Medium Term Budget Policy Statement

2008

Speech

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Introduction

Madam Speaker, in tabling the budget in February this year, I shared an economic weather report with Members of the House, which indicated that there were storm-clouds on the horizon. Indeed, on several occasions in recent years, we have drawn attention to the growing imbalances between the major trading regions of the global economy, the scale of the adjustments required and the risk to the international community of associated financial disruptions.

These imbalances have accumulated over more than a decade, and are embedded in global trade patterns, inequalities between and within nations, imprudent lending to households and the intricate mechanisms through which credit risks have been packaged and resold. The dimensions of these flows are staggering. The United States consumes US$700 billion more than it produces every year, financed mainly through surpluses in Japan, China and oil-exporting countries. Banks have become increasingly inventive in channelling foreign savings to American consumers and firms. For example, the market for credit default swaps through which bad debt has been passed onto pension funds and other investors grew from US$100 billion in 2000 to US$62 trillion last year. This is just one of the financial innovations of the last decade that has contributed to the current destructive implosion of global financial markets.

A structural correction was needed, but the ferocity of the financial crisis was not anticipated. Global stock exchanges have lost US$5 trillion in value over the past month, the oil price is down from its peak in May of US$145 a barrel to US$70, the platinum price has fallen from a high of US$2 254 to US$903 an ounce, the prices of coal, copper and steel have fallen sharply, manganese and aluminium stockpiles are mounting in ports and warehouses and all across the world industrial order books are shrinking. Several major banks and financial institutions have collapsed or have required direct support from their governments. The scale of fiscal interventions under way is historically unprecedented, but it is nonetheless expected that factories will close in industrial economies, unemployment will rise and foodstamp queues will lengthen. We do not yet know how the crisis will be concluded, nor what its impact will be on output and employment, trade relations or the world's financial system.

The storm has arrived, it is fiercer than anyone could have imagined and its course cannot be predicted.

But, Madam Speaker, we saw the signs early, and we took appropriate action. We can say to our people: *Liduduma lidlule!* The thunder will pass. We can say to our people: our finances are in order, our banks are sound, our investment plans are in place, our course is firmly directed at our long-term growth and development challenges, and we will ride out this storm, whatever it takes, together, on the strength of a vision and a plan of action that we share.

We can say these things, Madam Speaker, because this government, since 1994, took the tough decisions early. Beginning with the balance articulated between meeting basic needs and promoting investment and growth in the Reconstruction and Development Programme, and then in reprioritising spending and reducing the budget deficit in the 1990s, in the adoption of an explicit target for inflation, in our gradual approach to the relaxation of exchange controls, our strengthening of bank regulation and in the steady accumulation of foreign reserves during the last five years, we have kept our focus on the reforms required for long-term growth and development. We have adopted a macroeconomic framework and a fiscal stance capable of withstanding tough times and protecting our economy and our people during times of global economic turbulence.

I am very aware, Madam Speaker, that our policy decisions have sometimes been controversial. But if our economic policies were designed for their populist appeal, if we tried to finance everything, at once, for everybody, then short-term gains would quickly give way to long-term misery. Our policies are aimed, instead, at sustainable progress for workers in our factories and on our farms, support for families through steadily rising social services and income transfers, businesses that can invest in the confidence of a sound fiscal and financial environment, public services that will continue to serve our children and our children's children.

Economic outlook and the global economy

Yet there is no avoiding the coming storm. Global economic growth will slow for several years, our export earnings will be negatively affected and it will be more difficult to finance our investment needs. Economic growth in the seven richest countries, which make up half of world economic output, may well be zero or negative next year. Growth in the global economy is forecast to fall from over 5 per cent in 2007 to 3.9 per cent this year and perhaps less than 3 per cent next year. Growth in India and China will also slow, as exports to their trading partners decline.

Following four years of economic expansion of 5 per cent a year, the revised GDP growth estimate for South Africa for this year is 3.7 per cent, somewhat below our forecast of 4 per cent in February. Next year, we expect to grow by 3 per cent, accelerating moderately in 2010 and beyond, as the global economy begins to recover. Continuing investment in infrastructure contributes to the momentum of growth in South Africa, and is also reflected in our ongoing current account deficit on the balance of payments, which means that we need to continue to attract financial inflows from the rest of the world while improving our domestic saving performance as well. Navigating our way in this changed economic environment will be tougher, but we will continue to expand and improve public services, and invest in the infrastructure required for future growth.

There is an aspect of South Africa's interconnectedness with the global crisis that I need to emphasise, Madam Speaker. We will be negatively affected by the slowdown and uncertainty ahead, but we have also benefited from the strong growth and high commodity prices of the recent past. Reflected in our favourable terms of trade in recent years and identified as a cyclical revenue component that should be saved and not spent, this gain accounts for the moderate budget surplus we were able to report last year. We recognised that the world has enjoyed a long period of unbalanced growth, and that it could not persist indefinitely. That the imbalances lasted so long was made possible by excesses in the financial sector, bad loans dressed up as tradable securities, inadequate regulation and the presumption that bankers who earn huge salaries and bonuses must understand what they are doing. Such blind faith in unfettered markets is misguided, and has got the world into the difficulties we now see.

Our approach has been different. We have recognised that there is creative strength in markets and they assist in mobilising resources, encouraging innovation and creating jobs. But Madam Speaker, markets left without adequate supervision or regulation, sometimes fail spectacularly. The legal and regulatory framework within which markets operate is important, and governments have substantial responsibilities to intervene in support of economic and social stability, and to ensure that the benefits of growth are inclusive and broad-based.

This financial crisis invites all of us to revisit the critical questions of the relationship between market processes and their regulation, of the balance between public service delivery and private sector development and of the appropriate arrangements for safeguarding the integrity of our financial institutions.

Countries that put the interests of their people first, above dogmas and ideologies, have been able to grow and prosper in the face of adversity over several decades. Macroeconomic policy is about ensuring that we sustain our growth rates as the international business cycle rises and falls by managing the cost of capital and how much we save and invest. When we chose to budget for a surplus, it was not because of any particular ideological position. It was the right thing to do in the economic circumstances. And in time to come, as we revert to a budget deficit, along with several other countries in similar circumstances, it will not be because we have adopted a new economic creed but it will again be because it is the right thing for changed economic circumstances. Our fiscal stance is a considered one, putting the long-term interests of our people first.

Global financial crisis

Our low level of debt, especially foreign debt, and our prudent approach to fiscal policy, provide us with the space to adjust our policies to cushion the economy against the worst effects of the global crisis. Let me comment briefly, Madam Speaker, on the oversight of our financial institutions in the present circumstances, and the special role that trust and integrity play in securing effective credit markets and financial peace of mind.

The financial stability assessment conducted by the IMF and World Bank during April and May this year concluded that the financial system in South Africa is fundamentally sound, and noted that our financial sector regulatory framework is sophisticated, modern and effective.

Every day, sometimes more than once a day, I receive a phone call from Mr. Errol Kruger, our registrar of banks, who gives me an update on developments in our banking system. Mr Kruger, in turn, is in regular communication with the chief executives of our banks, and a constant flow of data and consultations keeps both the regulators and risk management teams of our credit institutions informed and alive to market developments. We are in regular communication with the governor of the Reserve Bank to discuss developments in the international environment and the wider financial sector. The Financial Services Board is constantly reviewing our insurance and pension fund industry, tracking the status of assets under management and reviewing fund governance, to ensure that the pension funds of workers are protected and prudently managed. These procedures and measures may seem technical and at times overly bureaucratic. But we proceed from the premise that this Parliament has entrusted us with responsibility for licensing and oversight of our financial institutions; and licenses to do business are granted on the understanding that the highest standards of financial responsibility and integrity will be maintained.

One of the features of the present financial crisis internationally is that banks have lost trust in each other, and so inter-bank lending has collapsed. A deterioration in public confidence has also resulted in runs on some banks in Europe. In countries such as Hungary and Iceland, high levels of reliance on foreign capital has left the domestic banking system unprotected from these confidence failures. In South Africa, Madam Speaker, the balance sheets of our banks remain sound. They rely on rand-based capital and South African deposits, and the local inter-bank market remains fully functional and competitively priced. The World Competitiveness Report ranked the soundness of South Africa's banks 15th in the world, above both the US and Switzerland.

I give these assurances, fellow South Africans, not to suggest that nothing can go wrong, nor indeed to pretend that our banking sector is somehow unconnected from international financial flows, but to indicate that your government is vigilant, and our vigilance rests on a clear appreciation of the trusteeship obligations of our financial institutions for the deposits of our citizens, the savings of our workers, the pensions of our senior citizens and the security of our children's future.

Allow me to add, Madam Speaker, that the strength of the capital structure of our financial sector is a necessary condition for its effective contribution to the broader social and developmental obligations recognised in our Financial Sector Charter. It is surely now clear that capital adequacy cannot be compromised in the interests of promoting unsound lending practices or pursuit of unrealistic equity participation targets in our banks.

Inflation measure and inflation targeting

Madam Speaker, since 2000 the measure of price trends that we have used for inflation targeting purposes has been CPIX. The target excluded mortgage repayments from the inflation measure because of the direct impact of monetary policy on these household expenses. But interest on loans is not an adequate measure of the cost of housing, and so in line with international best practice, Statistics SA will shortly replace this component of the consumer price index with "owners' equivalent rent", alongside several other changes to the CPI basket. The inflation measure for policy purposes will therefore revert to the full consumer price index for major urban areas. The target band for inflation remains 3 to 6 per cent and we expect that CPI will fall into the target band in the third quarter of 2009.

During 2008, the world experienced an almost unprecedented increase in the price of food and fuel. The world's poor bore the brunt of these price increases with many countries experiencing social strife as a result of higher food prices. Partly as a result of higher food and fuel prices, inflation in South Africa increased during 2008, reaching 13.6 per cent in August. Oil prices are now falling and food prices have moderated. Taking into account the slowdown in consumer spending and the clear resolve of the monetary authorities, we expect consumer price inflation to fall during the remaining months of 2008 and next year. The government has taken several steps to mitigate the impact of higher food prices, and income support for the poor remains one of the fastest growing categories of our public expenditure.

The circumstances behind rising prices over the past year were exceptional and largely external, and the Monetary Policy Committee has taken appropriate steps to ensure that inflation will subside over the period ahead. Moderation of inflation must remain a central policy objective, particularly as we seek to expand investment and job creation under conditions of heightened business uncertainty.

Economic policy challenges

Madam Speaker, since 1994, this government has affirmed that budgets are not about markets or bonds or statistics. Budgets are about people, their lives and their well-being. We have the tools and the resources to protect our economy and our people from the worst effects of this crisis. It is a testimony to the strength of our economy and our policies that we can take these measures.

Over the past six years, our economy has enjoyed rapid growth, rising employment, rising household incomes, a major expansion in public services and significant income and asset transfers to the poorest South Africans. Achieving our objective of reducing poverty and inequality, broadening opportunities and building a prosperous country remains our guiding light. In the period of slower growth ahead, our efforts need to focus on building stronger institutions and improving the quality of our investment in social and economic infrastructure and public services.

Amongst the economic challenges ahead, we need to lift our rate of national savings, we need to construct a more export oriented economy and we need to create a more labour-intensive growth trajectory. We must ask ourselves repeatedly where will South Africa be when the storm has passed, when the global cycle turns. Will our economy be more diversified, more competitive and more inclusive? Without addressing these challenges, we are not likely to meet the legitimate expectations of our people for a better life for all. While we have made progress in several areas of policy and service delivery over the past 14 years, there remain aspects of microeconomic policy where more has to be done. These include trade and industrial policy, labour market policy, enhancing competition in our economy, improving our skills base and increasing the effectiveness of the state – areas where we have just not seen sufficient dynamism in the implementation of policy. Stronger cooperation between government and the private sector and raising our level of investment in economic infrastructure are also imperative.

We live in a dynamic, rapidly changing world and the major changes that we are witnessing, the rise of India, China and Brazil as major industrial powers, are likely to be delayed only temporarily by the financial crisis. That these countries are increasing output and incomes rapidly is contributing to a more balanced world and to substantial reductions in global poverty. Several countries in Africa are also now expanding strongly and creating greater opportunities for their citizens. And so our own social and economic development is not a project undertaken in isolation and on terms that we can dictate for ourselves: we do not have the option of rolling down the shutters through high tariff barriers or adoption of a policy of detachment. Progress in accelerating trade and industrial reforms focused on productivity and competitiveness is therefore critical.

A recent report on the South African economy by the Organisation for Economic Cooperation and Development (OECD) points out that although an impressive improvement in growth and productivity has been achieved in recent years, many middle income countries are advancing rapidly and South Africa still trails behind the most dynamic emerging economies. The OECD report puts the focus firmly on creating employment as the key medium term priority. This is a challenge that needs intense scrutiny, perhaps under the auspices of Nedlac, so that we can give greater detail and substance to what a more labour intensive growth path would mean in our circumstances.

The budget framework

The budget framework we table today, which draws on the work of the Ministers' Committee on the Budget, shows that we have the ability to adapt to changing circumstances, to continue to forge ahead with our developmental mandate, within a sustainable budget framework. Over the three year medium term expenditure period ahead, R171 billion is added to the spending plans tabled in February, taking total proposed spending including the social security funds over the next three years to R2.4 trillion. The budget framework also draws on the extensive contributions of members of the Ministers' Committee on the budget.

The additional allocations include adjustments amounting to R59 billion over the next three years for higher salaries and other costs associated with the rise in inflation. Over R60 billion is allocated to new programmes or expanded spending on key priorities. As indicated in February, an amount of R10 billion this year and a further R50 billion over the period ahead will be provided as a loan to Eskom to support its capital spending programme.

As a consequence of strong economic growth in the recent past, our revenue performance has exceeded expectations, providing additional revenue for capital investment, spending on public services, to provide tax relief and to reduce our debt. Changes that we made to our tax system, including the introduction of capital gains tax, closing numerous loopholes, lowering tax rates and improving administration have provided us with a fairer, more equitable and buoyant tax system. In particular, the share of corporate tax has increased significantly, due both to these reforms and stronger economic growth. For the period ahead, as our economy slows, revenue growth is also anticipated to slow. In particular, revenue from corporate taxes and value added tax is likely to come under some pressure. This is a natural consequence of the business cycle and our adoption of a cyclically adjusted budget balance makes provision for such cyclical effects.

The net effect of higher spending and lower revenue growth is that the budget balance, including the social security funds, shifts into a moderate deficit of 1.6 per cent of GDP next year. It is the early decisions we took on fiscal management that allow us to adapt in the face of these more difficult circumstances, to protect public spending, to support investment and to contribute towards higher growth in the future, without eroding the sustainability of our budget framework.

Budget priorities and medium-term expenditure framework

Madam Speaker, a central purpose of the Medium Term Budget Policy Statement is to advise Parliament of the main spending priorities for the following year's budget. The medium term expenditure framework contributes to a better informed public debate on public service delivery and informs the more detailed allocations to national departments and provincial and municipal budgets that will be tabled next year.

Allow me to highlight some of the most pressing priorities that Cabinet has approved for the period ahead:

- Improving the quality of education and skills development to broaden opportunities for our people and to raise our level of productivity.

- Improving the provision of healthcare, with particular emphasis on reducing infant, child and maternal mortality and broadening prevention and treatment programmes tackling TB and HIV and Aids.

- Investing in the criminal justice sector to reduce the levels of crime and to enhance citizen safety. Key priorities here are to further expand police numbers and to invest in investigative capacity, forensic laboratories and enhanced IT network infrastructure.

- Expanding investment in the built environment to improve public transport and meet universal access targets on water, sanitation, electricity and housing.

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

In addition to these key priorities, the framework makes good on the pledge we made in February to increase spending on energy efficiency, reducing electricity demand, supporting renewable energy sources and providing complementary funding for co-generation projects. After taking into account the need for timely adjustment of municipal and other electricity tariffs, the levy on electricity generation from non-renewable sources we announced in February will be deferred to next July, and we will broaden its base to include other large industrial sources of greenhouse gas emissions.

It is recognised that the electricity outages that South Africans experienced in the first quarter of this year signal capacity constraints in several areas of infrastructure, including roads, rail, ports and most critically in skills. These capacity constraints have also slowed economic activity and will restrict growth in the near term. To break these constraints, we must invest more.

Financing these investments in the period ahead will be challenging. Government will support our state-owned enterprises through providing selective guarantees on their borrowing and through increasing the capacity of our development finance institutions to contribute to funding major infrastructure projects. At the same time, it is essential to price utility services appropriately so that we encourage more efficient use of these inputs and to generate the resources to fund greater expansion in capacity. We must also create a more amenable environment for the private sector to invest in economic and social infrastructure.

In tabling the 2008 Medium Term Budget Policy Statement, Madam Speaker, I invite this House and all South Africans to engage vigorously with the policy priorities this government has set itself, with the respective roles of the public and private sectors in accelerating economic growth and employment creation and with the challenge of financing development in an uncertain and rapidly changing global environment.

Legislation tabled

Madam Speaker, today I have six separate bills for the further consideration of the House.

- The first is a Finance Bill that regularises expenditure previously deemed to be unauthorised. These authorisations are made on the basis of recommendations of the Standing Committee on Public Accounts, approved by this House.

- The second is a bill to give effect to a resolution of this House in response to a petition, on special grounds, for a deviation from the normal rules of the Government Employees Pension Fund.

- The third is the Eskom Loan Special Appropriation Bill which requests Parliament to approve a subordinated loan of R60 billion to Eskom.

- The fourth and fifth are the Revenue Laws Amendment Bill and the Revenue Laws Second Amendment Bill, which gives effect to the revenue proposals announced in the budget in February. I need to advise that it is not light reading.

- The last is the 2008/09 Adjustments Appropriation Bill.

Adjusted estimates 2008/09

As in the past, there are various categories of adjustments, including R2.4 billion in unspent monies appropriated in 2007/08 which have been approved for rollover to the current year, for identified purposes. I would like to draw the attention of the House to several additional allocations included in the Adjusted Appropriation Bill, as provided for in section 30(2) of the Public Finance Management Act. These include:

- R2 billion to deal with several natural disasters and outbreaks of animal disease

- R2.5 billion for the Road Accident Fund

- R344 million for the school nutrition programme and R390 million for the National Student Financial Aid Scheme

- R1.4 billion to cover cost overruns on 2010 FIFA World Cup stadium projects and R600 million for last mile internet connectivity between the stadiums and the national backbone network

- R107 million for the Kha Ri Gude mass literacy programme, which has exceeded expectations in its first full year of operation

- R5 billion for higher salaries due to higher inflation and R2.2 billion for other inflation-related adjustments to cover the higher costs of fuel, textbooks, medicines and medical equipment and inflation-related adjustments to social grants.

R2.5 billion is recommended in the adjustment appropriation bill as a once off allocation for the Political Office Bearers Pension Fund on the basis of recommendations made by the Commission on the Remuneration of Public Office Bearers, chaired by Judge Dikgang Moseneke.

Madam Speaker, the adjustments budget also makes provision for R300 million to assist in meeting Zimbabwe’s short term food requirements, subject to acceptance of an appropriate role for international food relief agencies by a recognised multi-party government.

Including spending on social security funds, total spending in 2008/09 of R650 billion is proposed, R19 billion higher than the budgeted amount. Taking into account a R1.2 billion upward adjustment to revenue this year, a small budget surplus of 0.1 per cent of GDP is anticipated.

This year, government has taken several steps to mitigate the impact of higher food prices. Several of these programmes will continue over the medium term, and increased agricultural support should enhance our efforts to ensure food security for all. Amongst the short term interventions introduced, government is raising the value of the old age grant, child support grant, disability grant and care dependency grant by R20 each this month so that grant beneficiaries don't have to wait until April to see the buying power of their grants protected. Extra resources have also gone to the school feeding programmes and for agricultural starter packs. In total, adjustments to deal with the short and longer term implications of higher food prices amount to R11 billion over the next three years.

Alongside the Adjustments Appropriation Bill, we table the Adjusted Estimates of National Expenditure which provides a breakdown of all adjustments for each national department.

Transfers to provincial and local government

Returning to the medium-term expenditure framework for the next three years, provinces will receive additional allocations amounting to R51.3 billion. In addition to accommodating higher inflation, key provincial priorities supported include:

- Expanding no fee schooling to cover 60 per cent of learners, increasing the school nutrition programme from R1.9 billion this year to R4.6 billion in three years time, increasing the number of teachers in poor schools and increased spending on school infrastructure, including grade R infrastructure.

- Additional resources for the health sector provide for the introduction of three new child vaccines to reduce deaths from pneumonia and diarrhoea, new proposed salary scales for doctors, dentists, pharmacists and related professional, expanding TB track and trace teams and increased take-up of antiretroviral treatment programmes

- Resources to expand investment in agriculture with a view to extending extension services and providing better support for small scale farmers; and

- Increasing investment in housing, roads and other economic infrastructure.

Additional resources to the municipal sphere cover the higher costs of providing free basic services and over R4.3 billion more for the municipal infrastructure grant to accelerate the provision of basic services.

Next year, government will initiate the second phase of the expanded public works programme. Drawing on the successes and lessons of this programme over the past five years, R4 billion is added to this programme to incentivise the creation of longer term, more stable employment in provinces, municipalities and non-governmental organisations. It is anticipated that this programme will be phased up to grow the number of full time equivalent jobs from about 145 000 at present to over 300 000 a year.

Conclusion

This budget framework gives effect to our commitment to put people first, to use the space that we have created to protect and expand those programmes that make a difference to the lives of the poorest in the short term, while also investing in the programmes that broaden opportunities and ensure higher economic growth in the longer term.

Our country faces a difficult period ahead. There is no telling how deep the global financial crisis will be, nor how severe and enduring its impact will be on incomes and economic activity. We are obliged to table fiscal plans and spending proposals in a context of considerable economic uncertainty. Our economic and budgetary framework, constructed year by year since 1994, is built on solid policy foundations and provides fiscal space within which to respond to both global circumstances and domestic challenges. Over the next three years, we will continue to step up investment in infrastructure that will drive long term growth, we will continue to expand and improve the quality of public services, and most importantly, we will continue to take the necessary steps to protect the poor and most vulnerable.

We take these steps because we know that the storm will pass. Liduduma lidlule. We do this because we will always put people first.

Madam Speaker, permit me an opportunity to recognise the contributors to this MTBPS – firstly the colleagues who serve on the Ministers Committee on the Budget ~ there are a number of new members who had this task thrust onto them, in addition to being overwhelmed by the new responsibilities of office, a big thank you~ but the hard work lies ahead to agree on the allocations to departments: it would be entirely remiss of me not to recognise the former members of the MinComBud who were involved until a month ago, permit me to single out too the former Deputy Minister, Jabu Moleketi .

Secondly, their Excellencies President Motlanthe and Deputy President Mbete, who also had this load dumped on them quite late into the process. It is appropriate that I also express my sincerest appreciation to Former President Mbeki and former Deputy President Mlambo Ngcuka who supported us through the difficult period to evolve the budget process and bring it onto an even keel.

Madam Speaker, South Africa is privileged to have the quality of public servants we have ~ I want to single out those in the Departments with whom I work and who are most closely involved with this process – in the National Treasury, SARS and Stats SA; but also as we reflected on today, those involved at the Reserve Bank, especially in the Bank Supervision Department and at the Financial Services Board. Thanks for dedication, leadership and the quality of advice.

I always tend to forget to mention the staff in the Ministry – a team of wonderfully supportive, chirpy, competent and tolerant individuals.

And finally to you, for your patience in listening to me this afternoon.