Medium Term Budget Policy Statement

2011

National Treasury

Republic of South Africa

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Foreword

At this time last year, there was a shared international expectation that the worst of the global financial crisis was behind us, and that the world economy was on track for a relatively smooth recovery.

Things have not turned out that way. We are living through a deep crisis that has exposed fault lines in the global economy. The pace and progress of recovery is uncertain. Political decisiveness to enhance growth, manage sovereign debt and recapitalise banks in advanced economies, particularly in the euro currency area, is still not evident. The threat of global contagion is still with us.

Yet South Africa's economic fundamentals are sound. Growth is positive, projected to reach 3.1 per cent of GDP this year and 3.4 per cent next year. While this level of growth is not as vibrant as we would like, it is a base on which to build.

Over the next 5 to 10 years all South Africans – government, business, labour and society generally – must focus our creative energies and determination to restructure our economy so that it will grow faster, create more jobs, spread the benefits of growth more widely and reduce inequality.

The spending framework outlined in the 2011 *Medium Term Budget Policy Statement* creates the platform for us to manage our fiscal trajectory in a sustainable way. To achieve this in a manner that promotes faster, more inclusive growth means that we have to rise to the challenge of shifting the composition of spending towards infrastructure investment.

Let me repeat what I said last year: "South Africa's success in delivering the 2010 World Cup illustrates our ability to unite as a nation behind a common goal. We must draw on that experience and work to transform this economy into one that can grow fast enough to create the jobs that we need. To move forward we need to develop a national consensus, and the sense of urgency required to propel South Africa onto a new growth trajectory. In doing so, we will give hope to all our people and help to usher in a dynamic new era of economic development."

We need to use the period ahead to build on this unity, taking the opportunity to transform our economy and improve the quality of life of all citizens.

Pravin Gordhan

Pravin J Gordhan
Minister of Finance

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1

Recovery and reform in the face of uncertainty

Introduction

The 2012 Budget is being prepared in an exceptionally challenging environment. Slowing world economic growth, an unresolved financial crisis in the euro area and a sluggish recovery in the United States all point to extended difficulties in the global outlook. Inflationary pressures have emerged in several countries, including China. Rising income inequality and high unemployment have fuelled widespread public indignation. Although South Africa has seen positive growth since emerging from the 2009 recession, job creation has been weak. The volatility of the rand has harmed economic activity. Revenue has slowed and the budget deficit has increased.

The world economy holds substantial risks for South Africa's growth

The risks that these trends pose to the South African economy and fiscus are significant. The 2011 *Medium Term Budget Policy Statement* sets out a fiscal framework that will narrow the gap between spending and revenue, while providing support to the economy and strengthening infrastructure investment for sustainable long-term growth.

Fiscal framework provides economic support and investment in infrastructure for long-term growth

A deficit of 5.5 per cent of gross domestic product (GDP) is expected this year, moderating to 3.3 per cent by 2014/15. Over the medium term, fiscal consolidation will be accompanied by shifts in the composition of public expenditure towards investment and economic development. Measures to promote industrial development and expand trade opportunities will be strengthened. Financial support for housing and urban infrastructure investment will be extended. Funding for employment programmes and training will be increased.

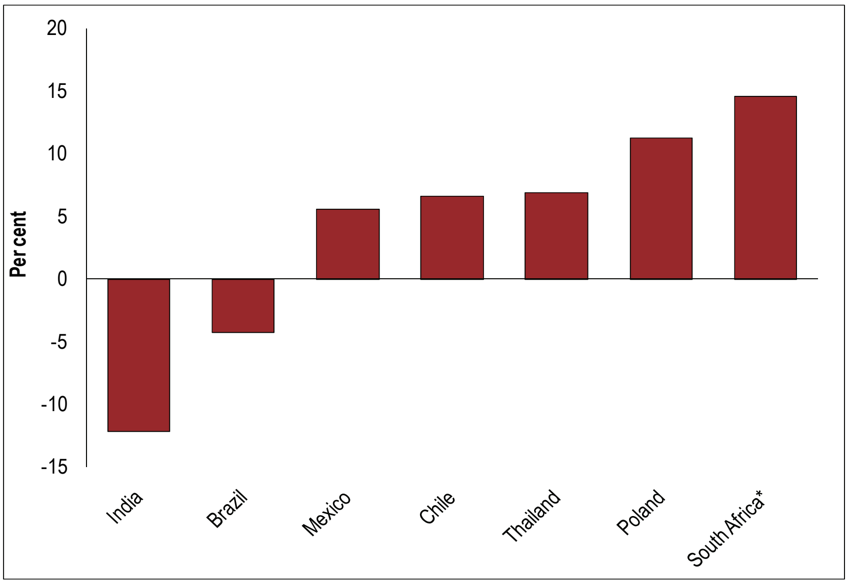
South Africa is not alone in facing challenging circumstances. Slower economic growth, falling tax revenue and uncertain financial conditions confront many of our trading partners and other developing economies.

South Africa's considerable strengths include moderate government debt and well-capitalised banks

However, South Africa's financial institutions are well capitalised and government debt is moderate. These are considerable strengths, and allow a countercyclical fiscal and monetary stance to be pursued into the year ahead, while helping enterprises to adjust to changing market conditions.

In response to the global financial crisis that began in 2008 and a sharp decline in revenue, government adopted an accommodative fiscal stance. Public spending has compensated in part for the deterioration in business activity, which has yet to regain momentum. Government debt is set to rise to about 40 per cent of GDP by 2015, after which it should stabilise and decline. In contrast, more restrictive fiscal policies have had to be adopted in several countries because of high initial debt levels, financial distress or rising inflation.

Figure 1.1 Change in government debt-to-GDP ratio, selected countries, 2007 – 2014



Source: International Monetary Fund WEO, September 2011 and National Treasury
**Gross national government debt in fiscal years*

Shifting the composition of government expenditure

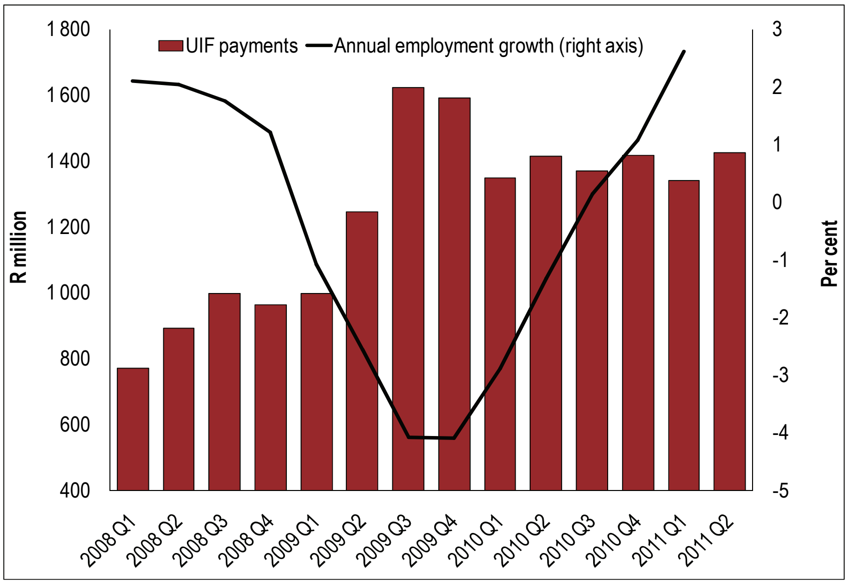
South Africa enjoyed strong economic growth in the five years leading up to 2008. This trend contributed to buoyant revenue, steadily improving public and private investment spending, and a declining public debt burden.

Despite lower economic growth over the past several years, public expenditure has continued to grow

Between 2002/03 and 2009/10, government spending as a share of GDP increased from 27.2 to 33.8 per cent. Despite lower economic and revenue growth since 2008, public expenditure has continued to expand, although at a more moderate pace since 2008/09.

In response to the steep deterioration in employment that began in 2009, the Unemployment Insurance Fund has provided income support to increased numbers of claimants. Workers and enterprises have also been assisted through a training lay-off scheme and financial support provided by the Industrial Development Corporation. Real increases in public-sector pay levels have been accompanied by increases in departmental personnel numbers, contributing positively to household earnings at a time of declining private-sector employment. Many households have received support through social assistance.

Figure 1.2 Unemployment benefits paid and formal sector non-agricultural employment growth, 2008 – 2011



Source: UIF and Statistics South Africa (QES-Quarter 2, 2011)

Investments in electricity, transport and water, alongside rural development and education initiatives, are crucial for the long term

Alongside assistance of a short-term nature, it is also necessary to invest in a longer-term recovery and economic adjustment to changing global conditions. Several important reforms are under way. Electricity generation capacity is being expanded, public transport is undergoing renewal and investment in water supply is in progress. Steps have been taken towards a more energy-efficient economy, integrated rural development programmes are being piloted, and new initiatives are under way in education and skills development.

Private sector and government investment, however, have declined since 2007. This trend must be reversed in the period ahead if more rapid growth and employment creation are to be achieved and sustained.

A shift of resources in favour of growth and job creation

The path for South Africa's public finances outlined in this statement of budget policy involves a shift of resources in favour of growth and job creation, and to support stronger private-sector investment in pursuit of new opportunities in a changing international environment. A fiscal framework grounded in countercyclicality, long-term sustainability and intergenerational fairness provides support to the economy in the medium term, while building strong foundations for faster growth, sustainable development and employment growth that benefits all South Africans.

Time to make difficult decisions

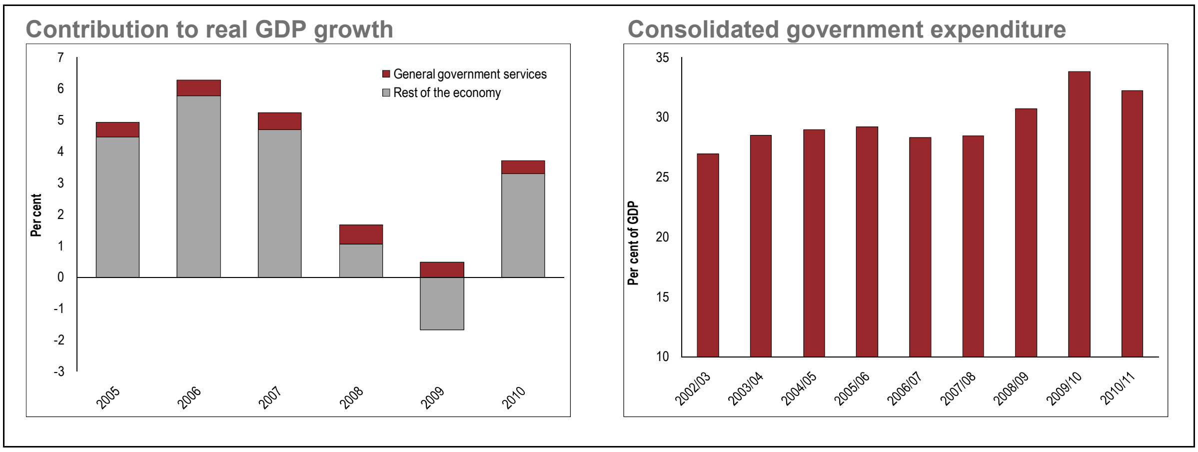
It is not the number of objectives in a strategy that matters, but the focus on the ones that count

The measure of a strategy is not in the breadth of objectives it seeks to address, but rather in its focus on those objectives that really matter. Fiscal constraints force government to choose carefully between competing objectives. Difficult decisions are required to ensure that scarce resources are directed towards economic development and more effective service delivery, while ensuring that debt levels are sustainable. As recent international experience has demonstrated, putting off tough decisions can have damaging consequences for public finances, economic growth and social stability.

Government's share of GDP will need to moderate to avoid an unwarranted future debt burden

Over the next three years, government's share of GDP will need to moderate to avoid an unwarranted future debt burden. Ensuring a sustainable level of debt is also necessary to create an environment in which the private sector can grow, invest and create jobs based on stable inflation, a low cost of capital and a competitive real exchange rate.

Figure 1.3 Government contribution to growth and share of GDP



Source: Reserve Bank and National Treasury estimates

Substantial improvements in public-service remuneration and increases in employment have raised the wage bill to about 42 per cent of government revenue, up from 31 per cent four years ago. Over the medium term, salary increases for all role players need to be given careful attention. The principle of moderation extends also to senior management and executive salaries, and remuneration of the employees of public entities. Within the corporate sector too, South Africa needs greater accountability, transparency and moderation in executive and financial sector remuneration.

Budget framework provides for a 5 per cent annual cost-of-living adjustment for public-sector employees

The proposed framework for the 2012 Budget provides for a 5 per cent cost-of-living adjustment for public-sector employees, implemented with effect from April each year. Similar adjustments to social grants are assumed in the expenditure estimates. Increased spending on municipal services and housing is proposed, alongside progressive improvements in education, health services and social protection, stronger spending on infrastructure maintenance and investment, and support for economic development.

Economic support for faster growth

South Africa's public finances are strongly redistributive. Progress towards a more equal economy also requires more inclusive private-sector growth, expanding levels of employment and a narrowing wage gap, thereby reducing inequality.

The 2012 Budget will include an economic support package aimed at strengthening the medium-term recovery and giving impetus to the longer-term structural shifts required for faster growth and development.

Economic support package to strengthen recovery and promote structural reforms

These initiatives, outlined in Chapter 2, will focus on enhancing the competitiveness of manufacturing, accessing new and emerging markets, continued investment in network infrastructure and identified industrial development zones, enhanced regional integration, environmental initiatives, and targeted support for low-wage sectors and enterprises.

Financing the economic support package will require significant additional resources. Realising these resources within the fiscal framework outlined in Chapter 3 requires government to be more efficient, and to achieve greater alignment between resources and priorities. In addition, consideration has to be given to the state's overall financial balance sheet, with a view to long-run strategic priorities, and sound management of financial and fiscal risks and liabilities.

Government needs to become more efficient in the way it spends money

Government has substantial investments in enterprises and public entities, which in many cases hold cash, excess financial reserves or assets that are not associated with public-service delivery. Where these resources could more productively be applied to finance future public-policy priorities, this can be effected through a return of surplus funds to the fiscus.

Better control of expenditure and a clear focus on core mandates by government departments also has potential to yield recurrent savings. In preparing the 2012 Budget, departments are expected to identify savings that will contribute to financing government's targeted outcomes.

Better control of spending and clear focus on mandates can yield recurrent savings

Social security and health care

Expenditure on health care and social protection has grown strongly over the past decade. About 27 per cent of the consolidated budget is devoted to these priorities, which form a large part of the social wage. Substantial reforms are currently under consideration for health financing and social security.

A discussion paper on the reform of South Africa's social security and retirement funding arrangements has been prepared and will be released before the end of the financial year. Its central focus is the inclusion of a retirement pension in the contributory social security system. Modernisation of the administrative arrangements for social assistance and social security is also proposed, as are changes to the regulatory framework governing retirement funds. These reforms complement measures to strengthen labour market institutions, including more effective employment services linked to training opportunities.

Social security reform discussion paper to be released before the end of the financial year

A green paper on national health insurance has been published. Steps will be taken over the medium-term expenditure framework (MTEF) period ahead to improve public health administration, accelerate the hospital revitalisation programme and pilot district-based primary health services as part of the preparation for national health insurance.

National health insurance and social security reform will have long-term implications for the fiscus

Over the longer term, the envisaged changes to social security and health systems will have implications for both the public finances and the structure of remuneration across the economy. These reforms, and appropriate transition arrangements, will be the subject of an in-depth consultation process during 2012.

Overview of the 2011 policy statement

Economic outlook

Chapter 2 provides an economic context to the public finances, and a discussion of broader developments in the domestic and international economy.

GDP growth is forecast to reach 4.3 per cent in 2014

The revised economic outlook shows growth slowing, mainly due to developments in the global economic environment. GDP growth is forecast to increase to 4.3 per cent in 2014 as global uncertainty subsides and confidence strengthens. The average annual increase in consumer prices is expected to remain at about 5.5 per cent a year.

Growth at the levels projected, however, remains insufficient for South Africa to meaningfully reduce unemployment and poverty in line with the objectives set out in the New Growth Path. Chapter 2 provides details on initiatives aimed at enhancing competitiveness and accelerating economic growth. Measures that broaden access to work opportunities, especially for young people, will enjoy special priority.

Table 1.1 Macroeconomic projections, 2010 – 2014

Calendar year	2010 Actual	2011 Estimate	2012	2013 Forecast	2014
Percentage change unless otherwise indicated					
Final household consumption	4.4	4.3	3.7	4.4	4.5
Gross fixed capital formation	-3.7	2.9	4.5	5.7	6.3
Real GDP growth	**2.8**	**3.1**	**3.4**	**4.1**	**4.3**
GDP at current prices (R billion)	**2 664.3**	**2 931.8**	**3 208.2**	**3 555.0**	**3 930.5**
CPI inflation	4.3	5.0	5.4	5.6	5.4
Current account balance (% of GDP)	-2.8	-3.4	-3.8	-4.0	-4.2

Fiscal policy and trends

Fiscal framework is supportive of growth

Chapter 3 presents a fiscal framework that is supportive of the economy over the medium term, while strengthening interventions aimed at boosting sustainable long-term growth. The budget deficit widens in the current year owing to lower-than-anticipated revenue. Moderation in spending, together with improving revenue performance, will reinforce the fiscal position over the next three years. It is expected that debt-service costs will stabilise as a percentage of GDP by 2014/15.

Table 1.2 Consolidated government fiscal framework, 2010/11 – 2014/15

R billion	2010/11 Outcome	2011/12 Estimate	2012/13	2013/14 Medium-term estimates	2014/15
Revenue	**758.4**	**814.2**	**890.0**	**994.5**	**1 113.0**
Percentage of GDP	*27.6%*	*27.3%*	*27.0%*	*27.3%*	*27.7%*
Expenditure	**885.8**	**978.8**	**1 062.3**	**1 157.4**	**1 247.0**
Percentage of GDP	*32.2%*	*32.9%*	*32.2%*	*31.8%*	*31.0%*
Budget balance	**-127.4**	**-164.6**	**-172.3**	**-162.9**	**-134.1**
Percentage of GDP	*-4.6%*	*-5.5%*	*-5.2%*	*-4.5%*	*-3.3%*

Medium-term expenditure priorities and the division of revenue

Chapter 4 outlines the proposed 2012 MTEF. The spending outcome for 2010/11 and adjusted estimates for 2011/12 are presented, along with indicative revisions to spending plans for the next three years. Spending trends and public-service priorities are reviewed, both by function and by level of government.

Real growth in non-interest spending will average just over 2 per cent a year over the medium term

Real growth in government non-interest spending will average just over 2 per cent a year for the MTEF period. Education remains the largest category of expenditure, followed by social protection, local government and housing, and health services. State debt cost, however, is the fastest-growing component of expenditure, followed by economic infrastructure (transport, communications and energy).

Table 1.3 Consolidated government expenditure, 2011/12 – 2014/15

R billion	2011/12 Revised estimate	2012/13	2013/14 Budget estimate	2014/15	Average annual growth 2011/12–2014/15
General public services	53.0	54.7	58.7	64.9	7.0%
Defence	38.3	41.8	44.4	47.0	7.1%
Public order and safety	90.6	98.8	105.9	112.1	7.4%
Economic infrastructure	77.4	85.5	91.9	101.5	9.5%
Economic services and environmental protection	52.4	56.3	60.2	62.6	6.1%
Local government, housing and community amenities	121.5	128.4	140.5	146.2	6.4%
Health	113.2	121.5	130.6	140.1	7.4%
Recreation and culture	9.6	9.6	9.2	9.7	0.2%
Education	190.8	202.6	218.2	231.7	6.7%
Social protection	147.8	159.8	172.6	182.3	7.2%
Science and technology	7.3	8.1	9.2	9.6	9.5%
Contingency reserve	–	6.0	12.0	24.0	
Non-interest expenditure	**901.9**	**973.2**	**1 053.3**	**1 131.9**	**7.9%**
State debt cost	76.9	89.1	104.1	115.1	14.4%
Total expenditure	**978.8**	**1 062.3**	**1 157.4**	**1 247.0**	**8.4%**

The proposed division of revenue between national, provincial and local government is set out in Table 1.4. National departments account for 47.1 per cent of expenditure in 2012/13, provinces 44.1 per cent and transfers to municipalities 8.8 per cent.

Table 1.4 Division of revenue, 2011/12 – 2014/15

R billion	2011/12	2012/13	2013/14	2014/15
National allocations	377.8	410.3	444.7	474.7
Provincial allocations	363.2	384.5	411.0	437.8
Equitable share	*291.7*	*308.5*	*328.4*	*348.8*
Conditional grants	*71.5*	*76.0*	*82.6*	*89.0*
Local government allocations	70.1	77.0	83.8	90.8
Total allocations	**811.2**	**871.9**	**939.5**	**1 003.3**
Changes to baseline				
National allocations	-2.3	1.9	5.8	15.1
Provincial allocations	5.3	4.1	6.7	9.4
Equitable share	*3.2*	*2.8*	*4.8*	*5.8*
Conditional grants	*2.0*	*1.3*	*2.0*	*3.6*
Local government allocations	–	–	1.5	3.5
Total	**2.9**	**6.0**	**14.0**	**28.0**

Conclusion

The *Medium Term Budget Policy Statement* contributes to South Africa's broader economic and development debate through improved understanding of public finances. Before the end of the year, work done by the National Planning Commission will provide a longer-term perspective on South Africa's growth and development challenges.

Policy statement summarises spending plans in preparation for the 2012 Budget

The budget policy statement provides a scan of the medium-term economic outlook, an overview of the fiscal framework and related issues, and a summary of government's spending plans, as background to the more detailed sectoral policies and departmental programmes that will accompany the 2012 Budget.

2

Economic outlook

Overview

The global economic recovery has slowed, though moderate growth is still expected for the period ahead. The unresolved European debt crisis and uncertainty over bank recapitalisation, alongside anaemic growth in the United States, are significant risks to the world outlook. While developing economies are expected to grow more rapidly than advanced economies, they are not immune to the effects of the slowdown in Europe or the US.

Growth outlook moderated by significant global risks

South Africa is highly integrated with the world economy, which plays a central role in shaping our long-term prospects. Since 2000, the world has experienced unusually strong economic cycles and shocks, and these have been reflected in domestic demand and GDP growth. Government's fiscal balance has responded to these fluctuations and plays an important role in offsetting them.

South Africa needs much faster growth, sustained over a decade or more, to reduce poverty and unemployment in line with the objectives set out in the New Growth Path. Growth must not only be rapid – it also needs to be inclusive, leading to broadening economic participation and a decline in inequality. Realising these goals depends on the private sector becoming more competitive in the rapidly evolving world economy. Government and state-owned enterprises can create an enabling environment in which businesses can grow and create jobs by providing the necessary infrastructure, delivery of public services, and regulatory and competition framework. Measures are required to improve spending of capital budgets, change the way network industries operate and promote competition. Education and skills levels need to be strengthened.

South Africa needs much faster growth, sustained over a decade or more, to substantially reduce poverty and unemployment

In the near term, South Africa will be affected by international trade and investment trends, and is vulnerable to slowing global demand.

GDP growth expected to reach 4.3 per cent in the outer year of the forecast

In recent months the domestic economy has lost momentum as a result of the disruption to world economic activity following the Japanese tsunami, domestic strike activity and moderating household consumption. In the first quarter of 2011, the economy grew at 4.5 per cent on an annual basis. In the second quarter, growth slowed to 1.3 per cent. Real GDP is now expected to grow by 3.1 per cent in 2011 – a downward revision from the 3.4 per cent forecast in the 2011 Budget. Growth is expected to pick up over the medium term as global uncertainty subsides and confidence strengthens. South Africa's GDP growth is projected to reach 3.4 per cent next year, 4.1 per cent in 2013 and 4.3 per cent in 2014.

Economic support package to enhance competitiveness and structural change

Fiscal and monetary policy will remain supportive of demand and economic growth over the short term. The 2012 medium-term expenditure framework (MTEF) will include a package of measures to support improvements in competitiveness and structural change to help enterprises adjust to new market opportunities, technological advances and a more challenging global environment. Over the medium term, fiscal consolidation will be accompanied by determined efforts to shift the composition of expenditure towards greater investment in infrastructure.

The world economy

2012 global growth forecast reduced from 4.5 per cent to 4 per cent

The world economic outlook has deteriorated since publication of the *Budget Review* in February. Production and consumption were negatively affected by disruption in global manufacturing supply chains and an oil price spike. Confidence and growth have been dampened by persistent weaknesses in labour and housing markets in developed economies, and the intensification of the European debt crisis. The International Monetary Fund (IMF) has lowered its global growth forecast from about 4.5 per cent to 4 per cent in 2011 and 2012. Advanced economies are only expected to grow by 1.6 per cent in 2011 and 1.9 per cent in 2012, with downside risks if decisive policy actions are not taken with greater urgency.

Table 2.1 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2011 – 2013

Region / country	2011	2012	2013	2011	2012	2013
Percentage	GDP projections[1]			CPI projections[1]		
World	**4.0**	**4.0**	**4.5**	**5.0**	**3.7**	**3.2**
US	1.5	1.8	2.5	3.0	1.2	0.9
Euro area	1.6	1.1	1.5	2.5	1.5	1.7
UK	1.1	1.6	2.4	4.5	2.4	2.0
Japan	-0.5	2.3	2.0	-0.4	-0.5	0.0
Emerging markets and developing countries	**6.4**	**6.1**	**6.5**	**7.5**	**5.9**	**5.1**
Developing Asia	**8.2**	**8.0**	**8.4**	**7.0**	**5.1**	**4.4**
China	9.5	9.0	9.5	5.5	3.3	3.0
India	7.8	7.5	8.1	10.6	8.6	7.1
Middle East and North Africa	**4.0**	**3.6**	**4.3**	**9.9**	**7.6**	**6.5**
Sub-Saharan Africa	**5.2**	**5.8**	**5.5**	**8.4**	**8.3**	**6.4**
South Africa[2]	3.1	3.4	4.1	5.0	5.4	5.6

1. IMF World Economic Outlook, September 2011

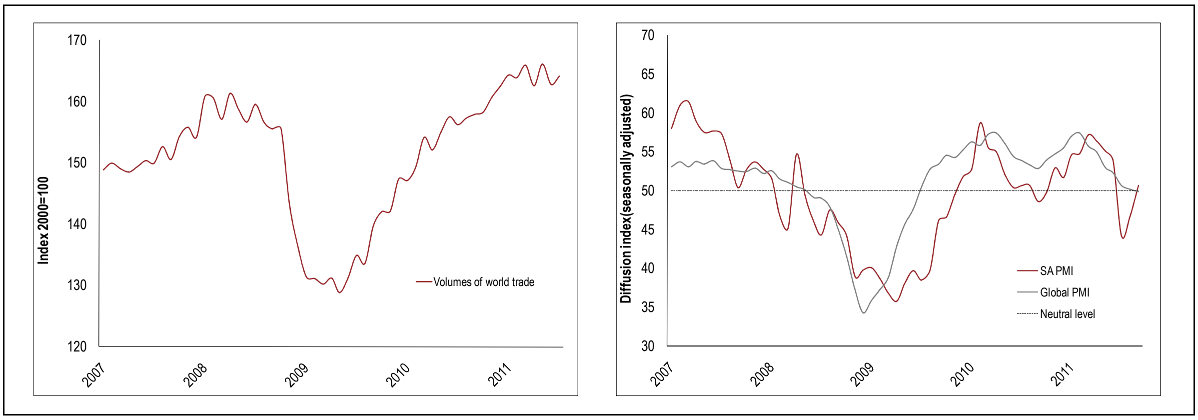
2. National Treasury forecasts

In advanced economies, financial stresses on governments, companies, banks and households have sapped demand, leading to weak consumption. Fast-growing emerging economies such as China, India and Brazil are facing inflationary pressures and the risk of overheating as a result of rapid credit extension and booming housing markets. More broadly, uncertainty about the strength of the recovery has acted as a brake on job creation. Employment in advanced economies is more than 12 million below pre-crisis levels.

Uncertainty about the pace of global recovery has acted as a brake on job creation in developed countries

After recovering strongly in 2010, international trade volumes have flattened this year, as shown in Figure 2.1. Indicators of the health of the manufacturing sector have been in decline for several months, suggesting that global growth will be slower over the near term.

Figure 2.1 Global trade volumes and purchasing managers' indices*



Source: CPB Netherlands Bureau for Economic Policy Analysis, Kagiso and JP Morgan

**A reading above 50 indicates an expansion compared with the previous month*

In the months ahead, international economic recovery depends largely on a credible policy response to the European crisis that will allow financial conditions to stabilise, restore confidence and provide an environment conducive for renewed growth. Weak growth and political deadlock over fiscal measures to strengthen recovery in the United States are also dampening the global outlook.

Recent conditions have fed volatility in capital flows and asset prices, knocking confidence and investment in emerging and developing countries, and exacerbating the negative shock from weak external demand in developed economies. Capital outflows from emerging market equities reached US$30 billion for the year to October as investors sought refuge in traditional safe-haven assets such as the US dollar. In the third quarter, portfolio outflows from emerging markets were the largest since the collapse of Lehman Brothers in 2008.

Capital outflows from emerging market equities reached US$30 billion for the year to October

Over the medium term, emerging markets with relatively buoyant growth prospects will continue to attract capital, placing upward pressure on currencies relative to the dollar – including in China, where the authorities have signalled a gradual move towards a more market-determined exchange rate.

Commodity prices are high and remain volatile. While the gold price has receded from the historic high it reached in August, it remains at elevated levels. The platinum price has declined in recent months but remains about US$500/oz above the average price of the last 10 years. The benchmark oil

Commodity prices are high and remain volatile price rose sharply in the first half of 2011, reaching US$127/bbl in April, before falling to just below US$110/bbl in mid-October.

The unfolding crisis in Europe

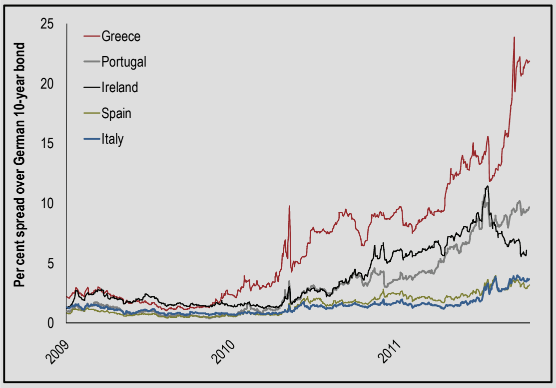
The present crisis in Europe is the result of high sovereign debt burdens and balance of payments strains accumulated over a number of years. The public deficits that led to these debt levels are unsustainable, and have come into sharp focus in the wake of the global financial crisis that began in 2008. While concerns were initially centred on Greece, the crisis has spread to several other eurozone countries and spilled over into the banking sector, putting growing pressure on the European Union (EU) currency union.

The possibility of a Greek default has made investors less willing to lend to vulnerable countries such as Italy and Spain, increasing the cost of borrowing. Bondholders and governments have failed to reach agreement on the level of losses that each may be obliged to absorb. Bond yields have shot up and financial markets have become more volatile. Affected countries are turning to severe austerity measures, dampening near-term growth and contributing to rising social tensions.

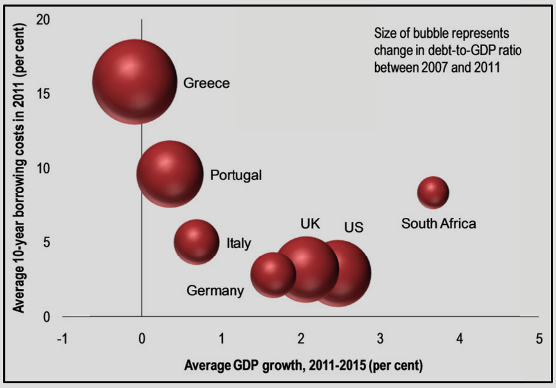
Banks in Europe are widely exposed to EU sovereign debt, and default by any country in the currency union will trigger large banking sector losses, with dramatic consequences for the world economy.

Recent commitments by EU leaders to ease the borrowing constraints faced by sovereigns and banks need to be complemented with credible plans to boost competitiveness and growth. Failure to do so could result in global contagion. Slower growth and instability in Europe would reduce demand for South African exports and increase rand volatility.

Borrowing costs



Change in debt, growth and interest costs



Source: Bloomberg and International Monetary Fund

Domestic outlook

South Africa's real GDP growth slowed from a seasonally adjusted annual rate of 4.5 per cent in the first quarter of 2011 to 1.3 per cent in the second quarter, as manufacturing, mining and agriculture contracted. For the remainder of 2011, uncertainty and the weak global environment will result in moderate growth.

Real interest rates are low and the banking sector is well capitalised

Domestic conditions are largely supportive of growth. Real interest rates are low, and will assist in bolstering private-sector consumption and investment over the medium term. The banking sector remains well capitalised, with little exposure to the sovereign debt risks in Europe. Manufacturing should experience faster growth as the world economy improves over the medium term, but sustaining increased exports requires structural improvements to the economy's underlying competitiveness.

Assuming an orderly resolution of the European financial crisis, the domestic outlook improves over the medium term

Over the next three years, growth is expected to increase gradually in tandem with the improved global outlook, rising above 4 per cent in the outer years of the forecast. This assumes an orderly resolution of the European debt crisis, the avoidance of a US recession and continued strong growth in emerging markets, particularly China. A different international outcome will affect the domestic outlook:

- Stagnating global growth would reduce South Africa's exports. Europe, Japan, and the US account for 44 per cent of total exports and 47 per cent of manufactured exports.
- Capital flow reversals could lead to weaker equities prices on the Johannesburg Stock Exchange, greater pressure on the rand, rising bond yields and higher borrowing costs.
- A weakening in emerging markets, especially China, could put downward pressure on commodity prices, reducing the profitability of the mining sector.

The macroeconomic projections over the MTEF are set out in Table 2.2.

Table 2.2 Macroeconomic projections, 2008 – 2014

	2008	2009	2010	2011	2012	2013	2014
Calendar year		**Actual**		**Estimate**		**Forecast**	
Percentage change unless otherwise indicated							
Final household consumption	2.2	-2.0	4.4	4.3	3.7	4.4	4.5
Final government consumption	4.7	4.8	4.6	4.4	4.1	4.1	4.1
Gross fixed capital formation	14.1	-2.2	-3.7	2.9	4.5	5.7	6.3
Gross domestic expenditure	3.4	-1.7	4.2	4.1	3.8	4.6	4.6
Exports	1.8	-19.5	4.5	4.0	6.9	7.1	8.0
Imports	1.5	-17.4	9.6	7.6	7.8	8.2	8.4
Real GDP growth	**3.6**	**-1.7**	**2.8**	**3.1**	**3.4**	**4.1**	**4.3**
GDP inflation	8.9	7.2	8.1	6.7	5.8	6.4	6.0
GDP at current prices (R billion)	**2 274.1**	**2 396.0**	**2 664.3**	**2 931.8**	**3 208.2**	**3 555.0**	**3 930.5**
Headline CPI inflation	9.9	7.1	4.3	5.0	5.4	5.6	5.4
Current account balance (% of GDP)	-7.1	-4.1	-2.8	-3.4	-3.8	-4.0	-4.2

Table 2.3 Macroeconomic projections, 2010/11 – 2014/15

	2010/11	2011/12	2012/13	2013/14	2014/15
Fiscal year	**Actual**	**Estimate**		**Forecast**	
Percentage change unless otherwise indicated					
Real GDP growth	3.3	2.8	3.8	4.1	4.3
GDP inflation	8.9	5.4	6.7	6.1	5.9
Headline CPI inflation	3.8	5.4	5.2	5.6	5.4
GDP at current prices (R billion)	**2 748.2**	**2 977.7**	**3 298.0**	**3 642.6**	**4 023.4**

Household consumption growth will moderate in the short term as rising inflation limits disposable income. In the outer years of the forecast, household consumption growth will rise back above 4 per cent.

Growth in gross fixed capital formation is expected to continue its recovery, rising from 2.9 per cent this year to 6.3 per cent in 2014.

The trade balance is expected to deteriorate as import growth outpaces export growth. The projected current account deficit widens to 4.2 per cent of GDP in 2014 from 3.4 per cent in 2011.

Current account balance widens from 3.4 per cent to 4.2 per cent of GDP in 2014

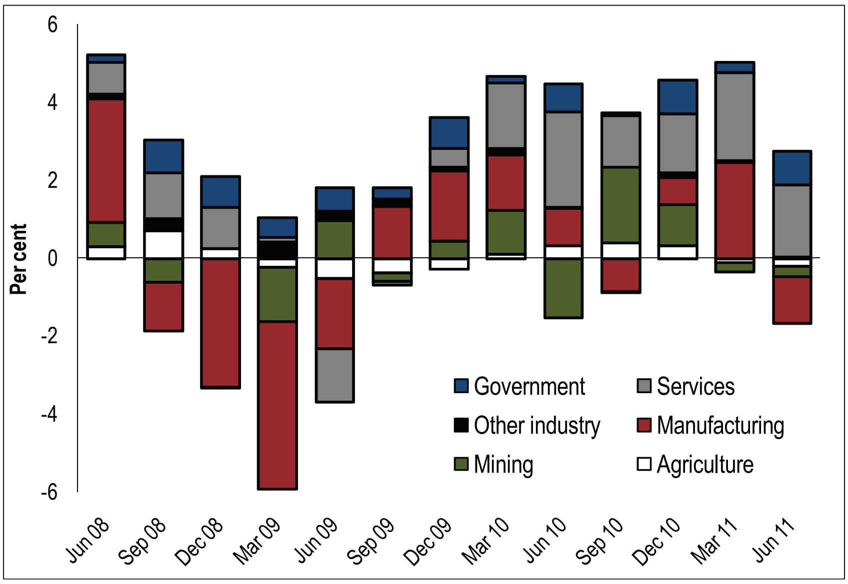
Inflation is expected to breach the 3-6 per cent target band temporarily in the first quarter of 2012, and to average 5.5 per cent over the forecast period.

Trends in the South African economy

Household consumption and signs of a revival in investment supported growth over the past 12 months

Household consumption and signs of a revival in investment have supported growth in the domestic economy over the past 12 months. Global supply chain disruptions, alongside temporary domestic factors affecting mining and manufacturing, contributed to slowing output growth in the second quarter of 2011. These developments, in combination with a weaker global outlook, rand volatility, sharp rises in administered prices, and policy and regulatory uncertainty, have weakened business and consumer confidence.

Figure 2.2 Sector contributions to GDP growth, 2008 – 2011



Source: Statistics South Africa

Currency volatility

Durable benefits of a more competitive rand can be obtained from improved productivity and lower costs

The rand remains one of the world's most volatile currencies, trading in a range of R6.58/US$ to R8.25/US$ between January and October of this year. In August, increasing global risk aversion led to capital outflows and the rand weakened alongside other emerging market currencies. The nominal trade-weighted rand declined by 18 per cent between January and October; in real terms, the decline has been less pronounced, owing to South Africa's higher inflation compared with its trading partners.

While this trend will benefit exporters, the costs of imported goods such as oil will increase. To obtain durable benefits from a more competitive currency, exporters need to improve productivity and contain domestic input costs.

Weak performance in mining, manufacturing and agriculture

Overall mining value added grew by 6.3 per cent in the first half of 2011, year on year. Production of platinum group metals rose by 16.3 per cent over this period. In the year to August 2011, overall mining production has declined by 4 per cent, with steep falls in diamonds and gold, despite a 12 per cent increase in primary commodity prices. Strikes and safety-related stoppages disrupted production.

Mining underperformance

Value added in South Africa's mining sector was flat between 2001 and 2008, compared with 12 per cent growth in Chile. Investment growth averaged 7 per cent per year during the 2000s compared with 24 per cent in Australia. Several factors contributed to this underperformance:

- Uncertainty in the regulatory environment governing the transfer of mining rights, and an opaque permit-granting process, compounded by inefficient administrative processes and lengthy waiting periods for the issuance of water licences.
- Logistical challenges, including operational inefficiencies in the rail system and high port charges.
- Investment in electricity generation capacity remains crucial to prevent production stoppages.
- Volatility of the exchange rate leads to widely fluctuating rand commodity prices.
- The debate on nationalisation has fed uncertainty among investors.
- Gold mining now occurs at very deep levels, with higher costs and risks.

Manufacturing gross value added grew by 3 per cent in the first six months of 2011, compared with the first half of 2010. Following value-added growth of 14.5 per cent in the first quarter, the sector contracted sharply, declining at an annualised rate of 7 per cent in the second quarter, as motor vehicle production fell due to delayed input supplies from Japan. Manufacturing output is likely to remain weak in the third quarter.

Table 2.4 Manufacturing production by subsector, 2010 – 2011

	Weights	Annual growth 2010	Production growth (saar[1]) Q1 2011	Q2 2011	Year to date growth Dec 2010 – Aug 2011
Petrochemicals	22.1%	6.0	29.4	-7.9	3.2
Basic iron and steel	22.9%	4.3	31.1	-0.6	0.6
Food and beverages	15.4%	4.0	-4.9	-9.2	3.2
Motor vehicles and parts	10.9%	20.1	7.8	-25.0	7.8
Wood and paper	10.2%	4.8	7.8	-18.7	-8.7
Furniture and other	5.2%	-2.5	49.4	0.4	17.1
Textiles and clothing	4.9%	-6.1	-4.5	-2.9	1.5
Glass, etc	4.8%	-2.9	1.9	-0.7	3.6
Electrical machinery	2.5%	5.5	8.1	-7.1	-4.1
Radio and television	1.1%	-3.9	10.0	15.9	14.3
Total	**100.0%**	**4.9**	**15.6**	**-8.7**	**2.5**

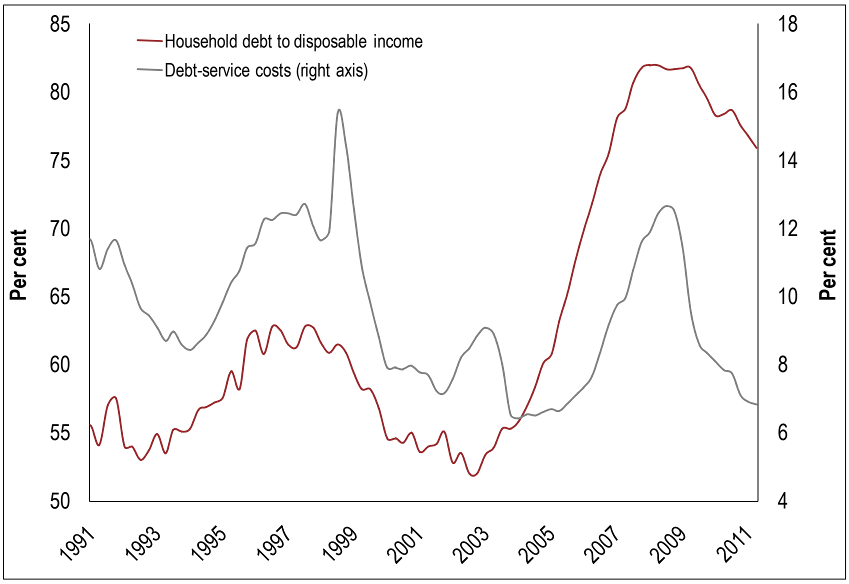
1. Seasonally adjusted annualised rates
Source: Statistics South Africa

Agricultural value added increased by 6.6 per cent in the first half of the year compared with the same period in 2010, but has contracted in each of the first two quarters of 2011, largely as a result of adverse weather conditions that affected harvests. Compared with the first six months of 2010, value added by services increased by 3.3 per cent in the first half of 2011, with robust growth across all sectors.

Household consumption underpins the recovery

Household consumption has continued to grow strongly, accounting for more than two percentage points of growth in the first half of 2011. Rising real disposable incomes, expanding employment for higher-skilled workers and low interest rates have sustained consumption spending, and also enabled households to pay down debt to levels last seen in 2006. The ratio of household debt to disposable income remains elevated, but has declined from a peak of 82 per cent in the first half of 2008 to 75.9 per cent in the second quarter of 2011.

Figure 2.3 Ratios of household debt and debt-service costs to disposable income, 1991 – 2011*



Source: Reserve Bank

**Data for 2011 is for first two quarters*

Low levels of credit demand, a sluggish housing market and high levels of non-performing loans have contributed to muted growth in credit extension to households.

A recovery in investment

Private gross fixed capital formation expanded at an annual pace of 4 per cent in the second quarter of 2011

Following a sharp contraction during the 2009 recession, private gross fixed capital formation has started to revive, expanding at an annual pace of 4 per cent in the second quarter of 2011, mainly due to increased purchases of machinery and transport equipment. Investment in mining and communications registered the fastest growth in the first half of 2011. Despite these improvements, real investment in the second quarter of 2011 was 8 per cent below its pre-crisis peak.

Table 2.5 Contribution to overall investment growth, 2007 – 2011

Percentage	2007	2008	2009	2010	2011[1]
General government	3.3	2.6	-0.6	-1.7	-0.2
Public corporations	4.2	5.1	4.3	0.8	0.8
Private enterprises	6.5	6.4	-5.9	-2.7	1.5
Total	**14.0**	**14.1**	**-2.2**	**-3.7**	**2.0**

1. First half of 2011 compared to the same period in 2010
Source: Reserve Bank

Inflationary pressures remain contained

Administered prices are a major contributor to inflation

Headline consumer price inflation has remained within the target range of 3 per cent to 6 per cent for 20 months and is expected to average 5 per cent in 2011. Rising food and petrol prices have put upward pressure on inflation, which increased from 3.2 per cent in September 2010 to 5.7 per cent in September 2011. Increases in administered prices (set by government or governing agencies) are a major factor: in 14 of the 18 administered price components, inflation is above 6 per cent, with double-digit increases in electricity, water supply, refuse collection and sewerage prices.

The Reserve Bank has kept the repurchase rate unchanged at a 30-year low of 5.5 per cent since November 2010.

Current account developments

Foreign direct investment inflows of R17.3 billion during the first half of 2011, up sharply from 2010

South Africa's terms of trade improved by 1.9 per cent during the first six months of this year compared with the 2010 average. Exports grew by 13.9 per cent in the second quarter following a substantial contraction during the first three months of the year. Imports grew by 9.8 per cent and the current account deficit increased marginally from 2.8 per cent of GDP in 2010 to 3.2 per cent in the first half of 2011. The financial account surplus totalled 5.5 per cent of GDP in the first half of the year, compared with 4 per cent in the whole of 2010. Inflows were dominated by R55.9 billion in portfolio flows, primarily into government bonds, and foreign direct investment inflows rose to R17.3 billion – nearly three times the amount recorded in the first half of 2010.

Towards a simpler, more competitive investment framework

Proposed reforms to the prudential and investment regulatory framework aim to promote investment into South Africa and as a gateway into Africa – and to reduce the cost of doing business.

Enhancing domestic capital markets

Following public comments received on the *Prudential Regulation of Foreign Exposure for Institutional Investors* discussion document, the National Treasury proposes that all inward listed shares on the JSE be classified as "domestic" for the purposes of trading on the exchange, and be included in its indices. Details will be provided by the JSE. Prudential institutions would still be required to report their foreign exposures to the regulatory authorities, subject to regulatory criteria. This proposal is intended to enhance the ability of the JSE to attract new listings and boost investments into Africa. Further work is in progress to modernise the foreign direct investment framework.

Improving access and competition in cross-border money remittances

Government proposes to remove ownership restrictions on international participation in foreign currency exchange bureaus, also known as authorised dealers with limited authority (ADLAs). The requirement for money remitters to partner with authorised dealers will also be removed. Remitters will be regulated as standalone entities, subject to reporting and regulatory requirements. These changes aim to reduce the cost of cross-border remittances, particularly to other countries in Africa.

Reducing red tape on cross-border transactions

Cross-border transaction thresholds will be amended to reduce red tape, simplify payment mechanisms and eliminate bias between resident and non-resident individuals.

The Reserve Bank will publish details on these proposals and other administrative reforms.

A sluggish labour market response

Unemployment has risen since the recession, and job creation has been particularly weak for young people and the less skilled

The labour market remains sluggish. While output has risen by 6.2 per cent over the last two years, formal sector non-agricultural employment is just 2.6 per cent higher than its low in March 2010. Unemployment increased from 21.8 per cent in the fourth quarter of 2008 to 25.7 per cent in the second quarter of 2011. This figure does not capture the estimated 2.2 million workers who have stopped looking for work. Formal sector non-agricultural job creation has been concentrated in government. Finance, real estate and business services, retail and wholesale trade, and mining have created net employment over the last year. Net job creation also occurred in construction during the first half of 2011. Job creation has been particularly weak for young people and the less skilled.

Table 2.6 Changes in formal employment by sector, December 2008 – June 2011

	Total employed June 2011 (thousands)	% of total	Change December 2008 – March 2010 (thousands)	Change March 2010 – June 2011 (thousands)	% Change in real monthly earnings 2008 – 2010
Community and personal services	2 324	28	44	121	14.9
Construction	416	5	-56	-2	25.7
Finance, insurance and real estate	1 820	22	-172	78	11.0
Manufacturing	1 152	14	-88	-35	13.8
Mining and quarrying	515	6	-27	24	13.5
Retail and wholesale trade	1 654	20	-117	24	9.3
Transport and communication	356	4	-7	-3	11.1
Utilities	59	1	-3	3	23.4
Total	**8 296**	**100**	**-426**	**210**	**14.2**

Source: Statistics South Africa (QES - Quarter 2, 2011)

Despite tepid demand for labour, nominal wage settlements averaged 7.7 per cent in the first nine months of 2011, compared with 8.2 per cent in 2010 as a whole. Real wage settlements increased by 3.1 per cent in 2011, following a 3.9 per cent increase in 2010.

Supporting demand and increasing growth

An economic support package funded within the fiscal framework to help make industry more competitive and create jobs

The 2012 MTEF will introduce an economic support package to encourage improvements in competitiveness and promote structural change. Government will provide about R25 billion over the next six years for a range of interventions to invigorate industrial development zones, assist enterprise investment and job creation, support the transition to a greener economy, and leverage infrastructure investment and risk-sharing partnerships with the private sector. The package will include temporary mechanisms to bolster productivity and innovation in industries that have demonstrated long-term competitive potential. Funding of the package over the next three years will be contained within the available fiscal envelope.

Continuing investment in network infrastructure

Public-sector investment is continuing in energy, roads, rail, telecommunications and water

Public-sector infrastructure investment, which has increased as a share of GDP from 4.3 per cent in 2005 to 7.5 per cent in the first half of 2011, remains central to government's economic development plans. Infrastructure projects in energy, roads, rail, telecommunications and water will ease bottlenecks and reduce costs in the rest of the economy, crowding in private investment and improving access to export markets. Complementary reforms to improve the quality of regulation and encourage increased private-sector participation will improve efficiency and lower costs in these sectors.

Building infrastructure for a globally competitive economy

South Africa needs adequate infrastructure to produce and transport goods and services more efficiently, promoting growth and creating jobs. Following a sustained decline between the early 1980s and the mid-2000s, capital investment by government and state-owned enterprises has grown rapidly in real terms over the last six years, rising from R67.5 billion in 2005 to more than R140 billion today. Key features of the capital investment programme include:

- Continued investment in the road network, including stepped-up rehabilitation and maintenance of provincial roads and national highways.
- Expanding investment of bulk freight rail to support mining production, including coal haulage capacity and the iron ore line to Saldanha Bay, to raise transport volumes from 47 million tons to 60 million tons.
- Investment in commuter rail infrastructure and rolling stock as part of an 18-year, R80 billion replacement and modernisation programme.
- Completion of Transnet's R23 billion Durban-to-Johannesburg multiproduct pipeline in 2014/15.

Eskom's capital expenditure programme is intended to double its electricity generation capacity from 40 000MW to 80 000MW by 2025 and ensure the economy benefits from a reliable supply of electricity. The Ingula, Medupi and Kusile power stations are projected to be completed by 2014, 2015 and 2018 at a cost of R21 billion, R99 billion, and R121 billion respectively. In addition, Eskom is investing R24 billion in returning old power stations to service and R28.8 billion on building transmission infrastructure.

The second phase of the Lesotho Highlands water project is a R15 billion investment in the Pohali reservoir, and associated water transfer and hydroelectric projects. Over the medium term, the Trans Caledon Tunnel Authority will invest R5 billion in various projects, including the Mooi-Mgeni transfer scheme, the Mokolo-Crocodile and Komati water supply projects, and the Olifants River water resource development project.

Private investment in telecommunications infrastructure will boost broadband speed and volumes, and reduce costs. By 2013 five submarine cables will connect South Africa to global telecommunications networks. In partnership with the private sector, government will roll out land-based fibre optic infrastructure in the large metros and build networks in underserviced areas to expand internet access.

Economic development zones

Promoting investment in industrial development zones to boost exports

Industrial development is central to sustainable growth, investment and employment in fast-growing cities and metropolitan areas. Incentives are under consideration to facilitate public and private investment in economic infrastructure, and attract employment-intensive industry and services into industrial development zones, with the potential to export, join global supply chains and become competitive logistics hubs.

Small business and competition

Regulatory and tax burdens should not unduly burden small business

High regulatory burdens related to labour and trade issues, licences and permits, taxation and access to finance impose a disproportionately large cost on small firms. Greater levels of competition and job creation can be achieved by working with small business to alleviate these problems. Regulatory and administrative burdens on small firms should not unduly impinge on business creation, growth and expansion.

Opening and competing in new markets

Government is working to diversify export markets

Developing countries account for about 43 per cent of world imports, up from 30 per cent in 2000. South Africa remains heavily reliant on its traditional trading partners (the US, European Union and Japan), making exports vulnerable to a slowdown in advanced economies. Rebalancing exports to achieve a greater presence in fast-growing regions will take time given differences in demand for goods and services, and the need to adjust logistics and institutional arrangements. Government is working to diversify export markets by providing an environment conducive for business to expand – including through its new association with Brazil, Russia, India and China as part of the BRICS grouping.

Regional integration

Eliminating non-tariff barriers would strengthen trade throughout Sub-Saharan Africa

There is much potential for expanded trade and investment in Sub-Saharan Africa. Strategies to promote regional integration should involve opening up the north-south corridor through collaborative infrastructure investment and participating in regional energy markets. Deterrents to trade – including inefficient customs procedures, complicated rules of origin and other non-tariff barriers – should be addressed. Talks have begun to create an African free-trade area comprising 26 countries with a combined population of 600 million and GDP nearing US$1 trillion.

Support for job creation

Real wages will increase over time, improving workers' living standards, as national income and productivity rise

Investment in infrastructure needs to be accompanied by strengthening labour market institutions to support faster growth, and to expand jobs and skills development. Real wages will rise over time, improving workers' standard of living, as national income and productivity rise. However, moderation in the growth of unit labour costs would support more rapid job creation and competitiveness. Wage moderation throughout government and state-owned entities would support a shift in the composition of state expenditure towards investment.

The recent agreement between the textile industry and the Southern African Clothing and Textile Workers Union, in which lower wages for new employees accompany a commitment to create new jobs, is a constructive approach to raise employment. Fiscal support for lower-wage employees and new entrants should be strengthened. Expanding the community work programme over the medium term will support low-income households and bring more people into the labour market.

Green growth

Steps to reduce greenhouse gas emissions and promote sustainable use of resources

Trade, industrial and energy policies need to be aligned to support the transition towards a green economy. The first steps have been taken towards major investments in renewable energy by the private sector. Electricity demand management measures have also been given greater impetus, and environmental employment programmes have received additional funds. Policies to ensure the sustainable use of resources include the financing of green projects by the Industrial Development Corporation and the Development Bank of Southern Africa, carbon emissions reduction through government's integrated resource plan, the proposed carbon tax, and the introduction of a dedicated fund for green economy initiatives.

Conclusion

While growth is expected to pick up over medium term, structural reforms are required to sustain more rapid, inclusive growth

The world economy is going through a period of slower growth and increased uncertainty. South Africa's growth has slowed but remains positive, and is expected to pick up over the medium term. Fiscal and monetary policy remains supportive of growth. Current growth rates are not fast enough to support the employment gains and poverty reduction that the country requires. This will require structural reforms to set the economy on a different growth trajectory that increases labour absorption, raises competitiveness and ensures that the benefits of growth are shared.

3

Fiscal policy and trends

Overview

The 2012 budget framework supports growth and employment, while strengthening government's commitment to fiscal sustainability. The fiscal stance is framed by a period of exceptional global economic volatility, centred on concerns about sovereign debt levels and financial stability in advanced economies.

Support for growth, employment and fiscal sustainability in a period of global volatility

In this context, the 2011 *Medium Term Budget Policy Statement*:

- Maintains government's countercyclical fiscal stance. Expenditure continues to grow in real terms, encouraging a stronger recovery with an economic support package, measures to bolster job creation and continued public investment in infrastructure. The budget deficit rises to 5.5 per cent in 2011/12 as a result of lower-than-projected revenue, and moderates towards 3 per cent by 2014/15.
- Recognises the need to shift the composition of spending towards the creation of long-term public assets through infrastructure investment. A precondition for this objective to be met is moderation in the growth of the government wage bill and recurrent expenditure generally.
- Strengthens the sustainability of the fiscus by adopting a clear path towards the stabilisation of public debt. By 2014/15, a moderation in spending growth, combined with a recovery in tax revenue, will reduce the deficit sufficiently to stabilise debt-service costs as a percentage of GDP. This will allow government to rebuild fiscal space to address future economic downturns and provide resources for development in a sustainable manner.

The fiscal guidelines proposed in the 2011 *Budget Review* are the foundation of the fiscal stance. Applied consistently, the principles of countercyclicality, long-term debt sustainability and intergenerational equity will enable government to improve social conditions in a

Countercyclicality, debt sustainability and intergenerational equity underpin fiscal policy sustainable manner, and strengthen South Africa's fiscal sovereignty in a turbulent global environment.

Long-term fiscal report to encourage public discussion and parliamentary oversight

The fiscal guidelines published in the 2011 *Budget Review* establish the principles of intergenerational equity, debt sustainability and countercyclicality as the foundation of South Africa's fiscal policy.

Ensuring that our social commitments are affordable requires government to consider demographic and economic trends, alongside the costs of current programmes, over the long term. The public finance implications of South Africa's development plans need to be considered, as do decisions about how to meet current needs, respond to unforeseen economic setbacks and ensure the progressive realisation of social objectives.

To encourage public discussion and greater parliamentary oversight of revenue and expenditure trends, the National Treasury will publish a long-term fiscal review within the next 12 months.

Countercyclical fiscal policy

Moderately expansionary budget to support growth and employment, and steps towards fiscal consolidation over the medium term

In the face of a weak economic environment, government proposes a moderately expansionary budget to support economic recovery and employment. Slowing growth in the world economy, and its effect on South Africa, will result in lower-than-forecast revenues in 2011/12 and 2012/13. In these circumstances, a slightly larger budget deficit is warranted and is in line with countercyclical management of the fiscus. The deficit will widen to 5.5 per cent of GDP in 2011/12. As the economy strengthens, the deficit will narrow steadily towards 3 per cent over the next three years.

Economic support measures applied during the 2009 recession strengthened South Africa's safety net and supported the return to growth. The expenditure required for this response, however, has pushed up public debt as a proportion of GDP, diminishing the fiscal space available for responding to future events. Therefore, while expenditure grows in real (albeit moderate) terms over the medium-term expenditure framework (MTEF) period, government will ensure that fiscal sustainability is reinforced.

While shifting spending to strengthen investment, government maintains its commitment to social expenditure in real terms

Within the spending limits that this commitment establishes, the MTEF will support economic recovery by promoting competitiveness, strengthening economic development, creating work and continuing to make large-scale investments in electricity, roads, rail and water. While shifting an increasing share of expenditure towards infrastructure investment, government will maintain its commitment to social expenditure in real terms.

Safeguarding fiscal sustainability

South Africa must take into account the long-term implications of short-term spending decisions

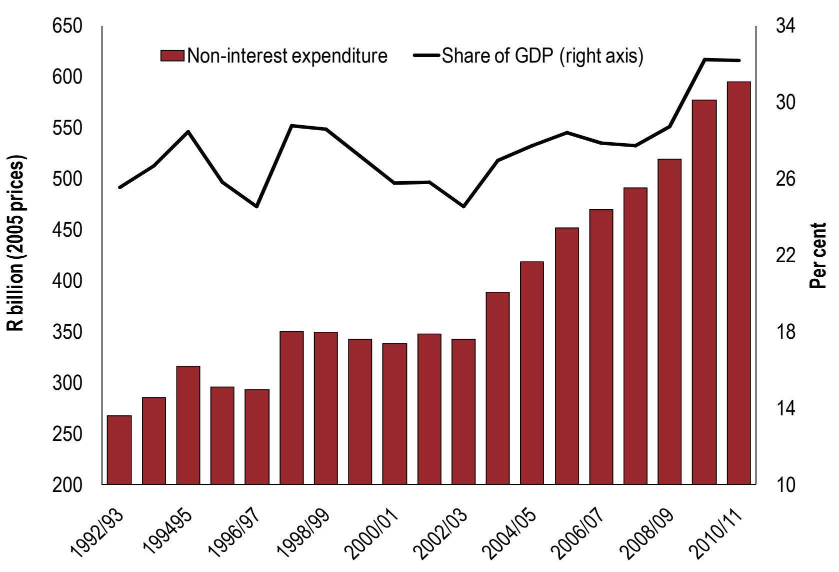
The fiscal choices that South Africa makes over the next three years will have implications for the next three decades. The principle of intergenerational equity implies that today's policy decisions should take into account how they will affect South Africans in 10, 20 or 30 years. The Constitution requires government to provide for a rising floor of socio-economic rights within its resources. Meeting the country's primary social and economic goals requires sustainable increases in real expenditure in the decades to come.

Over the long term, spending should increase at a pace commensurate with the rate of economic growth. Policy shifts that result in permanent step-changes in the level of expenditure need to be supported by corresponding changes in tax revenue.

In real terms, government spending is higher than ever before and constitutes a greater proportion of GDP than at any time since 1994. Non-interest spending rose by 8.2 per cent of GDP from 2002/03 to 2009/10. The 2012 Budget will see spending exceed R1 trillion.

Non-interest expenditure rose by about 8.2 per cent of GDP from 2002/03 to 2009/10

Figure 3.1 Real consolidated general government non-interest expenditure,* 1992/93 – 2010/11



Source: Reserve Bank and National Treasury estimates

** Includes extraordinary financial transfers*

Some of government's spending growth over the past decade was supported by structural increases in revenue, with improved compliance and administration playing a role. But higher revenue in the mid-2000s also reflected a temporary windfall associated with the commodity boom prior to the 2009 recession. To return the budget to a sustainable position over the medium term, government needs to limit spending growth in line with the capacity of the economy to generate revenue.

To return to sustainability, government will limit spending growth in line with capacity to generate revenue

Changing the composition of spending

Long-term sustainability depends partly on the composition of government spending. Governments that spend too much on consumption, or too little on building and maintaining public assets, can retard economic growth and so erode their own fiscal sustainability. Moreover, when a government borrows to finance non-capital spending, it takes on debt obligations that must be paid off years after the funds have been spent, often for little long-term gain.

Since the 2009 downturn, more than R120 billion in current spending has been financed by debt. In real terms, the fastest-growing component of current expenditure over the past decade has been government's wage bill.

Wage settlements need to be balanced against social and economic priorities

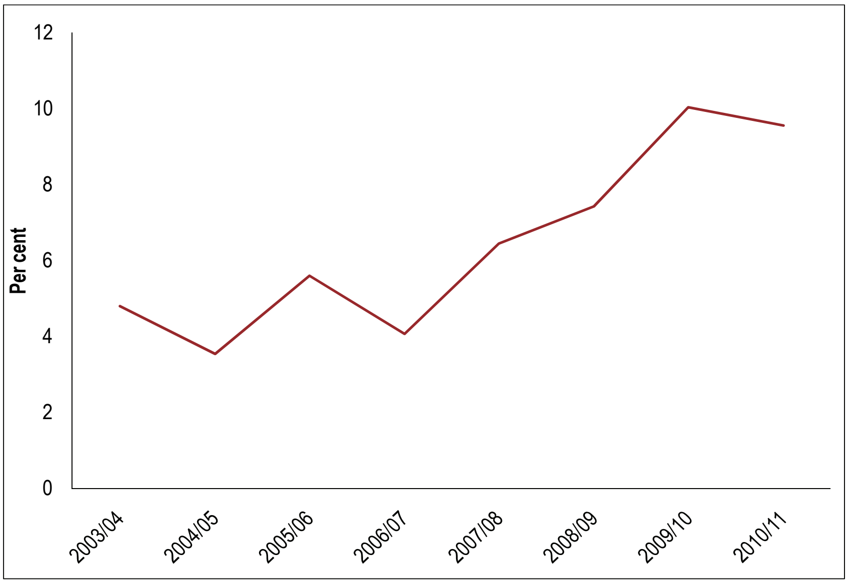
The extent of public-sector wage settlements must be balanced by the crucial consideration of the share of spending allocated to social and economic priorities, such as infrastructure and social security.

As a step towards sustainability, the 2012 fiscal framework is premised on a shift in the composition of government expenditure towards infrastructure investment. Moderation in the growth of the wage bill will see compensation as a proportion of non-interest spending decline over the MTEF period.

In general, government borrowing should finance investment

A recovery in tax revenue, more moderate growth in consumption expenditure, and additional savings from goods and service budgets will mean that by 2013/14, government will have sufficient revenue to pay for current expenditure. In general, government borrowing should be to finance investment. Priority will be given to spending that strengthens the asset base of the economy, including through capital investment, maintenance and refurbishment, and building public capacity to plan and manage infrastructure.

Figure 3.2 Real growth in compensation of employees, 2003/04 – 2010/11

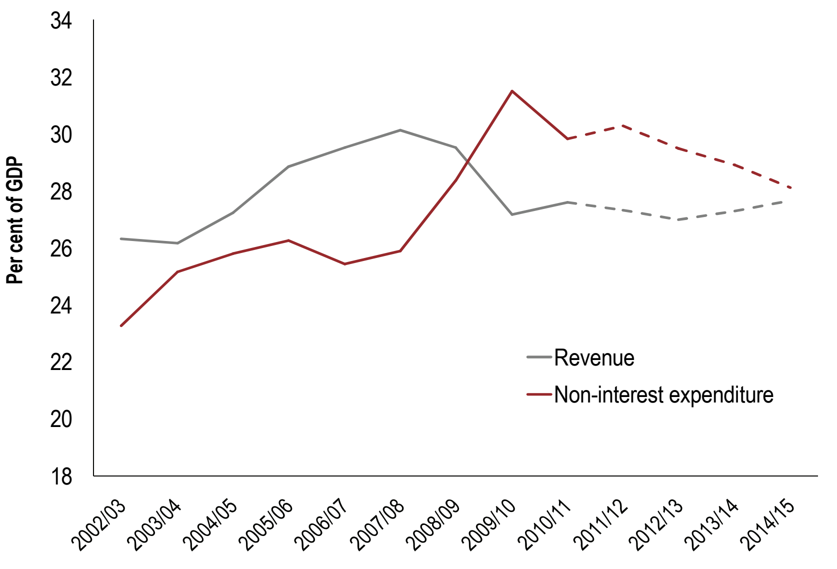


Debt sustainability

A path towards stabilisation of national debt

The acceleration in spending between 2007/08 and 2009/10, and falling revenue, resulted in a primary deficit (revenue minus non-interest spending). The moderation of spending, combined with a recovery in tax revenue, sets a clear and realistic path towards the elimination of this deficit – and stabilisation of debt as a percentage of GDP. Should the economy fail to recover as predicted, ensuring long-term fiscal sustainability would require a combination of slower spending growth and policy measures to raise tax revenue.

Figure 3.3 Consolidated non-interest expenditure and revenue as percentage of GDP, 2002/03 – 2014/15



Fiscal framework

The consolidated budget deficit is projected to narrow from 5.5 per cent this year to 3.3 per cent in 2014/15.

Table 3.1 Consolidated fiscal framework, 2009/10 – 2014/15

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
R billion	**Outcome**		**Estimate**	**Medium-term estimates**		
Revenue	**664.3**	**758.4**	**814.2**	**890.0**	**994.5**	**1 113.0**
Percentage of GDP	*27.2%*	*27.6%*	*27.3%*	*27.0%*	*27.3%*	*27.7%*
Expenditure	**826.6**	**885.8**	**978.8**	**1 062.3**	**1 157.4**	**1 247.0**
Percentage of GDP	*33.8%*	*32.2%*	*32.9%*	*32.2%*	*31.8%*	*31.0%*
State debt cost	57.1	66.2	76.9	89.1	104.1	115.1
Percentage of GDP	*2.3%*	*2.4%*	*2.6%*	*2.7%*	*2.9%*	*2.9%*
Non-interest expenditure	769.5	819.6	901.9	973.2	1 053.3	1 131.9
Percentage of GDP	*31.5%*	*29.8%*	*30.3%*	*29.5%*	*28.9%*	*28.1%*
Budget balance	**-162.3**	**-127.4**	**-164.6**	**-172.3**	**-162.9**	**-134.1**
Percentage of GDP	*-6.6%*	*-4.6%*	*-5.5%*	*-5.2%*	*-4.5%*	*-3.3%*
Primary balance (percentage of GDP)	*-4.3%*	*-2.2%*	*-2.9%*	*-2.5%*	*-1.6%*	*-0.5%*
Gross domestic product	*2 442.6*	*2 748.2*	*2 977.7*	*3 298.0*	*3 642.6*	*4 023.4*

Expenditure

Fiscal framework makes available R1.1 trillion for spending in 2012/13

Despite weaker-than-expected revenue performance, government spending will continue to grow moderately in real terms. The proposed fiscal framework makes R1.1 trillion available for spending next year. In real per capita terms, this represents a doubling of the resources available to the fiscus between 2002/03 and 2012/13.

Key spending priorities are to support job creation, maintain the real value of the social wage and support economic transformation along the New Growth Path. Allocations will also be made to pilot national health insurance in 10 districts.

Investment in new buildings and fixed structures, as well as maintenance of existing structures

Over the next three years, national departments and public entities will reprioritise and realign their budget baselines to make more effective use of resources. The fiscal framework also supports a determined effort to shift the composition of spending towards investment in long-term assets that can build the economy. Table 3.2 shows public-sector infrastructure expenditure estimates by sector over the MTEF period. Infrastructure expenditure includes spending on new buildings and fixed structures, as well as the maintenance and rehabilitation of existing structures.

Table 3.2 Public-sector infrastructure expenditure estimates by sector, 2010/11 – 2014/15

R billion	2010/11	2011/12	2012/13	2013/14	2014/15	MTEF total	% of total
Economic services	**161.9**	**197.3**	**217.8**	**228.2**	**230.1**	**676.0**	**84.3%**
Energy	52.5	71.7	90.4	98.8	102.7	292.0	36.4%
Water and sanitation	14.4	17.8	20.6	19.9	19.8	60.4	7.5%
Transport and logistics	69.1	79.5	76.3	76.9	72.3	225.6	28.1%
Other economic services[1]	25.8	28.4	30.4	32.5	35.2	98.0	12.2%
Social services	**17.2**	**26.6**	**26.8**	**32.5**	**35.2**	**94.5**	**11.8%**
Health	6.7	10.0	9.6	13.9	15.2	38.8	4.8%
Education	6.0	9.1	9.8	11.2	11.2	32.2	4.0%
Community facilities	3.5	5.2	4.7	4.8	6.2	15.7	2.0%
Other social services[2]	1.0	2.4	2.6	2.6	2.7	7.9	1.0%
Justice and protection services	**3.8**	**4.1**	**4.4**	**5.1**	**5.8**	**15.2**	**1.9%**
Central government and administrative services	**2.1**	**4.2**	**8.0**	**3.5**	**2.5**	**14.0**	**1.7%**
Financial services	**0.3**	**0.7**	**0.7**	**0.7**	**0.8**	**2.2**	**0.3%**
Total	**185.3**	**232.9**	**257.6**	**269.9**	**274.4**	**802.0**	**100.0%**
Percentage of GDP	*6.7%*	*7.8%*	*7.8%*	*7.4%*	*6.8%*		

1. Includes agriculture and environmental, telecommunications, housing, IDZ, etc.

2. Includes labour centres, heritage institutions, national libraries, etc.

The budgets for national and provincial government infrastructure spending have been revised upwards by more than R10 billion since the 2011 Budget, and a projected R71 billion will be spent on health and education infrastructure over the MTEF period.

Government is working to overcome obstacles to infrastructure planning and implementation

The main challenge associated with increased fiscal support for the recovery lies in overcoming obstacles to the implementation of infrastructure and job-creating programmes, rather than budgeting for higher levels of expenditure. These challenges are particularly striking in municipalities and state-owned enterprises, both of which have spent below budgeted amounts over the past three years. Government has implemented stricter monitoring of these institutions. Efforts to improve the capacity to plan, contract and execute infrastructure budgets are a discussed in Chapter 4.

Revenue

Tax revenue responds automatically to changes in the economic cycle

Tax revenue responds automatically to changes in the economic cycle. Weaker economic conditions have had an impact on revenue collection.

During 2007/08 gross tax revenue increased year-on-year by 15.6 per cent, reflecting strong economic conditions. This rate of increase slowed to 9.1 per cent during 2008/09 and, following the 2009 recession, gross tax revenues declined by 4.2 per cent. Sharp falls in corporate income tax, value-added tax (VAT), secondary tax on companies and customs duty revenues led the decline.

As conditions improved during 2010/11, nominal gross tax revenues grew by 12.6 per cent year-on-year, with significant increases in personal income tax, VAT, customs duty and fuel levy revenues. Despite the recovery in GDP growth, the lagged effects of the economic downturn meant that corporate income tax revenues continued to decline.

Table 3.3 Total tax and budget revenue, 2010/11 – 2012/13

R million	2010/11 Outcome	2011/12 Budget	2011/12 Revised Estimates	2011/12 Difference	2012/13
Persons and individuals	226 925	252 750	252 750	–	292 150
Companies	132 902	144 165	144 165	–	160 193
Value-added tax	183 571	200 880	187 464	-13 416	212 560
Secondary tax on companies/dividend tax	17 178	18 100	19 000	900	12 840
Specific excise duties	22 968	25 085	24 840	-245	25 610
Fuel levy	34 418	36 900	36 900	–	38 040
Custom duties	26 637	29 860	31 000	1 140	35 740
Other	29 584	33 880	32 473	-1 407	35 377
Total tax revenue	**674 183**	**741 620**	**728 592**	**-13 028**	**812 510**
Non tax revenue	12 893	10 001	11 713	1 642	12 357
of which mineral royalties	*3 555*	*4 890*	*4 890*	–	*5 140*
Less: SACU payments	-14 991	-21 763	-21 763	–	-38 983
Other adjustments[1]	-2 900	–	–	–	–
Provinces, social security and selected public entities	89 228	94 609	95 704	1 095	104 075
Total budget revenue	**758 413**	**824 466**	**814 246**	**-10 291**	**889 959**

1. Payments to SACU partners in respect of a previous error in calculation of the 1969 agreement

Since the publication of the 2011 *Budget Review*, economic performance has weakened, and this is reflected in slowing tax collection. Gross tax revenues are expected to increase by 8.1 per cent in nominal terms during 2011/12.

Estimated gross tax revenue is revised downwards by R13 billion

Estimated gross tax revenue is revised downwards by R13 billon to R728.6 billion. This is largely the result of a downward revision in net VAT receipts to R187.5 billion, R13.4 billion below the 2011 Budget estimate, owing to an underestimation of VAT refunds for 2011/12 at the time of the budget. The higher VAT refunds during 2011/12 appear to be mainly a result of increases in nominal imports, exports and gross fixed investment during 2010/11 and 2011/12.

Revenue collection for the current year and the forecast for 2012/13 reflect weaker economic conditions

Revenue collection for the current year and the forecast for 2012/13 reflect weaker economic conditions. Overall, budget revenue has been revised down by R10.3 billion in 2011/12 and by R18.8 billion in 2012/13. This takes into account a revision to the Southern African Customs Union (SACU) payment in 2012/13, which will include an adjustment for an over-collection in 2010/11. As the business cycle turns in the outer years, the fiscal framework envisages improved revenue performance.

Non-tax revenue, provincial revenue, social security fund revenue, and revenue for the public entities included in the consolidation have increased marginally over the 2011 Budget forecast.

Debt financing

Medium-term financing strategy

Cash balances will ensure that borrowing requirement does not result in higher bond issuance

South Africa's bond markets, which will be the primary source of financing over the medium term, remain healthy, liquid and deep. As a consequence of the wider deficit, the main budget borrowing requirement increases to R181.2 billion in 2012/13, before decreasing to R150.4 billion in 2014/15. Nevertheless, debt issuances over the medium term will be maintained at current levels by drawing on cash balances and exchanging debt maturing within the next several years for longer-dated debt. Debt issuance in the broader public sector will be closely monitored.

Table 3.4 Total government debt, 2008/09 – 2014/15

As at 31 March	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
R billion		Outcome		Estimate		Medium-term estimates	
Domestic debt							
Gross loan debt[1]	529.7	705.5	892.7	1 069.6	1 249.0	1 432.6	1 599.9
Cash balances	-101.3	-106.6	-111.4	-114.8	-107.2	-102.2	-102.2
Net loan debt[2]	428.4	598.9	781.3	954.8	1 141.8	1 330.4	1 497.7
Foreign							
Gross loan debt[1]	97.3	99.5	97.9	101.7	105.4	104.0	104.3
Cash balances	–	-25.2	-62.1	-50.4	-35.6	-18.3	-4.3
Net loan debt[2]	97.3	74.3	35.8	51.3	69.8	85.7	100.0
Total gross loan debt	**627.0**	**805.0**	**990.6**	**1 171.3**	**1 354.4**	**1 536.6**	**1 704.2**
Total net loan debt	**525.7**	**673.2**	**817.1**	**1 006.1**	**1 211.6**	**1 416.1**	**1 597.7**
As percentage of GDP :							
Total gross loan debt	*27.1*	*33.0*	*36.0*	*39.3*	*41.1*	*42.2*	*42.4*
Total net loan debt	*22.7*	*27.6*	*29.7*	*33.8*	*36.7*	*38.9*	*39.7*
Foreign debt as percentage of:							
Gross loan debt	*15.5*	*12.4*	*9.9*	*8.7*	*7.8*	*6.8*	*6.1*
Net loan debt[2]	*18.5*	*11.0*	*4.4*	*5.1*	*5.8*	*6.1*	*6.3*

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)

Borrowing in the international capital markets will continue to finance government's foreign currency commitments. While accounting for only a small proportion of government's debt portfolio, foreign borrowing has useful benefits, such as setting benchmarks for borrowing by private and public-sector institutions.

Table 3.5 Main budget net borrowing requirement and financing, 2010/11 – 2014/15

	2010/11	2011/12		2012/13	2013/14	2014/15
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget balance	**-135 956**	**-159 066**	**-169 476**	**-181 167**	**-175 627**	**-150 434**
Extraordinary payments	-839	-150	-520	–	–	–
Extraordinary receipts	3 010	1 350	3 380	–	–	–
Borrowing requirement (-)	**-133 785**	**-157 866**	**-166 616**	**-181 167**	**-175 627**	**-150 434**
Domestic short-term loans (net)	**34 893**	**22 000**	**22 000**	**22 000**	**22 000**	**20 000**
Domestic long-term loans (net)	**136 850**	**135 367**	**135 067**	**134 908**	**131 261**	**113 238**
Market loans	150 386	150 400	150 400	151 319	149 554	140 777
Redemptions[1]	-13 536	-15 033	-15 333	-16 411	-18 293	-27 539
Foreign loans (net)	**2 839**	**4 999**	**-2 363**	**-1 835**	**-3 522**	**-422**
Market loans	5 151	7 150	–	7 660	7 840	7 910
Arms procurement loan agreements	470	1 009	985	183	25	–
Redemptions (including revaluation of loans)[2]	-2 782	-3 160	-3 348	-9 678	-11 387	-8 332
Change in cash and other balances[3]	**-40 797**	**-4 500**	**11 912**	**26 094**	**25 888**	**17 618**
Rand	-3 830	10 496	215	11 241	8 600	3 600
Foreign currency	-36 967	-14 996	11 697	14 853	17 288	14 018
Financing	**133 785**	**157 866**	**166 616**	**181 167**	**175 627**	**150 434**

1. Domestic loan redemption figures are net of anticipated switches, reducing redemptions by R7.5 billion in 2011/12, R45 billion in 2012/13, R15 billion in 2013/14 and R34 billion in 2014/15

2. Foreign loan redemptions are net of anticipated switches, reducing redemptions by R1.5 billion in 2012/13, R5.3 billion in 2013/14 and by R2.6 billion in 2014/15

3. A negative change indicates an increase in cash balances

Public-sector borrowing requirement

The public-sector borrowing requirement, which includes state-owned enterprises and local government, represents the funds needed by the public sector to cover any deficit in financing its own current and capital expenditure.

Table 3.6 Public-sector borrowing requirement,[1,2] 2010/11 – 2014/15

	2010/11	2011/12		2012/13	2013/14	2014/15
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget balance	**136.0**	**159.1**	**169.5**	**181.2**	**175.6**	**150.4**
Extraordinary payments	0.8	0.2	0.5	–	–	–
Extraordinary receipts	-3.0	-1.4	-3.4	–	–	–
Borrowing requirement	**133.8**	**157.9**	**166.6**	**181.2**	**175.6**	**150.4**
Other government borrowing[3]	-3.5	4.8	1.2	-2.5	-5.9	-8.3
General government borrowing	**130.2**	**162.7**	**167.8**	**178.6**	**169.8**	**142.2**
Percentage of GDP	*4.7%*	*5.6%*	*5.6%*	*5.4%*	*4.7%*	*3.5%*
Plus: Non-financial public enterprises	47.1	113.7	73.7	79.7	78.9	63.8
Public-sector borrowing requirement	**177.5**	**276.4**	**241.5**	**258.4**	**248.7**	**206.0**
Percentage of GDP	*6.5%*	*9.5%*	*8.1%*	*7.8%*	*6.8%*	*5.1%*
Gross domestic product	2 748.2	2 914.9	2 977.7	3 298.0	3 642.6	4 023.4

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

2. 2011/12 – 2014/15 are based on National Treasury estimates

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

Conclusion

Fiscal policy will support the recovery by allowing the deficit to widen in the short term, and government will implement a series of measures to support economic growth and competitiveness. Economic growth has been weaker than anticipated at the time of the 2011 Budget. Revenue continues to be depressed, resulting in a wider-than-anticipated deficit of 5.2 per cent in 2012/13.

Spending grows moderately over the medium term, and over the longer term government will reduce debt

Over the medium term, government spending continues to grow, but at a more moderate pace than in recent years. Over the longer term, government will reduce debt and restore sustainability. To consider more rigorously the intergenerational consequences of government's revenue and spending choices, the National Treasury will publish a long-term fiscal report in 2012. More prudent and targeted spending is required over the next few years.

4

Medium-term expenditure framework and division of revenue

The budget policy framework

Policy framework expands infrastructure investment and maintains commitment to social development

The budget policy framework takes into account the uncertain economic outlook and the need to support structural transformation of the economy. Expanding infrastructure investment will underpin long-term growth and development, and spending on social development priorities will grow in real terms. An economic support package is also proposed.

Over the past decade, government has made substantial inroads in the provision of general public services. Expanded access to services has improved living conditions in poor communities across the country. Yet the broadening of access has not always been accompanied by commensurate improvements in quality, and a focus over the medium term is to improve the quality and pace of service delivery.

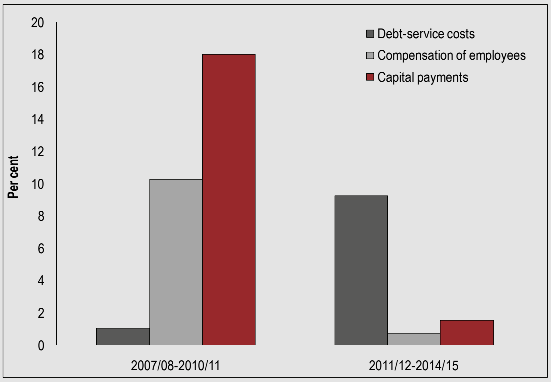
To ensure that government can afford its priorities now and in the future, the rate of public spending growth needs to moderate

To ensure that government can afford its priority programmes now and in the future, the rate of growth in public spending needs to be moderated over the medium term, even as public services, economic investment and job creation are strengthened. Over the next three years, national departments and public entities need to reprioritise and realign existing budget baselines to maximise their impact in achieving targeted outcomes. Government will support reforms that reinforce results-driven performance while encouraging better planning and budgeting.

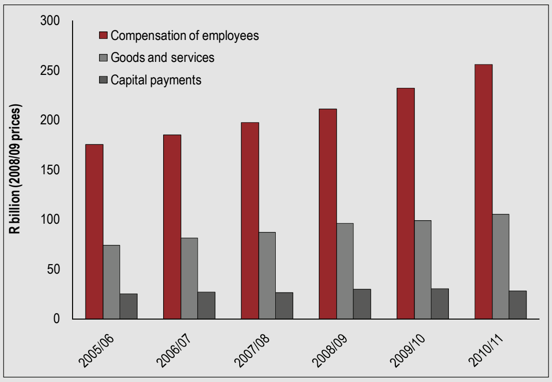
In recent years, personnel spending and debt-service costs have grown rapidly. Over the medium-term expenditure framework (MTEF) period ahead and beyond, the composition of spending needs to shift from consumption to investment in infrastructure and economic development.

Trends in the composition of public expenditure

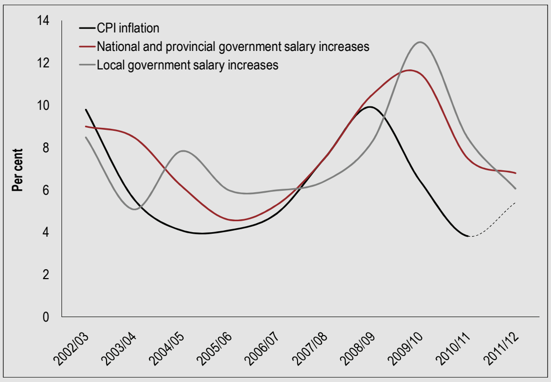
Real growth in areas of expenditure



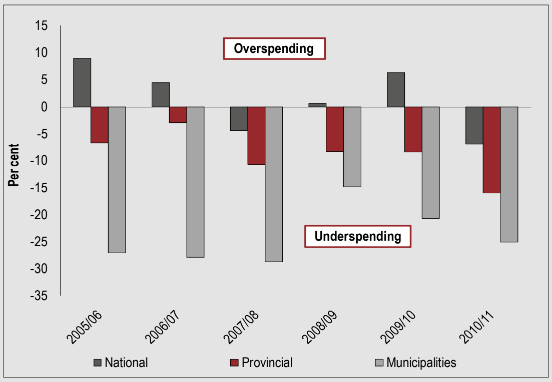
Real non-interest consolidated expenditure by main economic category



Public-service salary increases



Trends in capital expenditure



Several features of the composition of public expenditure need to be addressed over the period ahead.

- The *cost of servicing debt* is forecast to rise sharply over the next three years. Government is expected to spend more on servicing debt than on transfers to local government. To create fiscal space for service delivery now and in the future, these costs must be curtailed by reducing the deficit.
- The *public sector wage bill* has been a major driver of spending growth. Ways of managing this need to be explored. Remuneration should grow at a sustainable pace that supports job creation. For the MTEF period ahead, annual cost-of-living adjustments of 5 per cent a year are provided for, together with built-in pay progression of 1.5 per cent and improvements in overall remuneration. The balance between administration and service delivery staff should be corrected and supernumerary staff numbers reduced.
- *Underspending of capital budgets* is a core concern. Underspending by municipalities has risen from 14 per cent in 2008/09 to 25 per cent in 2010/11; provincial underspending rose from 8.3 per cent to 16 per cent over the same period. Government is establishing capacity to help municipalities plan and manage infrastructure better. At provincial level, the third phase of the infrastructure delivery improvement programme will be rolled out.

Funding priorities and eliminating waste

Wasteful public expenditure must be eliminated at all levels of government

The Constitution requires government at all levels to promote budgetary transparency, accountability and effective financial management of the economy and the public sector. Perceptions that government and its officials are living large undermine public trust. Wasteful public expenditure must be eliminated.

In preparing the 2012 MTEF, spending baselines have undergone rigorous review to identify areas of inefficient and non-priority expenditure. More effective use of resources has been sought across national, provincial and local government departments and public entities. Revised baseline allocations are being prepared taking into account the carry-through costs of the 2011 salary agreement, identified savings and reprioritisation proposals.

The overall impact of these adjustments is a decrease of R0.9 billion in the 2011/12 expenditure estimate, and additional funding totalling R48 billion over the MTEF period, financed within the fiscal framework. This is a marked decrease from the additional amount made available in the 2011 MTEF (R94.1 billion). Revisions to the 2011/12 appropriations and spending estimates are summarised on the next page.

Impact of adjustments is additional funding of R48 billion over MTEF period, compared with R94.1 billion in prior period

The 2012 MTEF proposals provide for average annual real growth in non-interest expenditure over the three-year framework of 2.3 per cent, compared with 7.9 per cent in the three-year period ending in 2011/12. Moderation in spending growth is in line with government's fiscal stance, which targets a stabilisation of the national debt over the medium term and rebuilding of fiscal space.

2010/11 outcomes and 2011/12 mid-year estimates

Details of the 2010/11 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 R805.1 billion in 2010/11, out of a total adjusted appropriation of R817.4 billion. Provincial expenditure amounted to R330.7 billion, compared with the 2010/11 adjusted budget total of R340.1 billion.

National expenditure in the first six months of 2011/12 amounted to R429.2 billion or 48.3 per cent of the adjusted appropriation for the year, and R34.8 billion more than the spending total for the same period in 2010/11. Expenditure by provinces amounted to R177.1 billion in the first half of 2011/12 or 48.4 per cent of the main appropriation for the year, and R24.5 billion more than for last year. Adjustments to the national budget are tabled alongside the *Medium Term Budget Policy Statement.* Adjustments to expenditure for 2011/12 are presented in the accompanying box.

Expenditure on national votes in first half of 2011/12 was 48.3 per cent of adjusted appropriation for the year

Revised national expenditure estimates, 2011/12

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:

- R3.7 billion in rollovers arising from commitments related to unspent balances in 2010/11
- R1.2 billion to cover the costs of higher-than-expected salary adjustments in national departments
- R185.8 million for natural disasters and the outbreak of animal diseases
- R40.6 million to cover a portion of the costs incurred by the Independent Electoral Commission to extend the casting of special votes in the local government elections
- R116.3 million for contractual penalties incurred by Denel Saab Aerostructures related to the A400M aircraft contracts
- R81.4 million to deploy resources for joint anti-piracy operations in the Mozambican Channel
- R21.2 million to help the National Nuclear Regulator meet its commitments under the Integrated Resource Plan and to retain experts
- R208 million for the management of acid mine drainage in the Witwatersrand area
- R838.1 million refunded to departments for monies paid directly into the National Revenue Fund from department-specific activities
- R266.3 million for a once-off gratuity for non-returning councillors following the 2011 municipal elections.

Revised provincial allocations

- R3.2 billion added to the provincial equitable share for higher-than-anticipated salary costs under the wage settlement
- R49.3 million to the *FET colleges grant* to cover the cost of wage agreements
- R752 million to various provincial conditional grants, including grants for the repair of infrastructure damaged by floods in December 2010 and January 2011.

Revised local government allocations

- R3.2 million rolled over on the *water services operating subsidy grant*
- R28.5 million to the *indirect water services operating subsidy grant*
- R11 million declared as savings from the *local government financial management grant.*

Taking into account funding set aside in the contingency reserve at the time of the 2011 Budget, projected underspending, savings declared by departments and the adjusted state debt cost estimate, the revised estimate of total expenditure in 2011/12 is R888.0 billion. In February 2011 at the tabling of the budget, provision was made for expenditure of R888.9 billion for 2011/12.

Medium-term spending estimates and priorities

Table 4.1 sets out the provisional 2012 Budget consolidated expenditure framework. The consolidated framework makes provision for an unallocated contingency reserve of R6 billion in 2012/13, rising to R24 billion in 2014/15. The baseline estimates reflect current spending priorities and those over the 2012 MTEF, particularly job creation and infrastructure investment.

Work is still in progress on the details of national and provincial expenditure plans. Special efforts are focused on improved value for money and administrative efficiency. Table 4.1 suggests that there is scope for further savings in the goods and services category, which increases markedly from 2011/12 to 2012/13 and beyond.

Table 4.1 Consolidated government expenditure, 2010/11 – 2014/15

R billion	2010/11 Outcome	2011/12 Revised	2012/13	2013/14 Medium-term estimates	2014/15	Average annual growth 2011/12 – 2014/15
General public services	**48.3**	**53.0**	**54.7**	**58.7**	**64.9**	**7.0%**
Defence	**34.0**	**38.3**	**41.8**	**44.4**	**47.0**	**7.1%**
Public order and safety	**83.2**	**90.6**	**98.8**	**105.9**	**112.1**	**7.4%**
Police	55.4	60.7	65.0	69.8	73.9	6.8%
Law courts	12.9	13.8	15.8	17.1	18.0	9.3%
Prisons	14.9	16.1	18.1	19.1	20.2	7.9%
Economic infrastructure	**71.1**	**77.4**	**85.5**	**91.9**	**101.5**	**9.5%**
Communication	2.4	2.7	3.3	3.4	3.4	8.4%
Fuel and energy	7.2	7.7	7.5	6.6	7.1	-2.7%
Transport	61.5	67.0	74.7	81.8	91.0	10.7%
Economic services and environmental protection	**45.7**	**52.4**	**56.3**	**60.2**	**62.6**	**6.1%**
Local government, housing and community amenities	**99.4**	**121.5**	**128.4**	**140.5**	**146.2**	**6.4%**
Housing development	21.1	25.9	28.7	31.9	34.1	9.5%
Local government and community development	47.5	56.3	61.1	66.9	67.1	6.0%
Water supply	30.7	39.3	38.6	41.7	45.0	4.7%
Health	**100.2**	**113.2**	**121.5**	**130.6**	**140.1**	**7.4%**
Recreation and culture	**10.4**	**9.6**	**9.6**	**9.2**	**9.7**	**0.2%**
Education	**167.8**	**190.8**	**202.6**	**218.2**	**231.7**	**6.7%**
Social protection	**131.4**	**147.8**	**159.8**	**172.6**	**182.3**	**7.2%**
Science and technology	**8.1**	**7.3**	**8.1**	**9.2**	**9.6**	**9.5%**
Allocated expenditure	**799.6**	**901.9**	**967.2**	**1 041.3**	**1 107.9**	**7.1%**
State debt cost	66.2	76.9	89.1	104.1	115.1	14.4%
Eskom loan	20.0	–	–	–	–	
Contingency and policy reserve	–	–	6.0	12.0	24.0	
Consolidated expenditure[1]	**885.8**	**978.8**	**1 062.3**	**1 157.4**	**1 247.0**	**8.4%**
Economic classification						
Current payments	**523.9**	**591.5**	**640.6**	**695.1**	**743.3**	**7.9%**
Compensation of employees	309.9	343.0	364.2	387.7	410.9	6.2%
Goods and services	142.4	163.8	178.0	193.8	207.2	8.2%
Interest and rent on land	71.6	84.8	98.4	113.6	125.3	13.9%
of which: state debt cost	*66.2*	*76.9*	*89.1*	*104.1*	*115.1*	*14.4%*
Transfers and subsidies	**278.5**	**312.7**	**341.1**	**368.7**	**389.1**	**7.6%**
Municipalities	65.7	75.2	82.7	89.8	96.6	8.7%
Departmental agencies and accounts	11.7	10.9	13.7	15.7	15.9	13.6%
Higher education institutions	18.0	19.7	21.0	22.4	23.7	6.5%
Foreign governments and international organisations	1.6	1.9	2.3	2.5	2.6	11.8%
Public corporations and private enterprises	25.2	29.9	32.1	33.0	30.2	0.3%
Non-profit institutions	21.9	23.6	25.5	27.4	29.4	7.6%
Households	134.5	151.5	163.8	178.0	190.6	8.0%
Payments for capital assets	**61.8**	**73.8**	**74.5**	**81.6**	**90.6**	**7.0%**
Buildings and other capital assets	45.9	58.5	59.8	67.2	71.5	6.9%
Machinery and equipment	15.9	15.3	14.7	14.4	19.1	7.5%
Payments for financial assets	**21.5**	**0.8**	**–**	**–**	**–**	
Total	**885.8**	**978.8**	**1 056.3**	**1 145.4**	**1 223.0**	**7.7%**
Contingency and policy reserve	–	–	6.0	12.0	24.0	
Consolidated expenditure[1]	**885.8**	**978.8**	**1 062.3**	**1 157.4**	**1 247.0**	**8.4%**

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

Job creation

Government promotes an environment for private-sector job creation and is the country's largest employer

Unemployment has grown since the 2009 recession and job creation is a core focus over the medium term. Government will continue to promote an environment conducive to private-sector growth and investment to generate employment. In addition:

- Delivered efficiently, public-sector infrastructure programmes can create a large number of direct jobs in construction and operations. Network infrastructure also provides a platform for expanded investment, more rapid growth and job creation.
- Government is the country's largest employer and has supported the labour market during the recovery. About half of all jobs created over the past 15 months were in the public sector. Provincial government accounts for about three-fifths of public-sector jobs (mainly in education and health), national government about a quarter and local government about 15 per cent. Public-sector hiring needs to support efficient and productive use of resources focused on frontline delivery, and avoid raising staff levels that do not contribute to these objectives.
- The expanded public works programme contributes to poverty alleviation through the creation of short- and longer-term jobs, while providing socially useful services such as early childhood development, fire prevention and fire control, recycling of waste, cultivation of food gardens, removal of alien vegetation, provision of fencing, road maintenance and craft development. Funding of the programme across national, provincial and local government amounts to R73 billion over the MTEF period. The infrastructure sector holds the greatest potential for job creation, but incomplete data provision and a lack of specialised capacity to design labour-intensive projects in provinces and municipalities have led to underperformance. To address this problem, government has assigned 90 data capturers and more technical design staff to work with provinces and municipalities. Over the MTEF, the recently established community work programme, which guarantees two days of work per week, will be expanded to about 250 000 participants by 2014/15.

Social services

Spending on education, primary health care, hospitals, social grants and welfare forms part of the social wage

Spending on social services accounts for more than half of consolidated non-interest expenditure, amounting to R461.5 billion in the current year. Spending on education, primary health care, hospitals, social grants and welfare forms part of the social wage, which benefits poor households in particular.

The size of the social services budget has to be weighed against success in service delivery. The social wage refers to the value of services that people actually receive relative to the money spent on these services. This underlines the importance of the efficient and transparent use of resources at all levels of government.

Education and related functions

Government recognises the need to improve the quality of education at all levels, enhancing the skills base and contributing to a productive labour force. The baseline amounts to R190.8 billion in 2011/12. Projected spending over the MTEF is estimated to increase at an average annual rate of 6.7 per cent, reaching R231.7 billion by 2014/15.

Spending increases have enabled a broadening of access to education, but quality must be enhanced

Spending increases have enabled a broadening of access to education. In 2007, the introduction of no-fee schools began to remove the burden of paying school fees from the poorest learners. In 2010 the policy was extended from the poorest 40 per cent of learners to the poorest 60 per cent, and as a result 8.1 million learners in 20 000 schools did not have to pay school fees.

Yet despite improved access and comparatively high levels of funding, the quality of education remains a central concern. South African learners fare poorly in global benchmarking exercises. Challenges include inadequate management, inappropriately trained teachers, insufficient time on task and a lack of basic resources in poor schools. Low levels of achievement in literacy and numeracy, illustrated by learner performance in the annual national assessment conducted for grades 1 – 6 in 2011, are symptomatic of these problems.

Funding will be reprioritised to school infrastructure improvements and expanded grade R access

Over the next three years, funding will be reprioritised to address these challenges. Annual national assessments of literacy and numeracy will continue and be extended to grade 9 in 2011/12. Over 9 000 student teachers are currently enrolled in the Funza Lushaka bursary programme, with many focusing on science and mathematics tuition. School infrastructure will be improved in poor schools and access to grade R will be expanded.

Government will continue to enhance skills development by strengthening further education and training (FET) colleges, with support for tuition, machinery and equipment. The links between sector education and training authorities, the national skills fund and FET colleges will be enhanced.

In addition to allocations for higher education institutions, the science and technology vote provides for funding of advanced research and post-graduate bursaries. Over the MTEF period more funding will be provided to expand post-graduate programmes and academic centres of excellence.

Health

Government's medium-term priorities include increasing life expectancy, decreasing maternal and child mortality, and combating HIV and Aids through strengthening the effectiveness of the health system. Reforms to public health are an essential preparatory step towards a system of national health insurance.

Growth in health funding has supported a levelling off of the Aids mortality rate

Health expenditure has grown strongly in the past three years, rising from R77.3 billion in 2008/09 to R113.2 billion in 2011/12. Significant progress has been made in delivering health services over the past decade. The Aids mortality rate has levelled off, there has been a rapid scaling-up of the antiretroviral treatment programme, and the HIV counselling and testing campaign launched in April 2010 has made progress. The national mother-to-child HIV transmission rate has fallen to 3.5 per cent from 8.5 per cent in 2009. Successes have been made in improving the accuracy of tuberculosis diagnosis and in campaigns for vaccination against measles and polio. Vaccines are offered to all South African children to protect them against pneumonia and diarrhoea.

The quality of health services, however, needs to be significantly improved. Challenges to be addressed include inadequate infrastructure, weak hospital management and a shortage of skilled health workers. Reforms to address these challenges will be piloted as part of the first phase of developing national health insurance.

Piloting national health insurance

National health insurance pilot projects will take place in 10 districts. The pilots will test the feasibility and scalability of proposals in the green paper, which focus on primary health care, health promotion and preventative care. These projects will include:

- District-based clinical specialist support teams
- School-based primary health care services
- Family health teams, including municipal ward-based outreach services
- A new approach to human resources
- General practitioner services.

Social security

15.2 million South Africans now receive some form of social grant

Social assistance and welfare services are effective redistributive and poverty-reduction measures that have expanded considerably over the past decade. Social welfare grants now support about 15.2 million South Africans, up from 2.5 million in 1998. The grants have been expanded in recent years by raising the threshold for the *child support grant* to a child's 18th birthday, and equalising the eligibility age for the old age grant for men and women at age 60. Government spends 10.9 per cent of its total budget on social grants.

For some years, government has been working on reform of South Africa's social security arrangements, of which social grants form a part. The social security system needs to become more efficient, ensuring the effective use of funds and providing better services. A discussion paper on social security reform will be released in the near future. Its proposals will include steps to establish a common administrative platform for social security agencies to eliminate duplication and wastage. Over the period ahead, government will take further steps to reduce fraudulent claims and renegotiate contracts for the delivery of cash grants.

Access to early childhood development services will be expanded

Access to early childhood development services will be expanded, and home- and community-based child care and protection will be given additional support. About half a million children are now receiving subsidised early childhood development services.

Basic household services

Local government provides a basic level of water, sanitation and energy free of charge to low-income households. These services, subsidised by the local government equitable share, improve health outcomes, support social inclusion and encourage economic participation. Better targeting allows municipalities to focus support on low-income households. Improved targeting will continue over the medium term. At the same time, municipalities need to collect revenue from households that can afford to pay for these services.

From next year, the local government equitable share formula will be revised to subsidise a greater share of the institutional costs of poor rural municipalities, which are dependent on transfers from national government. The equitable share formula makes allowance for an expected rise in basic services costs over the medium term to enable municipalities to maintain and extend free basic services to poor households.

Local government equitable share will be revised to subsidise a greater share of the institutional costs of poor rural municipalities

A new cities support programme involving several departments has been initiated to help cities manage the built environment in a way that promotes economic growth, job creation, access to basic services, environmental sustainability and public accountability. It draws on global best practice to link direct capacity support to fiscal and organisational incentives for improved performance, particularly through restructuring the system of fiscal transfers to reward achievement, encourage self-financing and support environmental sustainability.

Infrastructure and economic development

Over the medium to long term, government intends to shift the composition of spending to support higher levels of infrastructure maintenance and capital expenditure. Such investment will promote economic growth and job creation, and support an enabling environment for further investment by the private sector. Eradicating backlogs in basic services and housing, and improving provision of services by local government, will also receive greater attention.

Government is shifting the composition of spending to support higher levels of capital expenditure

Economic infrastructure

Targeted investments support an expansion of capacity in electricity, roads, rail, water and telecommunications. The overall scope of these investments is outlined in Chapter 2.

Long-term capacity expansion of electricity, roads, rail, water and telecommunications

Large-scale investments in transport are being implemented over the medium to long term. Increased delays in train services are largely the result of South Africa's ageing rolling stock and inefficiencies in maintenance. Deterioration in the rail network has put greater pressure on the country's roads. Investments in the national road network have resulted in significant improvements in road quality. There are, however, large maintenance backlogs in provincial and municipal road networks.

Cities need to take greater responsibility for operational costs of integrated public transport networks, which consist of both roads and rail routes. The National Land Transport Act (2009) provides for the devolution of public transport planning, management and funding to local government for the capacity to manage this transition.

Cities need to take more responsibility for integrated public transport networks

To ensure greater efficiency, the *provincial roads maintenance grant* requires provinces to adopt road asset management systems, increasing roads' life expectancy and reducing vehicle operating costs.

In addition to Eskom's large power plant projects, the focus in energy will be on electrification in informal settlements and capacity for the renewable energy sector. The national electrification programme aims to provide electricity connections to all households by 2014.

Improved planning, construction and maintenance of water infrastructure is required

South Africa requires an integrated approach to water provision, with reticulation supported by sufficient resources. Improved planning, construction and maintenance are needed at local level, where there is a lack of capacity. The regulatory function of the Department of Water Affairs needs to be strengthened to enhance management of the resource and minimise pollution of river systems. Support is provided to establish or extend regional bulk water systems in rural district municipalities, and to upgrade wastewater treatment works. Over the longer term, government will develop new waste management infrastructure that incorporates recycling as a core function.

Infrastructure delivery improvement

The infrastructure delivery improvement programme (IDIP) addresses a lack of capacity to plan and implement infrastructure projects at provincial level. Now in its third phase, IDIP works with departments of education, health, public works and provincial treasuries to improve the execution and management of projects. The programme places long-term technical advisors in departments to build a skills base that enables infrastructure units to overcome blockages to project implementation.

Human settlements and community amenities

Eradicating backlogs in basic services and housing, and improving the provision of services by local government, are among government's most important goals.

Local government and human settlements spending reaches R121.5 billion in 2011/12

Spending on local government and human settlements has increased from R68 billion in 2008/09 to R121.5 billion in 2011/12, at an average annual rate of 21.3 per cent. Government is committed to extending community development programmes, including the *human settlements development* and *urban settlements development infrastructure* grants that flow to provinces and metropolitan municipalities.

With about 1.2 million households living in informal settlements (Statistics South Africa, 2009), the medium-term priority is to upgrade such settlements in 45 large cities and towns, providing poor households with improved living conditions in areas where they are able to access economic opportunities.

Capital expenditure forms the largest share of human settlements allocations over the MTEF period

To increase the provision of services to households in informal settlements, capital expenditure forms the largest share of human settlements allocations over the MTEF period. The national upgrading support programme targets long-term interventions required to scale up infrastructure delivery.

Funded through the *human settlements grant to provinces*, the housing programme delivered about 900 000 units between 2007/08 and 2010/11 to households earning below R3 500 per month. The social housing programme, a medium-density rental housing initiative for households earning between R1 500 and R7 500 per month, delivered 8 155 units between 2006/07 and 2011/12.

Promoting efficient revenue and expenditure management in local government

Like national and provincial governments, municipalities need to closely examine their budgets to ensure they are using their available resources to maximise service delivery. This requires both cost-effective spending and revenue collection.

The *Local Government Budgets and Expenditure Review,* published by the National Treasury in September 2011, highlights several important considerations:

- **Revenue management** – To ensure the collection of revenues, municipalities should maintain accurate billing systems, send out accounts to residents and follow up to collect revenues owed.
- **Collecting outstanding debts** – This requires political commitment, sufficient administrative capacity, and pricing policies that ensure that bills are accurate and affordable, especially for poor households.
- **Pricing services correctly** – The full cost of services should be reflected in the price charged to residents who can afford to pay. Many municipalities offer overly generous subsidies and rebates that result in services being run at a loss, resulting in funds being diverted away from other priorities.
- **Underspending on repairs and maintenance** – Often seen as a way to reduce spending in the short-term, underspending on maintenance can shorten the life of assets, increase long-term maintenance and refurbishment costs, and cause a deterioration in the reliability of services.
- **Spending on non-priorities** – Many municipalities spend significant amounts on non-priority items including unnecessary travel, luxury furnishings, excessive catering and unwarranted public relations projects. Consultants are often used to perform routine tasks.

The *Local Government Budgets and Expenditure Review* can be accessed at www.treasury.gov.za.

Agriculture and rural development

Government is working to expand food production and support rural development.

Land Bank aims to increase developmental loans to emerging farmers

The Land Bank finances investments that improve the productivity of land, increasing production of food and fibre, and supporting economic activity in rural areas. The Land Bank has stabilised its financial position and will increase its developmental lending to emerging farmers over the medium term.

The Department of Rural Development and Land Reform and the Department of Agriculture, Forestry and Fisheries are aligning their programmes to facilitate better collaboration within government, and cooperation with the private sector, to improve funding and technical support for farmers. This should boost the commercial viability of newly settled farmers and increase food supply. Partnerships with commercial farmers will improve technology transfer to emerging farmers and their adaptability to changing farming conditions.

Climate change and the environment

Improving environmental management and addressing climate change resilience are key policy objectives. Spending on economic affairs and environmental protection has increased from R38.5 billion in 2008/09 to R52.4 billion in 2011/12, at an average annual rate of 11 per cent.

Funding has supported energy-efficiency measures in households and businesses

Through assistance provided to Eskom and municipalities, and Eskom's electricity generation tariff, government has made available more than R6 billion between 2008/09 and 2012/13 for energy-efficiency and electricity demand-side management initiatives. This funding has been used to install energy-efficient lighting, subsidise solar water heating systems and improve energy-efficiency in buildings.

Larger municipalities are beginning to integrate environmental concerns more directly into their planning

There are several medium-term challenges to supporting environmental sustainability. The skills base to undertake a range of environmental functions, particularly at municipal level, is inadequate. This includes, for example, issuing authorisations for households and businesses to use technologies that reduce greenhouse gas emissions. Larger municipalities, however, are becoming more responsive to environmental concerns. Cape Town, for example, intends to buy electricity from a wind farm, and eThekwini is producing electricity from landfill gas.

The 17th Conference of the Parties to the United Nations Framework Convention on Climate Change (COP 17), which will be hosted in South Africa later this year, has significantly raised awareness of environmental sustainability and climate change throughout the country.

Government will work to strengthen environmental and climate change policies

Over the next three years, government will work to strengthen South Africa's environmental and climate change policies, and to secure global and private sector funding for green interventions. Environmental monitoring linked to appropriate fiscal instruments and capacity support interventions is being considered.

General government services and administration

Well-functioning government systems are essential to provide the services that support economic growth, poverty eradication and public safety.

Government administration systems provide general public services, including those related to financial management, the public debt and tax collection. The aim is to achieve an efficient, effective and development-oriented public service.

While some state institutions require significant work to improve their efficiency, other parts of the public sector are performing well. For example, as a result of reforms within the Department of Home Affairs, the turnaround time for issuing an identity document was reduced from 127 days in 2008 to 46 days in 2011, and passports can now be issued in three weeks.

Substantial challenges remain in the provision of public works

Government faces substantial challenges in the management of government buildings and accommodation, including underspending of budgets by departments. Problems emanate largely from a shortage of technical and project management capacity, and incomplete asset registers. The Government Immovable Asset Management Act (2011) provides for the issuance of guidelines and minimum standards for immovable asset management by a national or provincial department. More needs to be done to improve administration in national and provincial departments of public works.

Defence, public order and safety

A safe and secure environment is a necessary condition for the well-being of citizens. The policy focus for policing and justice over the medium term is to reduce the high level of serious crimes, improve investigative capacity and increase access to justice services in underserved areas.

Expenditure for the defence and criminal justice cluster, excluding self-financing entities, provincial departments, and the military health support programme, increased from R93 billion in 2008/09 to R123.6 billion in

2011/12, growing at an annual rate of 10 per cent. Expenditure is projected to increase to R150.4 billion in 2014/15. Due to the labour-intensive nature of the function, the bulk of funding goes toward compensation of employees.

A 4 per cent decline in the overall crime rate between 2008/09 and 2010/11

Over the last three financial years, there has been a 4 per cent decline in the overall crime rate, from 4 310 crimes per 100 000 of the population in 2008/09 to 4 144 in 2010/11, owing in part to increased personnel in detective services and improved crime intelligence. Overcrowding in correctional facilities fell from 41 per cent in 2009/10 to 35 per cent in 2010/11. The security provided by departments under this function contributed to the success of the 2010 soccer World Cup.

Over the MTEF period investigative capacity in the criminal justice sector will be strengthened, as well as the control of the country's borders. The Independent Police Investigative Directorate Act (2011) will be implemented, allowing for the transformation of the Independent Complaints Directorate into an agency tasked with investigating police misconduct and offences, but with a broader focus on additional categories of serious and priority crimes.

Division of revenue, 2012/13 – 2014/15

Proposed allocation recognises need for government at all levels to prioritise frontline services

The fiscal framework makes available an additional R48 billion over the next three years. Allocations to national departments are increased by R1.9 billion in 2012/13, R5.8 billion in 2013/14 and R15.1 billion in 2014/15. The provincial share is revised upwards by R20.2 billion over the MTEF and local government allocations are increased by R5 billion. The proposed allocation of resources recognises the need for national, provincial and local government to redirect spending towards frontline services, and to reduce non-core and ineffective expenditure.

Significant additions are made to transfers to provinces and municipalities over the MTEF period. Of the R48 billion available for baseline revisions, 42 per cent goes to provinces and 10.5 per cent to local government. Table 4.2 sets out the proposed division of nationally collected revenue and changes to baseline allocations

Table 4.2 Division of revenue, 2011/12 – 2014/15

R billion	2011/12	2012/13	2013/14	2014/15
National allocations	377.8	410.3	444.7	474.7
Provincial allocations	363.2	384.5	411.0	437.8
Equitable share	*291.7*	*308.5*	*328.4*	*348.8*
Conditional grants	*71.5*	*76.0*	*82.6*	*89.0*
Local government allocations	70.1	77.0	83.8	90.8
Total allocations	**811.2**	**871.9**	**939.5**	**1 003.3**
Changes to baseline				
National allocations	-2.3	1.9	5.8	15.1
Provincial allocations	5.3	4.1	6.7	9.4
Equitable share	*3.2*	*2.8*	*4.8*	*5.8*
Conditional grants	*2.0*	*1.3*	*2.0*	*3.6*
Local government allocations	–	–	1.5	3.5
Total	**2.9**	**6.0**	**14.0**	**28.0**

Section 214 of the Constitution and section 9 of the Intergovernmental Fiscal Relations Act (1997) require the Financial and Fiscal Commission to make recommendations at least 10 months before the budget is tabled on the division of revenue for the coming budget. The commission tabled its submission in Parliament in May 2011. Government will formally respond to the matters raised in the submission when it tables the 2012 Budget in February 2012.

Funding provincial government

Provincial government delivers education, health, welfare services, housing, agricultural support, and provincial and rural roads. In line with the need to streamline and prioritise expenditure, provincial governments need to identify savings in non-essential expenditure in their existing budgets to fund core programmes, particularly in health and education. Rising personnel spending strains provincial budgets, especially in labour-intensive departments, limiting resources for infrastructure and complementary inputs needed for the delivery of quality services.

A focus on improving quality of education and health in the provinces

Resources are targeted to improve the quality of education and health services, and to take into account the general government salary agreement. Over the 2012 MTEF, transfers to provinces are increased by R20.2 billion, of which R13.4 billion is added to the provincial equitable share and R6.8 billion to provincial conditional grants.

Provincial equitable share

Resources will help provinces to address the developmental needs of the very young

Additions to the provincial equitable share provide for the carry-through costs of higher-than-anticipated wage agreements in 2011/12 and designated priorities in social development and education. In social development, the focus will be on increasing the subsidies and the number of days the subsidy is paid to non-profit organisations providing early childhood programmes. For education, additions are made to provide for the progressive equalisation of per learner subsidies paid to the poorest 60 per cent of schools, and to expand grade R provision at ordinary schools. These additional resources will put provinces in a stronger position to address the developmental needs of the very young, which will boost long-term education and skills outcomes.

The provincial equitable share formula was reviewed during 2010, leading to the introduction of a new health component; minor revisions that improve the transparency and simplicity of this component are made for the 2012 division of revenue. The data used in the provincial equitable share formula will be updated.

Provincial conditional grants

Further resources to fund repairs to roads and buildings damaged during floods in early 2011

Additions to conditional grants provide for costs of the wage agreements in further education and training colleges, additional access to HIV and Aids treatment in response to the lowering of the CD4 count threshold, and for upgrading of informal settlements in municipalities that lack capacity. Further resources are made available over the MTEF to fund repairs to roads, buildings and other infrastructure damaged by the floods in January and February 2011.

Additional resources are also set aside for piloting district-based health services as part of national health insurance reforms.

Funding local government

Local government is responsible for the provision of water and sanitation, electricity, refuse removal, municipal health services, storm water management and municipal transport and roads. The functions performed by local government rely largely on self-financing. Substantial progress has been made in overcoming the service disparities of the past through transfers from the national fiscus, but large backlogs remain. The major need is to provide municipal infrastructure to poor households and, increasingly, to pay for the institutional and governance needs of poor municipalities.

At local level, the major need is to provide infrastructure to poor households

Over the 2012 MTEF, transfers to local government grow by R5 billion, of which R2.2 billion is added to the local government equitable share and R2.8 billion to local government conditional grants. An amount of R994 million is also made available through indirect grants that will be spent by national departments on behalf of municipalities. Funding priorities for metropolitan municipalities and larger cities include informal settlement upgrading, social housing, and rehabilitation and maintenance of bulk infrastructure. High levels of service delivery backlogs have to be addressed in rural municipalities, which are characterised by poverty and geographical challenges to service delivery.

Local government equitable share

The local government equitable share helps municipalities to provide free basic services to poor households and subsidises the basic costs of running a municipal administration. Additions to the equitable share cater for the increased cost of providing free basic services to poor households and subsidising poor municipalities.

Over the last three years several adjustments have been made to the equitable share formula that have increased the allocations to poor rural municipalities. Further work will be done to review the formula, with revisions making use of the data from the 2011 Census, due to be released in March 2013. Allocations using the revised formula will be introduced from 2014/15.

Adjustments to formula increase allocations to poor rural municipalities

Local government conditional grants

The *urban settlements development grant* will be increased to enable metropolitan municipalities and larger cities to speed up delivery of serviced land for poor households to expand sustainable human settlements. Additions will also be made to the *integrated national electrification programme grant* to support the upgrading of informal settlements.

Support for large cities to speed up delivery of serviced land for poor households

Additions will support bulk infrastructure and solid waste management in rural municipalities. The lack of these services forms a major constraint to the further rollout of basic services connections to households. Bulk infrastructure is significantly more expensive to develop than reticulation infrastructure; as a result, transfers will be the main source of funding for this infrastructure.

Conclusion

The 2012 MTEF is marked by moderate growth in overall expenditure, taking into account the weaker economic outlook and the need to begin rebuilding fiscal space. Emphasis is placed on expanding infrastructure investment and job creation, while maintaining real growth on social development priorities. Rising allocations to municipalities reflect the need to improve basic services and bulk infrastructure. Allocations to provinces will accommodate higher personnel costs and infrastructure backlogs in education and health.

A shift in the composition of public expenditure will reinforce economic recovery and reform

Over the medium term, a change in the composition of government expenditure is needed to reinforce economic recovery and reform, and achieve a more efficient balance between personnel, goods and services, and capital spending.

Annexure A

2010/11 outcome and half-year spending estimates for 2011/12

Table A.1 Expenditure by vote, 2010/11 and 2011/12

	2010/11[1]				2011/12		
R million	Main budget	Adjusted budget	Audited outcome	Over(-)/ Under(+)	Main budget	Adjusted budget	Actual spending April to September
Central Government Administration							
1 The Presidency[1]	682	767	795	-28	815	931	411
2 Parliament[2]	1 179	1 202	1 199	3	1 265	1 273	561
3 Cooperative Governance and Traditional Affairs[1]	41 097	41 749	42 143	-394	47 934	48 205	19 053
4 Home Affairs	5 720	5 834	6 522	-687	5 464	5 851	2 851
5 International Relations and Cooperation	4 824	4 716	4 417	299	4 797	5 153	1 759
6 Performance Monitoring and Evaluation[1]	41	41	41	–	76	96	28
7 Public Works	6 446	7 365	6 615	750	7 819	7 830	3 187
8 Women, Children and People with Disabilities	98	106	110	-4	118	143	27
Financial and Administrative Services							
System	546	550	522	28	496	442	233
10 National Treasury[1]	38 715	38 705	38 125	579	22 598	23 839	9 687
11 Public Enterprises	351	556	540	16	230	353	120
12 Public Service and Administration	651	659	628	30	690	690	293
13 Statistics South Africa	1 973	2 101	1 695	407	3 241	3 730	1 152
Social Services							
14 Arts and Culture	2 407	2 441	2 249	192	2 469	2 537	1 033
15 Basic Education[1]	10 918	10 924	8 904	2 020	13 868	14 080	6 426
16 Health[1]	22 968	23 132	21 728	1 404	25 732	25 968	13 024
17 Higher Education and Training	23 721	23 776	23 752	24	28 229	28 300	20 877
18 Labour	1 784	1 836	1 826	10	1 981	2 017	911
19 Social Development	95 929	95 941	94 031	1 910	104 733	104 284	51 854
20 Sport and Recreation South Africa	1 246	1 255	1 252	3	803	821	400
Justice, Crime Prevention and Security							
21 Correctional Services	15 129	15 427	14 699	729	16 559	16 687	7 348
22 Defence and Military Veterans	30 715	30 443	30 442	–	34 605	34 349	15 771
23 Independent Complaints Directorate	129	131	128	3	152	154	62
24 Justice and Constitutional Development	10 250	10 787	10 685	102	11 413	11 582	5 832
25 Police	52 556	53 530	53 530	–	58 062	58 551	27 503
Economic Services and Infrastructure							
26 Agriculture, Forestry and Fisheries	3 658	3 954	3 851	103	4 720	4 964	2 119
27 Communications	2 114	2 138	1 426	712	1 889	2 003	564
28 Economic Development	419	450	401	49	595	598	266
29 Energy	5 535	5 649	5 505	143	6 090	6 201	2 888
30 Environmental Affairs	2 608	2 489	2 390	98	2 846	4 202	1 701
31 Human Settlements[1]	19 216	19 306	18 696	610	22 578	22 826	10 594
32 Mineral Resources	1 030	996	995	1	1 036	1 039	519
33 Rural Development and Land Reform	6 770	7 293	7 123	171	8 124	8 137	3 375
34 Science and Technology	4 616	4 128	4 052	76	4 405	4 407	2 488
35 Tourism	1 152	1 184	1 143	40	1 243	1 265	557
36 Trade and Industry	6 150	6 194	5 797	397	6 787	6 877	3 446
37 Transport[1]	30 178	30 381	29 721	660	35 084	35 767	17 805
38 Water Affairs	7 997	8 203	7 913	290	9 936	9 028	2 734
Total appropriation by vote	**461 518**	**466 339**	**455 592**	**10 746**	**499 481**	**505 179**	**239 457**
State debt cost	71 358	67 607	66 227	1 380	76 579	76 864	37 399
Provincial equitable share	260 974	265 139	265 139	–	288 493	291 736	144 246
General fuel levy sharing with metros	7 542	7 542	7 542	–	8 573	8 573	2 858
Other direct charges against the National Revenue Fund	10 751	10 751	10 639	112	11 667	11 666	5 251
Total direct charges against the National Revenue Fund	**350 625**	**351 040**	**349 548**	**1 492**	**385 312**	**388 839**	**189 755**
Unallocated and contingency reserve	6 000	–	–	–	4 130	–	–
Less: Projected underspending	–	–	–	–	–	-6 000	–
Total	**818 143**	**817 379**	**805 141**	**12 238**	**888 923**	**888 018**	**429 211**

1. The 2010/11 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, 2010/11 and 2011/12

	2010/11					2011/12	
R million	Main budget	Adjusted budget	Preliminary outcome	Over(-)/ Under(+)	Deviation from adjusted budget	Main budget	Actual spending April to Setember
Eastern Cape	**48 224**	**49 728**	**48 043**	**1 685**	**3.4%**	**52 644**	**26 211**
Education	22 680	23 183	22 578	605	2.6%	24 635	12 579
Health	13 341	13 842	13 273	570	4.1%	14 237	7 485
Social Development	1 560	1 566	1 564	2	0.1%	1 711	813
Other functions	10 643	11 136	10 628	508	4.6%	12 060	5 334
Free State	**21 381**	**21 801**	**20 974**	**826**	**3.8%**	**23 188**	**11 553**
Education	8 539	8 732	8 461	270	3.1%	9 496	4 701
Health	6 152	6 307	6 019	288	4.6%	6 821	3 220
Social Development	722	715	713	2	0.3%	802	379
Other functions	5 968	6 047	5 781	265	4.4%	6 069	3 253
Gauteng	**60 857**	**62 964**	**61 472**	**1 492**	**2.4%**	**67 645**	**32 505**
Education	22 486	22 841	22 264	577	2.5%	25 965	12 986
Health	20 072	20 387	20 467	-80	-0.4%	22 838	11 311
Social Development	2 165	2 182	1 913	268	12.3%	2 425	1 097
Other functions	16 134	17 554	16 827	726	4.1%	16 418	7 111
KwaZulu-Natal	**69 077**	**71 126**	**67 699**	**3 427**	**4.8%**	**77 300**	**37 336**
Education	29 035	29 570	28 761	809	2.7%	32 618	16 970
Health	21 658	22 120	20 679	1 441	6.5%	24 485	11 728
Social Development	1 668	1 668	1 438	230	13.8%	1 953	820
Other functions	16 717	17 767	16 821	946	5.3%	18 244	7 818
Limpopo	**39 653**	**41 193**	**41 063**	**130**	**0.3%**	**43 932**	**22 217**
Education	18 815	19 553	20 053	-500	-2.6%	20 859	10 769
Health	10 535	10 644	10 506	138	1.3%	11 588	5 895
Social Development	806	1 145	1 004	141	12.3%	1 159	657
Other functions	9 497	9 851	9 500	351	3.6%	10 326	4 897
Mpumalanga	**26 101**	**26 784**	**26 213**	**570**	**2.1%**	**29 198**	**14 074**
Education	11 530	11 962	11 598	364	3.0%	12 952	6 669
Health	6 421	6 591	6 528	63	1.0%	7 365	3 291
Social Development	881	881	848	33	3.8%	956	467
Other functions	7 268	7 349	7 239	110	1.5%	7 925	3 647
Northern Cape	**9 163**	**9 616**	**9 271**	**344**	**3.6%**	**10 285**	**5 123**
Education	3 458	3 509	3 506	4	0.1%	4 062	1 941
Health	2 657	2 655	2 541	114	4.3%	2 947	1 412
Social Development	464	479	478	1	0.2%	520	257
Other functions	2 583	2 971	2 746	225	7.6%	2 756	1 513
North West	**22 114**	**22 431**	**21 893**	**538**	**2.4%**	**24 465**	**11 153**
Education	9 051	9 177	9 102	74	0.8%	10 261	4 780
Health	5 583	5 705	5 717	-12	-0.2%	6 321	3 005
Social Development	750	740	740	–	0.0%	882	430
Other functions	6 731	6 809	6 334	475	7.0%	7 000	2 937
Western Cape	**33 241**	**34 412**	**34 072**	**339**	**1.0%**	**36 839**	**16 896**
Education	11 846	11 998	11 956	42	0.4%	13 332	6 337
Health	11 963	12 408	12 345	64	0.5%	13 395	6 269
Social Development	1 219	1 234	1 222	12	0.9%	1 332	570
Other functions	8 214	8 771	8 550	221	2.5%	8 780	3 720
Total	**329 810**	**340 052**	**330 701**	**9 352**	**2.8%**	**365 496**	**177 068**
Education	137 439	140 526	138 280	2 246	1.6%	154 181	77 732
Health	98 381	100 661	98 074	2 586	2.6%	109 997	53 615
Social Development	10 236	10 611	9 920	691	6.5%	11 740	5 490
Other functions	83 755	88 255	84 427	3 829	4.3%	89 578	40 230

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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 expenditure and 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 in terms of 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 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.
Inflation	An increase in the general level of prices.

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.
Industrial development zone	Designated sites linked to an international air or sea port, supported by incentives to encourage investment in export-oriented manufacturing and job creation.
Integrated resource plan	Government's plan to ensure that rising electricity demand is matched by expanded supply.
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 expenditure that flow through the National Revenue Fund. It does not include spending by provinces or local government from their own revenues.
National Revenue Fund	The consolidated account of national government into which all taxes, fees and charges collected by the South African Revenue Service and departmental revenue must be paid.
Nominal exchange rate	The current rate of exchange between the rand and foreign currencies. The "effective" exchange rate is a trade-weighted average of the rates of exchange with other currencies.
Non-interest expenditure	Total expenditure by government less debt service costs.
Organisation for Economic Cooperation and Development (OECD)	An organisation of 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.
Productivity	A measure of the amount of output generated from every unit of input. Typically used to measure changes in labour efficiency.
Public entities	Companies, agencies, funds and accounts that are fully or partly owned by government or public authorities and are regulated by law.
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.

Real interest rate	The level of interest 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.
Sovereign debt	Debt issued by a government.
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).