

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-term sustainability includes sound fiscal policy, macroeconomic – and social stability. This goal has been largely realised in today's Budget.

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

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**

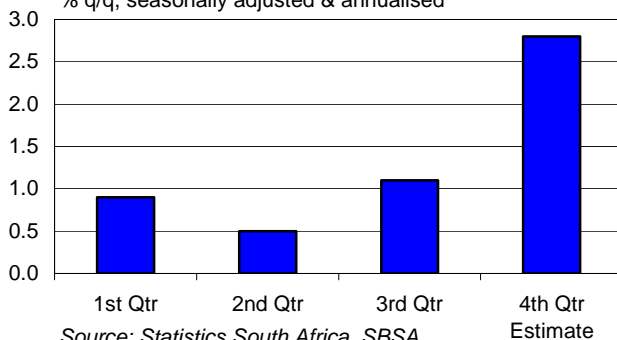
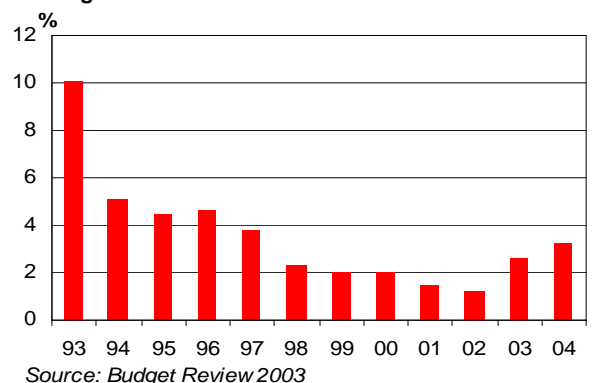
both the size and scope of government expenditure and has delayed any prospects of further substantial tax cuts.

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.

Real economic growth - 2003

% q/q, seasonally adjusted & annualised

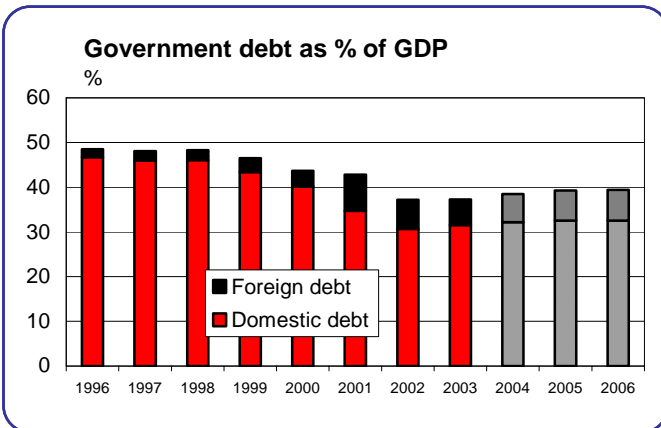

Budget deficit/GDP


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.

pressure on the financial markets. In this way it is unlikely to have a negative effect on this aspect of macroeconomic stability.

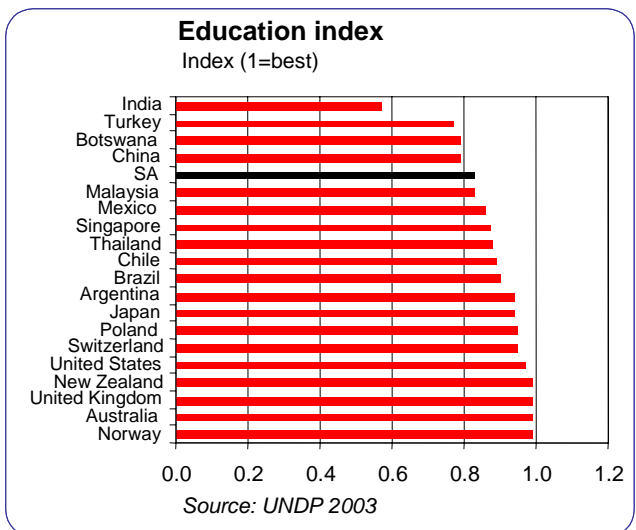
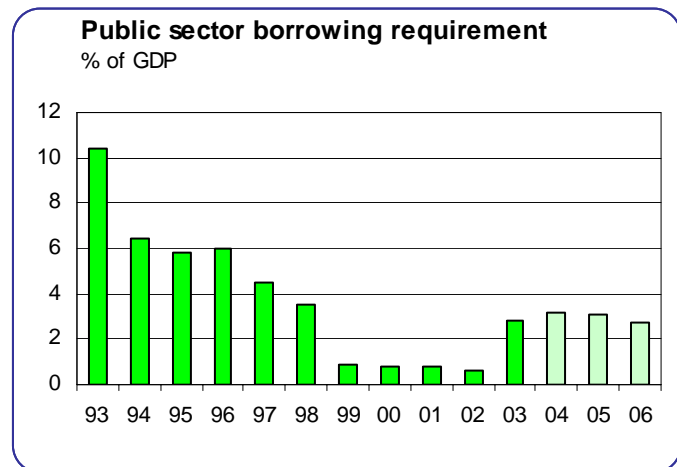
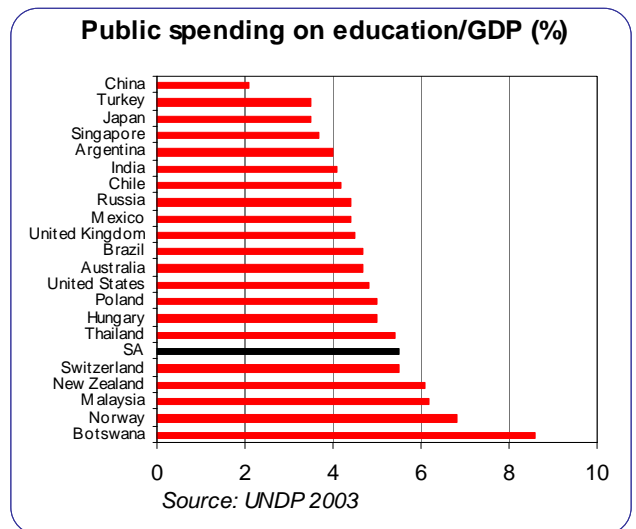
In terms of the redistribution pillar of a growth-oriented budget, the current budget allocation already favours growth and development. However, the emphasis should now fall on more **effective** use of the available resources. Although South Africa's allocation is in line with international standards, 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.



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



Main points of Budget speech

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

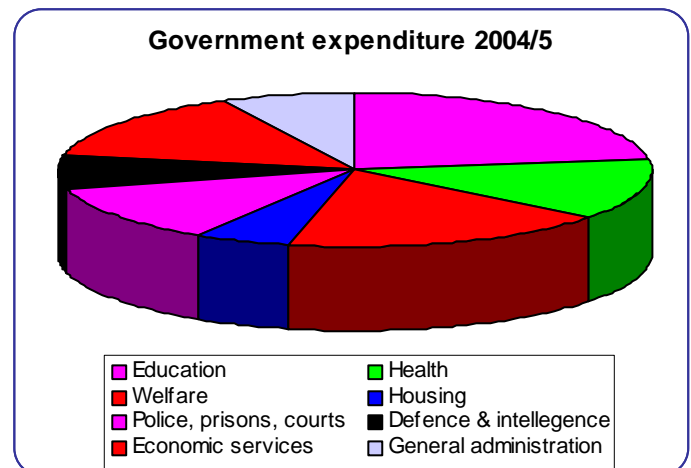
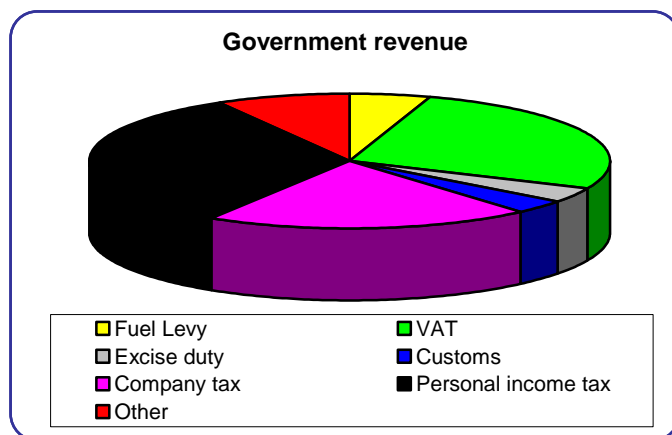
At the policy level, after a decade of structural change, the priority switches to the enhancement of economic growth and employment creation. Key priority areas for 2004 and going forward are:

- 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.

- 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.



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.

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

Standard Bank Economics Division research team

Iraj Abedian (PhD) – Director & Group Economist
 (+27-11-636-2910) Iraj.Abedian@standardbank.co.za

Africa research

Henry Flint (PhD)	+27-11-636-2875	Henry.Flint@standardbank.co.za
Jan Duvenage (BA, BCom (Hons))	+27-11-636-4557	Jan.Duvenage@standardbank.co.za
Isaac Matshego (BCom (Hons))	+27-11-636-7186	Isaac.Matshego@standardbank.co.za
Robert Bunyi (BA (Hons))	+27-11-631-1279	Robert.Bunyi@standardbank.co.za

Financial markets research

Monica Ambrosi (BA (Hons))	+27-11-636-5323	Monica.Ambrosi@standardbank.co.za
Shireen Darmalingam (BBusSc (Hons))	+27-11-636-2905	Shireen.Darmalingam@standardbank.co.za

Macroeconomic research

Johan Botha (DCom)	+27-11-636-2463	Johan.Botha2@standardbank.co.za
Elna Moolman (MA, MCom)	+27-11-631-2018	Elna.Moolman@standardbank.co.za

Public policy

Francis Antonie (MA, MBA)	+27-11-636-2909	Francis.Antonie@standardbank.co.za
---------------------------	-----------------	------------------------------------

Kindly email Brenda.Landsberg@standardbank.co.za should you wish to be included on our research distribution list. Do visit our web site <http://ed.standardbank.co.za> to view our most recent research or to access our archives.

Disclaimer

This document does not constitute an offer, or the solicitation of an offer for the sale or purchase of any investment or security. This is a commercial communication. If you are in any doubt about the contents of this document or the investment to which this document relates you should consult a person who specialises in advising on the acquisition of such securities. Whilst every care has been taken in preparing this document, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by the Standard Bank Group Limited, its subsidiaries, holding companies or affiliates as to the accuracy or completeness of the information contained herein. All opinions and estimates contained in this report may be changed after publication at any time without notice. Members of the Standard Bank Group Limited, their directors, officers and employees may have a long or short position in currencies or securities mentioned in this report or related investments, and may add to, dispose of or effect transactions in such currencies, securities or investments for their own account and may perform or seek to perform advisory or banking services in relation thereto. No liability is accepted whatsoever for any direct or consequential loss arising from the use of this document. This document is not intended for the use of private customers. This document must not be acted on or relied on by persons who are private customers. Any investment or investment activity to which this document relates is only available to persons other than private customers and will be engaged in only with such persons. In European Union countries this document has been issued to persons who are investment professionals (or equivalent) in their home jurisdictions. Neither this document nor any copy of it nor any statement herein may be taken or transmitted into the United States or distributed, directly or indirectly, in the United States or to any U.S. person except where those U.S. persons are, or are believed to be, qualified institutions acting in their capacity as holders of fiduciary accounts for the benefit or account of non U.S. persons; The distribution of this document and the offering, sale and delivery of securities in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by the Standard Bank Group Limited to inform themselves about and to observe any such restrictions. You are to rely on your own independent appraisal of and investigations into (a) the condition, creditworthiness, affairs, status and nature of any issuer or obligor referred to and (b) all other matters and things contemplated by this document. This document has been sent to you for your information and may not be reproduced or redistributed to any other person. By accepting this document, you agree to be bound by the foregoing limitations. Unauthorised use or disclosure of this document is strictly prohibited. Copyright 2003 Standard Bank Group. All rights reserved.