 4.0 per cent in 2009. The deficit remained relatively small at 3.6 per cent of GDP in the first six months of 2010 due to a continued improvement in the trade balance.

Table 2.7 Summary of South Africa's current account, 2005 – 2010

Percentage of GDP	2005	2006	2007	2008	2009	2010[1]
Trade balance	-0.1	-1.7	-2.0	-1.6	0.1	0.0
Net services, income and transfer receipts	-3.3	-3.7	-5.2	-5.5	-4.1	-3.6
Net service receipts	*-0.3*	*-0.8*	*-0.9*	*-1.5*	*-1.0*	*-1.0*
Net income receipts	*-2.0*	*-2.0*	*-3.4*	*-3.2*	*-2.2*	*-1.9*
Net dividend receipts	*-1.6*	*-1.6*	*-3.1*	*-2.5*	*-1.6*	*-1.5*
Net transfer payments (mainly to SACU)	-1.0	-0.9	-0.8	-0.8	-0.9	-0.7
Total current account	**-3.5**	**-5.3**	**-7.2**	**-7.1**	**-4.0**	**-3.6**
Current account excl. current transfers	-2.5	-4.4	-6.3	-6.3	-3.1	-2.9

1. Data for 2010 is for the first half of the year, seasonally adjusted and annualised.

Source: South African Reserve Bank

As domestic and international demand have recovered, export and import volumes have risen, but they remain well below pre-crisis levels. The improvement in the current account is expected to be temporary and the deficit is expected to rise from an estimated 4.2 per cent of GDP in 2010 to 4.9 per cent in 2011 and 5.8 per cent in 2013, driven by rising import demand.

Net capital inflows exceed the country's external funding requirement

Net capital inflows currently exceed the country's external funding requirement. Portfolio investments have made up the bulk of overall inflows, with strong demand for rand-denominated bonds driven by attractive yield differentials, falling inflation and interest rates. In the nine months to September, non-residents were net buyers of R77.6 billion worth of bonds and R21.7 billion worth of equities. Although net FDI was relatively small in the first six months of the year, several large cross-border mergers involving local companies such as Dimension Data and Massmart have been announced since July, fuelling positive sentiment towards the rand.

Income payments to the rest of the world will also rise as profit growth strengthens and increased international holdings of domestic bonds result in larger offshore interest payments. Payments to international investors will be offset over time by rising income from global assets as investments by South African companies and households become more internationally diversified. Strong capital inflows will ensure that the deficit remains adequately financed over the medium term.

Strong capital inflows will ensure that the deficit remains adequately financed over medium term

Table 2.8 Summary of South Africa's financial account, 2005 – 2010

R billions	2005	2006	2007	2008	2009	2010[1]
Net portfolio investment flows	30.1	129.5	73.5	-134.9	92.5	64.0
Net foreign direct investment flows	36.4	-44.6	19.2	100.3	34.8	2.1
Net other investment flows	9.8	21.9	60.8	130.7	-21.6	-4.8
Unrecorded transactions	12.3	16.6	38.7	91.4	7.7	9.0
Financial account balance	**88.6**	**123.4**	**192.2**	**187.5**	**113.4**	**70.4**
As a percentage of GDP	*5.6%*	*7.0%*	*9.5%*	*8.2%*	*4.7%*	*5.5%*
Change in net reserves due to balance of payments transactions	**34.3**	**29.8**	**47.8**	**26.1**	**17.0**	**30.2**
As a percentage of GDP	*2.2%*	*1.7%*	*2.4%*	*1.1%*	*0.7%*	*2.4%*

1. Data for 2010 is for the first two quarters of the year, not annualised.

Source: South African Reserve Bank

Conclusion

As the economy continues its gradual recovery, supported by countercyclical fiscal and monetary policies, it is important to remain focused on South Africa's larger economic challenge of reducing poverty through achieving more rapid growth and creating more jobs, particularly for low-skilled and young workers. Higher growth is needed to improve the living standards of all South Africans. To achieve this goal, our policies need to create a favourable environment for investment and productivity growth by removing bottlenecks to trade, reducing red tape, lowering the costs of doing business, delivering quality public services, increasing competition, removing barriers to entry, supporting innovation, expanding exports and encouraging youth employment.

Higher levels of economic growth are needed to raise the living standards of all South Africans

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3

Fiscal policy and trends

Growth, sustainability and the fiscus

Countercyclical fiscal policy supports economic growth and sustainable public finances, enabling South Africa to adjust to the ups and downs of the business cycle and to manage external volatility. Sound fiscal policy has supported the expansion of social and capital infrastructure programmes. In per capita terms, real non-interest expenditure has doubled over the past eight years, leading to a reduction in poverty levels and an expansion of public services.

Government will consolidate the fiscal position in line with economic growth

Over the next three years, government will balance the short-term need for fiscal stimulus with the medium-term need to consolidate the fiscal position as economic growth recovers.

Government increased spending on social programmes and infrastructure during the economic downturn of 2008-2009. Doing this at a time when revenue was falling required a significant increase in borrowing and led to a higher budget deficit. As the economy moves into a new growth cycle, government will stabilise its borrowing in line with countercyclical policy.

As the economy moves into a new growth cycle, borrowing will stabilise

Over the longer term, higher economic growth will support debt reduction, enabling government to rebuild fiscal space. Creating fiscal space during the upward phase of the economic cycle is necessary to ensure that the public finances are well positioned to respond when the cycle turns negative. Aligning government borrowing to economic growth in this way supports the economy by contributing to lower interest rates, limiting inflationary pressures arising from government consumption expenditure and reducing South Africa's reliance on overseas savings to finance borrowing.

The budget deficit is projected to narrow from 5.3 per cent of GDP in the current year to 3.2 per cent by 2013/14, reflecting a strong recovery in revenue and moderate growth in spending.

Table 3.1 Consolidated government fiscal framework, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
R billion		**Outcome**		**Estimate**		**Medium-term estimates**	
Revenue	**625.7**	**684.8**	**666.9**	**761.0**	**843.0**	**931.7**	**1 040.2**
Percentage of GDP	*30.1%*	*29.5%*	*27.2%*	*28.4%*	*28.7%*	*28.9%*	*29.1%*
Expenditure	**591.3**	**711.7**	**832.5**	**904.1**	**977.2**	**1 059.1**	**1 154.2**
Percentage of GDP	*28.4%*	*30.7%*	*33.9%*	*33.7%*	*33.3%*	*32.8%*	*32.3%*
Budget balance	**34.4**	**-26.8**	**-165.6**	**-143.1**	**-134.2**	**-127.4**	**-114.0**
Percentage of GDP	*1.7%*	*-1.2%*	*-6.7%*	*-5.3%*	*-4.6%*	*-3.9%*	*-3.2%*

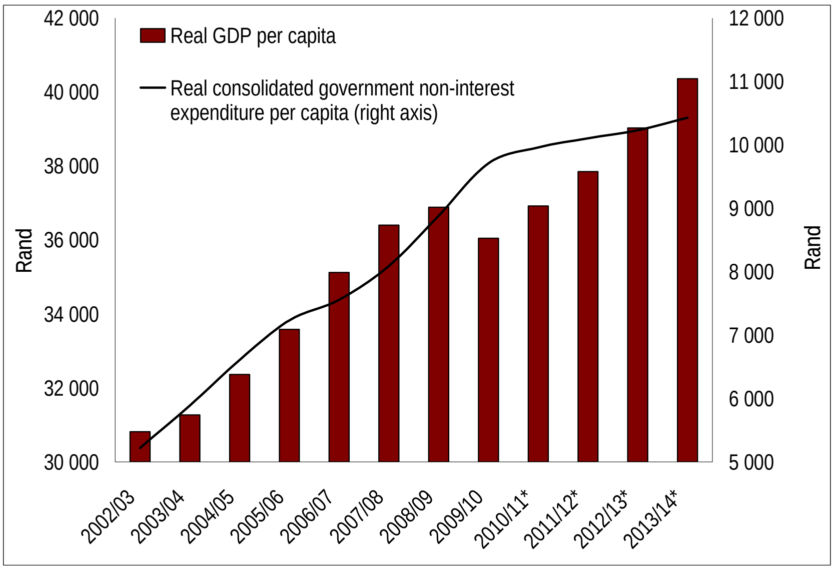
Public-sector capital infrastructure programmes will continue to provide stimulus to the economy over the medium term. Borrowing by the state-owned enterprises to finance these investments will keep the public-sector borrowing requirement at an elevated level.

Countercyclical fiscal policy

Over the next three years, the pace of growth in government spending will moderate

Government spending has supported the economy through the recession, and continues to do so into the recovery. Figure 3.1 below shows how real government non-interest expenditure per South African grew leading up to and during the economic crisis. Over the next three years, as the economy grows, the pace of government spending growth will moderate in a countercyclical fashion.

Figure 3.1 GDP and consolidated government non-interest expenditure per capita, 2002/03 – 2013/14



**2010/11 – 2013/14 are based on forecasts.*

Government is obliged to ensure that the fiscus is sustainable so that future priorities can be afforded

In addition to financing current expenditure, government is obliged to ensure that the fiscus can sustainably finance future priorities. Countercyclical fiscal policy assists in defining a sustainable fiscal path in two ways: by ensuring that expenditure that seems affordable when the economy is overperforming remains affordable during a recession; and by encouraging a growth-friendly environment with low inflation, a low cost of capital and a competitive real exchange rate.

Aligning fiscal policy to support economic growth

There is considerable international debate over how rapidly governments should reduce the large fiscal deficits that have emerged over the past two years. Some economists argue that deep budget cuts will retard the global recovery. Others maintain that austerity is needed to steady economies that have spent too freely.

This fiscal debate has been framed by weak economic recoveries in the United States and Europe. The US deficit is expected to remain above 10 per cent of GDP next year, and debt is likely to grow to about 85 per cent of GDP by 2035. The average debt of major European economies is expected to reach 95 per cent of GDP by 2014.

Economist Paul Krugman has criticised developed-country efforts to cut spending at a time when the global economy is still recovering. He argues that many industrialised countries continue to require fiscal stimulus and that premature consolidation will undermine global growth.

By contrast, Alberto Alesina of Harvard University argues that budget cuts can boost growth when fiscal sustainability is in question. Economic historian Niall Ferguson says that the slow US recovery is due partly to high deficits, and that fiscal consolidation now will reduce the need for harsher budget cuts in future.

South Africa's countercyclical policy is designed to steady the economy and to protect core social and economic programmes from undue volatility. In practice, a government pursuing countercyclical policy should save revenue (run a surplus) during good times in order to spend more (run a deficit) when the economy is faltering. This approach moderates the impact of the business cycle and raises long-term growth. As the economy's growth rate increases, the rate of growth in government spending needs to slow.

While the higher fiscal deficit was the appropriate countercyclical response during the downturn, government will have to reduce the level of borrowing in the years ahead. As the economy recovers, government will tighten its stance to avoid pushing up interest rates and crowding out private-sector investment.

Revenue, expenditure, the deficit and debt management

Over the next three years, the fiscal stance targets a combination of revenue and expenditure that will enable government to pay for existing programmes while reinforcing the sustainability of the public finances. The main features include:

- Higher GDP growth and reduced inflation
- A recovery in tax revenue from 24.4 per cent of GDP in 2009/10 to 26.4 per cent of GDP by 2013/14
- A moderation in the real growth of non-interest expenditure and a reduction in the proportion of expenditure to GDP over the medium-term expenditure framework (MTEF)
- A rise in government debt-service costs from 7.5 per cent of expenditure in 2010/11 to 9.6 per cent by 2013/14.

Expenditure

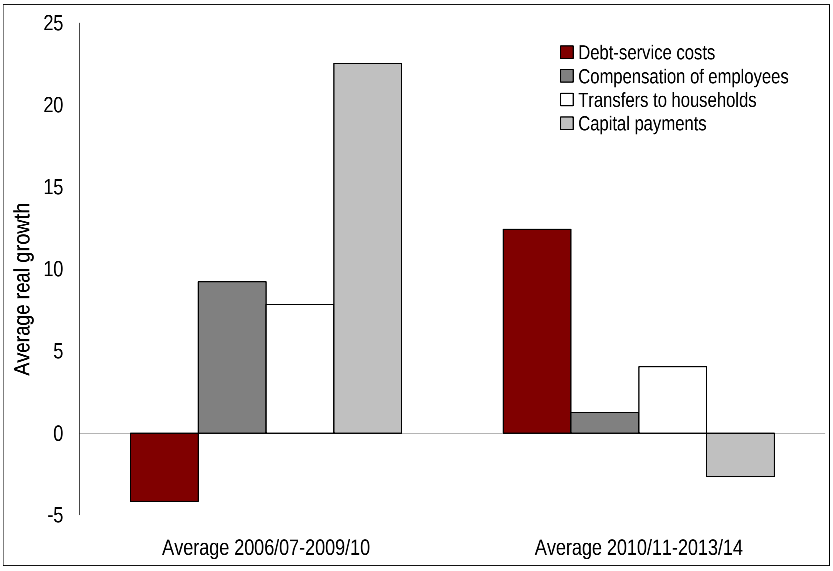
The proposed fiscal framework makes R977.2 billion available for spending next year. In real per capita terms, this represents a doubling of the resources available to the fiscus over the past eight years.

Fiscal framework makes R977.2 billion available for spending next year

Figure 3.2 shows how declining debt-service costs in the years preceding the downturn created the fiscal space for government to expand investment, social grants and public-sector employment. As revenue fell during the recession, the fiscus required higher levels of borrowing, resulting in a marked increase in debt-service costs for the period ahead.

Over the medium term, the higher costs of servicing debt crowd out growth in non-interest expenditure. Without a moderation in government spending, budgets will continue to be financed through borrowing instead of tax revenue, leading eventually to further reductions in the growth of non-interest expenditure and a rising debt burden to be borne by South Africans in the years ahead.

Figure 3.2 Real growth in expenditure, 2006/07 – 2013/14



Fiscal framework adds R89.1 billion to expenditure over the MTEF period

The fiscal framework adds R17.9 billion to expenditure in 2011/12, R28 billion in 2012/13 and R43.2 billion in 2013/14, resulting in average real growth of 2.7 per cent in government non-interest spending over the next three years. Since 2005/06 government has increased spending in education and health by 50 per cent in real terms.

Government recognises the need to improve the efficiency of public expenditure. This core fiscal objective is even more important as spending growth moderates over the medium term. The large-scale increase in public expenditure over the past decade needs to be matched by better public services. Over the MTEF period, government departments will be called on to prioritise effective programmes, while curtailing or withdrawing ineffective activities. Guided by government's 12 outcome priorities, the focus will be on improving public education and health, and investing in infrastructure that supports economic development and service delivery.

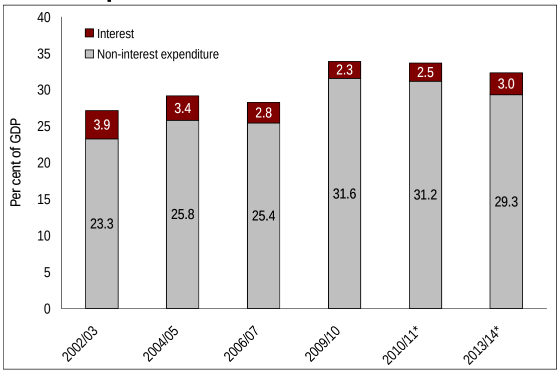
South Africa needs to keep consumption expenditure within sustainable limits

Within the proposed expenditure envelope, government will also need to assess the trade-off between consumption expenditure and investments that support higher growth and improved front-line service delivery. Expenditure on compensation lays claim to 40 per cent of tax revenue. Should wage growth continue to accelerate in excess of revenue growth, the sustainability of government employment, investment and other goods and services will be undermined. The proposed fiscal framework makes provision for average annual growth in compensation of 6.3 per cent.

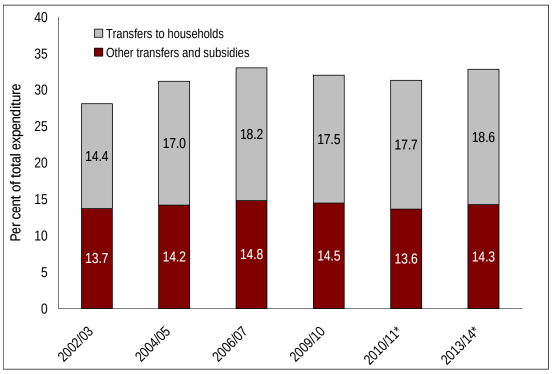
An appropriately balanced composition of expenditure is important, both for the effectiveness of public-service delivery, and its potential effects on inflation and potential growth. Disproportionate wage increases unrelated to productivity trends in the wider economy – and at the expense of capital and investment spending – would retard growth and employment through labour-market mismatches and rising production costs.

Figure 3.3 Consolidated government expenditure, 2002/03 – 2013/14

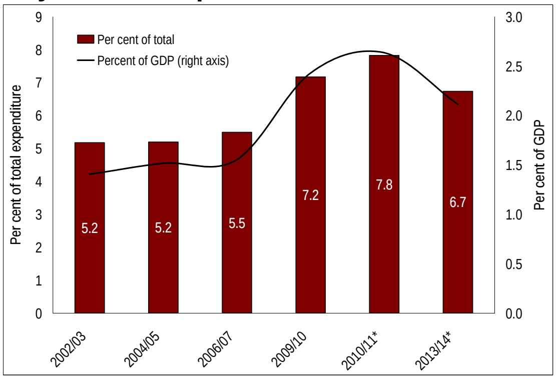
Total expenditure



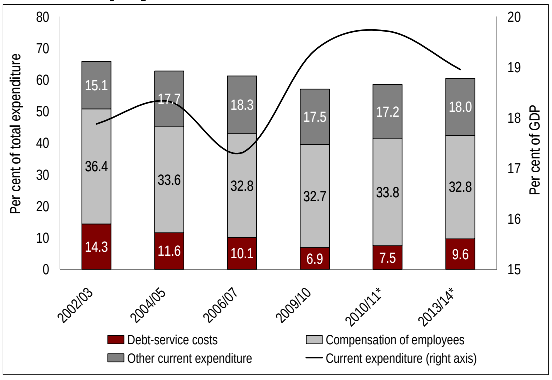
Transfers and subsidies



Payment for capital assets



Current payments



**2010/11 – 2013/14 are based on forecasts.*

Since 2002/03, government spending on capital has increased from 5.2 per cent of total spending to 7.8 per cent in 2010/11. Capital expenditure, however, continues to underperform budgeted amounts, with an estimated R12.9 billion of capital underspending by provincial and local government in 2009/10. Over the next three years, the rate of capital expenditure will slow moderately as higher interest payments, wage pressures and growth in social grants claim a greater share of expenditure.

Table 3.2 General government capital expenditure[1] preliminary outcome, 2009/10

R billion	Adjusted budget	Outcome	Deviation	% over/ underspending
National	8.2	8.7	0.5	*6.2%*
Provincial	24.0	21.4	-2.6	*-10.9%*
Municipalities	49.9	39.6	-10.3	*-20.7%*
Total	**82.1**	**69.7**	**-12.4**	***-15.1%***

1. Capital expenditure includes goods that will be used in more that one reporting period. This includes buildings and other fixed structures, machinery, equipment, heritage assets and biological assets.

Infrastructure expenditure includes spending on new buildings and fixed structures, as well as the maintenance and rehabilitation of existing structures. Table 3.3 shows the public-sector infrastructure expenditure estimates by sector over the MTEF period.

Addressing government's capacity to better plan and implement infrastructure projects is a priority

Over the next three years, provinces and municipalities will account for 75 per cent of general government's infrastructure spending, with R287.8 billion being spent mainly on health and education infrastructure, roads and public transport. Municipalities are expected to spend R137.8 billion on infrastructure over the period ahead. A number of projects at municipal level have been postponed owing to pressure on income from household rates and taxes. Addressing government's capacity to better plan and implement infrastructure projects is a priority over the medium term.

R428 billion to be spent on infrastructure over MTEF period by non-financial public enterprises

Looking more broadly at the public sector, the need for improved economic infrastructure in transport and energy continues to sustain the capital programme of non-financial public enterprises. Between 2011/12 and 2013/14, these enterprises are expected to spend R428 billion on infrastructure. Eskom projects will extend electricity generation, transmission and distribution in line with the country's present and future energy requirements. Upgrades and expansion by Transnet will improve the capacity of South Africa's railways and ports.

Table 3.3 shows that over the medium term, public-sector infrastructure spending totals R811.2 billion, increasing at an annual average of 4.7 per cent. In total, public-sector infrastructure expenditure is projected to have increased from 4.6 per cent of GDP in 2006/07 to an average of 8.4 per cent over the next three years.

Table 3.3 Public-sector infrastructure expenditure estimates by sector, 2010/11 – 2013/14

R billion	2010/11	2011/12	2012/13	2013/14	MTEF total	*% of total*
Economic services	**212.9**	**226.8**	**227.9**	**238.1**	**692.8**	***85.4%***
Energy	95.6	107.2	106.7	113.3	327.1	*40.3%*
Water and sanitation	24.1	30.5	27.3	29.4	87.1	*10.7%*
Transport and logistics	74.4	68.9	70.8	72.3	212.0	*26.1%*
Other economic services[1]	18.8	20.2	23.2	23.2	66.6	*8.2%*
Social services	**25.5**	**27.9**	**29.5**	**32.3**	**89.7**	***11.1%***
Health	9.4	9.9	10.3	10.4	30.7	*3.8%*
Education	7.6	8.9	10.6	13.2	32.6	*4.0%*
Other social services[2]	8.4	9.1	8.6	8.6	26.4	*3.3%*
Justice and protection services	**3.8**	**4.1**	**5.5**	**6.7**	**16.3**	***2.0%***
Central government and administration services	**2.6**	**4.3**	**4.9**	**3.2**	**12.4**	***1.5%***
Total	**244.7**	**263.0**	**267.8**	**280.3**	**811.2**	***100.0%***
Percentage of GDP	*9.1%*	*9.0%*	*8.3%*	*7.9%*		

1. Other economic services includes agriculture and environmental infrastructure, telecommunications and industrial development zones.

2. Other social services includes labour centres, heritage institutions, national libraries and community facilities.

Development finance institutions

Government has challenged its development finance institutions to play a more active role in contributing to economic growth. They will focus on supporting investment, with emphasis on emerging and expanding businesses, agrarian and land reform, infrastructure development and access to affordable housing.

The National Treasury has increased the lending capacity of the Development Bank of Southern Africa (DBSA) to step up provision and maintenance of municipal infrastructure, and facilities for social services. There is a growing realisation that South Africa's economic success also depends on growth in the region, and the DBSA is looking for ways to expand its activities in the Southern African Development Community.

Government has directed the Industrial Development Corporation to use its balance sheet to help distressed companies stem job losses resulting from the recession. In addition, government allocated R400 million during 2010/11 to rejuvenate the clothing and textiles sector.

The state has also strengthened the balance sheet of the Land Bank, with a R3.5 billion capital injection over the next three years to restore investor confidence and support emerging farmers. The National Housing Finance Corporation has for the first time secured international funds from multilateral agencies for low-cost housing development, relieving domestic credit demand.

Revenue

Tax revenue is the largest source of budget revenue. When the economy is underperforming, tax revenue tends to perform poorly; when the economy is doing well, tax revenue tends to perform above expectations. Countercyclical fiscal policy takes account of this natural oscillation.

Cyclical boost contributes to a strong recovery in revenue in 2010/11

Over the medium term, tax revenue is projected to recover in line with economic growth. Given the pronounced decline in revenue during the recession, it is expected that the recovery in 2010/11, coming off a low base, will be strong. This projection reflects cyclical effects, rather than a permanent or structural increase in the size of the tax base. Between 2011/12 and 2013/14, growth in tax revenue is expected to be broadly in line with economic growth.

Table 3.4 Consolidated government revenue, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
R million		Outcome		Estimate		Medium-term estimates	
Tax revenue	**572.8**	**625.1**	**598.7**	**679.2**	**751.4**	**840.1**	**943.8**
Percentage of GDP	*27.5%*	*26.9%*	*24.4%*	*25.3%*	*25.6%*	*26.0%*	*26.4%*
Non-tax revenue[1]	11.7	12.6	9.5	12.3	13.4	14.8	16.4
Estimate of SACU payments[2]	-24.7	-28.9	-27.9	-15.0	-20.5	-31.1	-34.5
Other adjustment[3]	–	–	–	-2.9	–	–	–
Provinces, social security funds and selected public entities	65.9	76.0	86.6	87.4	98.7	107.9	114.4
Budget revenue	**625.7**	**684.8**	**666.9**	**761.0**	**843.0**	**931.7**	**1 040.2**
Percentage of GDP	*30.1%*	*29.5%*	*27.2%*	*28.4%*	*28.7%*	*28.9%*	*29.1%*

1. *Includes mineral and petroleum royalties, mining leases and departmental revenue.*
2. *Estimates are based on National Treasury projections. Actual payment will be determined by outcomes of customs and excise revenue collections in line with the revenue-sharing formula contained in the SACU agreement.*
3. *Payment to SACU partners in respect of a previous error in calculation of the 1969 agreement.*

Over the longer term tax revenue must grow to finance spending commitments. This will require broadening of the tax base, driven by economic growth, higher employment and improved compliance. If the current mix of tax instruments cannot provide sufficient resources, changes to tax policy, including higher taxes, will need to be considered.

Transfers to South Africa's Southern African Customs Union (SACU) partners represent a large claim on customs and excise revenue. In 2010/11 and 2011/12, transfers to SACU partners will be low by historical comparisons due to adjustments for overpayments in 2008/09 and 2009/10. SACU transfers will continue to grow over the medium term in line with imports and consumption. The SACU revenue-sharing formula is being reviewed. This will in due course affect the level of payments from South Africa to its partners.

Fiscal deficit

Over the long term, government will reduce debt stock as percentage of GDP

Government will maintain an appropriate level of short-term stimulus and move deliberately to reduce public debt to sustainable levels over the medium term. The combination of targeted growth in spending and improving revenue will result in a measured decline in the borrowing requirement. Over the longer term, fiscal policy aims to rebuild fiscal space to allow government to provide stimulus during the next downturn.

The National Treasury estimates that debt stock will stabilise at about 40 per cent of GDP in 2015/16. The actual outcome will depend largely on the pace of economic growth. The probability of debt stock breaching 50 per cent of GDP remains relatively low. While this illustrates the underlying strength of the fiscus, it also highlights the constraining effects of high fiscal deficits and lower GDP growth on future expenditure.

The structural budget balance strips out cyclical revenue to provide an estimate of what the budget deficit would be if the economy was performing at its long-term potential growth rate. The balance is calculated by subtracting estimated structural expenditure from structural revenue.

Structural budget deficit is estimated to be 4.1 per cent in the current year

After removing the effects of the economic cycle on revenue, consolidated structural budget revenue in 2010/11 is about 29 per cent of GDP, resulting in a structural budget deficit of about 4.1 per cent of GDP. Over the next three years, improvements in potential GDP growth will lead to a gradual rise in structural revenue. In combination with moderate growth in spending, this will lead to the structural budget deficit improving to 3 per cent of GDP by 2013/14. The relatively large structural budget deficit over the period underlines the need for economic reforms to improve growth potential and place the fiscus on a more sustainable long-term foundation.

Funding strategy

South Africa continues to enjoy strong capital inflows, reflecting confidence in the economy and the management of public finances.

Table 3.5 Total government debt, 2007/08 – 2013/14

As at 31 March	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
R billion		Outcome		Estimate		Medium-term estimates	
Domestic debt							
Gross loan debt[1]	480.8	529.7	705.5	880.9	1 045.2	1 211.6	1 356.0
Less: cash balance	93.8	101.3	106.6	107.2	107.2	107.2	107.2
Net loan debt[2]	387.0	428.4	598.9	773.8	938.0	1 104.4	1 248.8
Foreign							
Gross loan debt[1]	96.2	97.3	99.5	96.7	104.4	107.7	104.4
Less: cash balance	–	–	25.2	45.3	56.5	51.5	37.8
Net loan debt[2]	96.2	97.3	74.3	51.4	47.9	56.2	66.6
Total gross loan debt	**577.0**	**627.0**	**804.9**	**977.6**	**1 149.6**	**1 319.3**	**1 460.4**
Total net loan debt	**483.2**	**525.6**	**673.2**	**825.2**	**985.9**	**1 160.6**	**1 315.4**
As percentage of GDP :							
Total gross loan debt	*27.7*	*27.0*	*32.8*	*36.4*	*39.2*	*40.9*	*40.9*
Total net loan debt	*23.2*	*22.6*	*27.4*	*30.7*	*33.6*	*36.0*	*36.9*
As percentage of total gross loan debt:							
Foreign gross loan debt	*16.7*	*15.5*	*12.4*	*9.9*	*9.1*	*8.2*	*7.2*

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).

The surge of capital inflows to emerging markets provides a window of opportunity to lower external vulnerability by reducing government's foreign debt through the purchase of foreign currency at attractive rates in the domestic market. This will also assist in moderating exchange rate strength. National government borrowing provides for the continued purchase of foreign currency as pre-funding to meet future currency commitments. This will be financed from cash reserves and borrowing.

Table 3.6 Main budget net borrowing requirement and financing, 2009/10 – 2013/14

	2009/10	2010/11		2011/12	2012/13	2013/14
R million	Outcome	Budget	Revised		Medium-term estimates	
Main budget balance	**-166 878**	**-174 904**	**-142 105**	**-146 239**	**-145 345**	**-130 804**
Extraordinary payments	-671	–	-572	-120	–	–
Extraordinary receipts	6 435	–	2 450	50	–	–
Borrowing requirement (-)	**-161 114**	**-174 904**	**-140 227**	**-146 309**	**-145 345**	**-130 804**
Domestic short-term loans (net)	**49 770**	**22 000**	**22 000**	**20 000**	**20 000**	**19 000**
Domestic long-term loans (net)	**118 856**	**137 740**	**137 740**	**129 136**	**120 234**	**102 802**
Market loans	132 395	151 344	151 344	142 677	142 950	133 500
Redemptions[1]	-13 539	-13 604	-13 604	-13 541	-22 716	-30 698
Foreign loans (net)	**23 258**	**11 564**	**-2 431**	**4 810**	**-3 467**	**-8 281**
Market loans	30 873	14 439	–	7 580	8 080	8 500
Arms procurement loan agreements	800	352	352	511	38	–
Redemptions (including revaluation of loans)	-8 415	-3 227	-2 783	-3 281	-11 585	-16 781
Change in cash and other balances[2]	**-30 770**	**3 600**	**-17 082**	**-7 637**	**8 578**	**17 283**
Rand	-5 594	3 600	2 993	3 600	3 600	3 600
Foreign currency	-25 176	–	-20 075	-11 237	4 978	13 683
Financing	**161 114**	**174 904**	**140 227**	**146 309**	**145 345**	**130 804**

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

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

Domestic borrowing is projected to remain in line with projections set out in 2010 Budget

Supported by deep and liquid domestic markets, domestic borrowing remains government's primary source of funding. Over the medium term, domestic borrowing is projected to remain in line with levels set out in the 2010 Budget, using a combination of treasury bills, fixed-income and inflation-linked bonds as financing instruments. A limited amount will be borrowed in international markets, primarily to maintain benchmarks in major currencies.

Public-sector borrowing requirement

The public-sector borrowing requirement represents the funds needed by the public sector to cover any deficit in financing its own activities.

Table 3.7 Public-sector borrowing requirement,[1] 2009/10 – 2013/14

	2009/10	2010/11		2011/12	2012/13	2013/14
R billion	Outcome	Budget	Revised	Medium-term estimates		
Main budget balance	**166.9**	**174.9**	**142.1**	**146.2**	**145.3**	**130.8**
Extraordinary payments	0.7	–	0.6	0.1	–	–
Extraordinary receipts	-6.4	–	-2.5	-0.1	–	–
Borrowing requirement	**161.1**	**174.9**	**140.2**	**146.3**	**145.3**	**130.8**
Other government borrowing[2]	14.8	7.2	10.7	-2.4	-6.6	-5.7
General government borrowing	**175.9**	**182.1**	**151.0**	**143.9**	**138.8**	**125.1**
Percentage of GDP	*7.2%*	*6.7%*	*5.6%*	*4.9%*	*4.3%*	*3.5%*
Plus: Non-financial public enterprises	45.3	117.4	121.0	124.9	108.6	93.1
Public sector borrowing requirement	**221.3**	**299.5**	**272.0**	**268.8**	**247.4**	**218.2**
Percentage of GDP	*9.0%*	*11.1%*	*10.1%*	*9.2%*	*7.7%*	*6.1%*

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

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

The total public-sector borrowing requirement continues to be higher than total borrowing by general government, reflecting the capital expenditure programmes of the non-financial public enterprises. The public-sector borrowing requirement is expected to be 10.1 per cent of GDP in 2010/11 and declines to 6.1 per cent in 2013/14. Borrowing by the non-financial public enterprises, such as Transnet and Eskom, will continue to support their capital programmes. Both public enterprises and development finance institutions need to operate on a financially sustainable basis.

Conclusion

By consolidating the fiscal position, South Africa will be well placed for future opportunities

South Africa responded to the recession by maintaining social expenditure and continuing to invest in infrastructure, providing a stimulus to economic activity. With a decline in revenue, government raised its borrowing level, bringing the fiscal position from a deficit of 1.2 per cent of GDP in 2008/09 to a deficit of 6.7 per cent of GDP in 2009/10. This was an appropriate response to the economic crisis. As the economy recovers, government will reduce the budget deficit in line with stronger economic growth. By consolidating the fiscal position over the medium term, South Africa will be well placed to take advantage of future growth opportunities.

4

Medium-term expenditure framework and division of revenue

Budgeting for outcomes

The medium-term expenditure framework (MTEF) reflects public-service delivery commitments, informed by an agreed set of development and transformation goals. As outlined in Chapter 1, the central goals of government's development strategy are organised around 12 outcomes and elaborated in delivery agreements, with priority given to education, health, infrastructure development and job creation.

Spending focuses on education, health, infrastructure and job creation

The proposed framework for the 2011 Budget gives effect to these spending priorities, and reflects government's determination to achieve better value for money and improved performance in public-service delivery. Substantial additions to departmental baseline allocations are proposed, but growth in expenditure remains moderate, in line with the fiscal policy framework set out in Chapter 3. Initiatives to improve spending discipline, and to reorganise public administration to reduce management deficiencies, are central to the transformation challenge.

Initiatives to improve spending discipline and management

In making strategic choices over the medium term, government will focus on those outcomes with the greatest potential impact on economic growth and development:

- Enhancing the quality of basic education and skills development
- Improving the quality of health care and health infrastructure
- Investing in new infrastructure and proper maintenance of economic infrastructure networks
- Accelerating the creation of jobs.

Additional support for agrarian reform, industrial development and the fight against crime

Significant reforms are also envisaged in supporting the proposed growth path. Government plans to increase support for land and agrarian reform to reduce inequality, boost food production and provide assistance to newly settled farmers. The fight against crime will continue to be prioritised, as will the integration process within the criminal justice system. Support for industrial development gives effect to the revised industrial policy action plan. Housing delivery will be better coordinated and synchronised with the delivery of related community services.

Value for money in public expenditure

Government's outcomes approach provides a framework for enhanced monitoring of service delivery, including guidelines for results-driven performance that form the basis of ministerial performance agreements and the related delivery agreements.

Improving performance is not only about better planning and prioritisation. Increasing capacity to deliver quality services also involves putting existing resources to work with greater efficiency. Progress on the outcomes should reflect, at a minimum, growth in the associated expenditure, with results evident in improved quality of frontline services.

Wasteful and inefficient patterns of organisation and use of resources must be rooted out

To achieve greater efficiency in public services over the MTEF, wasteful patterns of organisation and use of resources must be reversed:

- The balance between administrative and service delivery capacity is a specific focus of budgetary planning for the period ahead, especially in health and education departments, and in the protection services. Excessive or inefficient administrative capacity characterises too many departments and agencies.
- Funds set aside for training or skills development remain unspent in many departments. A new initiative is needed to ensure that effective training programmes are in place across the public service.
- During 2009/10, some R12.4 billion budgeted for capital projects was unspent. Government is adopting a new approach to budgeting and planning for major projects, together with dedicated technical support for underspending departments, agencies and municipalities.
- There has been a proliferation of quasi-independent agencies, regulatory bodies and special-purpose service delivery entities over the past decade. Non-departmental agencies and accounts will come under comprehensive scrutiny over the period ahead, with special focus on staff establishments, remuneration, governance and functional mandates.
- Procurement of goods and services and supply chain management, even when compliant with regulations, are frequently neither competitive nor transparent. Under the guidance of an interdepartmental team, strengthened capacity is in place to deal with wrongdoing. Improved rules and procedures to ensure transparency throughout the supply chain process will be phased in.
- Information technology systems and management of consulting services will be subject to additional scrutiny within the supply chain regulatory framework.

South Africa needs a culture of responsible stewardship of public resources geared towards obtaining better-quality frontline services for every rand spent.

Revised spending baselines

Parliamentary budget review reports require effective departmental reporting

Government's budget process is undergoing reform, shaped in part by the Money Bills Amendment Procedure and Related Matters Act (2009), which creates a procedure through which changes to appropriations may be considered in Parliament. A key step in this is the compilation by portfolio committees of "budget review and recommendation reports", which in turn require effective reporting by departments on their service delivery and expenditure performance. In support of improved planning and reporting, the National Treasury has issued a new *Framework for Strategic Plans and Annual Performance Plans,* applicable to national and provincial departments and public entities.

In planning the 2011 MTEF, the National Treasury has extended the scope of expenditure reviews beyond departments to include agencies and accounts in the broader consolidated government category. These reviews have been organised by function across national, provincial and local government, facilitating more effective comparison of allocations with service-delivery trends, and focused assessment of both reprioritisation and spending proposals.

Baselines are increased by R67 billion over the MTEF period

Revised baseline allocations have been prepared taking into account the carry-through costs of the 2010 salary improvements, higher costs of municipal rates and service charges, identified savings and reprioritisation proposals, and necessary adjustments to baseline spending estimates. The overall impact of these adjustments is an increase of R7.3 billion in 2010/11 and R67 billion over the next three years. The projected fiscal framework provides for further increases of R22.1 billion over the MTEF period, currently unallocated and set aside for policy priorities: education, health, infrastructure and job creation.

Revisions to the 2010/11 appropriations and spending estimates are summarised below. The 2011 MTEF proposals provide for average growth in expenditure over the three-year framework of 8.5 per cent a year.

2009/10 outcomes and 2010/11 mid-year estimates

Expenditure on national votes (including transfers to provinces) amounted to R747.2 billion in 2009/10

Details of the 2009/10 expenditure outcomes and estimates for the first half of the current financial year for national votes and provinces are set out in Annexure A. Expenditure on national votes (including transfers to provinces) amounted to R747.2 billion in 2009/10, out of a total adjusted appropriation of R755.5 billion. Provincial expenditure amounted to R305.5 billion, compared with the 2009/10 adjusted budget total of R303.9 billion.

Expenditure on national votes in the first six months of 2010/11 amounted to R394.4 billion or 48.3 per cent of the adjusted appropriation for the year, and R26.4 billion more than the spending total for the equivalent period of 2009/10. Expenditure by provinces amounted to R152.6 billion in the first half of 2010/11 or 46 per cent of the main appropriation for the year, and R7.3 billion more than that of last year. The national adjusted budget is tabled alongside the *Medium Term Budget Policy Statement.* Revised provincial appropriations will be tabled in provincial legislatures before the end of the financial year. Major adjustments to expenditure are presented in the box below.

Revised national expenditure estimates, 2010/11

The Adjustments Appropriation Bill and the Division of Revenue Amendment Bill deal with necessary amendments in the current financial year. The bills propose the following changes:

- R1.8 billion in rollovers arising from commitments related to unspent balances in 2009/10
- R2.3 billion to cover higher remuneration costs in national departments
- R320 million for occupation-specific dispensation salary adjustments in the Department of Justice and Constitutional Development, the National Prosecuting Authority and Legal Aid South Africa
- R363.4 million for unforeseeable and unavoidable expenditure associated with natural disasters and the outbreak of disease
- R100 million to scale up HIV and Aids prevention
- R200 million for the South African National Defence Force for activities during the 2010 World Cup
- R181.3 million for contractual penalties incurred by Denel Saab Aerostructures
- R396.3 million refunded to various departments for monies paid directly into the National Revenue Fund from department-specific activities.

Revised provincial allocations

- R4.2 billion is added to the provincial equitable share, including R3.8 billion for higher salary and housing allowance costs
- R350 million to cover the cost of occupation-specific dispensation agreements in health
- R31.3 million to the *FET colleges grant* to cover the cost of the wage agreements
- R214.4 million to the *provincial infrastructure disaster relief grant* for repair of flood-damaged roads, and R50 million is added to the *drought relief grant* to provide feed to distressed farmers
- R769 million to the *devolution of property rate funds grant* to provinces
- Of the R100 million added for HIV and Aids prevention, R40 million goes to the *comprehensive HIV and Aids grant to provinces* to increase male circumcision services
- The Department of Human Settlements has shifted R15 million to the *human settlement development grant* for community outreach programmes.

Revised local government allocations

- Of the R1.8 billion in rollovers, R391 million is added to the local government equitable share to allow the rollover of funds previously held back due to unspent conditional grants
- R92 million for drought relief to the Mossel Bay municipality
- R10 million to rollovers on the *water services operating subsidy grants*.

Taking into account projected underspending, savings declared by departments and the adjusted state debt cost estimate, the revised estimate of total expenditure in 2010/11 is R815.7 billion. In February 2010 at the tabling of the budget, provision was made for expenditure of R818.1 billion for 2010/11.

Medium-term spending estimates

Baseline estimates reflect strong growth in allocations for transport, housing, water supply and policing

Table 4.1 sets out the 2011 Budget consolidated expenditure framework, classified by function and economic category. These are revised baseline estimates that do not take account of policy-related spending proposals under consideration. The baseline estimates reflect current spending priorities: education, social protection, transport and health services take up the largest shares of planned expenditure, while strong growth is shown in housing, water supply, police services and law courts.

Table 4.1 Consolidated government expenditure, 2009/10 – 2013/14

R billion	2009/10 Outcome	2010/11 Revised	2011/12	2012/13 Medium-term estimates	2013/14	Average annual growth 2010/11 – 2013/14
Type of service						
General public services	**43.2**	**46.7**	**48.0**	**49.0**	**52.9**	**4.2%**
Defence	**36.4**	**35.7**	**40.6**	**43.6**	**46.2**	**8.9%**
Public order and safety	**77.9**	**86.8**	**94.2**	**101.6**	**108.2**	**7.6%**
Police services	51.5	57.4	62.6	66.8	71.3	7.5%
Law courts	12.0	13.3	14.3	16.0	17.0	8.4%
Prisons	14.4	16.1	17.3	18.8	19.9	7.4%
Economic affairs	**122.1**	**128.4**	**132.1**	**137.7**	**146.3**	**4.4%**
General economic, commercial and labour affairs	15.6	15.4	16.6	16.4	17.3	4.0%
Agriculture, forestry, fishing and hunting	15.2	16.8	18.0	19.1	20.2	6.3%
Fuel and energy	8.3	8.8	9.3	9.5	10.1	4.9%
Transport	64.0	68.1	67.5	71.2	75.8	3.6%
Economic affairs not elsewhere classified	19.0	19.3	20.7	21.5	22.8	5.6%
Environmental protection	**4.9**	**5.7**	**6.2**	**6.8**	**6.6**	**5.0%**
Housing and community amenities	**82.9**	**97.4**	**110.1**	**120.0**	**127.8**	**9.5%**
Housing and community development	56.1	68.6	77.5	83.5	89.3	9.2%
Water supply	26.8	28.8	32.7	36.5	38.5	10.2%
Health	**91.4**	**101.9**	**111.4**	**119.0**	**127.1**	**7.6%**
Recreation and culture	**7.7**	**6.4**	**6.0**	**6.4**	**6.7**	**1.6%**
Education	**156.1**	**173.2**	**190.7**	**201.7**	**215.8**	**7.6%**
Social protection	**122.9**	**134.2**	**148.4**	**161.7**	**174.2**	**9.1%**
Allocated expenditure	**745.4**	**816.5**	**887.8**	**947.3**	**1 011.7**	**7.4%**
State debt cost	57.1	67.6	78.9	93.1	107.5	16.7%
Eskom loan	30.0	20.0	–	–	–	
Contingency and policy reserve	–	–	10.4	18.7	35.0	
Consolidated expenditure[1]	**832.5**	**904.1**	**977.2**	**1 059.1**	**1 154.2**	**8.5%**
Economic classification						
Current payments	**474.7**	**529.1**	**581.0**	**629.1**	**676.4**	**8.5%**
Compensation of employees	271.9	305.6	328.9	346.9	367.2	6.3%
Goods and services	140.2	149.5	165.7	180.5	192.6	8.8%
Interest and rent on land	62.6	74.0	86.4	101.7	116.6	16.4%
of which: state debt cost	*57.1*	*67.6*	*78.9*	*93.1*	*107.5*	*16.7%*
Transfers and subsidies	**266.4**	**283.0**	**317.0**	**342.2**	**367.3**	**9.1%**
Municipalities	54.1	63.7	71.5	78.5	83.8	9.5%
Departmental agencies and accounts	24.5	16.7	22.3	22.2	24.5	13.7%
Universities and technikons	15.6	17.8	19.6	21.0	22.1	7.5%
Foreign governments and international organisations	2.0	1.8	2.2	2.2	2.5	11.6%
Public corporations and private enterprises	24.3	23.1	23.5	25.2	26.7	4.9%
Nonprofit institutions	18.5	20.0	21.9	23.2	24.5	7.0%
Households	127.4	139.9	156.0	169.9	183.2	9.4%
Payments for capital assets	**59.7**	**70.8**	**68.0**	**69.0**	**75.4**	**2.1%**
Buildings and other capital assets	45.5	54.6	52.4	53.3	59.2	2.7%
Machinery and equipment	67.7	69.1	88.0	100.9	107.7	15.9%
Payments for financial assets	**31.7**	**21.2**	**0.8**	**0.0**	**0.0**	
Total	**832.5**	**904.1**	**966.8**	**1 040.4**	**1 119.2**	**7.4%**
Contingency and policy reserve	–	–	10.4	18.7	35.0	
Consolidated expenditure[1]	**832.5**	**904.1**	**977.2**	**1 059.1**	**1 154.2**	**8.5%**

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

The consolidated framework makes provision for an unallocated contingency reserve, including R22.1 billion over the MTEF period as a policy reserve. Education and health care are likely to receive additional support as spending plans are finalised. Government also proposes to give specific consideration to job creation for young people seeking work. An administrative capacity will be established to consider proposals for innovative youth employment projects submitted outside of the normal annual budget cycle, and to respond promptly to sound business plans.

Education and skills development

University and further education enrolment need to be increased

The challenges facing the education system include substantial backlogs in buildings and facilities, an insufficient number of fully qualified teachers, poor school management and high absenteeism among students. University and further education enrolment need to be expanded given that available skills training programmes do not meet the economy's needs.

National assessments in literacy and numeracy for all grade 3 and 6 learners will be conducted as part of a long-term exercise to benchmark and raise educational levels. Learner workbooks and teacher lesson plans for literacy and numeracy for grades R to 6 will also be provided, and at the beginning of the 2011 academic year some 6.6 million learners and 125 000 teachers will be equipped with new learning and teaching materials.

National employment initiative: youth jobs funding

Young South Africans face long delays and considerable difficulties in finding work. Half of all 18-24 year-olds are unemployed, and the probability of a young work-seeker without a tertiary qualification finding a job within a year is just 25 per cent.

Expanded further education and training capacity is required, and will be prioritised over the period ahead. Potential for job creation in both the public and private sectors needs to be tapped. To encourage youth employment in the business and non-governmental sector, an incentive operating through the tax system was proposed in the 2010 Budget. This would complement direct employment initiatives supported through the expanded public works programme.

To encourage innovative proposals and to make rapid progress in meeting this challenge, government will establish capacity to assess proposals for youth employment projects. Funds will be set aside for such projects over the MTEF period, to be appropriated either in the main budget or subsequent adjustments. Projects will be favoured that provide young people with work experience in public service or community development, on-the-job and vocational training, and job-search assistance.

The emphasis will be on piloting job creation projects, with monitoring and evaluation to determine effectiveness. Projects that demonstrate potential for significant cost-effective job creation will receive support to be taken to scale and implemented nationally. Efficacy of service delivery and sustainable, cost-effective job creation will serve as allocation criteria. The preliminary budget framework sets aside R1 billion for these projects in 2011/12, R2 billion in 2012/13 and R3 billion in 2013/14, as part of the unallocated policy reserve.

Table 4.2 Education expenditure, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12	2012/13	2013/14	2011 MTEF Total
		Medium-term estimates			
National departments	20.6	27.6	30.9	35.3	93.7
Provincial departments	139.9	150.1	157.3	166.2	473.6
Public entities[1]	12.7	13.1	13.5	14.3	40.9
Total	**173.2**	**190.7**	**201.7**	**215.8**	**608.2**
of which: compensation of employees	*108.0*	*120.7*	*126.2*	*133.5*	*380.3*

1. Includes sector education training authorities, National Skills Fund and National Student Financial Aid Scheme.

Funding for provinces to replace informal and unsafe school buildings

Funding has been set aside over the MTEF for provinces to reduce the backlog in school infrastructure by replacing informal and unsafe school buildings. Not including additional allocations, there is already R40 billion in the baseline for education infrastructure. Reforms to provincial education infrastructure grant funding are being considered that will build on the lessons learnt during the 2010 World Cup and lead to accelerated delivery of infrastructure. A partnership with the Development Bank of Southern Africa is proposed to support education infrastructure investment.

Over the next three years, R5.4 billion is provided for provinces to implement the occupation-specific dispensation agreements in education. Further education colleges also receive additional funds and an expanded bursary scheme is supported. Work is in progress to channel skills development funding to targeted further education programmes.

The number of fully qualified teachers will increase over the medium term, supported through the Funza Lushaka bursary programme.

Health services

Focus on improving infant, maternal and child mortality

The health sector delivery agreement aims to reduce infant and maternal mortality, improve child mortality to 30-40 per 1 000 births over the medium term, and make further progress in preventing and controlling HIV and Aids. Expenditure over the period will target improving monitoring of women and infants after childbirth, upgrading support and training of paediatric and maternal health workers in district hospitals, increasing coverage of new child vaccines and enhancing the programme to prevent mother-to-child transmission of HIV.

Data from the Department of Health’s 2009 antenatal survey shows that the rate of HIV infection is levelling off. HIV prevention and treatment programmes are expanding rapidly and will continue to be prioritised. The antiretroviral programme is adding more than 300 000 people to treatment each year, and this is likely to rise to 400 000 new entrants a year over the medium term.

Remedial measures target improved financial management in provincial health departments

Provincial health departments are undertaking remedial measures to improve financial management and stabilise their finances. To retain critical and skilled health staff, occupation-specific dispensations for 40 health therapeutic groups have been agreed, including physiotherapists, occupational therapists and psychologists. Government has also prioritised funds to fill important posts, including medical registrars in obstetrics and paediatrics, and to recapitalise nursing colleges.

Table 4.3 Health expenditure, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12	2012/13	2013/14	2011 MTEF Total
		Medium-term estimates			
National departments	1.7	1.8	1.9	2.0	5.7
Provincial departments	96.3	105.4	112.8	120.5	338.8
Public entities	3.9	4.1	4.3	4.6	13.0
Total	**101.9**	**111.4**	**119.0**	**127.1**	**357.5**
of which: compensation of employees	*54.7*	*59.9*	*63.0*	*66.6*	*189.5*

Over the MTEF period, R7.3 billion is added to the provincial equitable share to address priority issues in health and R1.5 billion is added to the comprehensive HIV and Aids programme to meet increased demand for related services.

National health insurance

As part of broader reforms to the public health system, a joint ministerial committee, supported by research and advisory teams, is examining fiscal and financial aspects of national health insurance (NHI) proposals.

Public health funding stands at about 3.8 per cent of GDP and about 11.5 per cent of government expenditure. In view of South Africa's rising disease burden these ratios are likely to increase somewhat, and arrangements for bringing private-sector capacity into a common health funding framework are being explored.

In preparation for NHI reforms several preparatory steps are proposed. Changes have been made to the equitable share formula, making provision for a more specific and detailed health component with subcomponents for primary health care and hospitals. Amendments to improve the fairness of the tax treatment of medical scheme contributions will be introduced. Consideration is being given to ways of piloting improved family health care as part of an enhanced primary care system, including district-based contracts with independent general practitioners.

Options need to be explored for aligning procurement of medicines to optimise economies of scale from bulk purchases. There is potential for private hospital participation in training doctors and nurses in conjunction with academic institutions, and for bringing private-sector management capacity into public health delivery.

Social protection

More than 13.8 million South Africans now receive some form of social grant

Social assistance and welfare services are effective redistributive and poverty reduction measures, and have expanded considerably over the past decade. The number of social grant beneficiaries has more than tripled since 2002/03, reaching over 13.8 million in 2010/11, including child support grants.

South Africa has a relatively advanced social security system – both in terms of coverage against contingencies and levels of expenditure. However, there are challenges in delivering social protection, including poor service, fraud, high transaction costs to pay grants and long waiting periods before a beneficiary receives a grant. Over the longer term, direct income support needs to be complemented by rising employment and a broader tax base.

Table 4.4 Social protection expenditure, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12	2012/13 Medium-term estimates	2013/14	2011 MTEF Total
National departments	92.7	101.9	111.5	119.1	332.6
Provincial departments	10.3	11.5	12.2	13.0	36.7
Public entities[1]	31.2	35.0	37.9	42.1	115.0
Total	**134.2**	**148.4**	**161.7**	**174.2**	**484.3**
of which: compensation of employees	*7.5*	*8.1*	*8.6*	*9.0*	*25.7*

1. Includes Road Accident Fund, Unemployment Insurance Fund, Compensation Funds and South African Social Security Agency.

Improved administration is central to government's social insurance reform proposals. A committee of inquiry is investigating more cost-effective beneficiary payment options for the South African Social Security Agency. A new application process will be designed to reduce waiting times and upgrade customer service. Government's task team on social security and retirement reform is considering the scope for consolidation of administration and systems across the various social security arrangements.

Administration and systems of various social security arrangements may be consolidated

Recreation and culture

Arts and recreation play important roles in building social cohesion. Key challenges in this sector include the need to restore good corporate governance at the South African Broadcasting Corporation (SABC); establishing clearer differentiation of roles between national and provincial functions within the arts, culture and sports sectors; and developing the South African film industry.

Good corporate governance needs to be restored at the SABC

Table 4.5 Recreation and culture expenditure, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12	2012/13 Medium-term estimates	2013/14	2011 MTEF Total
National departments	1.5	1.5	1.6	1.7	4.7
Transfers to municipalities	0.5	–	–	–	–
Provincial departments	3.3	3.5	3.7	3.9	11.0
Public entities	1.1	1.1	1.1	1.2	3.4
Total	**6.4**	**6.0**	**6.4**	**6.7**	**19.1**
of which: compensation of employees	*2.0*	*2.2*	*2.3*	*2.4*	*6.8*

Government proposes to provide additional support to the National Film and Video Foundation to strengthen the South African film industry. These allocations will help to upgrade skills and increase local employment. Savings within the Department of Arts and Culture are reprioritised for this purpose. Over the MTEF, additional funding is also proposed for the development and support of sports federations.

Government is assisting both Sentech and the SABC with the migration of broadcasting services from an analogue to a digital platform. Once this process is completed, it will be possible to provide a greater range of broadcasting services to South African viewers and listeners.

Public order and safety

Excessive administrative costs must be reduced and reprioritised to support frontline services

Despite recent progress in reducing overall crime rates, the incidence of crime remains unacceptably high. Major challenges include the high proportion of violent crime, court case backlogs, prison overcrowding and a high rate of recidivism. Administrative costs within this function exceed 30 per cent of total budgeted expenditure, indicating scope for channelling a greater share of resources to core functions.

Table 4.6 Public order and safety expenditure, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12	2012/13	2013/14	2011 MTEF Total
		Medium-term estimates			
National departments	83.3	90.4	97.6	103.9	291.9
Police services	*53.8*	*58.8*	*62.8*	*67.0*	*188.6*
Law courts	*13.3*	*14.3*	*16.0*	*17.0*	*47.2*
Prisons	*16.1*	*17.3*	*18.8*	*19.9*	*56.1*
Provincial departments	2.1	2.3	2.4	2.6	7.3
Public entities[1]	1.4	1.5	1.6	1.6	4.7
Total	**86.8**	**94.2**	**101.6**	**108.2**	**303.9**
of which: compensation of employees	*58.3*	*62.6*	*66.3*	*70.7*	*199.6*

1. Includes Legal Aid Board, Special Investigating Unit and Office of the Public Protector.

Additional funding over the MTEF period will expand detective services, crime intelligence and crime prevention, especially at the local station level. Police numbers will increase from 200 660 in 2012/13 to 203 025 by 2014/15. Tactical response teams will be established in each of the provinces over the next three years to conduct medium-risk policing operations and make use of available intelligence to prevent crime.

The capacity of the Special Investigating Unit to fight corruption will be boosted by increasing its investigative capacity to over 650 by 2013/14.

Growing allocations support investment in court infrastructure

Access to justice remains a priority, reflected in rising allocations for court infrastructure, particularly in townships and rural areas. Modernisation of the criminal justice sector IT system, including seamless tracking of persons and cases, and efficient record-keeping, is critical for its effective functioning and integration.

Defence

An increased role for the South African National Defence Force (SANDF) in safeguarding the country's borders and preventing illegal immigration has been agreed, and will take effect over the next three years. Additional funds to cover the attendant costs have been proposed.

SANDF troops are also serving in peace-support operations in the Democratic Republic of Congo, Sudan and Central African Republic.

A need to shift the balance from regular force members to reserves over the medium term

Challenges over the medium term include aligning the SANDF with the Defence Review 1998, which calls for a reduction in the number of regular force members and an increase in reserve forces, to bring about a more affordable peacetime defence force.

Table 4.7 Defence expenditure, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12	2012/13	2013/14	2011 MTEF Total
		Medium-term estimates			
National departments	33.8	38.7	41.6	44.1	124.4
Public entities[1]	1.9	1.9	2.0	2.1	5.9
Total	**35.7**	**40.6**	**43.6**	**46.2**	**130.3**
of which: compensation of employees	*16.9*	*16.6*	*17.7*	*18.9*	*53.2*

1. Includes Armaments Corporation of South Africa Limited.

The Department of Defence has reprioritised R2.7 billion from slow-performing projects to its key programmes, including the new SANDF salary grading system. Delays in completion of strategic arms procurement contracts account for savings of more than R1 billion declared in 2010/11, with corresponding increases in procurement expenditure over the period ahead.

Transport

Government will continue to improve urban public transport and infrastructure

Investment in transport infrastructure and public transport services has increased by more than 20 per cent a year since 2007/08, partly to provide improvements ahead of the World Cup in 2010. Improved public transport and better maintenance of infrastructure will remain priorities for the period ahead, particularly in cities and metropolitan areas where transport modernisation can contribute significantly to a better life for workers, lower transport costs and a more productive economy.

Table 4.8 Transport expenditure, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12	2012/13	2013/14	2011 MTEF Total
		Medium-term estimates			
National departments	5.1	5.8	5.9	6.8	18.5
Transfers to municipalities	1.3	1.5	1.9	2.0	5.4
Provincial departments	26.9	28.5	30.2	32.1	90.8
Public entities[1]	34.8	31.7	33.1	35.0	99.8
Total	**68.1**	**67.5**	**71.2**	**75.8**	**214.5**
of which: compensation of employees	*7.5*	*8.1*	*8.6*	*9.1*	*25.8*

1. Includes Passenger Rail Agency of South Africa and South African National Roads Agency Limited.

In addition to the expenditure envelope covered by the consolidated government estimates, investments by Transnet in ports, rail infrastructure and a new liquid fuels pipeline are in progress, supported in part by state guarantees or co-funding. Investment by the Airports Company of South Africa in refurbishing airports also falls outside the consolidated government accounts.

New rail transport policy and investments in passenger rail rolling stock over the medium term

Over the medium term, government plans to introduce a new rail transport policy, establish a rail transport economic regulator and make additional investment in passenger rail rolling stock. Improved integration of port and rail operations is envisaged, and productivity and turnaround times at the container terminals will be improved. The private sector will be invited to participate in container port operations. The rail link between Coega and Gauteng will be upgraded.

The South African National Roads Agency Limited is continuing work on the Gauteng Freeway Improvement Programme, which represents a major advance in this currently congested road network. Tolling will commence in April 2011. Improved maintenance of regional roads and rural access roads has to be prioritised over the period ahead, together with better traffic management and overload control.

Energy, communication and general economic affairs

Economic development is supported through a wide range of incentive programmes, regulatory agencies and associated services. Investment in these areas provides the platform for a growing economy that creates more jobs, supports poverty alleviation and provides the foundation for environmental sustainability.

Table 4.9 Energy, communication and general economic affairs, 2010/11 – 2013/14

	2010/11	2011/12	2012/13	2013/14	2011 MTEF
R billion	Revised	Medium-term estimates			Total
National departments	14.1	14.7	14.8	15.2	44.7
Transfers to municipalities	7.6	9.3	9.8	10.5	29.6
Provincial departments	7.3	7.7	7.6	8.0	23.3
Public entities[1]	20.1	21.2	21.9	23.1	66.2
Total	**49.2**	**52.9**	**54.1**	**56.8**	**163.8**
of which: compensation of employees	*24.0*	*26.1*	*27.9*	*29.6*	*83.6*

1. Includes National Lotteries Board, National Research Foundation, Council for Scientific and Industrial Research, South African Nuclear Energy Corporation, South African National Parks and Sentech Limited.

Energy and environmental protection

Electrification of unserved communities will continue to be funded, as will support for renewable energy

Major investments by Eskom in power generation are in progress, including construction of the Medupi Power Station, expected to be completed by 2015. Eskom falls outside the consolidated government accounts, though its investment is supported by state guarantees and a R60 billion financing facility provided over the 2008/09 - 2010/11 period. Electrification of unserved communities will continue to be funded over the period ahead. Electricity demand-side management remains important over the medium term, although the funding mechanism will change.

South Africa has committed to substantial reductions in carbon dioxide emissions by 2025, and supports research and technology development aimed at environmentally sustainable economic growth. Government will also focus on improving biodiversity protection and will contribute to the costs of South Africa hosting the United Nations Framework Convention on Climate Change Conference of the Parties in 2011.

Industrial development

Support is provided for industrial development zones, automotive and clothing and textiles sectors

Investment in industrial development zones will continue over the period ahead, and support programmes for the automotive and clothing and textiles industries are included in the activities of the Department of Trade and Industry. Additional funding is proposed for key regulatory agencies, including the competition authorities, the National Metrology Institute of South Africa and the National Regulator for Compulsory Specifications.

Tooling up for technical apprenticeships

The Intsimbi National Tooling Initiative aims to reduce widening shortages of expertise in the tool, die and mould industry, which provides crucial support to the manufacturing sector. The initiative, led by the Department of Trade and Industry, supports skills development, transformation, building small business capacity, technology recapitalisation, competitiveness and export development.

A pre-apprenticeship training programme addresses the basic skills gap, preparing participants to find work as apprentice artisans, mechanists, technicians, engineers, designers and project managers. The intake for this programme is projected to grow from 175 in 2010/11 to 4 395 in 2015/16.

Agriculture, forestry, fishing and land affairs

Over the medium term, land reform and agricultural development have considerable potential to contribute to rural advancement, job creation, poverty reduction and food production, in addition to redressing past land dispossessions.

Table 4.10 Agriculture, forestry, fishing and land affairs expenditure, 2010/11 – 2013/14

	2010/11	2011/12	2012/13	2013/14	2011 MTEF
R billion	**Revised**	**Medium-term estimates**			**Total**
National departments	8.2	8.5	9.1	9.5	27.1
Provincial departments	7.2	7.8	8.3	8.9	25.0
Public entities[1]	1.4	1.7	1.7	1.8	5.2
Total	**16.8**	**18.0**	**19.1**	**20.2**	**57.4**
of which: compensation of employees	*5.7*	*6.3*	*6.8*	*7.2*	*20.4*

1. Includes Agricultural Research Council and Marine Living Resources Fund.

Additional funding will contribute to settling the 7 000 outstanding land claims. New models for supporting emerging farmers are being piloted, in partnership with the Land Bank and drawing on the capacity of commercial farmers. Additional funding is proposed to enable provinces to improve the quality of extension services offered to newly settled farmers.

Housing and community amenities

Pace of housing delivery appears to be slowing, owing partly to weak planning and coordination

The housing and community amenities function includes human settlements, water supply and community development programmes. While considerable progress has been achieved in the delivery of infrastructure and housing, the pace of delivery appears to be slowing, despite growth in the funding of conditional grants that also extend subsidies to households. This slowdown is partly the result of planning and coordination weaknesses.

Table 4.11 Housing and community amenities expenditure, 2010/11 – 2013/14

	2010/11	2011/12	2012/13	2013/14	2011 MTEF
R billion	**Revised**	**Medium-term estimates**			**Total**
National departments	8.7	11.3	12.8	13.5	37.6
Transfers to municipalities	48.9	55.1	60.8	65.0	180.9
Provincial departments	21.9	23.8	24.9	26.5	75.2
Public entities[1]	17.9	19.9	21.5	22.7	64.2
Total	**97.4**	**110.1**	**120.0**	**127.8**	**357.9**
of which: compensation of employees	*8.9*	*9.5*	*10.1*	*10.7*	*30.2*

1. Includes water boards.

Community development programmes account for about half of the budget in this function, and include the equitable share funding and infrastructure grants that flow directly to municipalities.

Human settlements provincial conditional grant has grown by 20 per cent a year over past three years

Human settlements are funded through a provincial conditional grant. This grant, which has grown by over 20 per cent annually since 2007/08, now exceeds R20 billion per year, and will continue to increase strongly over the period ahead. Housing subsidies flow directly to provinces to fund programmes that are largely municipal.

South Africa's cities face substantial challenges, owing largely to the pace of economic growth to date and continued migration from the countryside. Informal settlements are growing, and infrastructure bottlenecks and backlogs are widespread. Investment in urban centres to help turn cities into engines of economic growth will be supported over the MTEF period.

Cities to have more responsibility for housing, infrastructure and transport

Several reforms to financing arrangements are proposed to address coordination problems in urban development and housing. Over the 2011 MTEF the reforms include scaling up delivery in informal settlements and upgrading those settlements. Steps are being taken to change the financing arrangements for human settlement, infrastructure and transport. The goal is for cities to have more responsibility for these functions, leading to improved integration, outcomes and efficiency in connecting households to services and economic activities.

Accelerating municipal infrastructure delivery

To improve coordination of the built environment and deliver services to poor communities, the functions for housing development and public transport regulation will be devolved to cities over the medium term:

- Housing accreditation will allow cities to plan and allocate resources so that housing is developed in parallel with the rollout of basic services and in locations where economic opportunities are accessible.
- Assigning the function for issuing public transport operating licenses to cities will allow large urban municipalities to integrate public transport with the rest of their built environment planning.

Government will provide financial resources for these functions to the cities that implement them.

Over the next three years, R1.7 billion will be added to the R79 billion already allocated to local government conditional grants for infrastructure development.

In more rural municipalities, the major challenge is to step up delivery of bulk infrastructure, especially for water and sanitation, which are funded by the *municipal infrastructure grant* and the *regional bulk infrastructure grant*. Some 70 per cent of the *municipal infrastructure grant* is allocated for water and sanitation reticulation and local bulk infrastructure, while regional bulk infrastructure is funded by local government conditional grants. More needs to be done to align the planning between municipalities responsible for building and maintaining reticulation systems and the national departments overseeing the provision of bulk services.

The *rural household infrastructure grant* supports on-site solutions in villages. Implementation of this grant is expected to create employment for rural communities in construction and maintenance of the infrastructure.

Major investments in water infrastructure, including dam rehabilitation

To ensure adequate provision of water supply, government will invest in bulk water infrastructure, increase the number of dam rehabilitation and water conveyance projects, and establish a water regulator. Provision will also be made for the maintenance and supply of bulk water infrastructure to reduce backlogs, and to enable the construction and rollout of seven proposed water augmentation schemes.

Labour-intensity incentive supports more employment in public works projects

The current phase of the expanded public works programme aims to create 4.5 million short-term jobs lasting 100 days on average over the 2010-2014 period. To achieve this target, government has introduced a labour-intensity incentive for provinces and municipalities in infrastructure projects. The 2011 MTEF will extend the incentive grant to the social sector. These are likely to be longer-duration jobs at lower cost than in other sectors. The Department of Public Works has reprioritised funds to provide for growth in social-sector work opportunities.

General public services

General public services have grown by over 12 per cent a year over the past three years, and are set to expand more slowly over the period ahead. This function includes the national and provincial legislatures, central administrative departments such as Home Affairs and International Relations and Cooperation, Public Works and the National Treasury.

Table 4.12 General public services expenditure, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12 Medium-term estimates	2012/13	2013/14	2011 MTEF Total
National departments	16.8	17.5	16.8	18.7	52.9
Transfers to municipalities	1.1	1.3	1.5	1.6	4.3
Provincial departments	16.2	16.5	17.6	18.7	52.8
Public entities[1]	12.5	12.8	13.2	13.9	39.9
Total	**46.7**	**48.0**	**49.0**	**52.9**	**149.9**
of which: compensation of employees	*21.2*	*23.3*	*24.8*	*26.0*	*74.1*

1. Includes South African Revenue Service and Independent Electoral Commission.

Departments need to budget for rising costs of municipal services and to properly manage leases

Improving the management of property and departmental accommodation services is a pressing challenge, alongside better implementation of IT projects and more effective contract management. Departments have been slow to develop user-asset management plans, which form the basis of agreements with the Department of Public Works on accommodation requirements and future improvements. Difficulties continue to be experienced in budgeting for the rising costs of municipal services, and in managing accommodation costs and lease contracts. Substantial increases are included in the revised baseline estimates for the *devolution of property rates grant to provinces* to ensure that these costs are covered.

In support of the government-wide property management reforms, the asset register for the state's immovable assets needs is being updated. At a municipal level, billing systems need to be improved to eradicate or minimise the incorrect billing of property rates and municipal services, and to support simple resolution of disputes.

Statistics SA is preparing for the 2011 Census, which will employ 120 000 fieldworkers

To improve the quality of information that it offers, while stabilising and reducing the cost of surveys, Statistics South Africa is expanding and modernising its data collection methodologies. The 2011 Census will employ 120 000 fieldworkers (most of them on a stipend) compared with the 100 000 fieldworkers employed in 2001.

Division of revenue – 2011/12-2013/14

Transfers to provinces and municipalities reflect strong anti-poverty commitment

Strong growth in transfers to municipalities and provinces is proposed over the MTEF period. Table 4.13 sets out the proposed division of nationally collected revenue and changes to baseline allocations.

Table 4.13 Division of revenue, 2010/11 – 2013/14

R billion	2010/11 Revised	2011/12	2012/13	2013/14	2011 MTEF	Average annual growth 2010/11 – 2013/14
		Medium-term estimates				
National	**360.6**	**374.5**	**401.0**	**427.3**		**5.8%**
Provincial	**328.1**	**359.5**	**382.3**	**407.7**		**7.5%**
Equitable share	265.1	289.0	305.7	323.3		6.8%
Conditional grants	63.0	70.5	76.6	84.4		10.2%
Local	**59.3**	**67.2**	**74.0**	**79.0**		**10.0%**
Equitable share	30.6	34.1	37.6	40.0		9.4%
Conditional grants	21.2	24.5	27.4	29.5		11.6%
General fuel levy sharing with metropolitan municipalities	7.5	8.6	9.0	9.6		8.4%
Total	**748.1**	**801.2**	**857.3**	**914.1**		**6.9%**
Percentage share						
National	*48.2%*	*46.7%*	*46.8%*	*46.7%*		
Provincial	*43.9%*	*44.9%*	*44.6%*	*44.6%*		
Local	*7.9%*	*8.4%*	*8.6%*	*8.6%*		
Changes to baseline						
National	**1.5**	**4.0**	**7.3**	**12.5**	**23.8**	
Provincial	**5.3**	**9.0**	**13.0**	**18.2**	**40.1**	
Equitable share	4.2	8.3	10.3	11.2	29.8	
Conditional grants	1.1	0.7	2.7	7.0	10.3	
Local	**0.5**	**0.5**	**1.0**	**1.6**	**3.1**	
Equitable share	0.4	0.2	0.3	0.7	1.2	
Conditional grants	0.1	0.3	0.6	0.8	1.7	
General fuel levy sharing with metropolitan municipalities	–	0.0	0.1	0.2	0.3	
Total	**7.3**	**13.5**	**21.3**	**32.3**	**67.0**	

Of the R67 billion in additions to baseline allocations, 59.9 per cent goes to provinces, mainly to accommodate higher staff costs and for spending on infrastructure backlogs in education and health. Municipalities receive 4.7 per cent, most of which compensates for sustainable provision of basic services and bulk infrastructure. The national share sustains real growth in social grant provisions and public employment programmes.

Changes to the provincial equitable share formula will be introduced next year

Changes to the provincial equitable share formula will be introduced in 2011/12. A new health formula is being introduced, and the weights of the education and the health components will be revised. Several minor adjustments to the local government equitable share formula are planned in 2011, with a comprehensive review over the medium term. The 2011 adjustment will direct more funding towards poor rural municipalities without reducing funds allocated to metropolitan municipalities. Changes to municipal boundaries during 2011 will also be incorporated.

Annexure A

2009/10 outcome and half-year spending estimates for 2010/11

Table A.1 Expenditure by vote, 2009/10 and 2010/11 financial year

R million	2009/10[1]				2010/11		
	Main budget	Adjusted budget	Audited outcome	Over(-)/ Under(+)	Main budget	Adjusted budget	Actual spending April to September
Central Government Administration							
1 The Presidency	525	695	670	25	723	807	411
2 Parliament[2]	974	1 108	1 009	99	1 179	1 202	520
3 Cooperative Governance and Traditional Affairs	35 763	36 684	36 128	556	43 921	44 573	18 718
4 Home Affairs	5 051	5 264	5 195	68	5 720	5 834	2 065
5 International Relations and Cooperation	5 337	5 553	5 417	136	4 824	4 716	1 775
6 Public Works	5 139	5 890	5 534	356	6 446	7 365	2 780
7 Women, Children and People with Disabilities	68	68	78	-9	98	106	53
Financial and Administrative Services							
8 Government Communication and Information System	482	497	495	1	546	550	273
9 National Treasury	61 676	62 846	62 669	177	50 220	50 209	23 739
10 Public Enterprises	3 797	3 991	3 983	8	351	556	204
11 Public Service and Administration	596	683	671	12	651	659	262
12 Statistics South Africa	1 609	1 715	1 556	159	1 973	2 101	639
Social Services							
13 Arts and Culture	2 623	2 632	2 225	407	2 407	2 441	1 081
14 Basic Education	3 930	4 474	3 971	503	6 166	6 172	2 834
15 Health	17 058	18 423	17 966	457	21 497	21 662	10 599
16 Higher Education and Training	20 679	20 697	20 683	14	23 721	23 776	17 292
17 Labour	1 745	1 709	1 699	11	1 784	1 836	851
18 Social Development	86 408	86 508	85 318	1 190	95 929	95 941	49 609
19 Sport and Recreation South Africa	2 860	2 884	2 866	17	1 246	1 255	908
Justice and Protection Services							
20 Correctional Services	13 239	13 835	13 687	147	15 129	15 427	6 504
21 Defence and Military Veterans	32 024	31 325	31 324	1	30 715	30 443	14 263
22 Independent Complaints Directorate	115	116	106	10	129	131	48
23 Justice and Constitutional Development	9 568	9 721	9 654	67	10 250	10 787	4 632
24 Police	46 450	47 622	47 662	-40	52 556	53 530	24 752
Economic Services and Infrastructure							
25 Agriculture, Forestry and Fisheries	3 483	3 875	3 847	28	3 658	3 954	1 894
26 Communications	2 267	2 470	2 302	169	2 114	2 138	561
27 Economic Development	327	316	315	2	419	450	171
28 Energy	3 742	3 757	3 645	112	5 535	5 649	2 089
29 Environmental Affairs	2 261	2 244	2 229	15	2 608	2 489	1 156
30 Human Settlements	14 020	14 036	13 762	274	16 201	16 292	7 798
31 Mineral Resources	905	925	900	25	1 030	996	454
32 Rural Development and Land Reform	6 109	6 401	5 864	538	6 770	7 293	2 773
33 Science and Technology	4 234	4 262	4 184	78	4 616	4 128	1 685
34 Tourism	1 109	1 156	1 156	–	1 152	1 184	696
35 Trade and Industry	6 017	6 086	5 923	163	6 150	6 194	2 278
36 Transport	23 735	24 239	24 502	-263	25 086	25 289	14 003
37 Water Affairs	6 883	7 343	7 189	154	7 997	8 203	3 091
Total appropriation by vote	**432 811**	**442 049**	**436 384**	**5 666**	**461 518**	**466 339**	**223 460**
State debt cost	55 268	59 995	57 129	2 866	71 358	67 607	32 988
Provincial equitable share	227 883	236 878	236 891	-13	260 974	265 139	130 487
General fuel levy sharing with metros	6 800	6 800	6 800	–	7 542	7 542	2 514
Other direct charges against the National Revenue Fund	9 801	9 801	9 993	-192	10 751	10 751	4 986
Total direct charges against the National Revenue Fund	**299 751**	**313 473**	**310 813**	**2 660**	**350 625**	**351 040**	**170 975**
Unallocated and contingency reserve	6 000	–	–	–	6 000	–	–
Less: Projected underspending	–	–	–	–	–	-1 700	–
Total	**738 563**	**755 523**	**747 197**	**8 326**	**818 143**	**815 679**	**394 436**

1. The 2009/10 financial year numbers were adjusted to include function shifts.

2. The audited outcome for Parliament is converted from accrual to cash.

Table A.2 Expenditure by province, 2009/10 and 2010/11 financial year

R million	2009/10 Main budget	2009/10 Adjusted budget	2009/10 Preliminary outcome	2009/10 Over(-)/ Under(+)	2009/10 Deviation from adjusted budget	2010/11 Main budget	2010/11 Actual spending April to September
Eastern Cape	**42 635**	**44 565**	**45 235**	**-669**	**-1.5%**	**48 224**	**23 522**
Education	19 448	20 529	21 166	-636	-3.1%	22 680	11 003
Health	11 328	11 774	12 089	-315	-2.7%	13 341	6 825
Social Development	1 434	1 455	1 434	20	1.4%	1 560	711
Other functions	10 425	10 807	10 546	262	2.4%	10 643	4 984
Free State	**18 374**	**19 351**	**18 783**	**568**	**2.9%**	**21 381**	**9 189**
Education	7 407	8 005	7 846	160	2.0%	8 539	3 936
Health	5 169	5 513	5 208	305	5.5%	6 152	2 639
Social Development	667	670	666	4	0.6%	722	323
Other functions	5 131	5 163	5 064	100	1.9%	5 968	2 292
Gauteng	**55 259**	**58 547**	**59 695**	**-1 148**	**-2.0%**	**60 857**	**29 623**
Education	18 987	19 982	20 058	-76	-0.4%	22 486	10 783
Health	16 590	17 201	18 396	-1 195	-6.9%	20 072	9 974
Social Development	1 936	1 943	1 877	67	3.4%	2 165	818
Other functions	17 746	19 421	19 365	56	0.3%	16 134	8 048
KwaZulu-Natal	**59 586**	**61 907**	**63 812**	**-1 905**	**-3.1%**	**69 077**	**31 474**
Education	24 609	26 059	26 231	-172	-0.7%	29 035	14 460
Health	17 449	18 329	20 349	-2 020	-11.0%	21 658	9 696
Social Development	1 361	1 361	1 361	–	0.0%	1 668	608
Other functions	16 167	16 157	15 870	287	1.8%	16 717	6 710
Limpopo	**34 476**	**35 955**	**35 597**	**358**	**1.0%**	**39 653**	**17 865**
Education	16 362	17 322	17 865	-542	-3.1%	18 815	8 775
Health	9 018	9 359	9 020	339	3.6%	10 535	4 587
Social Development	762	783	773	10	1.2%	806	419
Other functions	8 334	8 491	7 939	552	6.5%	9 497	4 084
Mpumalanga	**22 545**	**23 856**	**23 684**	**172**	**0.7%**	**26 101**	**11 925**
Education	10 073	10 684	10 940	-256	-2.4%	11 530	5 470
Health	5 429	6 048	5 759	289	4.8%	6 421	3 044
Social Development	792	768	749	20	2.6%	881	370
Other functions	6 250	6 356	6 236	120	1.9%	7 268	3 040
Northern Cape	**7 941**	**8 391**	**8 179**	**212**	**2.5%**	**9 163**	**4 189**
Education	2 979	3 170	3 184	-14	-0.4%	3 458	1 620
Health	2 214	2 301	2 205	96	4.2%	2 657	1 234
Social Development	408	429	420	9	2.0%	464	221
Other functions	2 340	2 491	2 370	121	4.9%	2 583	1 115
North West	**19 866**	**20 671**	**20 365**	**305**	**1.5%**	**22 114**	**9 579**
Education	8 145	8 473	8 391	83	1.0%	9 051	3 960
Health	4 919	5 205	5 196	10	0.2%	5 583	2 598
Social Development	641	634	608	26	4.2%	750	294
Other functions	6 161	6 358	6 172	187	2.9%	6 731	2 726
Western Cape	**29 034**	**30 672**	**30 113**	**559**	**1.8%**	**33 241**	**15 245**
Education	10 346	10 664	10 613	50	0.5%	11 846	5 480
Health	9 893	10 464	10 371	93	0.9%	11 963	5 716
Social Development	1 163	1 181	1 165	15	1.3%	1 219	568
Other functions	7 633	8 364	7 963	400	4.8%	8 214	3 481
Total	**289 717**	**303 914**	**305 462**	**-1 548**	**-0.5%**	**329 810**	**152 612**
Education	118 357	124 889	126 293	-1 404	-1.1%	137 439	65 487
Health	82 009	86 194	88 593	-2 399	-2.8%	98 381	46 315
Social Development	9 163	9 224	9 053	171	1.9%	10 236	4 332
Other functions	80 188	83 608	81 524	2 084	2.5%	83 755	36 479

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Glossary

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

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.*
Financial and Fiscal Commission	An independent body established by the Constitution to make recommendations to Parliament and provincial legislatures about financial issues affecting the three spheres of government.
Financial account (of the balance of payments)	A statement of all financial transactions between a country and the rest of the world, including portfolio and fixed investment flows and movements in foreign reserves.
Financial year	The 12 months according to which companies and organisations budget and account.
Fiscal policy	Policy on taxation, spending and borrowing by government.
Fiscal space	The ability of a government's budget to provide additional programme resources without jeopardising fiscal sustainability.
Foreign direct investment	The acquisition of long-term business interests in another country, usually involving management, technology and financial participation.
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 *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.
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 total stock of money in an economy.
National budget	The projected revenue and expenditures that flow through the National Revenue Fund. It does not include spending by provinces or local government from their own revenues.

National Revenue Fund	The consolidated account of national government into which all taxes, fees and charges collected by the South African Revenue Service and departmental revenue must be paid.
Nominal exchange rate	The current rate of exchange between the rand and foreign currencies. The "effective" exchange rate is a trade-weighted average of the rates of exchange with other currencies.
Non-interest expenditure	Total expenditure by government less debt service costs.
Organisation for Economic Cooperation and Development	An organisation of 33 mainly industrialised countries.
Primary sector	The agricultural and mining sectors of the economy.
Private-sector credit extension	Credit provided to the private sector by banks. This includes all loans, credit card balances and leases.
Public-private partnership (PPP)	A contractual arrangement in which a private party performs part of a government function and assumes the associated risks. In return, the private party receives a fee according to predefined performance criteria.
Public sector borrowing requirement	The consolidated cash borrowing requirement of general government and non-financial public enterprises.
Real effective exchange rate	A measure of the rate of exchange of the rand relative to a trade-weighted average of South Africa's trading partners' currencies, adjusted for price trends.
Real expenditure	Expenditure measured in constant prices, i.e. after taking account of inflation.
Repurchase (repo) rate	The rate at which the Reserve Bank lends to commercial banks.
Reserves (foreign exchange)	Holdings of foreign exchange, either by the Reserve Bank only, or by the Reserve Bank and domestic banking institutions.
Seasonally adjusted and annualised	The process of removing the seasonal volatility (monthly or quarterly) from a time series. This provides a measure of the underlying trend in the data. Annualised: to express a rate as if it were applied over one year.
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).

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