

Initial Response to Budget 2006

1. The Budget Framework

After a number of years of limited economic growth, estimates of growth in real GDP for 2005 have settled at 5%. This higher than expected growth rate, combined with continued improvement in the efficiency of tax collection by SARS, produced a revenue over-run of R 41 billion for the 2005/2006 fiscal year. Not surprisingly, there were a wide range of opinions regarding what should be done with it.

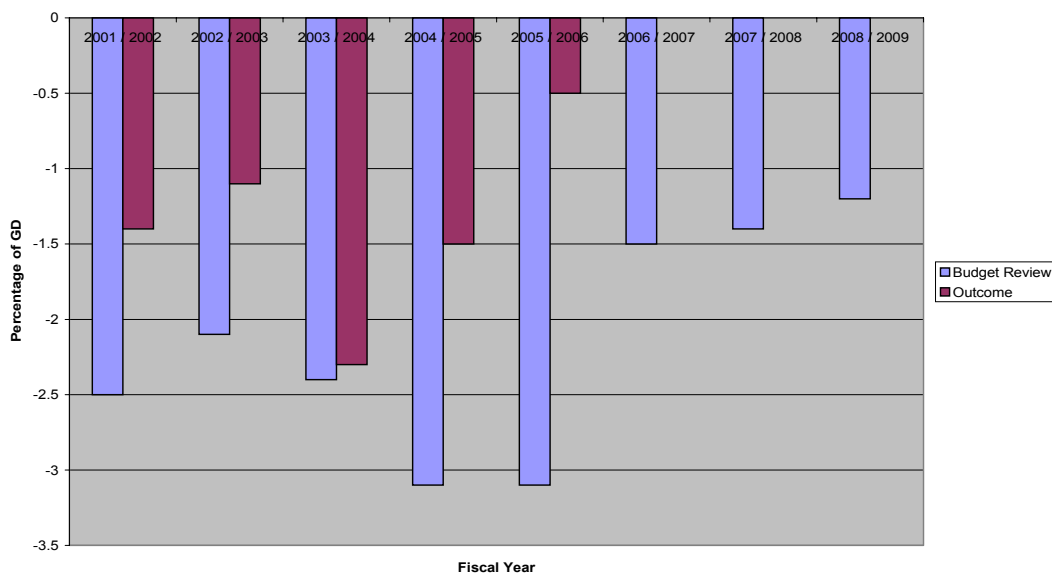
There was hope, primarily amongst private sector economists, that further reductions in the corporate tax rate and the secondary tax on companies would be on the cards, and, on the other side of the economic spectrum, hopes that the opportunity would be used for significant increases in social spending and direct income transfers to the poor and vulnerable. As is inevitably the case in a country still characterised by high levels of poverty, inequality and unemployment, the budget in other words again focused debate on budgetary *incidence*: who should contribute most to the fiscus and to what extent, and who should benefit most from it and to what extent.

Budget 2006 attempts to steer a middle ground between such contesting claims on public resources: we have personal income tax relief to the value of R19.1 billion over the medium-term expenditure framework (MTEF), with most of it going to low and middle income earners. There are no reductions in corporate rates (the abolition of the regional services levy was largely expected) but some measures to benefit small businesses. There are real increases in social spending and, as expected, significant allocations to infrastructural spending and a renewed commitment to skills development, given the emphasis on these as

pillars of government's Accelerated and Shared Growth Initiative (ASGI), which in essence seeks to identify and address the constraints to growth in the economy.

Is this an expansionary budget? Yes and No. Using a conventional measure, namely the ratio of the main budget deficit to GDP, it isn't. Figure 1 compares proposed budget deficits and outcomes, where available, since 2001.

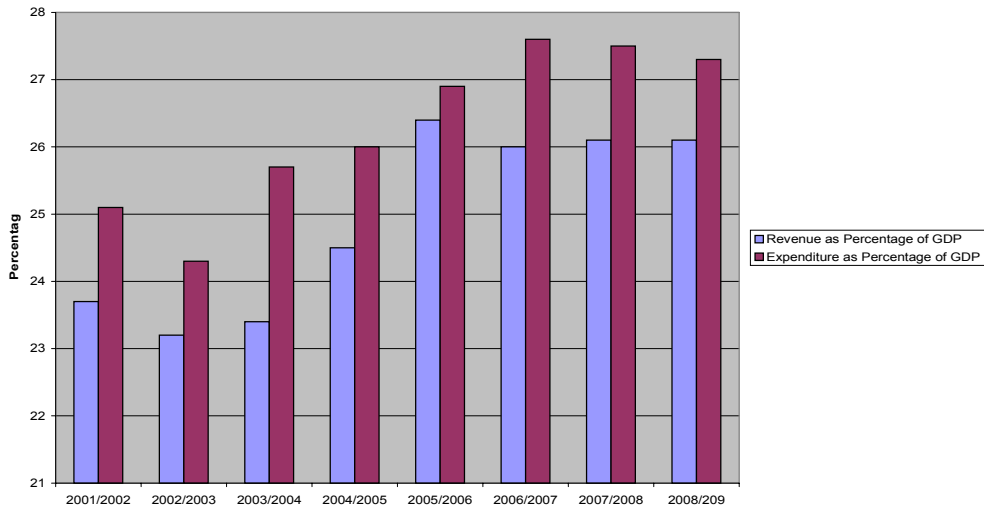
Figure 1: Recent Budgeted and Actual Deficits



Source: Various Budget Reviews, National Treasury

On the other hand, as figure 2 shows, the budget proposes maintaining the significant increases in expected revenue collection as a percentage of GDP over the MTEF which characterised fiscal year 2005/2006.

Figure 2: Trends in Revenue and Expenditure as a Percentage of GDP



Source: Various Budget Reviews, National Treasury

From this perspective, the small deficits are in fact due to the larger revenue claims of government on the economy. These larger revenue claims ensure that, notwithstanding a smaller deficit, we still see a significant real increase in government expenditure in Rand terms and as a percentage of GDP in the coming fiscal year. Debt servicing costs over the MTEF also decline further as a result. Though some will rue the opportunity for larger deficits, fiscal conservatism continues globally to be an indicator of good fiscal governance and the risks of challenging this consensus remain large.

2. Infrastructure and Skills Development

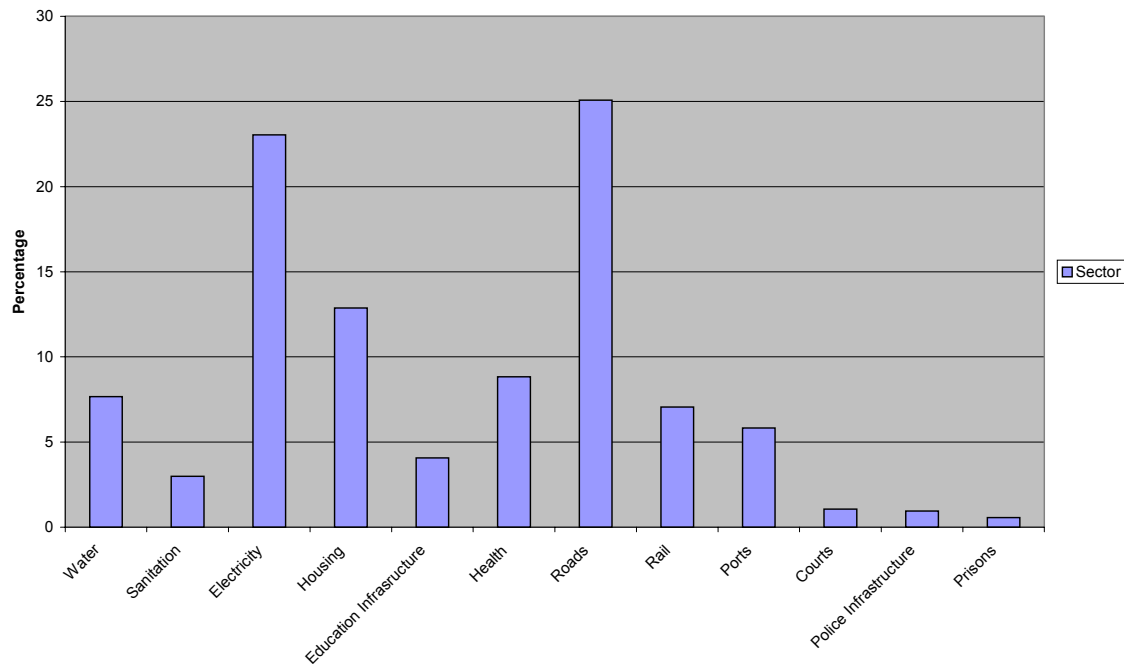
Though there is some disagreement about the precise extent of unemployment, it remains at very high levels. Budget 2006 includes a strong emphasis on measures to remove constraints on growth and generate increased employment opportunities.

Figure 3: Revised Unemployment Trends



The R 372 billion allocated to infrastructure under ASGI over the MTEF is a consolidation of a range of infrastructural spending projects. Figure 4 shows sectoral allocations of 68% of the R 372 billion allocated to infrastructure as part of the new growth initiative.

Figure 4: Infrastructure Spending: Sectoral Shares over MTEF



Source: Budget Review 2006

As we argued in our response to MTBPS 2005, three major challenges associated with the large increase in infrastructural spending are: government’s capacity to identify and efficiently implement public investment projects, the equitability of the distribution of the benefits of infrastructural spending, and adequate levels of transparency and accountability in the implementation and administration of infrastructural projects.

Lack of high level and intermediate skills continue to hamper economic participation for large proportions of the population. At 20% of public spending, education retains its priority in the budget, and additional allocations to the sector education and training authorities further reflect this priority. However, concerns

remain over the efficiency and the effectiveness of spending on human resource development.

3. The Budget, Poverty and Vulnerability

High levels of poverty and vulnerability continue to require that expenditure which targets them needs to be prioritised. Spending on them further needs to be monitored and evaluated continuously for efficiency and effectiveness.

Growth in allocated expenditure to social services will be significantly larger than expected GDP growth for the first year of the MTEF, and slightly larger than growth in total allocated expenditure. Within the social services portfolio, particularly large increases are proposed for Housing and Community Development. Table 1 shows real (that is to say with inflationary effects removed) changes in spending on social services over the MTEF, as well as changes in total allocated expenditure. As is generally the case, large changes in allocations, such as to community development in the coming fiscal year, raise questions of departmental absorptive capacity and require close monitoring and evaluation of spending.

Table 1: Real percentage changes in total allocated expenditure and social services expenditure

	2006/2007	2007/2008	2008/2009
Social Services	9.4	5.9	4.6
Education	5.8	5.2	3.8
Health	7.3	3.6	3.1
Social Development	5.8	4.8	4.4
Housing	13.4	16.3	4.2
Community Development	48.1	13.0	11.4
Total Allocated Expenditure	9.2	5.2	4.3

As is to be expected, these real increases in allocations to social services are accompanied by real increases in provincial equitable shares as well as conditional grants to provinces, given that the provinces remain responsible for the bulk of social spending. Real percentage increases in the provincial equitable share over the MTEF period average 6.5 %, and for conditional grants 11.7%.

Budget 2006 also proposes increases in all the social grants, which are set to be administered by the new national Social Security Agency:

Table 2: Changes to Social Grants

Child Support Grant	R 180 to R 190
Care Dependency Grant	R 780 to R 820
State Old-Age Pension	R 780 to R 820
Disability Grant	R 780 to R 820
Foster Care Grant	R 560 to R 590

By 2007 / 2008, it is expected that social grants will have risen to a very significant 3.3 % of GDP. However, a large percentage of the population continues to lack access to secure sources of income as well as access to any form of social security.

National government continues to strengthen its response to HIV and AIDS through increased specific allocations in the National Department of Health. The total HIV and AIDS sub-programme budget of the Strategic Health Programmes (which includes the Comprehensive HIV and AIDS Grant for provinces and specific allocations for the national department) will increase by 21% in real terms in the coming fiscal year. The HIV and AIDS sub-programme consumes 94 per cent of the total budget available for Strategic Health Programmes in 2006/7, increasing from 64 per cent of the total Programmes budget in 2002/3. The

Comprehensive HIV and AIDS Grant has increased from R1.1 billion in 2005/6 to R1.6 billion in 2006/7, representing a real growth of 32 per cent.

It has been confirmed that the Community and Home Based Care Services (CHBCS) Grant is being phased into the provincial equitable share. This means the grant is no longer available as a ring-fenced transfer from national government to provinces. Now the provincial social development departments have to engage actively with their provincial treasuries to ensure that resources are made available from the provincial equitable share budgets. Notably, given social development departments' lack of readiness to utilise equitable share funding for HIV and AIDS, concerted efforts need to be made to mobilise provinces to bargain through provincial treasury processes to secure enough funding to sustain the CHBCS activities.

4. Local Government in Budget 2006

National Transfers to Local Government are increasing by 44.3% in real terms, from R18.6 billion in 2005/06 to R28.0 billion in 2006/07. This increase is to a large extent due to the inclusion of R7 billion compensation for the abolished RSC levies. If the RSC compensation is excluded, the (unconditional) equitable share allocation to local government grows by 10.1% in real terms, implying a slower pace of growth than in the previous year (20.5%).

Infrastructure transfers to local government grow by 10.0% in real terms, also a slight reduction in the pace of budget growth compared to the previous year (15.0%). This can be explained by the need to urgently address service delivery and management capacity in a number of municipalities, before huge increases in capital spending can be absorbed efficiently.

The Current Grants to Local Government - mainly for capacity development - are decreasing by 4.0%, partly because amounts for the Restructuring Programme are phased into the equitable share. With regard to capacity development, the National Department of Provincial and Local Government has budgeted 34.2 million in 2006/07 to start implementing Project Consolidate, a “hands-on” support programme to address service delivery challenges in a targeted number of municipalities. That this is indeed necessary, is evidenced by the Preliminary in-year spending outcomes (2004/05, National Treasury website) for a selection of municipalities, indicating that some of the sample municipalities experienced difficulties with spending their capital budgets in particular.

5. Budget Administration

As we argued in our response to MTBPS 2005, budget policy in South Africa has stabilised significantly and is no longer characterised by surprises or uncertainty regarding changes in key variables. This is to be welcomed as the speculative efforts associated with fiscal uncertainty are generally damaging. The greater predictability of budgeting, which some may regard as ‘disappointing’ or ‘boring’, is a strong indicator of improvements in the quality of fiscal governance.

Government should further be credited with disseminating a wide range of budget policy and budget-administration related documents. These include the *Budget Review*, the *Estimates of National Revenue* and *Estimates of National Expenditure*, and the *Adjusted Estimates of National Expenditure* which details revised spending plans during the fiscal year. The ‘Budget at a Glance’ and ‘People’s Guide to the Budget’ series furthermore strive to make budget information broadly accessible. The ongoing challenge, looking forward, is to ensure improvements in the efficiency and effectiveness of spending. The importance of this was emphasised in the Budget speech when the Minister mentioned that both improved public administration and citizen activism were

needed in order to get things done. The focus in the media and amongst civil society remains almost exclusively on the budget review and the MTBPS, which, after all, represent *intentions*. This is occasionally at the expense of ensuring consistently high levels of public accountability by focusing greater attention on what *happens* to spending plans over the course of the fiscal year, and the extent to which audited spending reports compare to initial budget allocations. Engagement will all the stages of the budget process, rather than just the budget speech and review, is necessary to ensure that publicly provided goods, services and direct transfers reach their intended beneficiaries with a minimum of delay and waste and a maximum impact on social welfare.