People's Budget

2003-2004

Proposal from COSATU,
SANGOCO AND SACC

People's Budget

2003-2004

Proposal from COSATU, SANGOCO AND SACC

Published by

NALEDI

NATIONAL LABOUR & ECONOMIC DEVELOPMENT INSTITUTE

NALEDI
NATIONAL LABOUR & ECONOMIC DEVELOPMENT INSTITUTE

6th Floor, Cosatu House
Leyds Street
Braamfontein, Johannesburg 2001

ISBN 1-875043-51-9

Published on behalf of the People's Budget Campaign by the
National Labour and Economic Development Institute.

First published 2002

Proposal from COSATU, SANGOCO and SACC

Cover Design and Typesetting by Crazy Cat Designs
Repro by Graphic Descriptions
Printed by AdLitho

Acknowledgements

The National Steering Committee would like to extend its appreciation to all organisations and individuals who participated in the drafting of this budget input. Unfortunately, they are too numerous to mention.

The following persons or organisations made their research findings and publications available:

- Treatment Action Campaign
- Surplus Peoples Project
- Alliance for Children's Entitlement to Social Security (Access)
- Economic Policy Research Institute (EPRI).

In addition, many, many organisations and individuals provided comments and constructive criticisms. A special word of thanks goes to these individuals for creating the intellectual climate in which to develop our ideas.

Much of the research undertaken requires that government officials provide access to information. The openness of many government departments to share information and engage in ideas was commendable. We trust that this relationship will continue in the future.

Finally, we are grateful to Naledi for providing research co-ordination, logistical support and for assisting in the publication of this document.

A final word of thanks goes to the reader. We look forward to hearing your comments on this document.

National Steering Committee

People's Budget

February 2002

Contents

List of tables

List of figures

List of boxes

Introduction

Accelerated transformation means eradicating poverty in one generation. The purpose of this document is to stimulate debate, discussion and critical comment on the development path in South Africa in order to achieve this goal. In so doing, we hope to impact on the thinking and actions of the democratic government.

This input is intended for the 2003/2004 financial year. This enables the following:

- **Sustained dialogue with government**: By producing this document a full year ahead of the 2003/2004 budget speech, we look forward to a constructive engagement with government
- **Encouraging engagement**: This document opens up space for critical comment from all sections of society. This will enable us to refine proposals and to contest proposals with which we disagree. All are invited to critique, comment on and sharpen our proposals.

The People's Budget Campaign is a coalition of the South African Council of Churches (SACC), Congress of South African Trade Unions (Cosatu) and the South African Non-Governmental Coalition (Sangoco). The People's Budget Campaign will define fiscal strategies that can eradicate poverty, support economic development and ensure greater equity by race, gender and class, by:

- Meeting basic needs, especially by restoring and enhancing the public sector and social spending
- Ensuring the retention and creation of quality jobs in a context of economic growth
- Giving the majority of people greater access to assets and skills
- Supporting increasingly democratic and participatory governance
- Protecting the environment and ensuring sustainable development throughout the Southern African region.

Our proposals are tailored to provide a structured input to government around key budget events. In our discussions with parliamentarians, government officials, our members and the media, one lesson has been stressed: *the need for civil society organisations to present proposals well in advance.* Heeding this advice, we are submitting proposals a full year ahead of the 2003/2004 budget. We trust that government, business and other stakeholders will have sufficient time to assess our proposals. We look forward to the continuation of the open and frank discussion on fiscal policy that has taken place over the past year.

Activities of the People's Budget Campaign

The People's Budget Campaign has worked over the last 18 months to ensure that government considers our inputs and to stimulate meaningful dialogue on our proposals. The activities of the People's Budget Campaign are outlined in Box 1.

Box 1: Activities of the People's Budget

Campaign areas	Outcomes
Publications	• Publication of 2001/2002 People's Budget Framework • Publication of 'popular version' of the People's Budget • Production of leaflet introducing the People's Budget Campaign
Budget responses	• Medium Term Budget Policy Statement (MTBPS) response (2000) • Response to Budget (2001/2002) • MTBPS response (2001)
Education	• Production of an education booklet • Consultation and information meetings held in two provinces
Mandating	• Three organisations have discussed proposals in their constitutional structures • Consultative Conference held in February 2001 • Consultative Conference held in 2002
Advocacy	• Meetings with 12 committees in Parliament • Proposals for meetings with the National Treasury • Development of proposals for budget reform

While a great deal has been achieved, over the next year we will strive to improve in the following areas:

- **Broadening participation within civil society**: Over the next year, an extensive process of broadening the already wide participation in the People's Budget will be undertaken. We look forward to all progressive organisations to provide inputs into our future submission

- **Engaging the Executive**: A series of meetings are proposed between the People's Budget Campaign and the National Treasury. In addition, meetings with provincial departments and other national departments are to be scheduled. Most government departments have responded enthusiastically to our initial requests for meetings
- **Engaging provincial and local government**: A major aim for the next year will be to establish provincial and local level civil society coalitions to engage on budgets. This aim is extremely ambitious, but is required to deepen democracy and provide a progressive role for civil society
- **Engendering processes**: A concerted effort to ensure that women participate in the processes of the People's Budget Campaign. Moreover, proposals and policy choices aim to improve the status of women. However, more needs to be done to mainstream gender issues.

Aims and structure

This document aims:

- To locate fiscal policy within an integrated developmental perspective
- To provide proposals for rapid poverty eradication, particularly in rural areas
- To provide revenue and expenditure proposals that translate our vision into practice.

The report has six sections:

- Section one elaborates on a developmental budget
- Section two assesses fiscal policy and lessons since 1994
- Section three motivates for specific proposals
- Section four outlines a developmental fiscal package
- Section five provides proposals for a more open and participatory budgetary process
- Section six assesses ways to improve the effectiveness and efficacy of the public sector.

Research methodology

A participatory research process informed this input. The National Labour and Economic Development Institute (Naledi) served as research co-ordinator and produced research for this draft. Many non-governmental organisations (NGOs), academics, unionists, church leaders and others have provided input. The methodology for producing this report was as follows:

- The People's Budget National Steering Committee identified six areas for further research to build on last year's document. The research priorities were: rural development, military spending, deficits and debt, national health insurance (NHI), HIV/AIDS and free services
- Several smaller workshops were held on issues ranging from HIV/AIDS to debt. These workshops were intended to enrich the policy debates and to feed into the drafting process
- A national consultative conference was held on 22-23 January 2002, attended by representatives from Cosatu, SACC and Sangoco
- A draft deriving from the conference was prepared
- This draft was submitted to organisations for comment
- A final draft was prepared and endorsed by the National Steering Committee.

Copies of background papers and inputs will be published during the course of 2002.

Limitations

Two major limitations became evident in the research process:

- First, no official time series data exists on poverty. As a proxy, income and expenditure surveys and household surveys are used in this document
- Second, the costing presented here is indicative. During the course of the year efforts will be made to refine the costing in time for the 2002 MTBPS.

1 Towards a developmental budget

A developmental budget aims to use expenditure and income to eradicate poverty. There is a great deal of debate on what constitutes a developmental budget. This section explores the concept of a developmental budget in the South African context. In particular, it:

- Contrasts neo-classical and integrated approaches to development
- Analyses the prevailing vicious cycle of poverty
- Proposes an alternative virtuous cycle to eradicate poverty
- Assesses the strengths and weaknesses of government's fiscal policy.

1.1 Limits of neo-classical approach

The neo-classical approach to poverty eradication hinges on two major propositions:

- First, that growth is sufficient for development. At least since the 1960s, this approach has presented growth as synonymous with development
- Second, that extending markets will automatically benefit the poor.

Around the world, however, neo-classical policies have consistently failed to lift the poor out of poverty. Our own Reconstruction and Development Programme: A Policy Framework (RDP) acknowledges the limitations of the neo-classical approach in South Africa:

> *The RDP is based on reconstruction and development being parts of an integrated process. This is in contrast to a commonly held view that growth and development, or growth and redistribution are processes that contradict each other. Growth – the measurable increase in the output of the modern industrial economy – is commonly seen as a priority that must precede development. Development is portrayed as a marginal effort of redistribution to areas of rural and urban poverty. In this view, development is a deduction from growth. The RDP breaks decisively with this approach. If growth is defined as an increase in output, then it is of course a basic goal. However, where growth occurs, how sustainable it is, how it is distributed, the degree to which it contributes to building long-term productive capacity and human resource development, and what impact it has on the environment, are crucial questions when considering reconstruction and development. The RDP integrates growth, development, reconstruction and redistribution into a unified programme (1.3.6).*

The perspective of the RDP remains valid today. Key empirical studies have disputed the idea that growth in itself is 'super pro-poor'. These studies have found that:

- Internationally, not only the poor but also the majority of the labour force, have failed to share in the gains of economic growth (Weisbort et al, 2000). This finding was in response to assertions that the economic benefits of growth will inevitably trickle down, thereby reducing poverty (Dollar and Kraay, 2000)
- In countries with large rural areas, agricultural growth reduces poverty because it generates income for poor farmers and demand for goods and services (Mellor, 1999)
- Sub-Saharan Africa has experienced low rates of growth, but the capacity to translate growth into other dimensions of human welfare has also diminished (World Bank, 2000). In other words, a single-minded dedication to promoting growth may limit the state's ability to foster broad-based development and to eradicate poverty
- Equity dramatically enhances growth. Deninger (1999), for instance, finds that land inequality is one of the factors associated with low growth. Klasen (1999) also shows that tax rates and social spending have a positive effect on growth rates. In an extensive review of these studies, Kanbur (2000) thus concluded that equity and efficiency are linked.

The reason for stressing the relationship between growth and development is not to validate the argument in the RDP, but rather to indicate that meeting our developmental challenges requires us to link growth and development. More specifically, we must strive for a growth path that not only enables the poor to participate in the political and economic life of the nation, but that also improves their material circumstances in a sustainable manner.

Moreover, if growth cannot in, and of, itself resolve complex development challenges, this necessitates deliberate social action on the part of both the state and the wider society.

1.2 Unpacking an integrated vision

In response to the obvious limits of the neo-classical approach, development practitioners have advanced a new vision for societal change. Loosely, this has been described as an 'integrated vision'. While this concept has been variously interpreted, our perspective is one of radical, sustainable and deliberate social transformation.

The key problems facing South Africa remain the pervasive poverty and inequality generated by apartheid. The statistics are revealing:

- According to the United Nations Development Programme (2000), South Africa is the third most unequal society in the world, surpassed only by Brazil and Guatemala
- About half of all South Africans, some 18 million, live in households that earned less than R350 per month in the mid-1990s
- Regions that included the former homelands areas account for over two-thirds of all poor households in South Africa.

South Africa faces a classical poverty trap. In this situation, massive inequalities and associated poverty prevent growth and development, which in turn deepens poverty. Specifically, poverty lowers the productivity of the labour force by making it harder for people to acquire skills and by undermining social cohesion. This reduces household incomes, which in turn limits domestic markets. For this reason, the RDP argued that growth must be combined with redistribution.

Figure 1 portrays the vicious cycle that underlies the poverty trap, where poverty reinforces low growth, which in turn aggravates poverty.

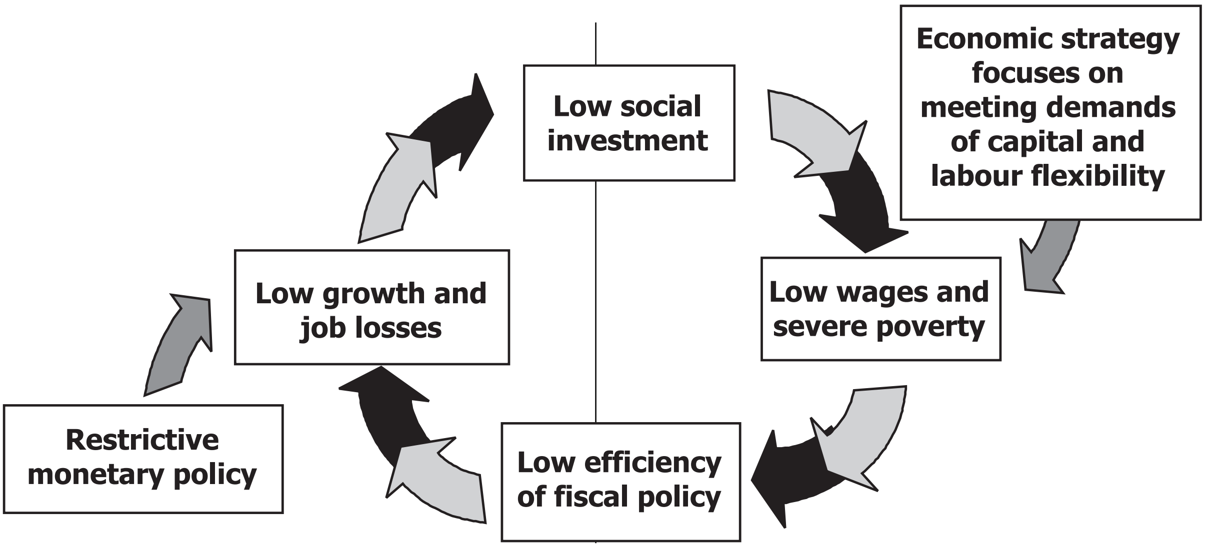
After the transition to democracy in 1994, the government responded to this vicious cycle with four strategies that, at least in part, contradicted each other:

- A robust effort to redirect government spending toward historically deprived communities
- A restrictive fiscal policy, associated with deep cuts in spending, based on the Growth, Employment and Redistribution (Gear) policy
- An industrial strategy focused primarily on improving competitiveness and especially exports, based largely on deregulating markets and cutting tariffs
- A labour policy designed to shift from the oppressive colonial relationships of apartheid to a modern labour market.

Gear reinforced the vicious cycle of poverty by supporting an economic strategy that did little to support greater equality. Because its proposals for restructuring the economy remained weak, it effectively maintained South Africa's historic growth trajectory. That growth path emphasised minerals production and refining for export – which generated few jobs, strengthened big business and reinforced the underdevelopment of the rural areas. Meanwhile, tight money policies were enforced through measures to increase interest rates, discouraging domestic investment.

At the same time, Gear called for measures to reduce the bargaining power of labour. As that would limit both wages and skills development, as well as aggravating conflict in the workplace, it would contribute to productivity problems. This component of Gear contradicted the new labour policy, which involved new laws designed to encourage the more productive use of labour through greater permanency,

Figure 1: South Africa's poverty trap



protection of labour rights and collective bargaining, and widespread skills development.

For the budget, a central contradiction emerged between the need to improve government services for the majority of South Africans and the tight restrictions placed on government expenditure by Gear's fiscal targets. As a result, spending on social services and infrastructure declined steadily in real terms in the second half of the 1990s, undermining a central strategy for addressing poverty.

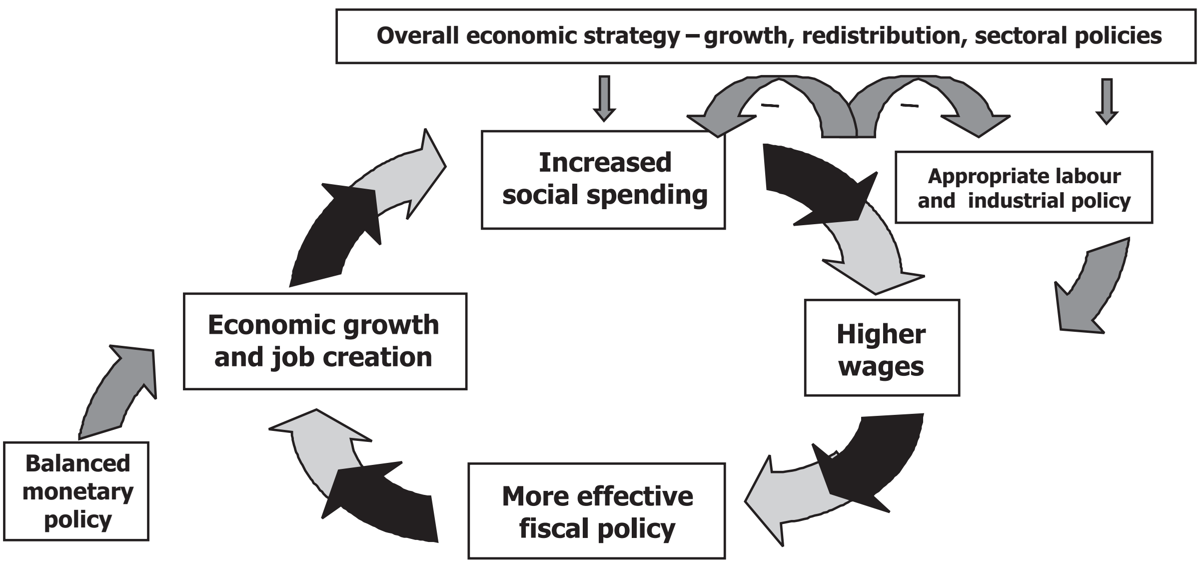
1.3 Towards a developmental budget

Figure 2 depicts how a more developmental strategy could break the vicious cycle of poverty, building on the reinforcing nature of the component macro-economic policies. This strategy bolsters the effectiveness of fiscal policy, which will have a greater effect in promoting economic growth and job creation, if households have higher living standards and greater access to resources and skills. Higher rates of economic growth also expand the fiscal resource base, supporting even greater levels of social delivery and accelerating the virtuous cycle.

Underpinning this vision is a developmental role for the state which entails four major responsibilities. These are:

- The state must drive a ***growth strategy*** that provides strong policy support for sectors to protect and create quality jobs, meet basic needs and expand exports
- The state must provide ***social protection***, which sets a floor under living standards for all South Africans. Social protection comprises government services and grants provided to households in addition to earned income. It should ensure that no one faces absolute poverty. Social protection must:
  - Provide welfare grants, education, health care, policing and housing at a level sufficient to support community development
  - Accelerate skills development and improve education on a mass scale
  - Develop more efficient, socialised systems to meet retirement, transport and health needs for working people, which effectively enhances the efficiency of the economy as a whole
  - Be designed to support economic growth and employment creation.
- The state must also transform itself to ***strengthen democracy and the public sector*** through the establishment of systems to permit greater participation by the majority, who historically have been shut out of power, as well as more coherent and effective delivery systems and structures. Steps to achieve this end include establishing participatory procedures for policy development and strengthening Parliament, especially to amend money bills and to take part in policy development. They must also include measures to control lobbying by big business and to limit patronage and corruption
- The developmental state must support ***more broad-based centres of economic power.*** All the other strategies can contribute to this aim. They can change the nature of wealth by supporting a stronger state sector, co-operatives and small and micro-enterprise, linked in part to land reform, improved housing and investment in skills development.

Figure 2: An alternative macro-economic strategy



1.4 New directions?

Recently, government has adopted a slightly more expansionary stance in the budget. The main elements of this expansionary stance have included:

- Increases in overall spending
- A rather poorly defined commitment to 'micro-economic reforms'.

We believe that the moderately more expansionary stance of this year's MTBPS is a small but important step towards recovering the 'lost years' of budget cuts in the late 1990s. However, it is still inadequate to meet the broader goals of alleviating poverty, creating employment and ensuring economic growth. This document proposes a bolder approach to accelerate poverty eradication.

Box 2 summarises the main elements of a bolder strategy. It contrasts a developmental approach to a neo-classical approach. Our view is that government should adopt and implement the basic tenets of the developmental approach.

Box 2: Neo-classical and developmental budgets

Perspective on …	**Neo-classical**	**Developmental**
Formal sector	Dynamic sector of the economy capable of transforming society	The formal sector is critical, but by itself cannot generate adequate jobs or ensure broad-based development
Rural and informal sectors	Backward area of the economy that must be modernised. Usually a formal commitment to rural development, but reluctance to commit the necessary resources	Direct interventions by government are needed to ensure higher incomes and productivity in the rural and informal sectors. Through asset-based redistribution and building capabilities, these sectors are capable of dynamic growth and employment creation
Economic empowerment	Consequence of growth. Strategies largely based on restructuring of state assets and affirmative procurement policies	Redistribution of assets, including through land reform, provision of infrastructure and other supports for Small Medium and Micro Enterprises (SMMEs), is needed to improve growth prospects and broaden ownership base
Investment and savings	Restrictive fiscal stance would 'crowd-in' private investment by cutting down on government spending and privatising state assets	Investment from government is needed to stimulate growth and investment. Government investment leads private investment
Policy mix	Getting deficit and other indicators right will send right signals to markets. Consequently, growth and investment will follow	Growth and development requires restructuring the economy. Fiscal policy must support measures to that end

2 Trends and lessons since 1994

The need for an economic alternative to Gear is today widely recognised. Government has indicated that it wants to move beyond macro-economic stabilisation to micro-economic reforms. Similarly, the ANC has acknowledged that Gear is not sufficient to catalyse development. We welcome this wide consensus, even though debates continue on the nature of the necessary policy changes. In light of the trends explored in this section, it is not surprising that all progressive organisations are searching for better fiscal policies.

This section:

- Reviews briefly the economy's overall performance
- Evaluates growth and investment trends
- Assesses the extent of both government's achievements and remaining needs
- Identifies lessons for fiscal, trade and industrial policy.

2.1 Overall trends

Gear's failures are evident in massive job losses, slow growth and low investment during the past three years. Table 1 contrasts Gear targets with actual achievements. It shows that government cut the deficit even more rapidly than expected, but that this failed to produce the anticipated levels of development and economic growth. In particular, employment fell massively instead of increasing; private sector investment grew only painfully slowly; and GDP growth averaged 2.4% a year, compared to Gear's projection of 4.2%.

2.2 Quality of growth

For many years, development economists have agreed that economic growth does not 'trickle down' – that is, it is not in itself sufficient for development. More recent studies suggest that development is a ***precondition*** for growth in developing countries. Without it, the vicious cycle of poverty will persist.

In South Africa, the current policies of freeing up markets and cutting budgets have failed to bring about rapid or robust growth. In addition, what growth has occurred has been associated with job losses, deepening inequalities and ultimately undermining the basis for future economic expansion.

Tables 2 and 3 show that economic growth tended to decline over the last few years.

Table 1: Gear projections and actual achievements, 1996-1999

	Annual average, 1996-1999	
	Projected in Gear	**Actual**
Projections		
Fiscal deficit as percentage of GDP	3.7%	3.1%
Average tariff as percentage of imports	7.6%	4.4%
Real bank rate[a]	4.4%	12.3%
Outcomes		
Annual change in formal, non-agricultural employment[b]	270 000	-125 200
Real private sector investment growth	11.7%	1.2%
Real non-gold export growth[c]	8.4%	6.7%
GDP growth	4.2%	2.4%
Inflation (CPI)	8.2%	6.6%

SOURCES: South African Reserve Bank (SARB), Quarterly Bulletin, June 2000; Department of Finance, Budget Review 2000; Department of Trade and Industry, Economics Database.

Notes:
a. For actuals, residential bond rate less CPI
b. Figures for 1996-2000
c. For actuals, real non-mining export growth.

Table 2: Growth in national income, 1993-2001

	National income (R bn)
1993	503 048
1996	560 442
1999	581 631
2000	587 788
Average annual percentage change	
1993-1996	3.7%
1996-2000	1.2%
2000-2001	1.1%

SOURCE: SARB, Quarterly Economic Bulletin, September 2001.

Table 3: Official unemployment rate and growth rates, 1996-2001

Years	Official unemployment rate (%)	Growth rates (%)
1996	19.4	4.2
1997	21.0	2.5
1998	25.2	0.7
1999	23.3	1.9
2000	26.7	3.0 *
2001	26.4	3.5 *

SOURCES: Statistics South Africa (1999), Labour Force Survey (2001), Budget Review (2001). *projected.

Table 4: Gross fixed capital formation by sector (2001)

			Real change	
Sector	**Value in 2000 (R bn)**	**Percentage of total**	**1993-1997**	**1997-2000**
Financial intermediation, insurance, real estate and business services	31.9	24%	40%	1%
Manufacturing	30.5	23%	46%	1%
Transport, storage and communication	19.4	15%	75%	27%
Community, social and personal services	17.0	13%	15%	3%
Mining and quarrying	10.6	8%	32%	-7%
Wholesale and retail trade, catering and accommodation	8.7	7%	39%	15%
Electricity, gas and water	7.0	5%	0%	-33%
Agriculture, forestry and fishing	4.1	3%	2%	-24%
Construction (contractors)	1.2	1%	15%	-2%
Total	**130.3**	**100%**	**37%**	**1%**

SOURCE: Calculated from, SARB, Quarterly Economic Bulletin, June 2001.

Table 5: Gross fixed capital formation to GDP (average since 1994)

Country	Gross fixed capital formation to GDP
Korea	32.2%
Czech Republic	29.2%
Taiwan	26.1%
Croatia	24.5%
Poland	23.7%
India	22.7%
Greece	21.9%
Hungary	21.5%
Brazil	19.8%
Russia	19.3%
South Africa	**15.7%**

SOURCE: Department of Trade and Industry, 2001.

The data demonstrate that government policies to date have not managed to ensure growth, and that Gear failed to meet its 6% target. At the same time, formal employment shrank by close to a million jobs, with most of the job losses in mining, the public sector, construction and manufacturing. Informal employment grew, but largely as a result of expansion in survivalist enterprises. The Labour Force Survey 2001 shows that 20% of informal jobs received no income at all, while a further 43% earned under R500 a month. Growth in this type of employment cannot bolster growth or raise productivity.

Government's reaction to this situation has been mixed. On the one hand, it has argued that the loss of jobs reflects a once-off and unavoidable cost of establishing freer markets, which in turn will lead to greater efficiency and international competitiveness, and ultimately to economic growth. By extension, no change in policy is required. On the other hand, it has begun to argue that it must now attempt more vigorous interventions at the sectoral level. To date only a general proposal on a wage subsidy has been provided.

The slight cyclical increase in growth in 2000 and 2001 has had at best a very limited impact on employment. This illustrates that it is not simply growth in, and of, itself that is important, **but that the nature and quality of growth are the important criteria.** In particular, it is important to determine whether growth is associated with the creation of decent work and whether the poor benefit from growth.

The sluggish performance of the economy has had substantially different impact on men and women and across racial groups. Since women – and, in particular, African women – tend to hold more 'vulnerable' jobs, they are often the first to be retrenched when the economy slows. Moreover, Gear was premised on expansion of the formal sector and did not involve major interventions in the rural sectors of the economy.

2.3 Investment

Ironically, Gear policies have seen both a decline in fixed investment and a net outflow of funds. Investment languished persistently at under 20% of the GDP. In 2000, investment fell to 14.9% of GDP – the lowest level since 1993.[1] Overall, investment remains biased toward capital-intensive sectors, with rising capital outflows.

Table 4 shows that investment had a particularly poor record in agriculture, manufacturing, electricity generation and financial services – critical sectors for development and job creation.

Moreover, when compared to other 'emerging market' economies, South Africa's gross fixed capital formation to GDP ratio has been low (see Table 5).

In addition, the capital outflow grew rapidly and steadily between 1994 and 1999, although it dropped slightly in 2000. In contrast, capital inflows have been markedly unstable, with a massive decline in 2000. As a result, a net capital outflow emerged in that year. Between 1994 and 2001, foreign direct investment into South Africa totalled R45 billion, while foreign direct investment out of South Africa came to R54 billion.

2.4 Achievements and needs

Government has, however, achieved a great deal since 1994, in spite of a restrictive fiscal policy. Box 3 indicates the major achievements in infrastructure provision, but also takes account of the massive needs that still exist.

Box 3: Major achievements in infrastructure provision

Sector	Achievement	Needs
Housing	1 129 612 houses had been built by 2000[a]	The household backlog is estimated at 2.9 million. New entrants are estimated at 25 000 per year
Electricity	Over 3 million electricity connections have been completed since 1993[c]	57.4% of rural communities and 37% of urban communities not electrified
Water	6 495 205 connections have been made by the Community Water supply programme[a]	Approximately 5 million people remain without water
Land redistribution	917 000 hectares of land have been transferred to black owners in terms of the redistribution programme[a]	The 30% redistribution envisaged in the RDP has not yet been achieved[c]
Telephones	Over 1.4 million telephone connections have been made since 1995[b]	An estimated 60% of homes do not have access to telephones

SOURCES:
a. Mbeki 2001
b. Calculated from Naledi , 1999
c. Bond and Khosa, 1999.

This cursory review indicates that there has been a great deal of progress in extending access to assets. It is not clear, however, whether the poorest communities have benefited adequately. More broadly, some critics argue that the level of service provided is often too small to support economic activity that the costs to households are unaffordable, and that delivery systems are not sustainable.

Water delivery is a case in point. Since 1994, government has embarked on a deliberate strategy to extend access to water. The water delivery programme was widely seen as one of the success stories of the post-apartheid government. Estimates indicated that about 12 million people did not have access to clean drinking water in 1993 (RDP, 1993). According to Mike Muller, the Director General for Water Affairs and Forestry, government delivered access to water to 6.5 million people between 1994 and 2001 (Muller, 2001). Indeed, government should be praised for its efforts to reduce backlogs rapidly. However, some studies suggest that, despite the undeniable achievements, there are important weaknesses in the programme. They suggest that government has inflated the numbers, citing the high rate of project breakdown (estimated at 60%) and the practice of counting pipes laid, as opposed to actual connections (Greenberg, 2001). The debate highlights continuing differences in the assessment of actual achievement and need.

In addition, questions have been raised about the sustainability of services for the poor in the absence of appropriate subsidy policies. The recent cholera outbreak illustrated the extent of the problem. In rural KwaZulu-Natal, many residents could not pay the R51 fee assessed for water provision. These communities returned to polluted river systems, which made them more susceptible to cholera (Salgado, 1999). In other places, communities that have received access to services such as telephones and electricity have subsequently been disconnected. These experiences highlight the need for the provision of free basic services, as discussed in our expenditure proposals in section 3.

Delivering ‘some for all’ is a tempting prospect, as it reduces the tension between stringent fiscal limits and the need to accelerate delivery. This approach, however, is not sustainable as it does not raise household productivity – a key element in the argument that poverty alleviation will also support employment creation and economic growth. Simply stated, delivering a 6 amp electricity supply or 50 litres of water a month is insufficient to support economic activity. Raising infrastructure standards has the potential to broaden the asset base in South Africa, if linked to local economic development strategies. In other words, delivering a basic service is not optimal investment if the capacities of the poor are not improved. This is particularly apparent in the housing sector (see Box 4).

Box 4: Housing as a lead sector

Housing delivery was seen as a means to link growth and development. Building houses would meet basic needs while simultaneously stimulating the economy. The RDP gave housing construction a central role in catalysing development and directing government spending. In this sense, housing was seen as a 'lead sector'.

This strategy had both a national and local rationale. At a national level, public investment in housing would boost aggregate demand in the economy and stimulate other sectors through backward and forward linkages. Locally, housing development would allow municipal governments to economically and spatially reconstruct and integrate communities. Housing development was expected to work with other improvements in income security and employment to help eradicate poverty.

Unfortunately, housing policy has not, in practice, achieved the desired results for a number of reasons:

- **Absence of forward linkages**: Forward linkages (also called sustainability linkages) are concerned with economic multipliers. Most new housing is still built far from economic centres, limiting access to employment opportunities and markets for goods and services produced in the home
- **Declining value of the subsidy**: The state housing subsidy plays a crucial role in determining quality and location of houses. In real terms, however, it has declined substantially since its introduction. A declining subsidy means not only smaller houses, but also that developers can only afford land far from city centres. Moreover, it impels government to search for additional funding through loans or savings and / or to impose more rigid cost recovery schemes. This could consume the disposable income of already vulnerable households
- **Cost reduction**: The decline of the subsidy, coupled with escalation of input costs, has spurred contractors to find cheaper ways to construct low-income housing. This has resulted in increased casualisation, peripheral building and the decline of wages in the construction industry. The cost-reduction approach has meant that contractors have shifted to more capital-intensive construction methods and / or to imported supplies. Either way, this limits the potential for job creation
- **Supply and demand side constraints**: Shortages of land and skilled site managers prevent the construction industry from assuming a larger (and job creating) role in delivery. This problem is exacerbated by demand constraints in the wider economy
- **Availability of credit**: The lack of available credit constrains improving performance. Since the housing budget is unlikely to increase (despite urgent housing needs), credit for low-income households becomes particularly important
- **Low inflation and higher savings**: Government's approach to reducing inflation and encouraging savings will continue to affect the construction industry. In particular, it means that government investment, which could be used as a counter-cyclical measure – using the lead sector rationale – will not occur. Moreover, government makes the debatable assertion that increased housing spending will result in inflationary pressures. Significant changes must be made in housing delivery before it can play a meaningful role as a lead sector.

2.5 Industrial and trade strategy

South Africa urgently needs a job-creating trade and industrial strategy. Current policy is focused on the information, communications and technology sectors. These sectors are important to the country, but are not typically labour-intensive industries. The People's Budget Campaign sees a job-creating trade and industrial strategy as central to eradicating poverty. Box 5 presents a vision for such a strategy.

Often when we hear talk about industrial strategy (or industrial policy) it is about 'demand side' and 'supply side' measures. Demand side measures increase demand for products made in South Africa by, for example, discouraging imports or promoting exports. Supply side measures, on the other hand, improve the ability of companies to supply products or services by making them more efficient (for example, by providing training or support for research and development).

These initiatives are important, but they are just part of a complete industrial strategy. Industrial strategy includes all of the ways and means the government uses to help different industries to achieve development goals and economic performance.

The instruments for taking forward sectoral strategies range from moral persuasion to state prescription. The main debates will likely revolve around the definition of appropriate interventions by stakeholders. Critically, measures must extend beyond calling for increased government subsidies. We must also consider how important it is to honour our obligations to the World Trade Organisation. Possible interventions include:

- The identification of clear-cut policy aims for each sector, to give guidance to all stakeholders
- Skills development programmes
- Increased funding of sectoral activities, including investment (through incentives and / or tax relief) and measures to cut the cost of credit. Possible strategies include community reinvestment rules, institutional changes in the financial sector, and prescribed assets
- Expanding markets through government procurement, tariff policies and 'Buy South African' campaigns, as well as improved marketing systems and strategies
- Measures to reduce production costs by re-organising work and upgrading management and by increasing state investment in infrastructure and production.

Box 5: A vision for a trade and industrial strategy

An effective trade and industrial strategy must restructure the economy to meet the needs of the majority of the South African population. That, in turn, will establish a more equitable and skilled society, which provides a stronger basis for engaging with the world economy.

From this standpoint, industrial strategy must be geared to:

Creating quality jobs: This requires upgrading existing production and expanding the formal sector, where possible. From this standpoint, creating sustainable employment is critical both to address poverty and, in the long run, to raise productivity for society as a whole. A critical element is to work more to complete production chains within the economy, so that the multiplier effect is increased

Meeting basic needs: Current industrial policies focus almost exclusively on increasing exports. But successful developing economies have also ensured the increasingly efficient production of wage goods, including infrastructure, for the poor. That approach cuts the cost of living and ultimately labour costs, ensures a growing domestic market, and raises overall productivity and social stability

Alleviating poverty and building social solidarity: The industrial strategy must improve the position of women in the economy, support rural development and enhance growth throughout the Southern African region. Again, these steps are critical to breaking the vicious cycle of poverty.

Democratising the state and society: Long-run economic growth requires greater equality based on more equitable distribution of assets and employment opportunities. Furthermore, an effective industrial strategy must be responsive to the needs and constraints of the major stakeholders. That means that the strategy must encourage broader ownership by strengthening the public sector as well as encouraging co-ops and SMMEs. Also, it must be based on open and consultative policy processes within the framework set by a strong developmental state

The process of sector jobs summits arising out of the Presidential Jobs Summit, as well as the Growth Summit proposed for later in 2002, should aim at developing this type of industrial strategy. By pulling in the major stakeholders, they provide an opportunity both for building broad support for developmental measures, and for tapping into the expertise of the major economic actors.

3 Spending proposals

Spending in strategic areas will create a deliberate and accelerated programme of poverty eradication. This section explores major spending proposals for the 2003/2004 budget. These are the central proposals, but the People's Budget Campaign recognises that additional priorities exist. In the run-up to the 2003/2004 budget, the People's Budget Campaign will explore more areas.

The main spending proposals are:

- Introduction of a universal basic income grant (BIG)
- Increased spending on land redistribution
- Extending the provision of free basic services
- Increasing spending on skills development
- Introduction of an NHI
- Implementing an integrated treatment and prevention plan for HIV/AIDS.

3.1 Basic Income Grant

At least 22 million people in South Africa – well over half the population – live in poverty. On average, they survive on R145 per month. Even in the new South Africa, poverty remains strongly correlated with race, gender and urbanisation, as Table 6 shows. Ninety-four per cent of people living in poverty are African. More than 70% live in rural areas. Households below the poverty line are twice as likely to be headed by women as by men.

Meanwhile, one in eight South Africans spend, on average, more than R2 000 on consumption each month. Nearly three quarters of this group are white, and the overwhelming majority (88%) are urban dwellers. In fact, South Africa has become one of the most economically unequal nations on earth. Such enormous disparities pose a grave threat to the stability of our society, the future of race relations and the sustainability of our internationally-admired transition to democracy.

South Africa's inherited social assistance system is wholly inadequate to cope with the scale of poverty or to meet the most basic needs of the majority of its people. As many as 13.8 million people living in poverty are not eligible for social grants. One in five households do not even have indirect access to social assistance because no one in the household is eligible for social assistance. Furthermore, recent research has found that less than half of those eligible for social assistance actually manage to secure the grants for which they are qualified (EPRI, 2002). Only the old age pension is adequately focused on poor households. The other grants are still disproportionately located in the Northern and Western Cape. Overall, welfare spending per person is not well related to the level of poverty in a province.

In sum, the partial coverage provided by the existing patchwork of grants is limited in its ability to close the poverty gap - the difference between actual income and the poverty line. Currently, social grants reduce the poverty gap by about 23%. Even with full take-up of existing grants, the poverty gap would only be diminished by 36% (EPRI, 2002). That means the present system is unable to satisfy the Constitution's

Table 6: Household characteristics by income quintile

Quintile[2]	Percentage of population	Racial composition of quintile				Rural dwellers	Average consumption per person per month (R)
		African	Coloured	Indian	White		
1	28.9%	96.3%	3.7%	0.0%	0.0%	78.4%	98
2	24.3%	91.4%	8.0%	0.4%	0.3%	63.2%	200
3	19.9%	82.3%	14.8%	2.3%	0.6%	41.9%	353
4	14.6%	62.1%	16.5%	9.0%	12.5%	22.1%	691
5	12.4%	15.2%	5.9%	6.0%	72.9%	12.4%	2 049

SOURCE: Haarmann, 2001.

guarantee of social security for all, including appropriate social assistance if they are unable to support themselves and their dependants. The Constitution requires the state to achieve the progressive realisation of this and the other constitutionally-recognised socio-economic rights (food, water, housing, and health care), a duty recently reaffirmed by the Constitutional Court in the Grootboom case.

To remedy this situation the People's Budget campaign, and many other organisations, have proposed the introduction of a BIG. The BIG is intended to alleviate poverty, to provide all households with a minimum level of income to enable the nation's poorest households to better meet their basic needs, to stimulate equitable economic development, to promote family and community stability, and to affirm and support the inherent dignity of all people. There has been broad agreement amongst BIG supporters that the grant should:

- Be set initially at R100 per month
- Be inflation indexed
- Be paid to every person legally resident in South Africa, regardless of age or income
- Supplement existing grants to households so that no one would receive less social assistance than he or she does now
- Be paid through public institutions
- Be financed primarily through the tax system.

The BIG would have a number of social benefits. It would:

- **Target the poor**: Although everyone would be eligible to receive the grant, the cost of the grant would be recovered from wealthier people through the income tax system. In fact, the richest households would pay, according to their means, to help to subsidise poorer households. Research indicates that a BIG could close the poverty gap by nearly 74%. With full take-up, the number of poor South Africans without access to social assistance would be nil, and abject poverty would be virtually eradicated
- **Be cost-effective**: As the grant is universal, there would be no need for a costly (and potentially corrupt) bureaucracy to investigate and adjudicate applications. More money would go directly to beneficiaries, rather than being absorbed in administrative expenses. The National Treasury (1999) has concluded that such direct transfers have the biggest impact on poverty
- **Discourage dependency**: Since everyone receives the grant, no one would risk losing benefits by taking a job or otherwise supplementing their income. In fact, it is poverty that ensures dependency. People who can rely on having at least a little money every month are able to be more independent, to take certain risks and to regain control of their lives
- **Stimulate economic growt**h: Cash transfers into households increase and stabilise demand, consumption and savings. Spending is likely to be concentrated on basic, locally-produced commodities, thus benefiting local markets and stimulating job creation. Increased consumption is likely to have particular impact on rural areas where it has the potential to kick-start the economy
- **Combat the 'poverty tax'**: Under the present system, it is typically the working poor, not the rich, who are ultimately responsible for helping the very poor to get by. The need to provide assistance to unemployed family members or friends act as an effective 'tax' on the wages of the working poor. The BIG reduces these demands, allowing workers to devote a larger proportion of their wages to productivity-enhancing consumption and social investment (in health, improved housing, skills development, children's education, etc.)
- **Improve the efficiency of social investment**: UN studies have shown that poverty undermines social investment. Inadequate child nutrition, for example, creates long-term health problems which are associated with higher medical costs, poorer educational performance, lower labour productivity, increased absenteeism, etc. This places an extra burden on women who are typically responsible for health care and education in the family. By strengthening the capacity of households to meet basic health and education needs, the BIG enhances the benefits of additional state investment in these public goods
- **Enhance responses to the HIV/AIDS pandemic**: The current social assistance system is ill-equipped to deal with the HIV/AIDS pandemic. The support given is insufficient to absorb the additional burden that affected households have to carry. Those most affected by HIV / AIDS - working age adults - have very little access to social grants. The BIG fills this gap and enables HIV-affected households to afford better nutrition and health care
- **Contribute to equity and social cohesion**: If it is financed through a progressive system of

taxation, the BIG would be strongly redistributive, helping to address the economic inequalities that are a legacy of the apartheid era. Evidence from other developing countries demonstrates that such inequality is a significant obstacle to economic growth and investment. The BIG could even act as a form of general reparation, along the lines proposed by the Truth and Reconciliation Commission.

The developmental logic of the BIG is widely accepted. The major stumbling block to implementation is a concern that it will prove to be too expensive. At one level the criticism is spurious; South Africa cannot afford **not** to have a universal system of social transfers. Failure to take bold and sustainable action to alleviate poverty now may have staggering social, political and economic costs in the future.

More importantly, the grant is affordable. Research undertaken by EPRI (2002) estimates the gross cost of the BIG at R43.8 billion. If the R100 grant is recovered from middle and upper income earners through the income tax system, this would yield an average recuperation of R16.7 billion per year. A further R3.3 billion is likely to be generated in additional VAT as household spending increases. This would leave a net cost of R23.9 billion to be financed by the state. (See section 4, for corresponding financing proposals.)

Above all, the sustainability of the grant must be assessed in a dynamic context. As the grant provides the basis for accelerated economic growth in the medium term, the fiscal burden reduces over time relative to the budget and the economy as a whole. In that sense, the BIG represents a critical investment whose longer-term returns more than justify the short-run costs. It ensures adequate social protection for all by overcoming the weaknesses in public administration and the inappropriate financing systems that bedevil current systems. In the process, it should support social and economic changes that are critical to overcoming the poverty trap and initiating sustainable development. Moreover, it will give a degree of stability and dignity to households, protecting them from the vagaries of the market.

3.2 Land

The RDP committed the government to redistribute 30% of agricultural land in five years to the poorest sections of South African society. Agricultural land in South Africa totals 82.6 million hectares (mha). Redistributing 30% of this land would entail 25 mha. This target was, however, revised with the Department of Land Affairs (DLA) committing itself to redistributing 30% of agricultural land over 15 years.

Meeting the 15-year target requires government to transfer 1.67 mha per annum. During the seven years prior to 31 October 2001, government (and the other agencies assisting it) transferred 365 567 hectares through the restitution programme and 684 914

Box 6: Leasing vs. sale of state land

State land is of strategic value in the context of the ongoing process of land restitution and redistribution and the integration of communities. But the current government policy on the disposal of state land and property is weighted in favour of maximising financial returns and balancing the books. Only 30% of the weighting is placed on the concept of redevelopment and socio-economic plans.

State land must be deployed in such a manner that fulfils the objectives of transformation of property rights, redistribution of economic wealth, and the creation of jobs. The state must therefore move towards a more coherent position of using its ownership of land as a strategic tool of engagement, which could enhance local economic development and provincial economic development.

Government must move away from the concept that state land is a liability that is to be disposed of to the highest bidder. The People's Budget calls for a review of the policy of selling, as opposed to leasing, state land.

Leasing of state land is a socially desirable activity since the social and economic value of state land cannot be simply measured by a defined selling price. The social and economic value of state land is measured through new economic activity, which involves housing delivery, job creation, infrastructure development and inter-governmental co-operation, all of which are revenue generators for the state and can be achieved without having to sell the land.

The danger in selling off state land is that private sector led development has shown through experience, both nationally and internationally, that the real potential of the land is not realised. Private capital's interest is in maximising returns and recovering its initial investment. Their development logic is not synonymous with that of the state. In the medium to long term, this leads to an undermining of the social and empowerment goals of the state. Social housing, together with comprehensive social amenities, remains a critical component in any transformation of state land.

hectares through the redistribution programme – a total of 1.05 mha. This is an average of 150 000 hectares per year. Consequently, for government to reach even its more modest goal, delivery would need to improve 10 times.

The ‘willing buyer-willing seller’ approach to land redistribution lies at the heart of slow pace of delivery. This practice means that government is required to buy and sell land at market prices. The use of other instruments (including appropriation with compensation) would enable more rapid redistribution of agricultural land. Equally important is the strategic utilisation of state land (see Box 6).

Implementing sustainable land reform is a complex process. It includes the acquisition of land but it also includes assisting those who acquire land to build sustainable institutions to maintain and use land and resources to ensure that the land is productive.

At the current pace of land reform, it will take between 125 and 150 years to distribute 30% of the land. This is clearly insufficient. A substantial change in the budget is essential as a precondition for stepping up the pace of change. This should provide increased funding in three key areas.

First, an increase in funds for land redistribution is needed to meet even the modest target of redistributing 30% of land in 15 years. In its Strategic Plan, produced in September 2001, the DLA made an assumption (for estimation purposes) of an average price of land of R1 000 per hectare. On this basis, R1.6 billion a year would be required to allow the DLA to meet its target. During the next three years the total allocation to land acquisition for both restitution and land reform (redistribution and tenure reform) is as shown in Table 7.

Even taking into account that the state is already in possession of 1.2 mha, it is clear from Table 7 that the government cannot hope to achieve its targets without a substantial increase in the DLA budget. Moreover, much of the state land cannot be used for agriculture, since it is either located within municipalities or has been poisoned by military misuse before 1994.

Recognising the demands of justice and the competing claims on the fiscus, the People’s Budget proposes that the current, very limited land reform target – 1.67m hectares per year – be used as a standard. (This means that in 2017, white farmers will still own about 45% of the agricultural land.) The budget for the acquisition of this land during the coming year would therefore be R1.67 billion. However, this does not provide for the additional personnel that will likely be required to sustain a faster rate of land acquisition and redistribution. The People’s Budget Campaign will therefore investigate ways to expedite land redistribution.

Second, more funds are needed to support land reform beneficiaries. The main source of support to land reform beneficiaries comes from provincial Departments of Agriculture. In some of these, there is a limited allocation for this purpose, notably Gauteng (R20.7m in 2001/2002) and Western Cape (R81.9m in 2001/2002). In others, it is more substantial: KwaZulu-Natal (R565.8m) and Northern Province (R669.9m) in 2001/2002. Additional resources are needed at the provincial level for both personnel and programmes.

Third, allocations to infrastructure, credit and other transfers are needed to make redistribution programmes sustainable. Land reform beneficiaries do not just need land; without the provision of other forms of support in terms of infrastructure and production resources, only the relatively rich will succeed[3] in the land reform programme. It is very difficult, however, to determine accurately the amounts currently allocated to such programmes as all provincial Departments of Agriculture, with the exception of KwaZulu-Natal and the Free State, are linked to departments that perform other related functions.

There are a number of critically important issues to note regarding this support:

- In many provinces, there is little or no support from the Department of Agriculture in the form of infrastructure and production resources required to ensure that the land acquired is used in a sustainable manner. While there may be support from other departments, such as the Department of Water Affairs and Forestry, and from agencies such as the Land Bank, this support is limited and is generally not co-ordinated
- The MTBPS anticipates a diminished allocation in some provinces, such as KwaZulu-Natal, the

Table 7: Funds for land acquisition and restitution

Programme	2000/1	2001/2	2002/3	2003/4
Restitution	205 733	136 528	236 091	283 340
Land reform	244 379	304 533	275 245	194 698
Total	**450 112**	**441 061**	**511 336**	**478 038**

Northern Province and Mpumalanga. It seems, therefore, that there will be decreasing support to serve the needs of an increasing number of land reform beneficiaries. This also does not take into account the need to provide continued support to those that have acquired land in the past six years.

Many issues must be considered in developing an alternative budget allocation for land reform:

- The current lack of access that the very poor have to credit from either the Land Reform Credit Facility or the Land Bank. Alternatives to these need to be identified and funded
- The level of demand for funding. The monitoring and evaluation reports of the DLA and Land Bank and other research should be used to permit the development of more realistic budget recommendations
- The extremely limited support available to land reform beneficiaries for infrastructure such as dams, irrigation systems, fencing and roads. More research is required to determine the current demand for such infrastructure.

3.3 Free basic services

The provision of free basic services is crucial to extending services in a sustainable manner. The People's Budget Campaign advocates the provision of a basket of services that are provided free at a basic level. The list of services includes water, electricity, telecommunications and refuse removal. This would establish a floor of basic living standards below which no South African should fall. This section starts by addressing the general situation of local government funding, before looking specifically at the delivery of free basic water.

Most of these services are provided at a local government level. The People's Budget Campaign supports a system of delivering free basic services that links local level schemes (e.g. increasing block tariffs) to a national level subsidy. In this section, we will focus on the transfers from national to local government.

Local government receives transfers from national government, as part of its equitable share. This allocation is provided in terms of an equitable share formula that consists of three components to support operating costs. These are:

- An institutional grant *(I Grant)* to support overhead costs of local authorities with a small rates base in relation to population
- A basic service grant *(S Grant)* to support the operating costs of basic services provided to low-income households
- An allocation to municipalities that have assumed former R293 functions and staff from their provinces.[4]

Several problems exist in terms of the equitable share. First, there is a widely held view that local governments do not use the *S Grant* for its intended purpose of supporting basic services to poor. Instead, it is used for general overhead expenses. Due to the opaqueness of municipal budgets on this question, it is difficult to ascertain the validity of this charge.

Table 8: Service subsidies for poor households

Service	Amount (R)
Electricity	36
Water	20
Refuse	20
Sanitation	10
Total	**86**

SOURCE: National Treasury, Budget Review (2001).

Table 9: Percentage shares of nationally raised revenue (1999-2004)

	Actual	Revised estimate	Budgeted	Medium-term estimates	
Sphere of government	1999/00	2000/01	2001/2002	2002/03	2003/04
National	39.0%	39.4%	40.5%	40.2%	40.0%
Provincial	58.4%	57.6%	56.4%	56.6%	56.7%
Local	2.6%	3.0%	3.1%	3.2%	3.3%

SOURCE: National Treasury, Budget Review (2001).

However, a simple change to the Division of Revenue Act would plug any holes that currently exist.

Second, the *S Grant* is based on a basket of services that significantly underestimates the costs of subsidising the poor. Table 8 summarises the basket used to calculate the annual per capita costs of providing basic services to households in poverty, which is a key component of the *S Grant*.

The state reimbursement for this basket of services does not provide for a complete subsidy for those living in poverty. The National Treasury is currently conducting a study to update the cost of this basket of services.

Third, the equitable share for local government consists of a meagre share of the total budget. Table 9 indicates the share of local government revenue as a percentage of allocated expenditure.

The small share of nationally raised revenue for local government creates an additional obstacle to the provision of free basic services, as the subsidy from national to local is small and there are many competing claims. However, it should be noted that local governments receive a range of other grants from national government.

The People's Budget Campaign thus calls for the pricing of the basket of services used for subsidy purposes to be increased, and for a greater proportion of nationally raised revenue to be allocated to local government.

3.4 Skills development and education

Apartheid left South Africa with both lower skills levels than most economies at a similar level of productivity and with a racially-skewed qualifications profile. Meanwhile, in the past decade, job losses have affected primarily unqualified workers. In these circumstances, skills development – through both basic education and the provision of training and qualifications for adults – is crucial for employment creation, economic growth and equity.

Unfortunately, since 1996 the budget has not reflected this priority. Education is easily the largest vote on the budget, absorbing over a quarter of total spending. But between 1996 and 1999, in real terms it shrank by 3% a year. The 2000 MTBPS projects only 0.8% real growth on average in the coming three years – well below the rate of growth in the population.

Since education is a provincial competency, it is heavily affected by provincial constraints and choices. Generally, the poorest provinces spend far less per learner – and also have a higher learner:classroom ratio and a lower matric pass rate (see Table 10). In these provinces, too, the pass rate for females is substantially lower than the pass rate for males.

Interestingly, the worst-funded departments employ far fewer non-educators than the Western Cape and Gauteng – yet their low budgets still mean that non-personnel spending is squeezed.

Four main areas of under resourcing have emerged in education, which current fiscal projections seem unable to address.

Historically African schools, particularly in the former homelands, typically never had clerical support, cleaners or security personnel. As a result, principals, teachers and learners end up carrying out these functions. The Statistics South Africa survey of

Table 10: Education statistics by province

	Actual spending per learner (2000) (R)	Thousands of learners (2000)	Learner: classroom ratio (2000)	Matric pass rate (2001)
Northern Cape	4 801	201	27	84.2%
Gauteng	4 398	1 554	32	73.6%
Western Cape	4 392	916	31	82.7%
North West	4 069	909	34	62.5%
Free State	4 024	743	33	59.0%
Northern Province	3 453	1 845	40	59.5%
Eastern Cape	3 415	2 106	43	45.6%
Mpumalanga	3 352	894	48	46.9%
KwaZulu-Natal	3 067	2 669	40	62.8%
Total	**3 654**	**10 257**	**38**	**61.7%**

SOURCE: Department of Finance, Intergovernmental Fiscal Review 2000, Department of Education.

child labour found that almost 10% of South African children end up doing five hours or more maintenance work at school every week. Some 96% of this group are African, and two thirds live in the rural areas. To equalise the ratio of teachers to support staff between provinces would require the creation of 30 000 unskilled and semi-skilled positions in the schools.

A second problem area lies in the lack of mathematics, science, culture and art teachers in historically African secondary schools. As the National General Council of the ANC pointed out in June 2000, these subjects are particularly important for employment and self-employment in the modern economy. The President listed information and communications technology and cultural industries as two of the growth sectors for the economy in 2001. Yet most historically African secondary schools still lack teachers for these subjects.

Third, historically African schools, particularly in the rural areas, still lack basic infrastructure. Table 11 indicates the situation according to the 1996 survey of school needs. Given the decline in education budgets, capital spending comes to only around 2% – far too little to meet these backlogs.

The Department of Education recently compiled a new School Register of Needs, which shows that considerable progress has been made in addressing certain backlogs, at least on an aggregate level. Between 1996 and 2000, the percentage of learners in schools without toilets dropped from 55%-17%. Schools without telephones diminished from 60%-35%, and 58% now have electricity (compared with only 43% in 1996).

The final area of underfunding is Early Childhood Development (ECD) and Adult Basic Education and Training. These types of education are critical for overcoming the backlogs in education left by apartheid. Yet they lack both systematic programmes and funds. Without modification of the highly restrictive fiscal targets established under Gear, they probably cannot be contemplated. In the words of the Department of Finance, writing about ECD:

While eventual returns to such an investment will be high, expenditure will have to compete with other mechanisms for improving quality in the schooling system. It will also place added pressure on provincial education budgets (Department of Finance, 2000).

To deal with the budget shortfall, the education system has permitted schools to levy fees. This system contributes heavily to inequalities. On the one hand, schools in richer areas can charge more, letting them hire more staff and improve their equipment. A school with 1 000 learners that charges R3 000 a year can raise R2.4 million more than a school of the same size that can only raise R600 a year. On the other hand, poor children cannot afford the fees to attend these schools. Schools are supposed to take ability to pay into account – but that creates an incentive to avoid admitting poor children at all.

The skills development system established by the Skills Development Act was designed to extend training for adults. This is especially important because apartheid deprived many adults of competencies and / or qualifications. The new system aims to provide qualifications for adults at all levels of training; to ensure that competencies are planned to meet sectoral needs, rather than being specific to

Table 11: Infrastructure backlogs in schools, 1996

		Per cent of the national shortfall of:		Per cent of schools lacking:			
Province	**Percent of all schools**	**Classrooms**	**Toilets**	**Water in walking distance**	**Flush or improved pit toilets**	**Electricity**	**Telephone**
Provinces with large homeland areas[a]	82%	91%	86%	20%	69%	60%	68%
Other provinces[b]	18%	9%	14%	3%	13%	10%	14%

a. Eastern Cape, Northern Province, KwaZulu-Natal, North West, Free State and Mpumalanga

b. Western Cape, Gauteng and Northern Cape.

one employer; and to ensure adequate funding of training through a 1% payroll levy.

When the skills development strategy was under debate, labour argued that the 1% payroll levy was too low. In industrialised and rapidly industrialising countries, studies suggest that spending on training comes to around 4% of payroll. The funding problems may be aggravated by the failure of many businesses to register to pay the levy. Furthermore, government departments only need to budget 1% of payroll for training. There are no consistent mechanisms in place to ensure that they actually spend the funds on training.

The People's Budget calls for spending on education to increase at an annual rate at least 2% greater than the rate of inflation. In addition, the system of fees must be reformed to ensure that it supports greater equality among schools.

3.5 National Health Insurance

South Africa spends 8.5% of its GDP on health, yet the outcomes – measured for instance by child, infant and maternal mortality and life expectancy – are worse than other middle-income developing countries. The reasons lie in part in inequalities in the health system and in part in the lack of basic infrastructure to ensure clean water and sanitation for many of our people. The HIV pandemic has aggravated the problem. To remedy this situation, the People's Budget proposes an NHI scheme.

The co-existence of private and public health care is an important factor behind the inefficiency of health spending in South Africa. The private sector provides the best care in the world for those who can afford it, while the majority continues to rely on inadequate public services. Private health care serves less than 20% of the population, but absorbs two-thirds of total health spending. In contrast, the public health sector serves the majority of our people, but remains under-resourced, resulting in poor quality care.

Only about 7 million South Africans, of whom only 9% are Africans, are covered by private medical schemes. The annual revenue of the private medical schemes comes to more than R29 billion a year, roughly the same as the total public health budget.

Meanwhile, the public health system faces rising demand and falling budgets. After 1994, government opened facilities to all races, provided health care free to mothers and young children, and expanded primary health care. These measures should ultimately reduce costs for curative care, but initially led to higher referrals to hospitals, with a consequent increase in costs there as well.

In the same period, budgets for health declined relative to inflation. Between 1996 / 7 and 1999 / 2000, provincial health budgets rose 4% a year, with inflation at 7.7% a year. In other words, in real terms health budgets dropped by over 3.5% a year, or close to 10% in three years. At the same time, the population was growing at over 2% a year. In per capita terms, then, the health budget dropped by 15% over the period. Of the new health care facilities constructed in the past six years, 46%[5] did not have an adequate supply of clean water and electricity. Many clinics are opened without necessary staff or resources.[6]

The two-tier system promotes a maldistribution of resources and wastage, inflates health costs, and defeats the commitment to health care for all. On the one hand, private health care has seen extraordinarily rapid increases in tariffs, largely due to excessive profits and administration costs, with increased instability among medical-aid schemes. On the other hand, the private health care system actively weakens the public health care system by shifting the cost of caring for patients with serious illnesses, including HIV, onto the public sector, and by setting up a parallel system of (expensive) private hospitals that diverts potential paying patients from public hospitals.

The People's Budget proposes the NHI to end the two-tier system by incorporating all health resources into the public sector. A new NHI Authority would allocate the health budget to hospitals and practitioners. It would be funded by the existing budget plus a progressive dedicated levy equal to existing private health costs.

The levy would be on high incomes, both salaries and other, and would effectively replace the current cost of health insurance and medical schemes. Because it would replace employee-employer insurance premiums and out-of-pocket expenditures, it should not increase the cost of health care to the South African currently accessing medical aid or to society as a whole.

In the long term, by reducing administration and procurement expenses, the cost of health care should ultimately decline. Instead of confused and often unjust dictates of insurance companies, a greatly expanded programme of technological assessment and cost-effectiveness would guide decisions about covered services, as well as about the allocation of funds for capital spending, drug formularies and other issues.

Each hospital would receive an annual global budget to cover all operating expenses. For patients not using hospitals, the diversity of existing practice arrangements necessitates a pluralistic approach. To minimise disruption, the NHI would include three payment options for doctors and other practitioners: fee-for-service payments, salaried positions in the institutions receiving global budgets, and salaried positions within group practices receiving per capita (capitation) payments.

The NHI would not increase the burden of health costs on society in the short run, and should reduce the burden per person in the longer term. This has great importance for controlling the cost of living and of production. It would, however, lead to an apparent increase in the budget, equal to the amount now spent on private health care.

There are key differences between our proposal and the SHI system proposed by government (see Box 7). We look forward to discussing these issues with government.

At a minimum, the NHI would:

- Fully cover everyone under a single, comprehensive public insurance programme
- Pay hospitals, clinics, nursing homes a total (global) annual amount to cover all operating expenses
- Fund capital costs through separate appropriations
- Pay for health professionals services and ambulatory services in any of three ways – through fee-for-service payments with a simplified fee schedule and mandatory acceptance of the NHI payment as the total payment for service or procedure (assignment), through global budgets for hospitals and clinics employing salaried doctors, or on per capita basis (capitation)
- Be funded, at least initially, from the same sources as at present
- Contain costs through savings in billing and bureaucracy, improved health planning and the ability of the NHI, as a single payer for services, to establish overall spending limits.

The structure and financing of the NHI is meant to be self-funding, as it will be raised as a levy. The funds raised through the levy would be ring-fenced, and used for medical care for all South Africans.

3.6 Integrated treatment and prevention plan for HIV/AIDS

Poverty and the spread of HIV / AIDS are directly linked and reinforce each other. Poverty makes people more susceptible to opportunistic infections and diminishes their control over their circumstances. At the same time, the spread of HIV / AIDS perpetuates the cycle of poverty, as parents and children are faced with higher medical costs and reduced quality of life. There thus exists a two-way link between HIV / AIDS and poverty, which must be tackled if other anti-poverty programmes are to succeed.

The epidemic also has a direct impact on the social security system, since most people with AIDS require state assistance. Only a relatively small percentage of people living with HIV / AIDS have medical cover, retirement or unemployment support, and few benefit from existing social grants. People with AIDS often face discrimination from officials when trying to access government services such as disability grants. A number of existing grants can be targeted to support people living with AIDS, including child support, foster care and disability grants. Rather than establishing a separate grant for people living with AIDS, government should adopt a conscious strategy of directing existing grants to meet their needs.

The People's Budget Campaign therefore proposes

Box 7: Main differences between NHI and SHI

NHI	SHI
Will provide the necessary financial base for an NHS employer and employee contribution	Will continue to drain state resources into private health sector; R8 billion per annum subsidisation through tax relief currently
Funding through payroll levy tax and progressive taxation system	Co-payment; system of deductibles at point of payment
Establishes a single provider of health care in the country at different levels	Private health system will remain in place, promoting dual system of health care delivery
Coverage is universal for necessary medical services irrespective of ability to pay	Provides for hospital cover – a minimum cover
One single administrative system, but decentralised	Different administrative systems and administrators; problems of rising costs, exclusions, brokerage and re-insurance are not dealt with

the development and implementation of an integrated treatment and prevention plan as a response to the HIV / AIDS epidemic. This plan would consist of both health and non-health components. The health components of the plan are:

- Expanded programme of voluntary counselling and testing for HIV and other sexually transmitted diseases (STDs)
- Treatment of STDs and other opportunistic infections
- A national programme to prevent mother-to-child transmission of HIV
- The effective prevention and treatment of opportunistic diseases
- Greatly expanded access to anti-retrovirals through the public health system
- A programme of palliative care, delivered through home-based care and community care givers
- Improved systems of surveillance of HIV and AIDS incidence, prevalence and impacts
- Increased budgets to fund research into microbicides, vaccines and other HIV-related issues.

The core non-health components are:

- The rapid introduction of a BIG (initially targeted at groups who are either especially vulnerable to HIV because of poverty or made poorer by HIV)
- The employment and training of Community Care Givers
- A programme, supported by the Department of Trade and Industry, to increase local manufacturing technology and capacity of essential medicines that can be produced and marketed at affordable prices under voluntary or compulsory licences.

4 Revenue proposals

Funding the major social and economic programmes proposed here requires raising social spending substantially. The proposals presented here seek to:

- Raise resources through a relaxation of overly tight macro-economic parameters
- Propose a means for reducing debt servicing
- Redirect military spending to social programmes
- Build a more progressive taxation system, through restructuring of the VAT system
- Restructure the Government Employee Pension Fund (GEPF), with the aim of releasing funds for development.

4.1 Resetting macro-economic parameters

There is an emerging consensus that relaxing macro-economic parameters is crucial to South Africa meeting its developmental challenges. Raising additional resources for social spending is the foundation for realising the programmes discussed earlier. This section looks at two crucial macro-economic indicators (the tax:GDP ratio and the deficit:GDP ratio). Through economic simulations, an argument is developed for raising both tax and the deficit relative to GDP. The section starts by outlining trends on both measures, before proposing more relaxed macro-economic parameters.

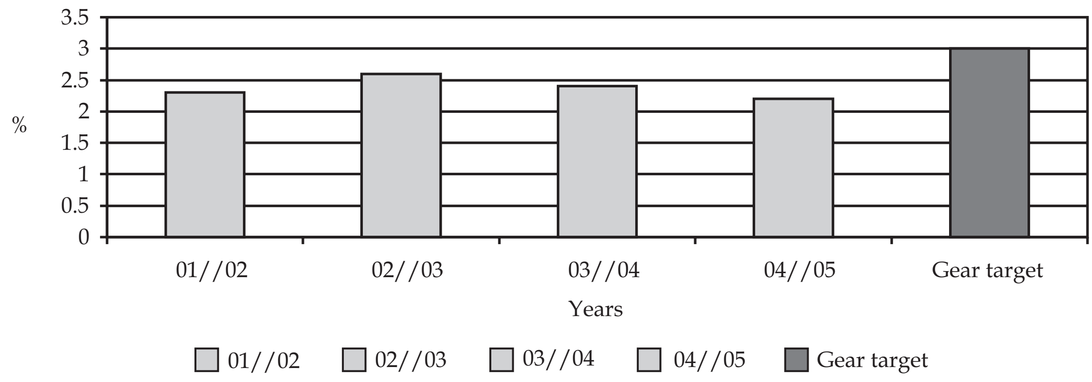
4.2 Are we in danger of a 'debt trap'?

Since 1996, both the tax:GDP ratio and the deficit:GDP ratio have declined significantly. Figure 3 compares the deficit:GDP ratio to the Gear target of 3% deficit. Figure 3 also indicates that deficit spending has become increasingly restrictive over the last few years.

It is questionable to assert that South Africa faces a 'debt trap'. Generally, the phrase 'debt trap' refers to a country with an unsustainable foreign debt, particularly when the burden of servicing the debt catastrophically restricts socio-economic development. South Africa's foreign debt is very small by international standards, and easily serviced from current export receipts. Furthermore, South Africa's domestic debt is not particularly large by international standards. Rapidly growing countries like Malaysia and Singapore have much higher debt levels (relative to national income), and most industrialised countries have significantly higher ratios of public debt to national income than that of South Africa. Figure 4 compares South Africa's public debt with that of other developing and industrialised countries.

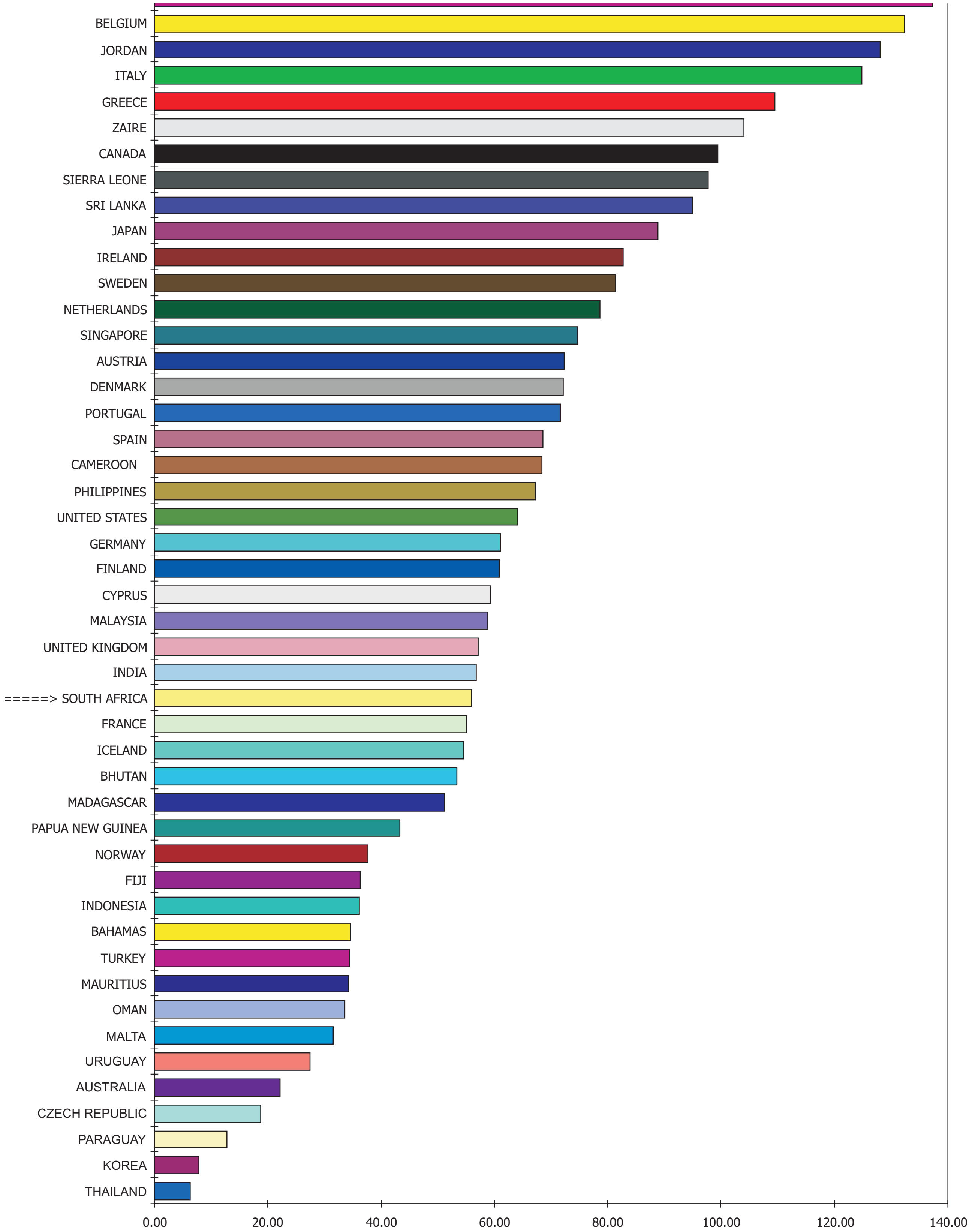
In spite of South Africa's relatively low debt levels, South Africa's debt burden is relatively onerous by international standards. This paradox is explained by South Africa's interest rates, which are higher than those of any industrialised country and among the highest in the world. Because of high interest rates, relatively low debt levels impose a severe debt burden on society. The government's economic strategy recognises this dilemma, but addresses the problem by focusing on debt reduction, low fiscal deficits, and austere social expenditure programmes. The government maintains a commitment to restrictive monetary policy, with the aim of reducing inflation by keeping interest rates high.

Figure 3: Deficit:GDP ratios (2001-2005)



SOURCE: Budget Review.

Figure 4: International public dept comparison, December 1996



SOURCE: OECD, IMF (most recent statistics available as of December 1996).

As a result, debt policy hampers employment growth, sharpens the sting of poverty, and undermines social welfare. The combination of reduced government expenditure and restrictive monetary policy has a contractionary impact on the economy, stifling job creation. In particular, the government has inadequately financed social investment in housing, health care, education, and infrastructure - failing to adequately address the legacy of apartheid that hampers job creation and socio-economic progress. In a market-oriented economy, public expenditure is the most effective mechanism for poverty alleviation and welfare enhancing economic redistribution. The government's current debt policy neutralises these instruments, allocating scarce resources to policy supported high interest payments while failing to mobilise resources through further borrowing to fund social imperatives.

4.3 Taxation

Similarly taxation levels have decreased relative to GDP, as indicated in Figure 5.

This has meant that less money is available for social investment. By raising the taxation levels relative to GDP, more resources would be available for social spending. Moreover, this would buttress the robust efforts by the South African Revenue Service (SARS) to raise additional resources.

Projections in the MTBPS point to a stabilisation of the tax:GDP ratio at around 24.1%. At the same time government attempts to increase spending, while keeping the tax:GDP ratio intact. This is premised on a combination of (a) improved tax collection and (b) increased levels of growth. In other words should growth not reach the expected levels the level of **actual resources** will decline even though the tax:GDP ratio remains the same.

The People's Budget Coalition supports the robust efforts by SARS to ensure tax morality. All South Africans should support social and economic transformation according to their means.

4.4 Scenarios

The proposals made here, and in particular the increase in social protection, requires an expansion in government spending. In the short run, that implies a moderate rise in the ratio of taxes and deficits beyond the targets provided in the MTBPS. In the longer run, as the economy begins to grow more robustly, the deficit and tax ratios will again decline.

EPRI has modelled the implications of this proposal for the People's Budget. Here we present three possible scenarios. All of them increase both taxes and government borrowing, as reflected by the increase in government revenue and the deficit as a percentage of the GDP. The resources raised through higher borrowing and taxes are channelled into productive social spending.

The results of these policies are summarised below and compared to the projections in the current MTBPS.

In all the proposed scenarios, the real growth rate increases substantially as a result of:

- Improvements in social protection, which stimulate domestic demand and increase capital and labour productivity
- A targeted growth strategy that encourages investment and employment creation.

The longer-term results reflect more fully the positive effects of social investment on expanded economic capacity. The real growth rate rises to 5% over the three-year horizon instead of fluctuating at lower levels. In spite of the higher levels of borrowing, the public debt (measured relative to national income) falls more rapidly than in the baseline scenario, since the growth rate of the economy is significantly higher.

4.5 Ring-fencing apartheid debt

This section introduces a policy debate on reducing debt servicing. The proposals presented here are aimed at creating a basis for further discussion on this important policy question. It is an area that government should address in the next budget round.

Until South Africa's first democratic elections in 1994, the government borrowed to finance distorted development policies that benefited a small minority,

Figure 5: Tax:GDP ratios (2001-2005)

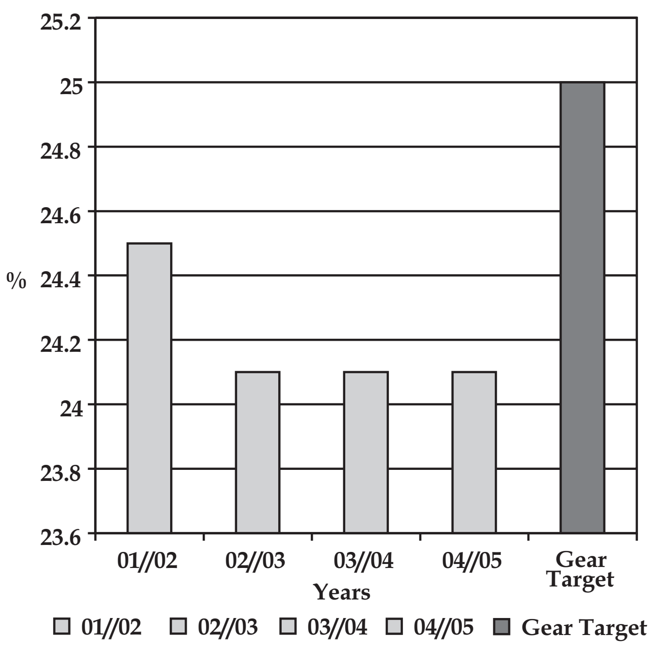


Table 12: Scenarios on deficit and tax targets*

Baseline scenario	2001/02	2001/03	2001/04	2001/05
Government revenue (% of GDP)	24.5	24.1	24.1	24.1
Government expenditure (% of GDP)	26.8	26.7	26.5	26.3
Government deficit (% of GDP)	2.3	2.6	2.4	2.3
Real GDP growth rate (%)	2.7	3.0	3.6	3.8

Gradual expansion	2001/02	2002/03	2003/04	2004/05
Government revenue (% of GDP)	24.5	25.0	25.8	26.4
Government expenditure (% of GDP)	26.8	28.0	28.7	29.3
Government deficit (% of GDP)	2.3	3.0	3.0	2.9
Real GDP growth rate (%)	2.7	3.5	4.5	5.1
Additional social investment (R billions)	-	14.4	29.4	46.7

Rapid expansion	2001/02	2002/03	2003/04	2004/05
Government revenue (% of GDP)	24.5	25.7	26.4	26.9
Government expenditure (% of GDP)	26.8	29.7	29.8	29.8
Government deficit (% of GDP)	2.3	3.9	3.4	2.9
Real GDP growth rate (%)	2.7	4.5	5.1	5.3
Additional social investment (R billions)	-	35.5	46.6	59.1

Moderate expansion	2001/02	2002/03	2003/04	2004/05
Government revenue (% of GDP)	24.5	24.8	25.5	26.1
Government expenditure (% of GDP)	26.8	28.7	28.9	29.0
Government deficit (% of GDP)	2.3	4.0	3.4	2.9
Real GDP growth rate (%)	2.7	4.2	4.8	5.1
Additional social investment (R billions)	-	25.0	35.2	46.7

Notes:

Baseline scenario
Assumptions: based on analysis of MTBPS 2001.

Gradual expansion scenario
Assumptions: relaxed deficit target (ex ante 3%) and gradually rising tax revenue targets (1% in 2002/03, 2% in 2003/04, 3% in 2004/05). Scenario reflects growth effects.

Moderate expansion scenario
Assumptions: temporarily increased deficit target (ex ante 4% in 2002/03, 3.5% in 2003/04, and 3% in 2004/05) and gradually rising tax revenue targets (1% in 2002/03, 2% in 2003/04, 3% in 2004/05). Scenario reflects growth effects.

Rapid expansion scenario
Assumptions: temporarily increased deficit target (ex ante 4% in 2002/03, 3.5% in 2003/04, and 3% in 2004/05) and more rapidly rising tax revenue targets (2% in 2002/03, 3% in 2003/04, and 4% in 2004/05). Scenario reflects growth effects.

SOURCE: EPRI (20 January 2002).

*Modelled by EPRI at the request of the People's Budget.

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 entirely a legacy of apartheid.

This burden of the apartheid debt 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 increased 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 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 as well as undermining the capacity of the majority of South Africans for 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 macro-economic 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.[7] 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 of the debt. While most developing countries owe their debt to foreigners, South Africa is primarily indebted to its own domestic constituents. Furthermore, while most developing countries have borrowed loans from banks, governments and international financial institutions, South Africa's debt principally takes the form of bonds that are frequently traded in secondary markets.

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. 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.

A debt cancellation strategy aims to redress the imbalances unjustly imposed by the apartheid debt, freeing resources for social priorities while shifting the burden onto the beneficiaries of apartheid. An alternative strategy may achieve the same objective, yet more directly and with less risk, for the nation as a whole. The entire apartheid debt – which is the total public debt of the government – could be set aside in a special fund. Appropriate policies can then be put in place to ensure that the burden of this apartheid fund is shouldered primarily by the beneficiaries of apartheid. With the burden of the apartheid debt removed, the billions currently spent on interest could be re-allocated to social development and job creation. The apartheid debt would be 'ring-fenced', isolated from the government's main task of socio-economic development and redressing the apartheid legacy.

Cognisant of the fact that the holders of the apartheid debt are not necessarily the beneficiaries of that debt, as part of this alternative strategy the government would commit to servicing the debt in a manner that shifts the burden as effectively as possible on the beneficiaries of apartheid. A combination of policies can help to achieve this goal:

- 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 the government debt. A major reason for the high interest rates currently constraining the government is the SARB's policy of inflation-targeting, which requires high interest rates to reduce inflation
- The government could issue bonds that pay lower interest rates than those which financial markets currently offer. In order to ensure that investors hold these bonds, the government can renew financial regulations prevalent during the 1970s and 1980s that required major financial institutions to hold minimum levels of government debt. These regulations (called

'prescribed asset requirements') were used by the apartheid government to ensure sufficient finance for their policies. As policy makers planned the process of democratisation in the late 1980s, the government eliminated these regulations, thus increasing the cost to future governments of financing not only the apartheid debt but also any future debt

- The reduced debt burden can be financed by a more progressive tax structure that incorporates a higher capital gains tax, effective capital transfer taxes, more progressive corporate and individual income taxes as well as progressive taxes on goods and services and increased tax compliance. The tax burden on the poor could be reduced, and the upper income groups could shoulder an increased responsibility. The surplus of additional revenue over and above that which is necessary to finance the reduced apartheid debt service should be invested in social priorities. (Over the past several decades, the share of the income tax burden borne by corporations has fallen substantially, while the share borne by individuals has risen steadily. Further, the government's reliance on more regressive taxes on goods and services has increased significantly.)

4.6 Redirecting military spending

In late 1999, the Cabinet approved a strategic arms procurement package priced at US$4.8 billion, equivalent at the time to R30.3 billion. The package included 28 Saab / British Aerospace Gripen fighter jets, 24 British Aerospace Hawk lead-in fighter trainers, four Meko corvettes, three submarines and 30 Agusta light utility helicopters.

The configuration of the weapons package was informed by the Defence Review undertaken two years before. This produced a broad consensus in favour of a diminished 'core force' and purely defensive military capacity backed by a credible conventional deterrent. Accordingly, the review report, approved by Cabinet and the relevant parliamentary committees, identified a long list of ageing and obsolete weapons, the ultimate replacement of which was considered essential to the maintenance of a 'growth core' force 'without the permanent loss of capabilities'. However, the report emphasised that this should not be seen as an immediate 'shopping list', but should be pursued 'subject to available finance':

> *While the process is intended to produce a force design representing the best defence value for money within the selected parameters, it may not be possible to ensure the capabilities for a required level of defence within a restrictive budget ... the approval of a force design by the parliamentary Defence Committee, Cabinet or Parliament does not constitute blanket approval for all implied capital projects or an immutable contract in terms of the exact numbers and types of equipment. At best, it constitutes approval in principal for the maintenance of the specified capabilities at an approximate level (Defence Review, 1997).*

Subsequent decisions about how to prioritise procurement and how to balance ideal defence capabilities with competing resource demands were not, however, open to the same level of public or parliamentary involvement.

It therefore remains important to assess the likely developmental impact of the arms deal in light of South Africa's other pressing social and economic needs. Two areas of particular concern are the long-term costs of the deal and its affect on social spending.

4.6.1 An ever-growing bill

Although the price of the weapons package was originally announced to be R30.3 billion, the expected actual cost has been growing steadily ever since. Four factors will affect the final cost of the deal:

- **Inflation**: The contracts contain escalation clauses that allow price adjustments to be made in line with cost inflation, either in South Africa or in the relevant supplier country. In May 2001, the Minister of Finance reported that inflation had already driven up the cost of the package by R7.45 billion
- **Exchange rates**: Roughly 75% of the total purchase price is denominated in foreign currencies and therefore exposed to exchange rate fluctuations. Furthermore, much of the deal is being financed by foreign borrowing through national export credit agencies. This further increases the deal's vulnerability to adverse foreign exchange movements
- **Interest rates**: Rising interest rates could increase the cost of servicing the debt incurred to finance the weapons purchases
- **Hidden costs**: In December 2001, the Auditor General told MPs that there are roughly R2 billion in 'hidden' costs associated with the arms deal. These represent additional equipment, excluded from the original package to satisfy the Cabinet's cost criteria, but without which the functionality of the weapons will be impaired. These will ultimately be expenses incurred over and above the cost of the weapons themselves.

As a result of the first two factors, the expected cost of the package had already grown to R43.8 billion by February 2001. The 2001 Budget Review detailed a 12-year financing plan for the package, as shown in Table 13.

This massive expenditure on weapons has reversed the steady decline in defence spending achieved in the first years of the post-apartheid era. Defence spending, as a proportion of the total budget, dropped from 7.65% of the budget in 1995/96 (the first democratic budget) to 4.99% in 1999/2000. Since then, it has risen again to 6.12% of the budget in 2001/02. It is expected to remain above 6% for the duration of the current Medium Term Expenditure cycle.

The accelerated decline in the foreign exchange value of the Rand at the end of 2001 will have a dramatic inflationary effect on the ultimate cost of the total package. If there is substantial cost escalation in the foreign-currency denominated contracts, the increase would be exponential. Current cost estimates run as high as R60 billion.

4.6.2 'Crowding out' social spending

Given government's commitment to adhering to restrictive macro-economic parameters, the growing cost of the weapons package threatens to divert resources from spending on social services and infrastructure. Indeed, this was one of the main concerns of the 'affordability team' formed by Cabinet to assess the potential fiscal impact of the deal. The team report (1999) observed:

> *The arms procurements are likely to impact on expenditure by other government departments in two ways, both negative. Firstly, … certain amounts of expenditure will be shifted from other government departments to Defence for the packages. Secondly, to the extent that the overall pool of funds available to government is likely to grow in line with the growth in the economy … then any additional expenditure on the defence packages will reduce the portion of these funds which would otherwise have been available to other departments.*

The Affordability Team estimated that only about 30% of the cost of the deal could be met from the defence budget. The remaining 70% would have to be found elsewhere within the budget. Presumably a large proportion of this amount would ultimately have to come from social services and infrastructure.

In an effort to mitigate this negative impact on development, the government negotiated a range of civilian and defence related industrial participation and trade agreements, reportedly valued at roughly R104 billion. However, a number of analysts – including the Affordability Team – have raised doubts about the likelihood that these agreements will be entirely fulfilled. In its review of the arms procurement deal, the Standing Committee on Public Accounts pointed out that although the tenderers were liable for penalties if they failed to meet their obligations, these penalties were relatively low – typically 10% (or less) of the value of the tender. It has also been suggested that to the extent that these 'offset' arrangements reflect sound business decisions, they are deals that would have occurred anyway, even without the defence contracts.

Thus, the arms deal pits the uncertain benefits of the offset agreements against very real constraints on social spending. Shortly before the defence procurement contracts were signed, the 1999 Budget Review anticipated that defence spending would increase by an average of 3.5% per year in the three years from 1998/99 to 2001/02. However, the 2001 Budget Review revealed that, in fact, spending rose from R10.6 billion in 1998/99 to a budgeted R15.8 billion in 2001/02 – an average annual increase of 14.4%. Over this same period, consolidated spending on education rose an average of 8.7% per year, while health and welfare both averaged 8% annual growth.

While the government has made a welcome decision to relax somewhat its austere deficit target, it is regrettable that more of the additional funds generated will not be available for expenditure on social programmes. The MTBPS lists the government's official spending priorities over the next three years as: infrastructure, the criminal justice system, the social services, provision for HIV/AIDS and employment creation. Defence does not

Table 13: Expected spending on strategic defence package by year

Year	Amount (R)	Year	Amount (R)	Year	Amount (R)
2000/01	2 849 bn	2004/05	5 533 bn	2008/09	2 863 bn
2001/02	4 220 bn	2005/06	5 793 bn	2009/10	1 194 bn
2002/03	5 078 bn	2006/07	4 712 bn	2010/11	1 041 bn
2003/04	5 828 bn	2007/08	3 635 bn	2011/12	1 027 bn
Total					**43.776 bn**

SOURCE: Budget Review (2001).

appear on the list, yet its budget has been growing faster than any of these. The 2001 Budget Review indicates that the government has allocated R4.6 billion to poverty relief and job creation between 2001/02 and 2003/04. During this same period, it plans to spend R15.1 billion – more than three times as much – on weapons.

Moderate defence spending is not unjustified. The state has a constitutional duty to protect the nation's borders and natural resources. However, in the South African context where poverty, inequality and unemployment remain perilously high and there is no foreseeable threat of military action against the nation.

Current commitments, including peacekeeping and natural resource protection, could be met with more modest investment.

The investment of as much as R60 billion in sophisticated weaponry is difficult to reconcile with national development objectives. A developmental investment package would more appropriately allocate funds to transforming the social security system, improving infrastructure and enhancing the delivery capacity of local government.

4.6.3 Limiting fiscal exposure

Contractual obligations make it difficult to reduce spending on arms procurement in the short run. Cancellation of the deal could expose South Africa to substantial penalties and potential legal action.

However, the final arms procurement contracts call for the Gripen and Hawk aircraft to be supplied in three stages or 'tranches'. South Africa's initial commitment is only to the purchase of nine (of 28) Gripen fighters and 12 (of 24) Hawk trainers. The government has the option of declining further purchases within certain time limits. The decision on the additional Hawks must be made in 2002, and the decision on the Gripens in 2004.

The cost of these weapons has been 'front-loaded' as an incentive to taking up the options. In other words, the aircrafts in the first tranche are being sold at premiums of 34-35%, while the those in subsequent tranches are being sold at large discounts. In 1999, the government estimated that the cost of the first tranche would be roughly the same as the second and third tranches combined – approximately R6.6 billion (calculated at an exchange rate of R6.25 to US$1).

By declining the options, the government would be compelled to pay high unit prices for the first batch of Gripens and Hawks, but it would ultimately save at least R12 billion – and possibly much more, depending on future exchange rate movements.

The People's Budget therefore calls for the immediate rejection of these options and the redirection of the saved funds to social programmes. In addition, any future procurement plans should be subject to extensive public debate and more vigorous parliamentary oversight.

4.7 Restructuring VAT

Value-added tax, or VAT, is a highly regressive form of taxation, with the poor paying a higher percentage of their income than the rich. Table 14 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 over R10 000 a month.

In the past three years, tax cuts have concentrated on personal income tax and corporate taxes. Since only those earning over around R2 000 a month pay income tax, these reductions do not benefit the poor. Ironically, even the reduction of personal income tax has been regressive, with much greater relief for the high-income group.

Private capital and some opposition parties have been calling for a VAT increase, both to expand the revenue base of government and to fund a BIG. The People's Budget rejects the idea of funding programmes for the very poor by taxing the poor. That would not assist in taking our country out of the poverty trap, or address the fundamental inequalities that characterise our economy.

Table 14: VAT burden on households, by income level

Annual household income (R)	Total VAT paid (R)	VAT paid as a percentage of total tax paid	VAT paid as a percentage of annual income
18 000	1 799	86%	10%
30 000	2 910	54%	10%
75 000	6 141	25%	8%
140 000	10 241	18%	7%

SOURCE: Department of Finance.

In order to deal with the regressive nature of VAT, many countries exempt necessities and impose higher rates on luxury goods. Although many theorists argue for a single, uniform rate, only 18 countries have actually adopted this approach (Cosatu, 1999). Thus, 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 (see the Appendix).

The People's Budget proposes an extension of zero rating to additional basic necessities beyond those already zero-rated by government,[8] and an increase in VAT on luxury goods.

The actual choice of additional goods to be zero-rated should be informed by current expenditure patterns, with a prioritisation of goods that can substantially contribute to improved social welfare of the poor. To minimise the impact on revenue, commodities with a high value would be a relatively low priority for zero-rating. The health impact of goods – both positive and negative – would also influence the choice of items for further VAT zero-rating. For example, although lower income groups spend a greater proportion of their income on tobacco than do the higher income groups, negative health effects would rule out zero-rating it.

The weighted equity gain ratios cited by the Katz Commission[9] suggests the following goods as prime candidates for zero-rating: paraffin, bread flour, white sugar, matches, candles, coal, coal stoves and white bread. In this regard, we applaud the decision of government to zero-rate paraffin. However, we note that benefits of zero-rating are not always being passed on to the poor. The People's Budget Campaign calls for measures to prevent profiteering by businesses selling zero-rated goods.

Over the counter drugs, generic drugs, and items of the government's essential drugs list should also be considered for zero-rating, as should school clothes and other education needs.

The increase in the number of goods to be zero-rated would obviously have revenue-loss implications. For this reason, the People's Budget proposes the introduction of higher VAT rates on luxury goods. This measure would compensate for the decline in revenues.

Certain goods tend to be mainly or almost exclusively consumed by the upper income brackets. These goods are typically relatively import and capital intensive, so that suppressing their demand through higher taxes would have relatively little impact on the domestic economy. It is proposed that two lists of goods be agreed upon: those that *prima facie* qualify for a luxury tax; and those that qualify for a luxury tax above a certain price threshold.

The first list would include, for instance, video cameras and recorders, decoders, satellite dishes, furs, air conditioners, caravans, yachts and microwaves. The second list would include cars, motorcycles, fridges, freezers, stoves, radios, TVs, watches, jewellery, sunglasses, cosmetics, and furniture. Such a system is already in place in other countries. For example in the United States a car costing over $30 000 is subject to additional tax on the difference between its price and this threshold.

The efficiency of tax collection should also be a consideration. It would be undesirable to have a system with excessive administrative costs. From this point of view it may be preferable to have fewer items subject to luxury tax at a higher rate, rather than a high number of items at a lower rate. We also recommend that below a minimum cost, no luxury taxes are levied.

Combining an extension in VAT zero-rating with increased VAT on luxury goods should mitigate the regressive burden of VAT without affecting overall government revenues.

4.8 Restructuring the GEPF

A third leg of the developmental fiscal package is to restructure the GEPF. The Presidential Jobs Summit agreed on the importance of reviewing the funding of public servants employees as a way to release resources to increase social spending. Most public service unions have supported this review.

The GEPF is a defined-benefit fund – that is, employees' benefits are guaranteed. If the GEPF's investments do not return enough to cover retirement costs, they must be met out of the budget. The evidence is that it would be cheaper to reduce the funding level of the GEPF and turn the funds to developmental uses, meeting the cost of pensions where necessary from the budget.

The GEPF is currently funded at between 80 and 96%, depending on the investment strategy. The level of funding has risen extraordinarily quickly since 1996, when it was at 60%. This indicates that the current rate of employer contribution – now at 15% of salaries, or about R9 billion a year – is too high.

In the light of this situation, a modest reduction in the level of funding could release substantial resources. The People's Budget proposes that:

- The employer contribution could be reduced to 12% of salaries. That will save a total of R1.5 billion a year

- The funding level could be reduced by 2%, or R3 billion a year, for the next three years, and the funds utilised for once-off investments in infrastructure and housing.

The total increase in funds available for other purposes would thus come to R4.5 billion a year for the next three years. A more substantial reduction in the level of funding, establishing a fully Pay-As-You-Go system, would release even more resources.

5 Budget reform

The transformation of the economy, and the assertion of democratic control over the allocation of public resources, depends to a great extent on the reformation of the budgeting process. Six years after the adoption of a new, democratic Constitution, Parliament – the primary mechanism for public engagement with policy development – still has no effective power to amend government spending proposals, in spite of a constitutional requirement that money bill amendment powers be extended to Parliament 'within a reasonable period'. If South Africa's transition to democracy is to be complete, it is essential that the process of allocating and appropriating public resources is opened to greater public participation. This includes the introduction of meaningful parliamentary money bill amendment powers.

Since late 1999, a group of civil society organisations has been meeting to consider various options for expanding opportunities for participation in the budget process, both by elected representatives and by the public at large. This process has resulted in the development of detailed proposals for budget reform, which have been developed by the Budget Reform Working Group (BRWG).[10]

The People's Budget has identified a number of basic principles which inform their common approach to budget reform. These include:

- 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
- Parliament must have adequate and appropriate research and analysis capacity to enable it to use its powers effectively
- Nedlac, and organs of civil society, must have structured opportunities to make substantive input on the budget
- 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.

Expanding on these principles, the BRWG has developed a framework for budget process reform that involves substantial reconfiguration of the budget process to enhance democratic oversight and input at all stages.

5.1 Medium Term Expenditure Framework reform

The Medium Term Expenditure Framework (MTEF) process is intended to cost major strategies and policies, to enhance public understanding of the aims of fiscal policy and corresponding resource allocations, and to give departments more stable allocations as an aid to medium-term planning.Unfortunately, the current MTEF system does not meet these objectives adequately. Instead, at the departmental level it has degenerated into a mere projection of annual budgets, with little link to strategic decision-making. This situation has arisen because:

- Departments must draw up an MTEF for all line items on their budgets, which distracts managers from more strategic issues around resource allocation
- The Department of Finance feels free to vary MTEF allocations each year, typically in response to changed deficit targets, so that the intended stability has not been achieved
- The MTBPS is presented as a final document, leaving little scope for public input and critique.

To remedy this situation, the BRWG has proposed:

- That the MTEF focus primarily on major projects and strategies, leaving other, routine activities to annual budgets
- That the MTEF be published as a draft, not a final document, to permit structured consultation at Nedlac, Parliament and in other structures.

5.2 Amendment powers of Parliament

One of the most contentious debates about budget reform revolves around the scope and timing of parliamentary amendment powers. Those who emphasise budgetary stability and the importance of technical management of the budget are inclined to want to limit Parliament's capacity to alter the Executive's budget. They fear that giving Parliament wide-ranging powers to alter the budget would invite populist grandstanding and a 'pork barrel' mentality as individual members try to ensure that their pet programmes receive funding. They point out the technical complexity of budgeting and wonder if parliamentarians have the capacity to assess the impact that changes in one vote will have on the programmes of another department.

In contrast, others argue that one of the fundamental functions of government is the collection and allocation of public funds. Other policy decisions are meaningless if there are insufficient resources – both financial and human – to realise the stated objectives. Consequently, this camp would argue that the legislature must exercise budgetary and financial powers commensurate with its legislative and policy-making powers. This implies that Parliament must be able to make fairly substantial changes in the budget, including changes in total spending – changes that have unavoidable implications for macro-economic policy.

The BRWG has endeavoured to chart a middle course between these two extremes. On the one hand, its members acknowledge the legitimacy of the 'technocrats' interest in defining a stable and efficient budgeting process which is not prone to being held hostage to political or other special interests of the legislature. (One scenario that the BRWG has considered, for example, the future possibility of a coalition government or hung Parliament. If Parliament enjoys extensive budget amendment powers, the budget could get enmired in party political disputes, leaving government paralysed.) On the other hand, members of the working group agree that Parliament must be able to have substantial influence on spending priorities, if there is to be meaningful democratic control over the deployment of public resources. This implies that Parliament must have the ability to amend the budget. The difficulty is to balance these competing objectives.

In an effort to do so, the BRWG has proposed a three-tiered model for interaction between the Executive and Parliament on budget matters. It has distinguished, first, between revenue and expenditure matters. It has further broken down areas of decision-making into different 'levels', each of which informs the parameters for the subsequent level. Level 1 decisions are of an overall macro-economic nature. Level 2 refers to the broad composition of expenditure and revenue within aggregate amounts. Level 3 relates to the structure and composition of particular taxes and expenditure line functions.

Box 8 presents this disaggregation schematically, identifying the types of decisions to be made at each level. The subsequent discussions propose appropriate locations, timing, and powers with respect to these decisions.

5.2.1 Macro-economic parameters

Key macro-economic issues with respect to the budget include the appropriate revenue:GDP, expenditure:GDP and deficit:GDP ratios. Apart from macro-economic issues which are clearly linked to expenditure or revenue, other macro-economic issues such as the level of inflation, interest rates, debt, and so on also need to be determined at this stage.

There can be a fine line between projections and targets. A projection implies something which is just extrapolated as an outcome of other decisions and factors, whereas a target implies a deliberate attempt to use policy tools to get a variable to a particular level. This can be seen as a continuum with most

Box 8: A three-tiered model for budgetary decisions

Level	**Revenue side**	**Expenditure side**
Level 1	Revenue:GDP ratio, real change in total revenue, *e.g. 25% 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*

macro-economic variables somewhere in between. There is also an element of choice as to which variables are targeted and implicitly prioritised, and which are left as an indirect outcome of our factors. Naturally certain variables, over which government has more direct control, better lend themselves to targeting.

Decision-making with respect to the above issues needs to balance:

- The prerogative of the Executive to take key decisions on macro-economic policy
- The right of the legislature to influence all areas of policy – including spending priorities – and to give direction to the bureaucracy
- The democratic right of stakeholders outside government to scrutinise, comment on and influence macro-economic policy and budget priorities in a formal and systematic fashion.

Currently, macro-economic policy is the preserve of Cabinet, the Department of Finance, and the SARB. More particularly, there is a sense that it is the Ministry and Department of Finance which have virtually complete control over this area, to the extent that it is, in practice, elevated to the status of a 'super-department'.

Macro-economic decisions should to be made prior to the presentation of, and debate around, the budget itself. If the only way to shape macro-economic 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 become perceived as a vote of confidence in the government. Unless there are two clearly separate mechanisms for commenting on macro policy and amending the budget, neither is likely to happen as long as there is a ruling party with a clear majority. This would also give some certainty to the process and focus budget debates on level 2 and 3 decisions rather than on broad economic policy.

The MTBPS is the most appropriate vehicle for debating macro-economic policy, provided that the debate is structured in a way that allows Parliament to be critical of the Department of Finance's proposals without appearing to be expressing a lack of confidence in the government. It is therefore proposed that the Department of Finance 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, the Department should table a draft, enabling MPs to hold public hearings and deliberate on it. The recently established Budget Committee provides an ideal institutional vehicle for this debate. The Budget Committee could then table a report in which it proposes amendments to the MTBPS.

The Department would subsequently table a revised MTBPS in Parliament. The Department would also be required to table a corresponding response to Parliament's report in which it indicates which of Parliament's recommendations have been incorporated, which have been rejected, and the reasons for such rejection. Parliament would then need to assess the Department's response and decide if its concerns have been adequately answered.

If Parliament feels its concerns have not been addressed, but its only alternative is to reject the MTBPS (an effective vote of no confidence in the government) than this is likely to be a largely academic exercise. The Department could be fairly certain that it could ignore Parliament's objections with impunity. Consequently, the BRWG has proposed a third option: Parliament should be able to vote simply to 'receive' the revised MTPBS. Such a vote 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 be satisfied with the revised MTBPS and vote to accept it, it would then be limited to exercising ordinary amendment powers with respect to subsequent (levels 2 and 3) budget decisions. In other words, it could shift within and between functions without revisiting macro-economic policy by changing the overall (level 1) parameters.

Should Parliament vote to 'receive' the revised MTBPS, a different, lagged model would come into play. In year one (i.e., the 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 macro-economic parameter by changing total spending.

The lagged model attempts to build stability into the system by limiting Parliament's overall amendment powers in a given year and promoting co-operative 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 National Treasury to take seriously Parliament's views in the intervening period so that the MTBPS of the following year is accepted, and the extraordinary amendment powers would not be invoked.

Parliament would also have the option of rejecting the MTBPS outright. In this instance, Parliament would not be bound by the MTBPS parameters in the forthcoming budget and would have immediate access to extraordinary amendment powers (including level 1). In practice, such a scenario is probably highly unlikely.

Agreement at one level should establish boundaries for decisions at subordinate levels. For example, if Parliament approves the macro-economic parameters of the MTBPS, it would not be able to make changes to the budget that failed to respect those boundaries.

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 the parameters for the following year, but comment formally on the outer two years. This would allow the MTEF to retain an element of flexibility. There may also be a need for an 'escape clause' to be built into the model to cover exceptional circumstances, for example a natural disaster or major exogenous shocks between the MTBPS and the budget.

5.2.2 Budget decisions

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 BRWG 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).

On the expenditure side, Parliament could put in selective bottom-line claims on expenditure as part of its report at the MTBPS stage. For example, Parliament could insist on a 3% real per capita increase in health spending, and the onus would be on the Department of Finance to either juggle expenditure or adjust macro-economic parameters to meet such claims. Possibly Parliament should be obliged to suggest mechanisms for funding such claims or trade-offs.

Further discussion is needed on the concept of a qualified freeze on spending in specific programmes, which could potentially be a useful tool. It should be possible to target a freeze as specifically as possible to avoid unintended negative consequences. However, it must be noted that in many departments, contracts (especially with employees) account for the bulk of spending. A freeze could thus only be applied to spending that is discretionary month-on-month, unless a special provision is made for example for top-level management.

On the revenue side, decisions during the budget stage would focus on the composition of revenue (what proportion should come from individuals vs. VAT vs. company tax, etc.), and on tax rates (how tax rates should be set for different income brackets in order to generate a certain aggregate amount of revenue). Given the recent record of under-estimation of revenue, an adjustment budget should be required if actual revenue deviates from projections by more than a certain percentage by the midpoint of the fiscal year.

5.3 Enhancing parliamentary capacity

5.3.1 Parliamentary research and analysis capacity

Parliament will require enhanced research and analytical capacity if it is to exercise its budgetary amendment powers responsibly and effectively. While Parliament itself is best placed to determine what form this increased capacity should take, the following points are relevant:

- Expert capacity will be particularly essential in areas such as macro-economic 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 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 has suggested that a 5-8% increase in Parliament's budget could build a good skeleton service.

5.3.2 The role of parliamentary committees

If Parliament is to fully engage budget issues, there must be a shift in emphasis (notably in terms of allocation of time) from debate in the House 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 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. For example, the Department of Transport could set out what they had proposed and the motivations for this, what the Department of Finance proposes giving them, and how the difference between this would affect infrastructure, traffic enforcement, commuter subsidies and each of the other programmes and functional areas within its ambit.

In October 2001, Parliament established an ad hoc Budget Committee. The precise powers and responsibilities of this committee are not yet clear. However, through interaction with departments, the Portfolio and Select committees should be empowered to make informed inputs to the 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.

5.3.3 The role of the NCOP and reform of provincial budgeting

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. This is one aspect of the budget process that requires considerably more discussion and consultation. Some of the matters that should receive special consideration in that debate include the following:

- Currently, the structure of budgets as well as variations in provincial budgeting and reporting make it very difficult to monitor total spending on provincial competencies. This needs to be revised in a way that, while respecting provincial autonomy, ensures that the proportion of expenditure/total amount budgeted for a particular function is indeed spent on it, irrespective of which sphere of government has competency
- The NCOP should hold hearings on provincial budgets, going through the major functions to make comparisons possible. These hearings should inform the decision on the division of funds between provinces and national budgets
- Provincial Finance and Public Accounts committees should play a larger role in holding provincial governments accountable
- Provinces should as far as possible use the same programme and portfolio structure. The Public Finance Management Act (PFMA) requires the National Treasury to provide these common formats but it is unclear what degree of uniformity will be required
- Provincial budgets should preferably be tabled on the same day as each other, or at least within the same week
- The Division of Revenue Bill should be tabled and passed before both national and provincial budgets
- Parliament should try to ensure standard publication formats and timetables for parliamentary budgets, if at all possible
- Steps should be taken to improve the capacity of both provincial exchequers and legislatures.

5.4 Creating opportunities for broader engagement

5.4.1 Nedlac

Nedlac should be able to engage substantively with the budget process in a way which complements the role of elected representatives.

The Public Finance and Monetary Chamber of Nedlac (possibly with the addition of representatives from the Community Constituency for the purposes of the budget process) should engage with the budget throughout the cycle and should be able to deal with all three years of the MTEF. Both level 1 and level 2 decisions should fall within Nedlac's ambit, as do certain level 3 decisions, such as tax rates and expenditure allocation within functions. Nedlac should be involved in all important aspects of the MTEF, and specific sites of intervention in the budget cycle could include the following points:

- Prior to the presentation of the draft MTBPS, the

Department of Finance could present its macro-economic projections (growth rates, etc.) for the next three years to Nedlac. Nedlac, or its constituencies, could mandate independent analysis and projections, and there could be engagement within the chamber around what projections are realistic and / or desirable, with an emphasis on the coming year

- The draft MTBPS could be tabled at Nedlac. Constituencies would then table inputs focusing on macro-economic parameters. At this point 'bottom-line claims' could also be put in around level 2 and 3 aspects of expenditure and revenue. The onus would be on the Department of Finance to accommodate these. For example, constituencies – or at least labour, business, and community – could agree that spending on economic infrastructure should increase by at least 5% in real terms. The intention would be to negotiate constituencies' positions to reach, if not consensus, then agreement on the bands within which key parameters should fall. Such agreements would then inform the final MTBPS
- The final MTBPS could then be tabled at Nedlac. As in its presentation to Parliament, the Department could be required to indicate to what extent it has incorporated Nedlac agreements / constituency proposals, and if not, why not
- After the presentation of the budget, constituencies could table their inputs to Nedlac focusing on level 2 and 3 decisions. Constituency proposals would be forwarded to the relevant portfolio committees and the Budget Committee to inform their deliberations
- At some (early) point during the budget cycle Nedlac could also address itself to significant definitional issues (for example the classification of personnel vs. current expenditure, or the definition of the deficit) and propose more appropriate standards of measurement and presentation.

Nedlac's role should be explicitly spelled out in the Money Bills Amendment Procedure Act.

5.4.2 Civil society

In the medium to long term, opportunities should be created for the structured participation of civil society in the budget process along the lines of the poverty hearings. Organs of civil society (as well as individual community members) have valuable inputs to make in terms of their needs, expenditure priorities, and problems in current programmes. This information would not only improve the quality of the budget but give people a sense of ownership of the budget. Interaction could take the form of hearings on particular functions in particular provinces on an annually rotating basis (e.g. one year the Eastern Cape could deal with health, Northern Cape with water, Gauteng with education, etc. and the following year each province would deal with a different function).

In the short term, there would be two main ways that civil society organisations could influence the budget process if the BRWG's proposals are adopted. First, they would be able to make submissions to Parliament itself at the various stages of the budget cycle. Once Parliament has meaningful amendment powers, this would become a worthwhile process. Second, there would be opportunities for input through Nedlac. The youth, rural, disabled and women sectors that currently sit only in the Development Chamber, should also be invited to participate in budget deliberations in the Public Finance and Monetary Chamber.

6 Building capacity to implement a developmental strategy

Significant improvements must be made in government's capacity and capabilities if it is to be able to intervene decisively to support the proposed development strategy. Many positive steps have already been taken towards transforming the public sector. In short, however, we must not only spend more, but also spend better.

In this section, we examine two key issues:

- Underspending
- Developing a strategic role for state-owned enterprises.

6.1 Spend well!

Various factors inhibit the ability of departments to spend their budgets effectively. These include: systemic weaknesses in conditional grants, lack of appropriate management skills, excessive reliance on private partners, the procurement system, and the broader effects of fiscal restraint.

Reliance on private partners: A central reason for the inability to spend resources is the increasing dependence on private actors to deliver services. Part of the problem lies in lack of experience and systems to manage these relationships. The management of contracts is a specialised skill. Even with a strong skills development strategy, it will be several years before a corps of skilled contract managers emerges. Even if this can be accomplished, improved capacity will not guarantee the success of a strategy that relies on private partners. As the arms deal has shown, public-private partnerships are likely to invite questions about the probity of politicians. Valid or not, such debates consume resources and undermine confidence in the public service. Furthermore, the South African private sector often lacks capacity to meet contract requirements.

Systemic weakness in conditional grants: 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.

Management skills: The public service currently lacks a corps of skilled project managers to design, implement and monitor infrastructure extension projects. This obstructs forward planning (i.e. planning before the actual allocations are made), slows implementation and often causes project breakdown.

Multi-year projects: Many projects run over several years. Whilst the MTEF encourages multi-year planning and budgeting, departments are often not aligning projects to budgets. Government officials in the infrastructure departments argue that the budget is still too rigid to support long-term project planning.

Design of project systems: Project design is often complicated by the need to prevent corruption and misuse of funds. All too often, however, these safeguards prevent any spending at all. The Poverty Relief programme illustrates the problem. Before anti-poverty funds could be disbursed, three sets of contracts had to be drawn up – between the Departments of Welfare and Finance, between the Department of Welfare and the project managers, and between the project managers and the recipient communities.

Procurement systems: Procurement is plagued by similar delays. The government tender process can delay major expenditures by three to six months or more. In 1998, the Presidential Review Commission had to terminate all its work and start it over because the Tender Board argued it had not followed the proper tender procedures in hiring consultants. 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.

Fiscal restraint: 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.

6.2 Strategic role for state-owned enterprises

Over the last year, the role of state-owned enterprises has come under the spotlight. The issue has both a fiscal and delivery dimension. In his Budget Speech (2001), Minister Manuel said:

> *… [a]fter taking account of our spending proposals and revenue estimates, there is a budget deficit of R24,9 billion to finance next year, or 2.5% of GDP.* ***We expect to finance the deficit largely through restructuring proceeds.*** *(Emphasis added.)*

This acknowledgement comes as a surprise, as government officials have been at pains to claim that the restructuring of state-owned enterprises is not a 'fire sale'. In other words, it is not about the short term raising of resources, but about repositioning state enterprises to play a developmental role. Now the National Treasury is proposing to use the proceeds of restructuring as a short-term facility for debt financing.

The debate on the restructuring of state assets must continue. The central focus, however, should be on increased and equitable service delivery and not on raising resources to reduce the debt. In section 4, we propose ring-fencing as an alternative method of dealing with the apartheid debt.

7 Conclusion

By submitting our proposals a year in advance we are opening space for a dialogue between all sections of South African society on fiscal matters. The creation of a participatory budget is a cornerstone of our work. Our proposals have sketched expenditure proposals, revenue proposals and ways to improve the capacity of the public sector. These proposals are not meant to be exhaustive, and greater specificity on costing will be needed. These proposals have been guided by our understanding of a developmental budget. We look forward to engaging government on our proposals.

Selected References

African National Congress.

1994: The Reconstruction and Development Programme: A Policy Framework. Umanyano: Johannesburg.

1999: Report of the National General Council.

Cilliers, J. 1998. Defence Acquisitions – Unpacking the Package Deals. ISS. Johannesburg.

Cosatu.

1999. Proposals to NEDLAC Public Finance and Monetary Chamber on Increasing the Progressivity of Elements of the Tax System (www.cosatu.org.za).

2000: Response to the 2000/2001 Budget (www.cosatu.org.za).

2000: Submission to the Social Security Committee (www.cosatu.org.za).

Department of Finance.

1996. Growth, Employment and Redistribution: A Macro-economic Strategy. Pretoria.

1998: Medium Term Review Report on Infrastructure.

2000: Budget Review (2000). Pretoria.

2000: National Expenditure Survey. Pretoria.

Economic Policy Research Institute (EPRI). 2002. Research Review on Social Security Reform and the Basic Income Grant for South Africa.

Geffen, N. 2000. Cost and Cost-Effectiveness of Mother-to-Child Prevention of HIV (emailed copy).

Hassen, E.K. 2000. When More Means Less: Low-Income and Housing and Macro-Economic Policy. Isandla Institute and WITS Public and Development Management Project on Housing. National Labour and Economic Development Institute. Johannesburg.

2001: Lessons in Acceleration: Assessing Service Delivery in South Africa (draft).

Hensher, M. 2000. Confidential Briefing: The costs and effectiveness of using NVP or AZT for the prevention of mother-to-child transmission of HIV – current best estimates for South Africa. Health Financing & Economics (confidential document, 19 April 2000).

Haarman C., Haarman D. 1998. Towards a comprehensive social security system in South Africa. Working Paper prepared for the Congress of South African Trade Unions.

Haarmann, C. 2000. Social Assistance in South Africa: Its potential impact on poverty. Report submitted in partial completion of a doctorate. Research Monograph No. 21. Applied Fiscal Research Centre. Cape Town.

2001: Poverty and the Current Social Assistance Programmes in South Africa.

Hensher, M. 2000. The costs and effectiveness of using NVP or AZT for the prevention of mother-to-child transmission of HIV – current best estimates for South Africa. Department of Health. Health Financing & Economics, 19 April, 2000.

People's Budget. 2000. Response to the Medium Term Budget Policy Statement (2000).

Ramos, M. 2000. Presentation to the NEDLAC Public Finance and Monetary Chamber at the Metal Box Centre in October 2000.

South African Health Systems Trust. 1996. South African Health Review. South African Health Systems Trust. South Africa.

United Nations Development Programme. 2000. South Africa: Transformation for Human Development (2000). United Nations Development Programme. Pretoria.

South African Reserve Bank. Quarterly Bulletin, June 2000.

Statistics South Africa. 1999. October Household Survey (1999) Statistics South Africa. Pretoria.

Background papers prepared for the People's Budget Process

Hassen, E.K. 2001.Free Basic Water National Labour and Economic Development Institute. Johannesburg.

Sampson, M. 2001. Macroeconomics. Economic Policy and Research Institute. Cape Town.

Mayson, D. 2001. Comment on an alternative land reform budget for the People's Budget Campaign.

Appendix

VAT rates across countries[11]

Region/country	Lower rates (%)	Standard rate (%)	Higher rate (%)
Western Europe			
Austria	10; 12	20	
Belgium	0; 1; 6; 12	21	
Denmark		25	
Finland	0; 5; 6; 12; 17	22	
France	2.1; 5.5	20.6	
Germany		15	
Greece	4; 8	18	
Holland	0; 6	17.5	
Italy	0; 4; 10; 16	19	
Luxembourg	3; 6; 12	15	
Portugal	5; 12	17	
Republic of Ireland	0; 3.3; 12.5	21	
Switzerland	0; 2; 3	6.5	
United Kingdom	0; 8	17.5	
Asia			
China	0; 6; 13	17	
Indonesia	0; 5	10	15
Japan	0	5	
Korea	0	10	
Singapore	0; 1	5	25
Australasia			
New Zealand	0	12.5	
Africa and the Middle East			
Algeria	7; 13	21	
Israel	0	17	
Ivory Coast	0; 11.11	20	
Kenya	5	15	25
Malawi	0	20	
Nigeria	-	5	
Turkey	0; 1	15	40
Zambia	0	17.5	
South Africa	0	14	
South America			
Argentina		21	27
Brazil	7; 12	18	25
Mexico	0; 10	15	
North America			
Canada	0	7	

End notes

1 Unless otherwise noted, information on financial flows, interest rates, savings and investment are from SARB 2001.

2 A quintile represents 20% or one-fifth of a particular population. Table 6 looks at households, so the first quintile represents the poorest 20% of households, while the fifth quintile represents the wealthiest 20% of households.

3 Success here means the ability to create a sustainable livelihood.

4 Some of the former homelands did not have municipalities and thus provided municipal services directly. These areas were known as R293 towns, after the proclamation that established them. In 1994, R293 towns and their functions were transferred to provinces with the intention of integrating them into local governments. Since then, the national government has budgeted a separate allocation to support the transfer of these functions and personnel from provinces to municipalities.

5 CASE survey.

6 Child Health Unit and Health Systems Trust in 1996.

7 See Archbishop Njongonkulu Ndungane's address 'Seizing the new Millennium: Reshaping the World's Economy' (1997); Cosatu's 'Social Equity and Job Creation' (1996); and AIDC's 'Challenging Apartheid's Foreign Debt' (1997).

8 Basic food items that are zero rated are: brown bread, maize meal, samp, mealie rice, dried mealies, dried beans, lentils, pilchards / sardines in tins, milk powder, dairy powder blends, rice, vegetables, fruit, vegetable oil, milk, cultured milk, brown wheaten meal, eggs, edible legumes and pulses of leguminous plants. The number of zero-rated items has varied from time to time. The current list arose with the increase in the VAT rate from 10-14% in April 1993.

9 This ratio indicates the relative importance of a good in the budget of the lowest income bracket as compared to the budget of the highest income bracket.

10 Organisations represented in The People's Budget Campaign also participate in the BRWG. The People's Budget Campaign acknowledges the work of the BRWG in the formulation of these proposals.

11 SOURCE: Deloitte and Touche (1997). 'VAT Handbook'. In most cases, a zero-rating relates to exports and basic food items, and sometimes to clothing.