Budget 2004: A sober but sensible Budget

19 February 2004

Introduction

Ever since the introduction of the medium term expenditure framework in 1997, Budget Day has been anticipated not so much as embodying a set of surprises or shocks, but rather as a day on which government revenue and expenditure can be monitored by citizens. In effect the Budget has become a vehicle for fine-tuning the fiscus. The challenges this Budget faces are two-fold, namely those arising from the current economic context, that is, seeing to raise the level of economic growth, reducing unemployment and tackling poverty alleviation. A second set of challenges relates to fiscal issues. The challenge here is for fiscal policy to contribute towards realising these economic challenges, but in an ongoing and sustainable way. This Budget (as indeed any national budget) should thus be evaluated in terms of the objectives of fiscal sustainability, macroeconomic stability and redistribution.

Trevor Manuel summarising the direction of fiscal policy, and hence the framework for this year's budget, in the Medium Term Budget Policy Statement in November last year, had anticipated the main thrust and direction of today's Budget. He observed that the imperative for government would be a growth-oriented fiscal framework, which affirmed Government's commitment to long-term sustainability. Long-tem sustainability includes sound fiscal policy, macroeconomic – and social stability. This goal has been largely realised in today's Budget.

Highlights:

- **Personal income tax relief no surprise – R4bn**
- **Budget deficit widens to 3.1% of GDP**
- **R44.5bn added to public service delivery programmes**
- **Fiscal policy directed at strengthening economic capacity**
- **Strong increase in social spending and infrastructure**
- **Additional R2.1bn towards HIV and Aids treatment programme**
- **R6bn for broad-based Black Economic Empowerment Initiatives**

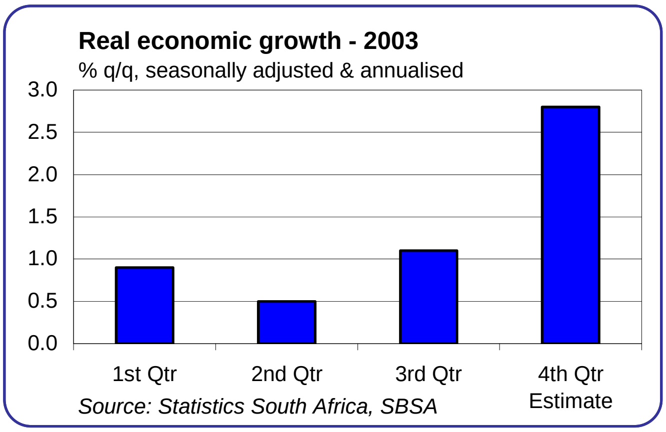
Economic backdrop

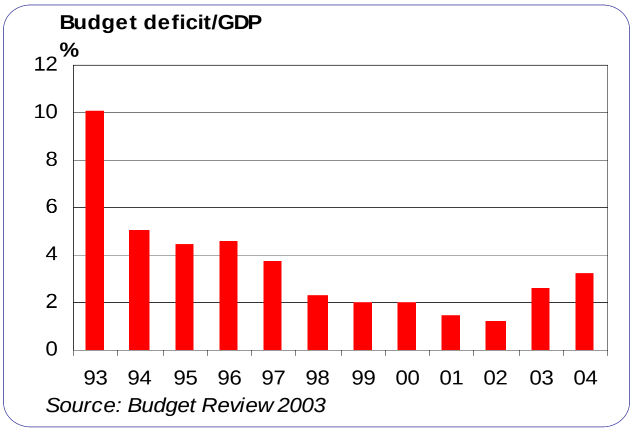
The 2003/04 economic environment, both international and domestic, has been disappointing. Global growth stuttered along, with none of the important global economies showing signs of robust and sustainable high levels of economic growth. Even the US economy, the powerhouse economy during the 1990's and early 2000's, struggles to convince skeptics that it has turned the corner in terms of sustained high levels of growth over the medium term. The global economy lacks an engine of growth.

Weak global growth and a strong rand have reduced demand and lowered profitability, thereby shrinking the tax base. A reduced tax base resulted in lower government revenues. The increase in the Budget deficit has affected both the size and scope of government expenditure and has delayed any prospects of further substantial tax cuts.

Fiscal sustainability

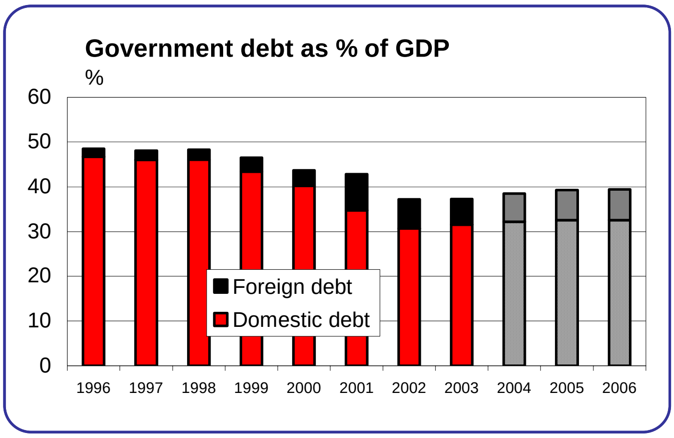
Fiscal sustainability means that, in the long-run, the budget deficit should not grow faster than the economy. In other words, the budget deficit to GDP ratio should converge to a sustainable level. The international rule of thumb in this regard is 3%. However, this is not a technical benchmark. Technically, the rate of government borrowing, over and above its existing debts, should not exceed economic growth. The key issue is the ability of the fiscal revenues to service the government's accumulated debt. At no point should the fiscus have to borrow in order to service its debt. Although the deficit for 2004/05 at 3.1% is slightly higher than what we have come accustomed to in the recent past, it is not larger than the expected growth rate for the economy in 2004/05.





Apart from the budget deficit to GDP ratio, fiscal sustainability can be assessed by the level of tax rates, the tax burden and government debt. Judged by these criteria, South Africa's fiscal affairs were in disarray with an unsustainable fiscal situation a decade ago. However, since then fiscal affairs have been brought on a sustainable level and path. It has been consolidated, stabilised and brought under control. For example, the budget deficit to GDP ratio has declined from more than 10% in the 1993/4 budget to 2.3% in the 2002/3 budget. This is lower than that of the US, UK, France and Japan.

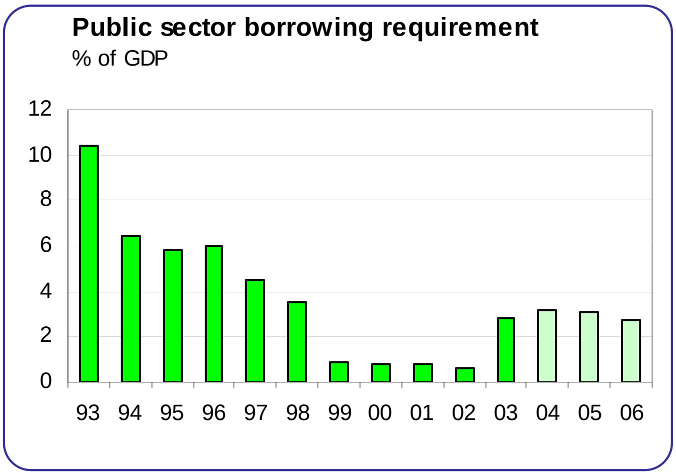
The decline in government debt has also allowed government to increase social expenditure in recent years.



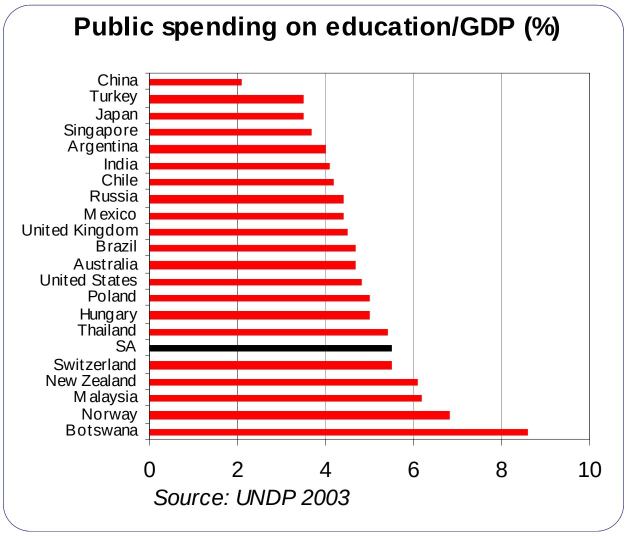
Macroeconomic stability

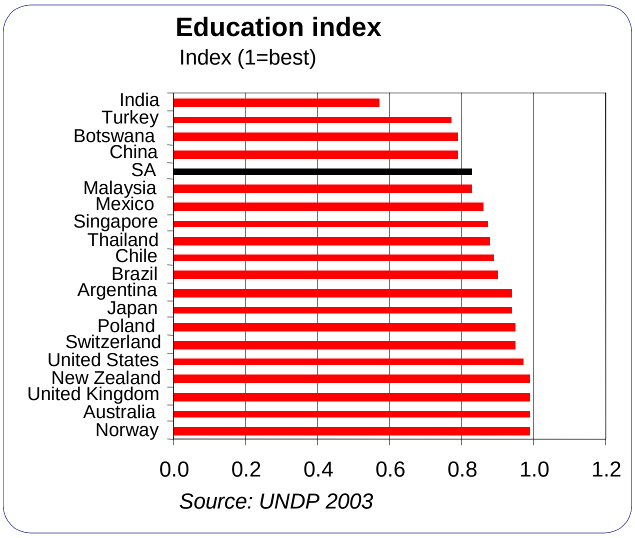
Fiscal policy has an important role to play in macroeconomic stability, but it cannot operate in isolation. Fiscal, labour, trade and monetary policies have to be in concert if macroeconomic stability is to be maintained. Fiscal policy has a dual role in this regard: it may play an anti-cyclical role; and it can contribute to creating an environment of certainty, which is a pre-condition for higher long-term growth. One important indicator of the impact of fiscal policy on other policy areas is the public sector borrowing requirement (PSBR).

Although the PSBR has increased since the last Budget after four years of extremely low levels, the current level and the planned levels over the MTEF, are doubtful to put undue pressure on the financial markets. In this way it is unlikely to have a negative effect on this aspect of macroeconomic stability.



In terms of the redistribution pillar of a growth-oriented budget, the current budget allocation already favours growth and development. However, the emphasis should now fall on more **effective** use of the available resources. Although South Africa's allocation is in line with international standards, the effectiveness of public spending still leaves much to be desired compared to other countries. For example, according to the UNDP's human development indicators, less than 20% of 175 countries spend more (as percentage of GDP) on education than South Africa, and yet 50% of these countries perform better than South Africa in terms of the UNDP's education index.





Main points of Budget speech

The main points mentioned or touched upon by the minister include the following:

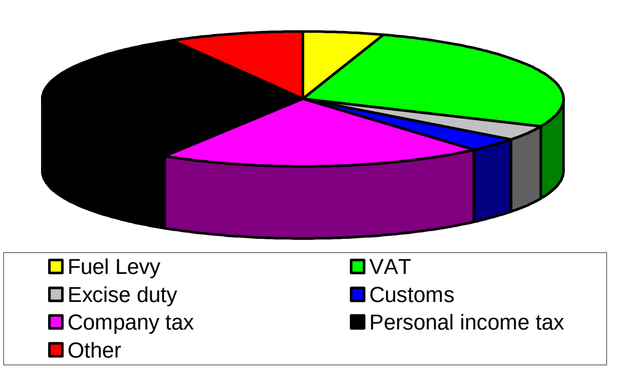
At the policy level, after a decade of structural change, the priority switches to the enhancement of economic growth and employment creation. Key priority areas for 2004 and going forward are:

- To increase the share of investment and savings out of national income
- To improve education and access to training opportunities
- To reduce poverty by creating work opportunities, and
- Continue to build sound institutions.

With regard to the budget framework:

- Revenue projections have been lowered by R4.5bn compared to the initial 2003/04 estimate
- The projected Budget deficit is now 2.6% of GDP rather than the original 2.4% for 2003/04
- The projected revenue for 2004/05 is R327bn, projected expenditure is R370bn and the deficit R43bn, which is 3.1% of expected GDP
- The tax burden will remain stable at about 25% of GDP.

Government revenue

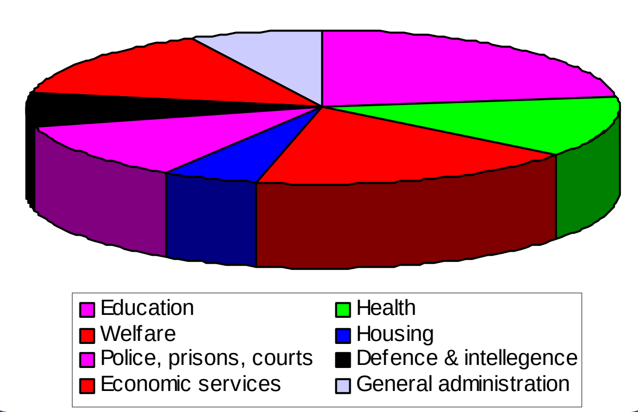


Tax proposals are as follow:

Average tax rates for taxpayers under 65	
Taxable income	**Proposed rates**
Below R32 222	18%
R74 000	25%
R115 000	30%
R195 000	35%
R270 000	38%
Above R270 000	40%

- Tax relief of R4bn
- Threshold below which people do not pay income tax is R32 222 and R50 000 for people over 65 years
- The interest and dividend exemption for taxpayers under 65 years increase from R10 000 to R11 000 and for people older than 65 from R15 000 to R16 000
- The threshold for housing transfer duties is raised to R150 000
- Broad-based equity participation is encouraged by considering issuance of shares not as income
- Reducing transactions cost in the housing market by eliminating stamp duties
- Adjustment to alcohol and tobacco taxes, and an increase in fuel levy, and
- Some relative minor changes to exchange control.

Government expenditure 2004/5



Spending changes over the next three years include:

An additional R3.2bn goes to provinces and municipalities for public works programmes

R2.1bn more for HIV/AIDS treatment programmes

R6bn available for Black Economic Empowerment

R700m more for land reform

R1.9bn more for crime fighting, and

An additional R1.1bn for international peacekeeping.

Remaining challenges

Some progress has been made in the utilisation of public resources, but much more needs to be done, especially at the provincial and local government levels. At this stage, the operational efficiency levels of fiscal spending leave much to improve on. Factors contributing to the inefficacy of government spending include inappropriate or insufficient skills and capabilities within the state, which to a large extent reflects the general shortage of skills within the country. Furthermore, inadequate institutional capacity and infrastructure in relation to the demand for service delivery is another factor.

Although fiscal policy plays an important role in promoting economic growth, there are limits to the contribution of the budget towards this goal. The budget can ensure that the allocation of resources is growth-oriented, but this cannot guarantee that fiscal spending will have the maximum impact on growth. Two crucial impediments still have to be addressed in this regard. Firstly, the imbalances in the provincial capacity perpetuate historical disparities, which has critical implications for growth and regional discrepancies. Secondly, it is critical that all the different spheres of the government, especially local and provincial government, are capable to spend their budgets efficiently and effectively.

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