

Developmental financing package



Introduction

The preceding sections of this Budget Framework have outlined a set of spending proposals aimed at accelerating the pace of poverty eradication and job creation in South Africa. Critics of the People's Budget Campaign often raise two questions regarding our proposals: These are:

- Will government be able to find resources to finance such an expansive programme?
- Will the implementation of an expansive programme result in sustainable economic growth and job creation?

This section responds to each of these concerns by providing an integrated developmental fiscal package. This section of the report focuses on the following:

- Presentation of scenarios for increased spending;
- Raising resources through increased taxation, while lessening the tax burden on the poor;
- Deficit financing to support economic growth, while managing the recurrent costs associated with debt;
- Reallocation of resources from spending on the military and the Pebble Bed Modular Reactor (PMBR).

Taxes, deficits and economic growth

The positive effects of increased social investment on economic growth and poverty eradication are immense. In debating the extent of increased social spending, the People's Budget Campaign commissioned the Economic Policy Research Institute (EPRI) to develop a set of scenarios focusing on increasing taxation and deficit levels. Moreover, the results were not only to focus on spending, but on the impact of increased spending on economic growth and the sustainability of deficits. This section explores the results of that exercise.

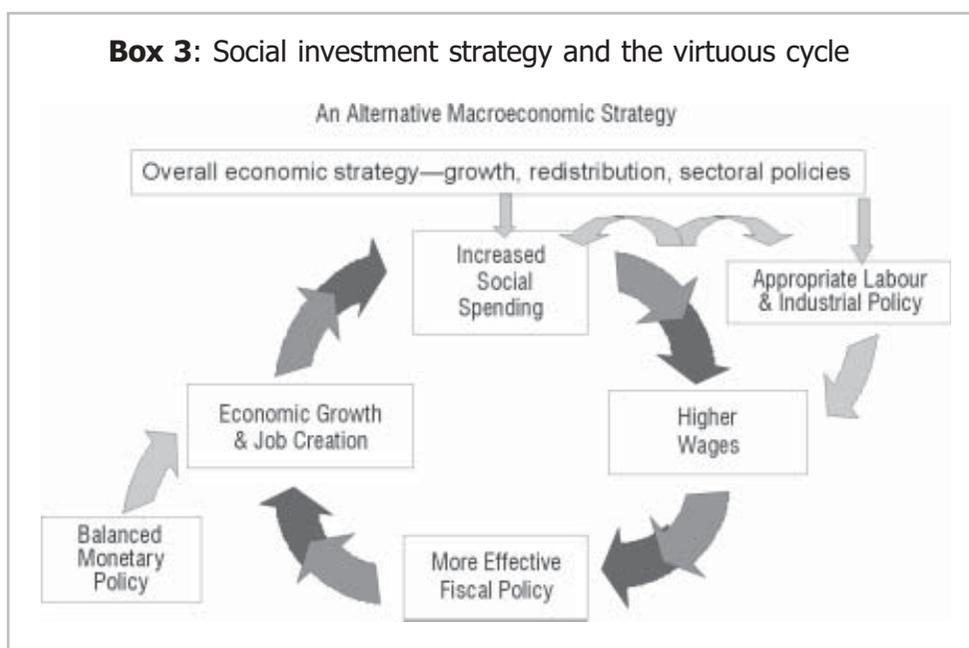
Foundations of the model

Government's ability to deliver poverty eradication, social development and job creation depends on its ability to mobilise fiscal resources in a sustainable manner. The 2000 People's Budget provided an analysis of scenarios for moderate fiscal expansion, identifying the growth and development opportunities associated with sustainable investments in social infrastructure. Evidence over the past four years supports these initial findings – more expansionary fiscal policy can support economic growth, poverty reduction and sustainable development. These trends – along with economic theory and international experience – suggest that continued fiscal expansion will further support the achievement of South Africa's critical social objectives.

The fundamental basis for evaluating a macroeconomic strategy is its achievement of critical policy objectives. In South Africa, this involves an assessment of the policy impact on job creation, poverty reduction, redistribution, social delivery and economic growth. South Africa's macroeconomic strategy from 1996 to 2000 focused on macroeconomic stability and the attraction of investment as an engine to promote growth. Over the past five years, the government has shifted towards a moderately more expansionary fiscal policy, mobilising higher tax revenue, increasing borrowing in a prudent manner and significantly increasing social and economic expenditure.

Underlying the approach of the People's Budget campaign is a social investment strategy that is depicted in Box 3. It depicts the reinforcing nature of the component macroeconomic policies. Increased social investment combined with appropriate labour and industrial policies support higher wages that reduce poverty. This bolsters the effectiveness of fiscal policy, since efficient social delivery produces a greater growth effect if the economy can break out of the poverty trap. For example, expanding access to education is not as efficient if households lack the resources to provide learners with adequate nutrition. Expanding access to electricity fails to yield optimal

Box 3: Social investment strategy and the virtuous cycle

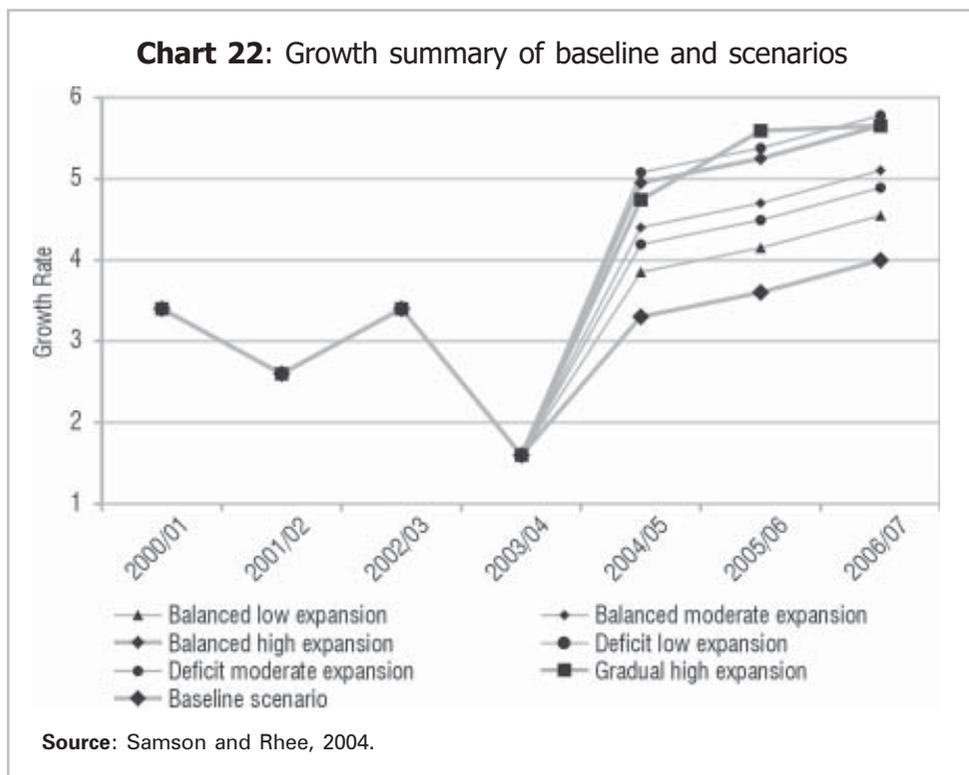


results if households lack the capacity to pay the associated service charges. With higher wages and less poverty, fiscal policy has a stronger effect promoting economic growth and job creation. An appropriately balanced developmental monetary policy can reinforce these effects. Higher rates of economic growth in turn expand the fiscal resource base, supporting even greater levels of social delivery, and the entire 'virtuous circle' is accelerated.

Since 2001, the government's fiscal stabilisation programme has given way to a moderately more expansionary strategy. Social development expenditure in particular has driven the increase in overall spending. Economic studies have documented the productive impact of social security in terms of reduced poverty, improved household well-being, greater productivity and heightened labour market activity.¹⁶

Between 2000/1 and 2003/4 fiscal years, real social expenditure *per capita* has increased by an annual growth rate of 6,1%, compared to the 0,3% annual growth rate of the same indicator between 1994/95 and 1999/2000. This contrasts sharply with the decline of 0.3% in real social expenditure *per capita* over the sub-period from 1996/97 to 1999/2000. Total social expenditure *per capita* in 2003/4 stood at R3 823, including education, health, social development, housing and community development and other services. The projected increase in social expenditure for the next three years, however, is expected to moderate to an annual increase of 2,5% between 2004/5 and 2006/7.

Chart 22: Growth summary of baseline and scenarios



Source: Samson and Rhee, 2004.

Table 19: Macroeconomic projections of government, 2001/2002-2006/2007

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Revenue (% of GDP)	24.6	25.5	25.3	25.7	25.7	25.9	25.9
Expenditure (% of GDP)	26.6	26.8	26.2	27.9	28.6	28.7	28.5
Fiscal deficit (% of GDP)	2.0	1.4	1.0	2.2	2.9	2.8	2.6
National debt (% of GDP)	43.6	42.1	36.3	36.8	38.1	38.9	39.2
Economic growth rate	3.4	2.6	3.4	1.6	3.3	3.6	4.0

Source: National Treasury, 2004. Budget Review, 2004

Scenarios

For comparison purposes, the baseline scenario was drawn from the 2004 Budget Review. Table 19 summarises some of the key characteristics of the government's macroeconomic strategy until the 2006/7 fiscal year.

Six models were developed working off this baseline scenario. These scenarios are summarised in Table 20.

The results of the different scenarios are assessed in terms of the impact on economic growth and additional social spending. The graph depicts increased GDP growth rates (over and above the growth rates projected for the baseline scenario) under each of the six scenarios explored, varying from a 0,6% increase under the balanced low expansion to a 1,8% increase under the moderate deficit expansion in fiscal year 2006/07. The scenarios with the highest GDP growth rate yields are the moderate deficit expansion, the gradual high expansion and the balanced high expansion, all yielding growth rates within the range of 5,7% and 5,8% for fiscal year 2006/7 (See Chart 22).

The debt-to-GDP ratio may produce a significantly different picture depending on the time horizon of the analysis, due to the interaction between the growth rate of the economy and the growth rate of the deficit. The resulting debt-to-GDP ratios for each scenario, including the results of simulation for the additional three years, 2007/8-2009/10, are depicted in Chart 23. All but one scenario, the gradual high expansion, maintain a positive relative position with respect to the debt ratio of the baseline scenario throughout the entire time period under analysis. In the medium-term, by 2006/7, three scenarios yield higher debt-to-GDP ratios than that of the baseline scenario (39,2%) – the moderate deficit expansion at 43,0%, the low deficit expansion at 41,1%, and the gradual high expansion at a marginally higher 39,3%. All three balanced expansions yield lower debt-to-GDP ratio – at 38,7%, 38,2% and 37,7% for the balanced low, moderate and high expansion respectively. Over

Table 20: Scenarios for government spending and economic growth

Years	2000 /01	2001 /02	2002 /03	2003 /04	2004 /05	2005 /06	2006 /07
Gradual High Expansion Scenario							
Revenue (% of GDP)	24.6	25.5	25.3	25.7	26.7	27.9	28.9
Expenditure (% of GDP)	26.6	26.8	26.2	27.9	30.6	31.7	31.5
Fiscal deficit (% of GDP)	2.0	1.4	1.0	2.2	3.9	3.8	2.6
National debt (% of GDP)	43.6	42.1	36.3	36.8	38.6	39.7	39.3
Economic growth rate	3.4	2.6	3.4	1.6	4.7	5.6	5.7
Balanced Low Expansion Scenario							
Revenue (% of GDP)	24.6	25.5	25.3	25.7	26.7	26.9	26.9
Expenditure (% of GDP)	26.6	26.8	26.2	27.9	29.6	29.7	29.5
Fiscal deficit (% of GDP)	2.0	1.4	1.0	2.2	2.9	2.8	2.6
National debt (% of GDP)	43.6	42.1	36.3	36.8	37.9	38.5	38.7
Economic growth rate	3.4	2.6	3.4	1.6	3.9	4.2	4.6
Balanced Moderate Expansion Scenario							
Revenue (% of GDP)	24.6	25.5	25.3	25.7	27.7	27.9	27.9
Expenditure (% of GDP)	26.6	26.8	26.2	27.9	30.6	30.7	30.5
Fiscal deficit (% of GDP)	2.0	1.4	1.0	2.2	2.9	2.8	2.6
National debt (% of GDP)	43.6	42.1	36.3	36.8	37.7	38.2	38.2
Economic growth rate	3.4	2.6	3.4	1.6	4.4	4.7	5.1
Balanced High Expansion Scenario							
Revenue (% of GDP)	24.6	25.5	25.3	25.7	28.7	28.9	28.9
Expenditure (% of GDP)	26.6	26.8	26.2	27.9	31.6	31.7	31.5
Fiscal deficit (% of GDP)	2.0	1.4	1.0	2.2	2.9	2.8	2.6
National debt (% of GDP)	43.6	42.1	36.3	36.8	37.5	37.9	37.7
Economic growth rate	3.4	2.6	3.4	1.6	5.0	5.3	5.7
Low Deficit Expansion Scenario							
Revenue (% of GDP)	24.6	25.5	25.3	25.7	25.7	25.9	25.9
Expenditure (% of GDP)	26.6	26.8	26.2	27.9	29.6	29.7	29.5
Fiscal deficit (% of GDP)	2.0	1.4	1.0	2.2	3.9	3.8	3.6
National debt (% of GDP)	43.6	42.1	36.3	36.8	38.8	40.2	41.1
Economic growth rate	3.4	2.6	3.4	1.6	4.2	4.5	4.9
Moderate Deficit Expansion Scenario							
Revenue (% of GDP)	24.6	25.5	25.3	25.7	25.7	25.9	25.9
Expenditure (% of GDP)	26.6	26.8	26.2	27.9	30.6	30.7	30.5
Fiscal deficit (% of GDP)	2.0	1.4	1.0	2.2	4.9	4.8	4.6
National debt (% of GDP)	43.6	42.1	36.3	36.8	39.5	41.6	43.0
Economic growth rate	3.4	2.6	3.4	1.6	5.1	5.4	5.8

Source: Samson and Rhee, 2004.

the longer term, using projections for fiscal year 2009/10, the model documents the deepening impact of each scenario on the debt-to-GDP ratio, with the exception of the gradual high expansion scenario, for which the debt-to-GDP ratio first rises and then falls. The moderate deficit and low deficit expansions yield higher level of debts (46,4% and 43,2% respectively)

compared to the baseline scenario (Chart 23).

The three balanced scenarios continue to yield lower levels of debts than the baseline scenario, at 39,0%, 38,1%, and 37,2% for the balanced low, moderate and high expansion, respectively. The gradual high expansion actually shows a decline in the national debt level from the peak of 39,3% in 2006/7 to 39,1% in 2007/8, 0,4 percentage points lower than the debt level under the baseline scenario, and continues to decline. By 2009/10, the top three scenarios with the lowest level of national debt are the balanced high expansion at 37,2% (a decrease of 2,8% compared to 39,9% of the baseline), the balanced moderate expansion at 38,1%, and the gradual high expansion at 38,4%.

Two of the six scenarios proposed stand out as particularly attractive. Both of the proposed scenarios require significant increases in the expansionary fiscal stance of government. The proposed scenarios are:

- The gradual high expansion; and
- The balanced high expansion scenarios.

Both yield a significantly higher GDP growth rate (5,7%) than the baseline scenario (4,0%) and lower debt-to-GDP ratio (37,2% for the balanced high and 38,4% for the gradual high) than the baseline scenario (39,9%). Both of these scenarios result in substantially higher employment levels, particularly if reinforced by appropriate industrial, labour and tax reforms that encourage labour-intensive (rather than capital-intensive) expansions. With increased expenditure, and subsequently higher levels of social investment

in education, health, and social services, these policy scenarios will improve the social capital stock while contributing to poverty eradication, social development, job creation and economic growth.

The results of the summary show the possibilities of arriving at a situation of:

- Increased government spending which stimulates economic growth;
- Slightly increased deficits in the short-term, followed by lower deficits in the longer term.

However, both the scenarios that we are recommending for policy debate require a significant increase in initial government spending.

Transforming the taxation system

If taxation systems are regressive (i.e. the rich pay a lower share of income in tax than the poor) raising taxation levels may in fact hurt the poor. Thus, while calling for increased levels of taxation, we make proposals for the tax burden of the poor to be reduced. Furthermore, we motivate for an increase in tax: GDP ratios, and provide proposals for the reforming of VAT.

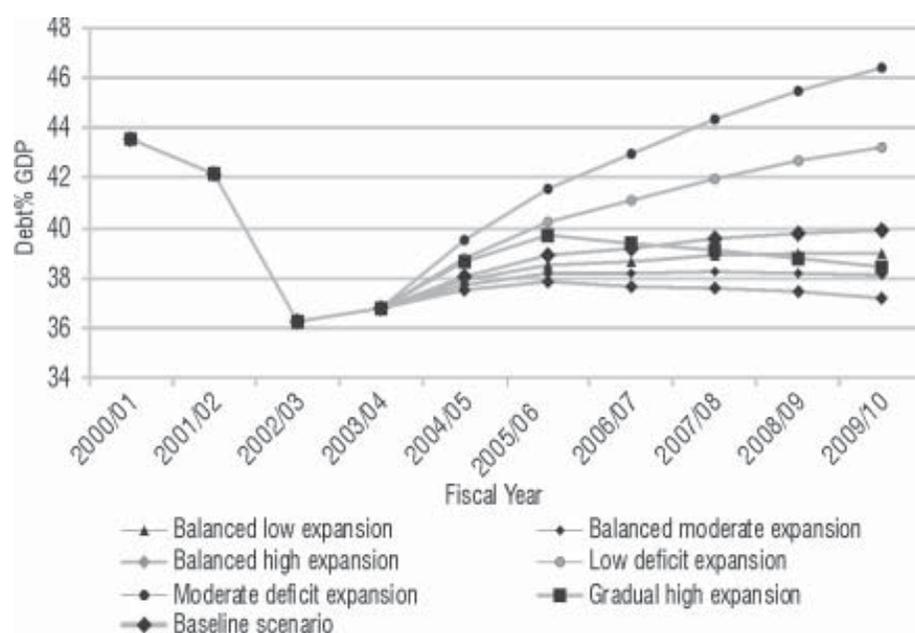
The vast majority – more than 90% – of the money available to government to finance public administration and service delivery is raised through taxes. Taxation is not only a way to cover the costs of governance and the provision of public goods, it is also a mechanism for the redistribution of wealth. In

South Africa, where past policies concentrated wealth in the hands of a few and created an enormous gap between rich and poor, this redistributive function is particularly important for the achievement of social and economic transformation.

It is therefore essential not only that the system of taxation raise sufficient revenue to support government's developmental goals and public spending priorities, but also that the structure of taxation is strongly progressive – in other words that it places the largest demands on those most able to pay while minimising the costs to the poorest households.

In this section, we first review the overall trends in taxation,

Chart 23: Deficit summary of baseline and projections



Source: Samson and Rhee, 2004.

Box 4: Summary of macroeconomic scenarios

Scenario name	Summary	Modelling assumptions
Gradual high expansion scenario	This scenario seeks to show the possibilities of a sustained increase in government spending through raising tax and deficit targets.	<ul style="list-style-type: none"> In 2004/5 expenditure is increased by 2% of GDP, and revenue by 1%. In 2005/6 expenditure is further increased by 3%, while revenue is increased by 2% with an increase of 1% in the fiscal deficit. In 2006/7, both expenditure and revenue are raised by 3%, resulting in the same fiscal deficit level as the baseline scenario, at 2,6%.
Balanced low expansion scenario	This scenario shows the results of increase in revenue and expenditure by 1%, while keeping the fiscal deficit in line with the baseline scenario.	<ul style="list-style-type: none"> For the medium-term projection period between 2004/05 and 2006/07, both government revenue and expenditure are increased by 1% compared to the baseline scenario. The fiscal deficit is unchanged compared to the baseline scenario (hence the term 'balanced').
Balanced moderate expansion scenario	This scenario shows an increase in revenue and expenditure of 2%.	<ul style="list-style-type: none"> For the medium-term projection period between 2004/5 and 2006/7, both government revenue and expenditure are increased by 2% compared to the baseline scenario. The resulting fiscal deficit is the same as the figure provided in the baseline scenario for each corresponding year.
Balanced high expansion scenario	This scenario models the impact of increasing revenue and expenditure by 3%, and keeping the budget deficit unchanged.	<ul style="list-style-type: none"> For the medium-term projection period between 2004/5 and 2006/7, both government revenue and expenditure are increased by 3% compared to the baseline scenario. The resulting fiscal deficit is the same as the figure provided in the baseline scenario for each corresponding year.
Low deficit expansion scenario		<ul style="list-style-type: none"> For the medium-term projection period between 2004/5 and 2006/7, only government expenditure is increased by 1% compared to the baseline scenario for each fiscal year, while no change is made in government revenue. The resulting fiscal deficit is raised by 1% compared to the baseline scenario for each corresponding year.
Moderate deficit expansion scenario	This model looks at increases in the deficit alone by raising the deficit to 2% above the baseline.	<ul style="list-style-type: none"> For the medium-term projection period between 2004/5 and 2006/7, only government expenditure is increased by 2% compared to the baseline scenario for each fiscal year, while no change is made in government revenue. The resulting fiscal deficit is raised by 2% compared to the baseline scenario for each corresponding year.

Shaded scenarios are those proposed for debate.

Source: Adapted from Samson and Rhee, 2004.

then we propose policy adjustments that would generate more revenue and enhance the progressiveness of the tax system.

Tax trends

The economic strategy adopted by government in the late 1990s (GEAR) led to cuts in both taxes and spending. Although tax revenue initially rose rapidly as a percentage of GDP in the first years of the democratic administration, it dropped back again between 1998/9 and 2000/1. Since 2002/3, this ratio

has again been slowly growing and is expected to reach 25,2% by 2007/8.

Throughout this period, nominal tax revenue grew steadily, in spite of the fact that the tax:GDP ratio declined in the late 1990s. This apparent contradiction is explained in part by the improved capacity of the South African Revenue Service (SARS) to collect taxes and to enforce compliance with revenue laws. As a result, tax revenue exceeded the National Treasury's predictions in virtually every year. However, enhanced compliance has also

Table 21: Estimated, nominal and real revenue, 1995/96-2007/08 (R billions)

Year	Budget revenue estimate	Total nominal budget revenue ¹⁷	Budget/Actual deviation	GDP deflator	Total real revenue (in 1995 rands)	GDP	Tax to GDP ratio
1995/96	124,1	126,0	1,9	8.5%	126,0	564,2	22.3%
1996/97	144,7	146,5	1,8	8.4%	135,0	635,2	23.1%
1997/98	162,3	163,4	1,1	7.7%	138,9	699,6	23.4%
1998/99	177,6	184,0	6,4	7.5%	145,3	752,6	24.5%
1999/00	190,9	198,2	7,3	6.0%	145,6	819,4	24.2%
2000/01	210,4	215,6	5,2	7.2%	149,4	914,6	23.6%
2001/02	233,4	248,3	14,9	7.8%	160,5	1 010,9	24.6%
2002/03	265,2	278,5	13,3	10.0%	167,0	1 149,9	24.2%
2003/04	304,5	299,4	(5,1)	5.3%	163,2	1 232,5	24.3%
2004/05	327,0	328,2	1,2	5.1%	169,9	1 340,7	24.5%
2005/06	363,0			5.3%	178,8	1 466,8	24.7%
2006/07	399,1			5.2%	186,6	1 598,6	25.0%
2007/08	440,5			5.3%	195,8	1 755,7	25.1%

Source: Budget Reviews, Annexure B, Table 1; 2004 MTBPS, Table 3.4; Real revenue and tax:GDP ratio for 2005/06-2007/08 calculated on the basis of revenue forecasts in MTEF.

reduced the prospects for overachievement of revenue targets in future years (Table 21).

As important as the total revenue pool is the progressiveness of the tax system. This is influenced by two factors:

- The composition of revenue – the proportion of total revenue raised from different tax sources. Some taxes, such as taxes on consumption (e.g. VAT), tend to be regressive because poorer

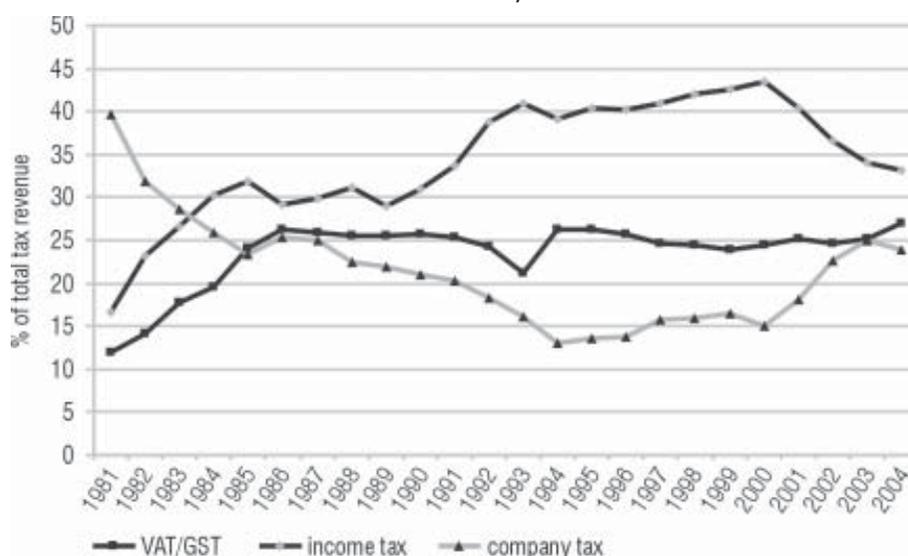
households inevitably spend a larger share of their income on purchasing goods and services. Other taxes, such as those on wealth and income, are more likely to be progressive.

- The structure of tax rates. Most taxes can be made more progressive by shifting a greater share of the tax burden onto wealthier taxpayers. Income tax, for example, can be applied to everyone at a flat rate, but typically income tax is progressive because top earners are expected to pay a much

higher percentage of their income in tax than middle-income households, while poor households are not expected to pay at all.

Presently, three taxes account for over 80% of all revenue raised at the national level: personal income tax, VAT and company taxes. As Chart 24 shows, the composition of revenue changed dramatically between 1981 and 1994, remained fairly constant between 1994 and 2000, and then shifted again in recent years. During the last fifteen years of the apartheid era, companies' share of the total tax burden was slashed from 40% to less than 15%, while personal income tax and taxes on goods and services (GST/VAT) became increasingly

Chart 24: Contribution of primary tax sources to total tax revenue, 1981-2004



Source: van Niekerk, 2004.

important sources of revenue. Income tax, which contributed about 17% of all national revenue in 1981, comprised nearly 40% of tax revenue in 1994. Similarly, GST represented 12% of taxes in 1981, while VAT contributed 26% in 1994. Since 2000, the corporate share of the tax burden has grown again from 15% to 25%, while personal income tax has become slightly less important, falling from 44% of tax revenue to 33%. In the past year, VAT, which consistently contributed roughly 25% of tax revenue since 1997, rose sharply to 27%, compensating for a decline in company tax collections.

The structure of taxation has also changed significantly. Personal income tax rates have been cut repeatedly over the past decade; the cumulative impact of these cuts now stands at R66 billion. Although the cuts have been designed to provide greater tax relief to middle-income households, less than half of all formal workers earn enough to be liable for income tax (currently R32 222). While the unemployed realise no direct benefit from income tax cuts – and may even suffer if tax cuts reduce government's capacity to deliver basic services – those in the top income bracket have enjoyed a substantial reduction in their tax rate from 45% to 40%.

Over the same period, corporate taxes have been reduced by a total of R6 billion. Consequently, although companies contribute a larger proportion of total tax revenue than they did in 2000, their contribution is relatively small and the effective rate of taxation on companies remains relatively low.

Such cuts are more likely to hinder, rather than aid, poverty reduction. Government has justified these changes in the tax regime by arguing that they would stimulate savings and capital formation, promote economic growth and provide incentives for business development. However, as noted above, the restrictive fiscal policy has, in fact, been associated with low growth and rising unemployment.

The tax that imposes the greatest burden on poor households is VAT. However, the only significant adjustment to VAT in the past decade has been the zero-rating of illuminating paraffin in 2001 – an effective tax cut of R400 million for poor households or the equivalent of 0,6% of the tax cut given to those earning more than R2 685 a month.

Raising the tax:GDP ratio

In order to finance increased public investment in health, education, social security and infrastructure, as the People's Budget Campaign proposes, government must raise additional revenue by reversing, at least partially, the tax cuts of the last decade.

Tax effort analysis conducted for the People's Budget assessed the tax capacity of nearly fifty

developing and industrialised nations. Applying a model that considered factors such as a country's degree of urbanisation, agriculture's contribution to GDP, measures of monetarisation, stock market turnover, and *per capita* income, the study calculated an expected tax:GDP ratio for each of the countries surveyed. This research found that South Africa's average tax rate during the period 2000 to 2003 was 24.6% of national income, or well below the country's estimated tax capacity of 29.7% (van Niekerk, 2004).

In light of this evidence, the People's Budget Campaign proposes raising the tax:GDP ratio by 3% to 28.5% for the MTEF beginning with the 2006/2007 budget. Assuming that GDP projections remain intact, this would release billions of rands over the next three financial years. In 2006/7 alone, with current revenue and GDP projections, the additional amount collected will be approximately R56,5 billion. This proposal is broadly in line with the Balanced High Expansion model we identified above as a preferred growth scenario.

Reforming VAT

Value-added tax, or VAT, is a highly regressive form of taxation, which weighs more heavily on the poor than on the rich. Table 22 indicates the VAT burden on households by income level. It shows that households earning R1 500 a month pay 10% of their income on VAT, compared to 7% for those earning more than R10 000 a month.

The People's Budget Campaign therefore continues to call for changes to VAT to diminish its regressive impact. First, we reiterate our longstanding request for the introduction of a variable rate VAT that would exempt more basic commodities and impose a higher rate on luxury goods. Although theorists often argue for a single, uniform rate, only 18 countries have adopted this approach (COSATU, 1999). Belize, Canada, Ireland, Jamaica, Kenya, Poland, Romania, Trinidad and Tobago and the United Kingdom zero-rate basic goods, while a further 76 countries have special low rates for basic foodstuffs. Many countries have two or more VAT rates.

Table 22: Estimated VAT burden on households, by income level

Annual household income	VAT paid as a % of annual income	Total VAT paid in rands
R18 000	10%	1 799
R30 000	10%	2 910
R75 000	8%	6 141
R140 000	7%	10 241

Source: National Treasury.

Secondly, we call for a 1% decrease in the basic VAT rate. Such a 'people's tax cut' would cost the state between R9 billion and R10,4 billion in 2006/7 depending on the impact of the reduction on the demand for goods and services. The lower figure (which assumes unitary elasticity) is the more likely as the savings for many families, particularly in poorer households, will stimulate marginal increases in consumption (van Niekerk, 2004).

The combined impact of the changes proposed by the People's Budget would be to generate R56,5 billion in additional revenue, reduce the tax burden on the poorest households, and shift roughly R66 billion of the total revenue burden to upper income households and companies – substantially less than the R72 billion in tax cuts that they have enjoyed over the past decade.

Debt

Apart from taxation, the other main source of funding for government is borrowing or deficit spending. In recent years, the South African government has adopted a slightly more relaxed perspective on the deficit. Chart 25 shows the deficit as a percentage of GDP from the 2000/2001 financial year to the projected deficits in 2006/2007.

Government's approach to relaxation of deficit targets is welcomed as it represents an important source of funding for increased government spending on infrastructure and service delivery. This, in turn, is likely to stimulate increased activity and growth throughout the economy.

There are, however, two common criticisms for increased deficit spending. These are:

- Deficit financing could lead to a debt trap; and
- Deficit financing may increase the debt burden on future generations.

These criticisms may indeed be valid in certain circumstances, but South Africa has nowhere near the debt levels of the Latin American, Asian and other

African countries that have faced debt crises. Moreover, rapidly growing economies have traditionally had higher levels of deficit spending. Thus space exists to utilise deficit spending to fund development programmes.

In particular, funding programmes for electricity generation and improving the transport system require additional once-off funding. Utilising the deficit to finance large-scale infrastructure projects presents an opportunity to both lower input costs for businesses and increase the provision of services to poor communities.

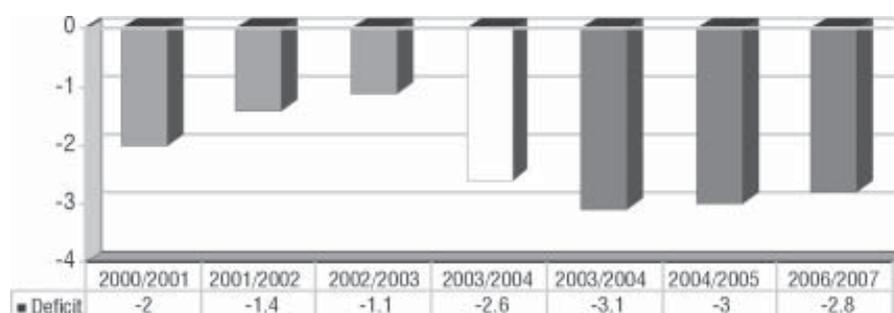
The People's Budget here proposes a three pronged strategy for dealing with the debt.

Reducing the cost of borrowing

Two mechanisms are available to government to increase deficit spending, while reducing debt service costs. These mechanisms are:

- **Interest rate reductions.** The South African Reserve Bank (SARB) could implement a prudent and managed programme of interest rate reduction, leading to a reduction in the interest payment on government debt. Over 2004, the SARB has moved cautiously to reduce the interest rates. While this is welcomed, the policy of inflation targeting is a major obstacle to quick reduction of interest rates.
- **Issuing low interest bonds.** The government could issue bonds that pay lower interest rates than those that financial markets currently offer. This would be in line with commitments of the Growth and Development Summit (GDS) to boost levels of investment by both public and private sector. The prescribed assets requirements which existed in the 1980s and 1990s may be a model which we can follow. However, the People's Budget Campaign is looking at several different ways to mobilise private sector spending to be in line with the country's development objectives.

Chart 25: Deficit as percentage of GDP



Source: National Treasury, 2004. Budget Review, 2004.

Managing apartheid debt

A second proposal of the People's Budget Campaign is ring-fencing and renegotiating the debt – both domestic and foreign – that was incurred under the apartheid regime. Currently domestic debt is around 79% of the total state debt, making it easier for South Africa to negotiate this internally. These debts could then be replaced by special bonds at a reasonable interest rate.

Until South Africa's first democratic elections in 1994, the government borrowed to finance distorted development policies that benefited a small minority, skewing the nation's allocation of wealth and income, as well as employment and social services. After 1994, however, the government has funded all non-interest expenditure from tax revenue; borrowing has been used only to pay interest or retire the debt. The interest burden that South Africa now bears is thus virtually entirely a legacy of apartheid.

The apartheid debt burden continues to drain resources that are needed to redress imbalances in areas of health, education, housing, social development, and job creation. Rising debt levels and high interest rates significantly increase the share of the government's budget allocated to servicing the debt. The interest on the debt constitutes the second largest expense item for the government, absorbing nearly a fifth of the budget and diverting resources from social priorities.

South Africa's public debt has financed a skewed allocation of social capital, adversely affecting human well-being and undermining the capacity of the majority of South Africans to achieve socio-economic upliftment. Historically, extraordinary resources were mobilised for social services and investments that improved the living standards of a privileged minority while promoting their control over economic resources and employment opportunities.

Within the current macroeconomic policy framework, debt constrains the government's ability to redress past imbalances. The disadvantaged majority must sacrifice essential social investment in order to repay the apartheid debt, which accrued to finance benefits for the minority. This predicament poses the twin-edged dilemma of the apartheid debt: how can the burden of the debt be shifted onto the beneficiaries of apartheid while mobilising resources for redressing past imbalances?

Church, labour and NGO leaders have identified the moral case for the cancellation of South Africa's apartheid debt, as well as the crippling foreign debt of developing countries. Economic analysis of the apartheid debt supports the moral case for this initiative. However, several economic factors specific to South Africa's situation mitigate the case for repudiation (non-payment) of the debt.

First, it will likely be met with severe hostility on the part of lenders, who will employ retaliatory defences to protect their economic interests. International financial transactions may be interrupted, foreign trade hampered, and the cost of additional borrowing will certainly increase – if it is available at all.

Second, most of the privately held debt is owned by major financial institutions, such as banks, private pension funds, and insurers. Cancelling this debt could lead to the collapse of South Africa's financial system, with adverse consequences across the socio-economic spectrum. Debt repudiation would not necessarily increase resources available for redressing the imbalances of the past, and those who profited from apartheid would not necessarily incur the cost. The present holders of marketable debt are not necessarily the same individuals who benefited from the apartheid debt, since this debt is frequently traded.

For this reason, instead of simply repudiating the debt, the People's Budget Campaign argues that it should be ring-fenced and as far as possible renegotiated. The process would have to analyse who ultimately benefits from government repayment of the debt and ensure that the overall impact remains progressive.

Raising deficit spending to fund infrastructure programmes

Government has announced an infrastructure programme that consists of three important initiatives. These are:

- **Financing state owned enterprises to play a developmental role.** This will entail large injections of resources for capital projects, primarily in the electricity generation and transport sectors.
- **Expanded public works programme.** Rolling out of the expanded public works programme may provide short-term employment, and has the potential to catalyse economic participation.
- **Housing.** The new approach to housing development as part of building sustainable communities will require additional resources in terms of making RDP housing settlements viable.

In all three cases an anticipated funding gap may arise. Releasing funds through increased deficit spending for these infrastructure projects is in the long-term interest of the country. Taken together these projects could lead to important multiplier impacts in the economy including:

- Reducing the input costs for businesses.
- Providing funds to expand the delivery of services to the poor in the context of building sustainable human settlements.

- Catalysing rural economies through infrastructure investment.
- Potentially improving household productivity by providing water and electricity at levels that allow small-scale economic activities.

However, we are conscious of the dangers of deficit spending. We address the dangers through an economic model that outlines the potential for reaching a point where deficit is increased in the short-term and then falls over a period of time. This approach is elaborated upon in the next section.

Mobilising pension funds

A major strength of the South African economy lies with its institutional investors, with total assets of R1 000 billion or 50% of South Africa's total asset value. Pension funds account for R600 billion of institutional investor assets and own 60% of the equity listed on the Johannesburg Stock Exchange. Pension fund contributions amount to over R54 billion a year – 14% of total personal remuneration in South Africa. As a result, South Africa ranks fourth in the world for *per capita* pension fund assets, after the UK, Switzerland and the Netherlands; in terms of the ratio of private pension fund assets to GDP, South Africa is first in the world.

In the post-apartheid era, the presence of a powerful pension fund industry is positive for three reasons. First, the future income of a significant proportion of citizens is well provided for. South Africa is more able to focus on the elimination of poverty and job creation, without having to compensate for bankrupt social security systems, unlike many developing economies, such as those in Eastern Europe. Second, the financial services sector has developed substantial skills and expertise that can prove useful in the growing global economy. Third, the fully funded status of private pension funds has resulted in the accumulation of a tremendous stock of assets. This stock of assets could be a potential source of capital to finance reconstruction and development, much like such assets were used to finance the apartheid state prior to the mid-1980s (when 40% of pension fund assets had to be invested in apartheid government bonds).

The potential of the pension fund industry in promoting socially targeted investments, this time for RDP purposes, has become critical in light of the low levels of investment discussed above. There is a clear logic to getting pension funds to boost domestic growth, development and job creation.

First, pension fund assets belong to citizens of South Africa, and the accumulated capital should in the first instance be invested in benefiting citizens and the local economy.

Second, there is a strong correlation between employment levels and the stability of pension funds.

When the economy is in recession, more jobs are lost and the funds pay out more than they receive. When jobs are being created, funds pay out less and receive more by way of increased membership and contributions.

Third, pensioners require individual and community assets (such as housing and local infrastructure) and not just retirement incomes. So there is a role for pension fund investment in such asset creation without compromising adequate retirement incomes.

In light of these benefits to pension fund members, the labour movement has already called for increased investment of pension resources in employment-creating projects. At the recent Financial Sector Summit, as well as at the GDS, the unions agreed with business and government to work to achieve this aim. The People's Budget Campaign now adds its voice to these calls.

A major obstacle to the proposal remains the lack of guidance from the state. Often, projects to address poverty do not make much in the way of profit. If the government does not indicate a clear development strategy, it becomes very difficult for pension funds to take the associated risks.

Reprioritisation of resources

Implementing a developmental fiscal package requires not only increasing resources, but also redirection of existing resources away from some areas to those that are more developmental. In this section we present a case for redirecting spending away from military equipment and the Pebble Bed Modular Reactor.

Limit defence spending

The People's Budget Campaign recognises the need for South Africa to maintain a competent and adequately equipped defence force. Although poverty, inequality and unemployment pose more immediate threats to our national security than does the prospect of military aggression, our defence force continues to play an important role in maintaining regional peace and security. However, we believe that it is possible to divert some funds from defence to more strongly developmental initiatives without significantly compromising the defence force's core capacity to perform these tasks.

In theory, the largest savings could be achieved by curtailing or abandoning the US\$4,8 billion strategic arms procurement programme that Cabinet approved in 1999. This hi-tech weapons package has already cost South Africa close to R25 billion over the past five years, and it is expected to drain a further R23,8 billion from the public purse before it is finally paid off in 2012.

Although the rand's strong recovery over the past three years has helped to stabilise the ballooning rand cost

of the deal (which is largely denominated in foreign currencies), the financing mechanisms will leave South Africa vulnerable to unfavourable movements in exchange, inflation and interest rates for some time to come. Furthermore, there are hidden costs associated with the deal that are still coming to light. As early as 2001, the Auditor General warned that supplementary equipment, required to make the weapons systems fully functional, could add as much as R2 billion to the overall cost of the package. Recently, Department of Defence officials told Parliament that it lacked the financial and human resources necessary to ensure that the new weapons can be properly integrated into existing systems.

The People's Budget Campaign has consistently opposed the arms deal as inappropriate and excessively expensive. By now, however, there seems to be little hope that the costs of the deal can be trimmed substantially. Government has had two chances in the past three years to decline optional components of the deal, but it has allowed both of these opportunities to slip past unused. Government no longer seems to have an 'escape hatch' other than breaking the contracts, a move that would probably expose South Africa to penalties, legal action and other damage.

Apart from the costs of the strategic defence procurement package, government has done an admirable job of curtailing defence spending (See Table 23). The 2004/5 Budget anticipated that, by 2006/7, the defence budget, which had grown to 6,5% of main budget expenditure in 2002/3, would be back down to 5,1% of total spending. Although this is encouraging, it still exceeds the 5% level achieved in 1999/2000, the last year before arms deal payments became due. The People's Budget Campaign urges that defence spending be capped at 5% of the budget. This would free up roughly R400 million for reallocation in 2006/7.

In addition, we call on government to put in place more vigorous and transparent monitoring mechanisms to assess the impact of the industrial participation agreements associated with the current arms deal, especially the defence-related agreements. The People's Budget Campaign would also support a new, broadly participatory Defence Review to update the force design options and strategic direction of the

defence force in light of changing national, regional and global realities.

Pebble Bed Modular Reactor¹⁸

The People's Budget Campaign proposes redirecting all funds government plans on spending on the Pebble Bed Modular Reactor. Our reasons are based on (a) effective use of resources and (b) the undesirability of the project.

In terms of the effective use of resources, we believe that the PBMR is an unwise expenditure for four reasons:

- **Resources could be better used to extend the electrification programme.** Government intends allocating R500 million to the PMBR. At the same time, government has allocated slightly more than a billion rand in the 2004/5 financial year, according to the Budget Review 2004, for the National Electrification Programme. The spending on the PBMR is almost half of the projected spending to achieve universal access.
- **The project involves high risks and unpredictably high costs with the prospect of limited returns.** The current funding for the PBMR is only an initial cost. Estimates suggest an ultimate cost of around R10 billion rand for the pilot project. However, this estimate could not be verified as the cost is deemed to be 'commercially confidential'. The first commercial modules are only planned for 2013. Moreover, once the plant is decommissioned, recurrent costs of storing nuclear waste remain, with the possibility that future governments could bear this cost. Thus the PMBR seems likely to become a long-term drain on public resources even though the potential returns of this experimental technology are uncertain.
- **The scheme subsidises private participation in industries that create few jobs.** The PBMR is a private initiative between Eskom, the Industrial Development Corporation, and British Nuclear Fuels. Government has a role to play in supporting industrial development. However, the PBMR is a capital-intensive project, which means few jobs with potentially large subsidies.

Table 23: Defence and Strategic Defence Procurement (SDP) expenditure, 1999/2000-2006/7 (R billions)

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Defence	10 717,3	13 932,1	16 044,6	18 835,8	19 905,0	20257,3	22 123,6	22 360,7
SDP		2 899,2	4 223,4	6 475,9	5 889,0	5 501,9	7 026,6	5 886,7
Main budget expenditure	214 749,9	233 934,0	262 904,5	291 529,1	331 685,9	371 686,0	404 653,5	439 057,5
Defence as share of MBE	4,99%	5,96%	6,10%	6,46%	6,00%	5,45%	5,47%	5,09%
SDP as share of MBE		1,24%	1,61%	2,22%	1,78%	1,48%	1,74%	1,34%

Source: National Treasury, 2004. Estimates of national expenditure, various years.

Moreover, the PBMR would, in the long-term, put pressure on the current electricity generation industry, having negative forward (e.g. employment in the distribution industry) and backward linkages (e.g. coal mining).

- **The reactor is not critical to plans to build generation capacity.** Government is currently in the process of creating new generation capacity. The strategy is to have 70% of new generation capacity through Eskom, and 30% through private partnerships. As it stands, South Africa has a strategy to meet our foreseeable generation needs without resorting to nuclear energy.

Apart from the economic arguments against the PBMR, we believe that that project is highly undesirable on the following health and environmental grounds.

- **Lack of attention to safe, renewable technologies.** The Environmental Impact Assessment (EIA) process associated with the project required tenderers to consider alternative technologies. Eskom sidestepped this requirement by arguing that the nuclear demonstration plant is not intended primarily for commercial power generation. We believe that government should rather encourage investment in the development of safer and more sustainable alternatives. Approval of a demonstration nuclear project gives official sanction to an energy development

path that prioritises nuclear options. This is at odds with the spirit of the Energy Policy White Paper, which implied that nuclear generation should be seen as a less desirable alternative.

- **Storage of nuclear waste.** A major drawback for the project is that South Africa has limited capacity to store nuclear waste. For instance, Vaalputs, Northern Cape, is only allowed to store low and intermediate radioactive waste, such as 45 gallon drums containing used protective clothing, resin filtrates, etc. Indeed, the EIA that Eskom filed when it tendered for the project conceded that no storage facility anywhere in the world had yet been licenced to accept high-level nuclear waste. Even if Vaalputs eventually receives such a licence, the potential for long-term environmental damage seems enormous.
- **Health.** Internationally there is increasing evidence that exposure to low dose radiation causes cancer. The European Committee on Radiation Risk (2003) found that the nuclear industry has calculated the risk posed by ionising radiation in a way which underplays its negative health impact. Thousands of people who live near reactors are at risk. Before we even think of more nuclear reactors, we need to see epidemiological studies of communities around Koeberg.

Building capacity for implementation



Raising resources and adopting an expansive programme of poverty eradication requires a committed, innovative and service-oriented public service. There has been a tendency to portray the public service as bloated, inefficient and corrupt. While there are indeed areas of the public service that require massive overhauls, there are, many areas of the public service that operate on an effective and efficacious basis. This section of the report looks at a three point intervention strategy to realise the ideal of *Batho Pele* – Putting People First. These intervention areas are bold interventions aimed at creating a public service to support the goals of a developmental state.

In summary the interventions are:

- Retaining and recruiting a committed cadre of public service workers;
- Improving financial management; and
- Initiating restructuring at an institutional level.

A committed cadre of public service workers

The government's decision to increase the number of nurses and police officers indicates that certain areas of the public service are indeed understaffed. Skills shortages remain in certain areas of the public service (e.g. maths and science teachers, project managers for infrastructure projects). The commitment of government to increasing the numbers of workers in service areas, and the introduction of Community Development Workers, are initiatives that we endorse.

However, in building the capacity of the public service, we must focus on building long-term capacity through:

- **Introduction of career pathing systems.** At present, the career pathing systems for key occupations, like nurses and teachers, are either ineffective or simply do not exist in practice. Government, together with labour, must focus urgent attention on creating career pathing systems. The implementation of career pathing

systems will improve retention in the public service, and create a culture of performance within the public service.

- **Matching skills, plans and resources.** The Public Service Co-ordinating Bargaining Council has agreed to a process of matching skills and resources. The agreement seeks to align organisational structure to strategic plans, and is thus a welcome initiative. The implementation of this agreement has not yet yielded positive results. Nonetheless, the intent of matching skills, resources and plans is an important one. We propose that this process be a bottom up one, which links the needs of communities to the provision of resources. Furthermore, national standards of personnel to people served must be developed. For instance, we must set in place standards for the number of nurses per hospital bed.
- **Project management skills.** As government undertakes infrastructure expansion, the need for project management skills in the public service will increase. The recent reports of corruption in the low-income housing sector provides a sharp reminder that government lacks the ability to monitor contracts with the private sector. Thus our view is that within the public service, people be identified for training specifically geared to managing projects.
- **Systemic weaknesses.** This relates to the delivery of funds from national to provincial and local government on time, particularly on conditional grants. Anecdotal evidence indicates that the delivery times are too near the end of financial year to ensure good quality spending. The current system of conditional grants cannot support rapid and effective spending. The problem is not with the concept of conditional grants, but rather with the system's operation. The procedures used for conditional grants are extremely complex and time-consuming. Although the budget is announced in February every year, conditional grants are

often only disbursed between April and June. This shortens the period in which departments must use the grants.

Improving financial management

The introduction and implementation of legislation to improve financial management systems and capacity are a step in the right direction. Both the Public Finance and Management Act and the Municipal Financial Management Act provide a solid base for increasing probity in the public service. The next set of reforms to financial management must however focus on the efficacy of spending on the poor, if a truly developmental public service is to emerge.

In this regard, our proposals are for the following changes in systems.

- **Cost-recovery model.** Cost-recovery systems (fee for service, etc.) have become common in public sector service delivery. This is largely due to insufficient funds being made available for roll-out and the reluctance to structure stronger cross-subsidises from the rich to the poor. Cost-recovery systems have run into the predictable problem of non-payment. While some ideological advocates for cost-recovery argue that this is due to the 'culture of non-payment', this appears largely false. Grinding income poverty, which is also rising significantly, is leading to the 'economics of non-payment'. Cost-recovery systems are generally undermining the sustainability of government roll-out. For example, while government has showed impressive results in water roll-out, many of these service delivery projects have collapsed due to non-payment.
- **Procurement systems.** Procurement is plagued by long delays. The government tender process can delay major expenditures by three to six months or more. Usually, just getting a tender announcement in the Gazette takes a few weeks. Similarly, it takes months to fill a management position in the public service, making it very difficult to start new programmes quickly. This is the case despite important changes in the procurement system.
- **Culture of under-spending.** The heavy fiscal restraint applied to public service institutions has become another barrier to spending. On the one hand, departments tend to see any saving as good, even at the cost of overall delivery. On the other, budget cuts have led to employment freezes and even untargeted cuts in employment. This has reduced capacity, without improving efficiency. As a consequence, the capacity of the public service is further reduced. Ironically, under-spending often leads to further budget cuts.

- **Attacking corruption.** Efforts at reducing and exposing corruption are critical to building efficient and effective government spending. Recent exposures in the low-income housing and developmental welfare sectors indicate that government is making progress in protecting its fiscal resources on behalf of all South Africans. Similarly, the efforts by SARS to build tax compliance are beginning to yield results. A coordinated national campaign between government and civil society would provide a base for a longer-term campaign to attack poverty.

Institutional level restructuring

The restructuring programme needs to focus on turning around the performance of schools, hospitals, grants offices and police stations. This may lead to more tangible results in practical terms for people who use the public service, who are generally the poorer sections in our society. This would be the main medium-term intervention in the public service, and would create much needed public service success stories.

The argument for focusing on institutions includes:

- **Interventions at an institutional level have a larger direct impact on the lives of the poor.** Several innovative pilots in courts, hospitals and schools indicate that restructuring at an institutional level is needed. These case studies demonstrate that through changes in work organisation and service line, big improvements in service delivery are possible.
- **In turn, institutional level restructuring may catalyse wider changes in public service.** The restructuring agenda for the public service is often guided by macro concerns (e.g. reducing personnel spending) which often bear little relevance to the goal of improving services. Through institutional level restructuring the debate on public service transformation would be enriched, as would the feasibility and appropriateness of macro level interventions.

The combination of building a cadre of public service workers, institutional level restructuring and improved financial management would provide the structural changes required to create an effective and efficacious public service in South Africa. The changes proposed are substantial and will require a great deal of effort. The People's Budget Campaign is committed to realising these visions, and is open to criticism and comment on this important area.

Budget reform



Our central concern with budget reform is ensuring that civil society organisations with a poverty eradication agenda play a meaningful role in the budget process. The proposals contained in this section focus on budget reform initiatives at a national and local government level.

Budgeting at a national level

One of the central objectives of the People's Budget Campaign is to expand opportunities for individuals and organisations to take part meaningfully in debates about economic policy and spending priorities. At the national level, Parliament is the primary forum in which civil society organisations express their views on legislation and policy. However, Parliament is still unable to amend money bills – those that raise or spend public funds – despite a constitutional requirement that Parliament have this power. Section 77 of the South African Constitution states that:

- A Bill that appropriates money or imposes taxes, levies or duties is a money Bill. A money Bill may not deal with any other matter except a subordinate matter incidental to the appropriation of money or the imposition of taxes, levies or duties.
- All money Bills must be considered in accordance with the procedure established by section 75. An Act of Parliament must provide for a procedure to amend money Bills before Parliament.

Seven years ago, the Portfolio Committee on Finance rejected a draft Money Bills Amendment Bill as it gave very little power to Parliament. No further drafts have been tabled. Instead, the introduction of the Medium Term Expenditure Framework (MTEF) has lent greater predictability and transparency to the budget cycle, while the establishment of a Joint Budget Committee in Parliament and the tabling of more budget matters for discussion in NEDLAC have created new opportunities for engagement on fiscal issues. Although these reforms are welcome, they

have not diminished the National Treasury's overwhelming dominance in the budget process.

The People's Budget Campaign has argued that effective reform of the budget process at a national level must:

- **Enhance the role of Parliament and build Parliament's capacity to fulfil this role.** To achieve this:
 - Section 77 of the Constitution must be implemented fully and expediently so that Parliament is empowered to amend the budget;
 - Parliament must be given substantial and meaningful amendment powers – rather than being confined to tinkering with details – so that it can exercise its democratic mandate as an instrument of popular sovereignty; and
 - Parliament must have adequate and appropriate research and analysis capacity to enable it to use its powers effectively.
- **Improve the budget system to ensure that civil society organisations have additional opportunities to engage government on the budget.**

To achieve this:

- NEDLAC and organs of civil society must have structured opportunities to make substantive input on the budget; and
- Formal opportunities for input, both public and Parliamentary, must be introduced throughout the budget cycle. They should not be confined to the final stages when substantial changes become difficult to incorporate without causing serious disruption.

Working from these principles, the People's Budget has developed a set of proposals for expanding Parliament's role in the budget process. These were spelled out in detail in the 2005-2006 People's Budget document and are summarised in the following section.

Amendment powers for Parliament

The People's Budget Campaign has endeavoured to articulate a model for Parliamentary amendment of money Bills that balances the Executive's need to define a stable and efficient budgeting process that is not prone to being held hostage to political or other special interests of the legislature,¹⁹ with Parliament's duty to facilitate broad public engagement on economic policy and to exercise meaningful democratic control over the deployment of public resources. We have therefore proposed a three-tiered model for interaction between the Executive and Parliament on budget matters that distinguishes not only between revenue and expenditure matters, but also between different 'levels' of decision-making. Box 5 presents this break down schematically, identifying the types of decisions to be made at each level.

Level 1 decisions are essentially those related to overall macroeconomic policy. They should to be made prior to the presentation of the budget. If the only way to shape macroeconomic policy is by amending the budget, then there is the risk that every vote on an amendment to the budget, no matter how modest, will be perceived as a vote of confidence in the government. There must therefore be two clearly separate mechanisms for commenting on macro policy and amending the budget.

The MTBPS is the most appropriate vehicle for debating macroeconomic policy, provided that the debate is structured in a way that allows Parliament to be critical of the Treasury's proposals without appearing to be expressing a lack of confidence in the government. Consequently, we propose that the Treasury's consult extensively during the drafting of the MTBPS, in the manner of a Green/White Paper. Rather than simply presenting Parliament with a final version, it should table a draft earlier in the budget cycle (June, instead of late October or November), enabling Parliament – presumably the Finance Committees – to hold public hearings and to deliberate

on it. The relevant committees would then table a report proposing any amendments to the MTBPS. The Treasury would respond by tabling a revised MTBPS, together with a written reaction to Parliament's recommendations indicating if each has been incorporated or rejected and why. Parliament would then need to assess the Department's response and decide if its concerns have been adequately answered.

Should Parliament be satisfied with the revised MTBPS and vote to accept it, it would have limited powers to make amendments with respect to subsequent (levels 2 and 3) budget decisions. For example, it could shift within and between functions without revisiting macroeconomic policy by changing the overall (level 1) parameters.

If Parliament feels its concerns have not been addressed, it could vote to reject the MTBPS. However, as this would effectively be a vote of no confidence in the government, this option is unlikely to be invoked except in extreme circumstances. If this is the only way Parliament can register continuing concerns, then the Treasury is likely to feel that it can ignore Parliament's objections with impunity. The People's Budget Campaign has therefore proposed a third option: Parliament should be able to vote simply to 'receive' the revised MTPBS. This would signal Parliament's unhappiness with the MTBPS and the failure of Treasury to incorporate its recommendations, but would stop short of outright rejection.

Should Parliament vote to 'receive' the revised MTBPS, it would have access to a different set of amendment powers associated with a lagged amendment process. In year one (i.e. when considering the budget of the following February), Parliament would still be confined to ordinary amendment powers and would therefore be prevented from altering the MTBPS parameters, even though it did not accept them. However, should Parliament feel that its concerns still have not been addressed in the next MTBPS, and should it vote to receive the MTBPS for a second consecutive time, then the following February it would

have access to an expanded set of extraordinary budget amendment powers. These would permit it to amend all aspects of the budget, including altering the macroeconomic parameter by changing total spending. (In the unlikely event of Parliament voting to reject the MTBPS, it would gain immediate access to these extraordinary amendment powers without having to wait until the second year).

The lagged model attempts to build stability into the system by limiting Parliament's overall amendment

Box 5: Budgetary decision matrix

Level	Revenue side	Expenditure side
Level 1	Revenue:GDP ratio, real change in total revenue, e.g. 28% revenue:GDP ratio.	Expenditure:GDP ratio, real change in total expenditure, e.g. 2% real total expenditure growth.
Level 2	Composition of tax revenue, e.g. proportions of revenue to come from company tax, VAT, etc.	Vertical and horizontal divisions of expenditure between functions, e.g. proportions going to different provinces and functions.
Level 3	Tax rates, e.g. income tax rates for different income brackets.	Allocation of expenditure within different functions, e.g. spending within the education vote.

powers in a given year and promoting cooperative governance. It sets up a one year cooling off period in which differences between the Executive and legislature can be resolved politically. The possibility of Parliament having access to a set of expanded amendment powers in a subsequent year would act as an incentive for the Treasury to take seriously Parliament's views in the intervening period so that if the MTBPS of the following year is accepted, the extraordinary amendment powers would not be invoked.

Agreement at one level should establish boundaries for decisions at subordinate levels. For example, if Parliament approves the macroeconomic parameters of the MTBPS, it would not be able to make changes to the budget that failed to respect those boundaries.²⁰ Decisions during the budget stage would focus on levels 2 and 3: the vertical and horizontal divisions of revenue and the pattern of allocation within functions. The People's Budget Campaign has proposed that Parliament be given unlimited amendment powers at these levels (i.e. to adjust expenditure allocations within the overall expenditure envelope without any Executive veto and without any ceiling on the number of amendments).

Enhancing Parliamentary capacity

Parliament will require enhanced research and analytical capacity if it is to exercise its budgetary amendment powers responsibly and effectively. Expert capacity will be particularly essential in areas such as macroeconomic analysis and modelling, analysis of spending and identification of obstacles to spending, and accurate costing of alternative proposals on both the expenditure and revenue sides. A Parliamentary Budget Office could be an appropriate institutional mechanism for providing Parliament, and the Finance and Joint Budget committees in particular, with the necessary backup. Other Portfolio committees should also have access to specialised budgetary research and analysis (e.g. in health economics, transport economics, etc.). Research conducted by IDASA concluded that these improvements could be accomplished with a 5-8% increase in Parliament's budget.

In addition, there should be a shift in emphasis (notably in terms of allocation of time) from plenary debate to committee deliberations. All Portfolio and Select committees will need to become more actively involved in the budget process, rather than leaving primary responsibility for budget to the Finance Joint Budget and Public Accounts committees.

While there is already some (uneven) interaction between departments and the relevant Portfolio committees, it is proposed that this be structured in a formal, uniform way as part of the budget process. This would include departments preparing reports to

the relevant Portfolio and Select committees comparing their budget requests with their draft allocations and assessing the impact of any cuts.

The Portfolio and Select committees should be empowered to make informed inputs to the Joint Budget Committee around functional budgets. These recommendations could then be debated, modified, and reconciled within the Budget Committee. There would thus be a direct relationship between committees' oversight and accountability roles and their input into the budget process. The Budget Committee would ultimately be able to table a set of specific proposed budget amendments (of a level 2 and level 3 nature) for discussion in the House.

Finally, the reform of the budget cycle should pay close attention to the role of the National Council of Provinces (NCOP) and, in particular, to making better use of the NCOP's unique role as a link between national and provincial structures involved in policy making and resource allocation.

Budgeting at a local level

Section 152 of the Constitution allows and encourages the involvement of communities and community-based organisations in matters of local government. It is the only sphere of government where legislation²¹ allows for direct participation in the budget process of municipalities.

In particular, the recently enacted Municipal Finance Management Act prescribes the level of participation from communities. The official responsible for the budget should immediately make a copy of the draft budget available to communities and community-based organisations (CBOs) for comment and scrutiny.

However, the budget process limits public participation in the actual drafting and final approval phase. Furthermore, the participation of CBOs and the public in the budget process will require a general level of skill and knowledge of budgets. Without municipalities enhancing their capacity to participate in the process, the community participation provisions of our legislation become futile. It should be noted that to a large extent councillors who actually approve the budget do not really understand either the process or what is incorporated in the budget. Active encouragement, capacity building and transparency are a critical requirement in the budget process.

The Municipal Systems Act 2000 makes provision for the development of an Integrated Development Plan (IDP) for each municipality. Municipalities are expected to develop IDPs at five-year intervals. IDPs serve a number of functions:

- They explain how the municipality plans to expand municipal services, build infrastructure,

and initiate local economic development. All these roles are defined within a participatory paradigm.

- They show how the municipality will deliver during the next five years.
- They act as a guide to municipal budgeting. Municipal budgets must reflect how the Council is going to spend to achieve IDP objectives. The budget must be congruent and linked to the implementation of the IDP.
- They prioritise important development issues in a municipal area.

Most CBOs and NGOs have little experience in drafting and monitoring the implementation of municipal plans such as IDPs. Prior to 1994, many communities were engaged in the fight against apartheid. The local focus then was to take on apartheid-based local authorities. Today, our legislation is geared to enabling community participation and transparency at a local level, especially with regard to poverty and development issues. However, participation is hindered by:

- A lack of relevant skills, capacity and resources within many CBOs and NGOs;
- The highly technical nature of much of the information associated with this process;
- The lack of clear and regular opportunities for participation – regulations do not stipulate a standard process for engaging communities;
- A narrow definition of ‘participation’ that excludes the most vulnerable sectors in the community, such as those who cannot read and write, people with disabilities and other disadvantaged groups.

Improving community participation at the municipal level requires:

- Building community level structures, through ward committees; and
- Democratising the IDP process so that it ceases to be consultant-driven.

The People’s Budget Campaign will be discussing the possibilities of more focused work on local government budgets.

Conclusion



Fifty years after the Freedom Charter we are able to say that political transition is something we will work to sustain. Sustaining our democracy must run together with social and economic reconstruction of our society if we are to achieve the goals of the Freedom Charter and the RDP. The strategies for spending and raising resources contained in our proposals provide a robust and strategic approach to achieving these goals.

The revenue and spending proposals contained in the 2006/2007 People's Budget comprise a sustainable, affordable and developmental package, capable of promoting job creation, poverty eradication and social justice. We believe that the measures outlined above would significantly contribute to achieving the following goals of the Freedom Charter:

- **The People shall govern!** The proposals on budget reform would enhance and deepen democratic processes in South Africa.
- **The People shall share in the country's wealth!** The proposals provide an integrated approach to raising living standards and redistributing resources.
- **The Land shall be shared among those who work it!** Our proposals on land reform would significantly improve the redistribution of land over the next ten years.
- **There shall be work and security!** The economic stimulus package we propose offers the best hope for rapid growth that leads to job creation.
- **The doors of learning and culture shall be opened!** Our proposals on education call for a major rethink in how government funds education. The proposals for increased spending that we endorse would significantly improve the long-term prospects of the poor in our country.

- **There shall be housing, security and comfort!** Our proposals call for greater security for women by funding the implementation of the Domestic Violence Act, as well as the introduction of a comprehensive social security package that includes a Basic Income Grant. Furthermore, the People's Budget campaign has in previous years supported increasing the housing budget to 5% of the budget.

Our understanding of the Freedom Charter is, however, not a mechanical one. We are conscious that the Freedom Charter was a popular document – developed through public meetings and engagements, designed to meet the needs of all South Africa's people, in part through the establishment of a democratic, developmental and compassionate state.

However, the main lesson from our compatriots is that when our society comes together sustainable change is possible. The People's Budget Campaign makes a modest step in trying to forge a consensus on these issues. We urge government, business, civil society and ordinary citizens to discuss our proposals. We look forward to discussing our proposals with the third democratic government in South Africa, and call on our constituencies to undertake voter education, to campaign and vote in the coming local government election. All stakeholders (viz. government, business, labour and civil society) should reassert their commitment to the GDS Agreements agreed to at NEDLAC in 2003. Critical partnerships with government, beyond mere public private partnerships, are necessary to realise the goals we are collectively striving for.

These proposals do not offer a quick fix, but a longer-term strategy for achieving poverty eradication within one generation. The proposals are not meant to be exhaustive, and we acknowledge that greater specificity on costing is still needed. However, taken as a package, the proposals represent a way forward for the government and South Africa

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Endnotes

- 1 Section 27 of the Constitution states: 'Everyone has the right to have access to ... social security, including, if they are unable to support themselves and their dependants, appropriate social assistance.' The legal implications of this imperative have been discussed in detail in light of the Constitutional Court's *Grootboom* decision in the Basic Income Grant Coalition's 9 June 2003 submission to the public hearings on the Taylor Committee report convened by the Portfolio Committee on Social Development. Government's political commitments are articulated in a number of documents, including the 1997 White Paper on Social Welfare, which states: 'The Government is committed to the provision of a comprehensive national social security system and the Government's Growth, Employment and Redistribution strategy recognises the importance of a broad social security net comprising social payments and targeted welfare services. There will be universal access to an integrated and sustainable social security system. Every South African should have a minimum income, sufficient to meet basic subsistence needs, and should not have to live below minimum acceptable standards.' [Ch. 7, paras. 26–27].
- 2 Committee of Inquiry into a Comprehensive System of Social Security for South Africa, *'Transforming the Present – Protecting the Future'*, Consolidated Report, March 2002, p. 62.
- 3 Intergovernmental Fiscal Review 2004, 77.
- 4 Policy Coordinating and Advisory Services, Office of the Presidency, *Towards a Ten Year Review* (Pretoria: GCIS, October 2003), 18.
- 5 Economic Policy Research Institute, *The Social and Economic Impact of South Africa's Social Security System*, Report Commissioned by the Economics and Finance Directorate, Department of Social Development, 30 September 2004; available at <http://www.epri.org.za/rpSOCDEV.htm>.
- 6 *Ibid.*, 132.
- 7 This section and the one that follows are adapted from BIG Financing Reference Group, *Breaking the Poverty Trap': Financing a Basic Income Grant in South Africa*, March 2004.
- 8 For this reason, a BIG is radically different from a 'dole'. However, as a household's income rises and its living standards improve, a growing portion of its BIG benefits will have to be recovered through the tax system. Recovery rates will have to be determined in a way that does not create perverse incentives (in other words, so that no one incurs a net penalty for earning additional income).
- 9 These include the obvious benefits of savings, the extension of affordable credit, including the use of low interest rates to assist people with cooperative and other ventures, housing etc. This is broadly in line with government policy, but the extension of the public sector has ironically been resisted by the private sector financial institutions, despite the fact that the vast majority of black South Africans are unbanked (over 70%).
- 10 The participating economists were Prof. Pieter le Roux (University of the Western Cape), Prof. Charles Meth

- (University of Natal, Durban), Dr. Michael Samson (Economic Policy Research Institute) and Dr. Ingrid Woolard (Human Sciences Research Council). They modeled net cost scenarios for 2005 – the first year in which it was then thought to be realistic to implement a BIG – assuming universal eligibility, full take-up, and a monthly grant set at R100 of purchasing power in terms of 2000 prices. They also assumed that a BIG would be a foundational component of all other social grants; in other words, those already receiving any type of state grant would not receive a additional amount.
- 11 BIG Financing Reference Group, *‘Breaking the Poverty Trap’: Financing a Basic Income Grant in South Africa*, March 2004, 55.
 - 12 There has been some inconsistency in the way that various provincial DLA offices have calculated and reported beneficiary statistics over the years. All DLA figures now combine household and individual beneficiaries, as LRAD grants are disbursed to individuals while all other products are disbursed to households. It is not strictly possible to integrate the two data sets, however, on average households receiving grants are reported to have three adults per household.
 - 13 R440 million expenditure on land in settlement of restitution claims (CRLR, 2003b) and R1,28 billion expenditure on land redistribution and tenure reform (National Treasury 2003a) up to March 2003.
 - 14 *‘Beating the backlog: meeting targets and providing free basic services’* by Dr. David Hemson.
 - 15 Cynthesis Business Consultants provided much of the data used in this report. The conclusions, however, are those of the People’s Budget Coalition.
 - 16 See Taylor (2002), Samson *et. al.* (2004), Posel (2004), Maitra and Ray, etc.
 - 17 Actual outcome for 1995/96-2000/01; preliminary outcome for 2001/02-2003/04; revised estimate for 2004/05; estimates for later years.
 - 18 This section draws on work undertaken by Earthlife Africa.
 - 19 One scenario that the People’s Budget Campaign has considered, for example, is the future possibility of a coalition government or hung Parliament. If Parliament enjoys extensive budget amendment powers, the budget could get mired in party political disputes, leaving government paralysed.
 - 20 As the MTBPS covers a three-year period, it would be necessary to establish precisely on which aspects Parliament would be voting. One scenario would be for them to vote only on the parameters for the following year, but comment formally on the outer two years.
 - 21 The Municipal Systems Act of 2000 and Municipal Finance legislation allow for direct community participation in the budget and other municipal process.