Tinkering at the margins of GEAR?
A review of the economy

Wolfe Braude
Introduction

This chapter of the review seeks to outline economic developments and changes to economic policy within the review period by examining broad themes that run through economic life in South Africa. Ensuring broad-based economic development, creating jobs and improving incomes remained the principal challenges of the ANC government during this period. The government’s response to these challenges likewise remained the Growth, Employment and Redistribution Strategy (GEAR), adopted in 1996. With a restrictive fiscal policy and a commitment to free market principles, GEAR is not very different from a standard International Monetary Fund/World Bank structural adjustment programme, and is, in fact, a policy that owes much to the ‘Washington Consensus’. While slightly more varied than traditional IMF programmes, there are similarities between GEAR and the neo-liberal model (Mather and Adelzadeh, 2000:2), and GEAR’s main tenets and its current approach to the South African challenge reinforces such a description, namely:

- budget reform to strengthen the redistributive thrust of expenditure within deficit targets;
- fiscal deficit reduction across government to contain debt service obligations, counter inflation and free resources for investment;
- an exchange rate policy of keeping the real effective rate stable at a competitive level;
- consistent restrictive monetary policy to prevent a resurgence of inflation;
- gradual relaxation of exchange controls with a view to their removal;
- tariffs reduction to contain input prices and facilitate industrial restructuring, compensating partially for exchange rate depreciations;
- tax incentives to stimulate new investment in competitive and labour-absorbing projects;
- restructuring of state assets to optimise investment resources;
- an expansionary infrastructure programme to address service deficiencies and backlogs;
- structured flexibility within the collective bargaining system;
- a strengthened levy system to fund training on a scale commensurate with needs;
- an expansion of trade and investment flows in Southern Africa; and
- a commitment to the implementation of stable and co-ordinated policies.

As has been extensively noted by government, these policies were expected to produce growth and economic expansion adequate to addressing South Africa’s socio-
economic backlogs while also reducing unemployment and providing employment for new entrants to the labour market. However, the reality from 1996 to 2002 was that while certain of GEAR’s technocratic targets were met, and a measure of economic stabilisation was achieved, the end result remained sluggish growth and only slight poverty reduction. South Africa’s GDP growth has remained around 3 per cent, and as the 1996 GEAR strategy document itself noted, a growth trajectory of 3 per cent per annum would “fail to reverse the unemployment crisis in the labour market; or provide adequate resources for the necessary expansion in social service delivery; or yield sufficient progress toward an equitable distribution of income and wealth” (GEAR:1996).\(^1\) These failures are clear when key indicators and their performance against the targets set by GEAR are examined.

<table>
<thead>
<tr>
<th>TABLE 1: GEAR PROJECTIONS AND ACTUAL ACHIEVEMENTS, 1996-1999</th>
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<tr>
<td><strong>Annual average, 1996-1999</strong></td>
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<tr>
<td>Fiscal and Monetary Variables</td>
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<tr>
<td>Fiscal Deficit (per cent GDP)</td>
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<td>Real govt consumption (per cent GDP)</td>
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<td>Inflation (CPI)</td>
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<td>Real bank rate</td>
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<tr>
<td>Real Variables</td>
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<tr>
<td>Real private sector investment growth</td>
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<tr>
<td>Real non-export growth</td>
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<tr>
<td>GDP growth</td>
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<tr>
<td>Average tariff as per cent of imports</td>
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<tr>
<td>Annual change in formal, non-agricultural employment</td>
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<tr>
<td>Income Distribution</td>
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<tr>
<td>Gini</td>
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<tr>
<td>Source: Seidman-Makgetla (2001)</td>
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</tbody>
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While GEAR has been successful in the areas of fiscal restraint, tariff reductions, and inflation control, it has been very weak in the real economy.

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\(^1\) GEAR does not include projections of changes in inequality or poverty, and indeed makes no mention of inequality at all. However, Weeks (1999:801, cited in Carter, May and Padayachee:2002) suggests that the recommended growth scenario contained in GEAR implied increasing inequality.
Limitations of GEAR

Rather than meeting the growth challenges facing the country, the GEAR policy has been useful only as a stabilisation package, in order to correct the more obvious monetary and fiscal policy imbalances of the Apartheid era and prevent further economic decline, and has done little more than orient the country toward limited growth and industrial competitiveness. It has failed in its efforts to produce the substantial growth envisaged by its designers, and has failed in terms of large-scale poverty alleviation. In a country facing lesser challenges than South Africa, this may have been satisfactory, given that South Africa's growth rate during a period of protracted weakness in the global economy since 1998 has been stronger than in most other developing nations. However, the unique challenges of the post-Apartheid period faced by the new democratic state call for innovative solutions and policy options.

GEAR has often been fiercely attacked for what are seen as unrealistic projections, with both labour and civil society calling for re-analysis of its central tenets. These calls were strengthened by the seeming inability of GEAR to do more than safeguard weak economic growth and the socio-economic status quo, rather than making significant inroads into infrastructural backlogs, unemployment and poverty.

The GEAR policy parameters have achieved some degree of success in decreasing the inflation rate, with most financial commentators expecting the long-term trend to bring inflation to close to 7 per cent by 2003. Government dissaving has been steadily reduced, with a concurrent reduction in the annual deficit to within the targets set by GEAR. In the context of the financial laxity of the Apartheid regime, and its abuse of public spending for political purposes, the reduction in government dissaving has been a remarkable achievement. However, the Congress of South African Trade Unions (COSATU) and organisations such as the South African Council of Churches have noted that these measures have often come at the expense of spending on, for example, social services and poverty reduction. Tax reform has proceeded apace, with increased revenue from improved individual and company collection continuing throughout this review period, reflecting a trend of 11.6 per cent average main budget revenue growth since the 1999/2000 budget, which has allowed the Minister of Finance to implement successive tax cuts within the budget since 1999. Labour economists such as Neva Makgetla of COSATU have noted that although such cuts are aimed at encouraging domestic consumption and saving, they do not necessarily benefit those outside of the formal economy, where poverty is concentrated and where wages exist below the threshold for personal income tax, thus remaining outside of the tax cut net. Tax cuts therefore benefit the middle and upper classes, and not the poor. This is in line with GEAR's political constituency, which appears to be the middle and upper class minority of the South African population, which is well-mobilised within the private and public sectors, and enjoys the support of global capital.
However, the successes noted above have been overshadowed by the now obvious limitations of current macro-economic policy. Government has also consistently refused to enter into debate over the premises, successes and failures of GEAR, and the policy has to date been described as ‘non-negotiable’. Before examining examples of alternative policy choices proposed by, inter alia, COSATU, it is useful to note some of the ongoing limitations and miscalculations of GEAR. While some of these factors have been outside the control of Government, this has only served to reinforce persistent calls for more flexibility in macro-economic policy, which by definition would require a frank and open discussion.

Private sector investment, domestic savings, foreign direct investment, small business support, employment growth, industrial incentives, public sector restructuring and tariff reductions have all failed to fulfil the projections of the model. Private sector investment has remained low, with unions such as the National Union of Metalworkers of South Africa (NUMSA) and the National Union of Mineworkers (NUM) describing it as a conscious decision, or a ‘domestic investment strike’. Other civil society stakeholders such as the South African National NGO Coalition (SANGOCO) and the National Labour and Economic Development Institute (NALEDI) have noted that the decision to allow some of South Africa’s largest firms to list overseas in effect condones a form of regulated ‘capital flight’. Domestic savings remain low (25 per cent is viewed as necessary to stimulate growth, but savings have not risen above 18 per cent), while the continuing medium levels of tax on savings interest and pensions discourages saving. Foreign direct investment (FDI) has remained conspicuously low\(^2\), notwithstanding attempts to secure FDI through GEAR’s investor-friendly policies which include the lowering of tariffs in most sectors and the ongoing withdrawal of the state from the market, often evidenced by reductions in social spending.

The lowering of tariffs has often been deliberately implemented as a ‘big bang’ or ‘sharp shock’ process, in the erroneous belief that in certain industries such shocks will encourage increased competitiveness. Instead of a phased process such as that favoured in the automotive sector, sectors such as clothing and textiles were hit by a rapid reduction in tariffs, with resulting massive job losses. The Minister and the Department of Trade and Industry were responsible for these short-sighted decisions, which ignore the experience of other developing countries, but follow the policy models of the IMF and the World Bank. As is often the case with GEAR, policy purity was elevated above international experience and employment-friendly scenarios.

\(^2\) The 1998 World Investment Report showed that South Africa attracted a mere $380 million in foreign direct investment compared to Brazil’s $29 billion and Australia’s $6 billion (Sowetan, 22 May 2000).
Although GEAR’s supposed investor-friendly policies have been rigorously applied, they have not resulted in increased investment, highlighting calls by critics to focus instead on growth.

The consistently high interest rates in the review period have reduced the rate of return from long-term fixed investments, attracting short-term speculative capital inflows only. Small business support and industrial incentives have been criticised for their limited scope and poor implementation, and neither have unlocked growth as anticipated. These failures have occurred in the context of increasing liberalisation and concomitant vulnerability of the South African economy.

Public sector restructuring continued through the review period, with Telkom’s initial public offering close to realisation, and increased efforts to part-privatise productive elements of Spoornet. A 20 per cent stake in M-Cell was transferred in January 2002 from Transnet to an offshore passive holding company, and has been sold to MTN management and staff. For 2003/2004, proposed restructuring projects include the planned concessioning of the Durban port container terminal, sale of a 30 per cent stake in Denel to British Aerospace, sale of 30 per cent of Eskom’s generation business, transformation of the electricity distribution industry under the management of an Electricity Distribution Holding Company, disposal of a 51 per cent stake in the Western Cape Safcol forests and completion of the sale of Aventura resorts.

The emphasis on restructuring, as a number of critics have pointed out, has not been of benefit in addressing either poverty reduction or general empowerment, with the real rewards being reaped by both elite black empowerment interests and traditional white capital. Rather than repositioning state enterprise to play a developmental role, the proceeds will be used to reduce government debt, with a large part of the proceeds being absorbed by the increasing costs of the new defence procurement package, and by ongoing tax cuts. Restructuring has led to continuing job losses, as well as large injections of taxpayers funds to ‘polish’ the assets in order to make them attractive to prospective buyers. Anti-restructuring activists such as the Anti-Privatisation Forum note that alternative approaches to achieving debt stability and operational efficiency are ignored by government, reinforcing criticism that the restructuring is influenced by private sector pressure for control of the most profitable state assets, and is both short-sighted and unsustainable. It is, however, in unemployment and poverty reduction that government is most heavily criticised, with GEAR’s policies unable to provide adequate resources or the economic dynamism necessary to reduce poverty and rapidly expand the economy. Such policies have served to reinforce what economist Sampie Terreblanche calls the ‘capitalist enclave’ of the economy, increasing the profitability of the existing largely white, wealthy formal sector ‘enclave’ whilst providing minimal absorption or inclusion of the largely poor, black, informal and unemployed sector. The ‘elite compromises’ made by the
new black elite with the corporate sector and its global partners have now trapped policy-making within narrow ‘anti-poor’ parameters (Terreblanche, 2002:422).

There are suggestions, however, that GEAR has lost its appeal even for government, as evidenced in the shift from ‘stabilisation’ to increasing social spending. That government is now calling this phase from 2001 on the ‘growth phase’ may indicate an increasing realisation that GEAR is not able to provide more than stabilisation in its current form. Critics such as NALEDI and the Community Agency for Social Enquiry (CASE) believe that an entirely new economic approach to poverty and joblessness is required, rather than expansionary tinkering with GEAR. With the third democratic elections in early 2004 and clear evidence that poverty and joblessness are increasing, the government is coming under renewed attack for its unilateral stance on macro-economic strategy.

The state of the economy

Key economic indicators

The South African economy grew slowly and inconsistently over the 2001 and 2002 period, and growth rates are expected to remain within a range of 2-4 per cent over the 2003/2004 period, as shown in Table 2 below.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2000/01</th>
<th>2001/02</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>3,4 per cent</td>
<td>2,2 per cent</td>
<td>3 per cent</td>
<td>3,3 per cent</td>
<td>3,7 per cent</td>
<td>4,0 per cent</td>
</tr>
<tr>
<td>Main budget revenue</td>
<td>213,4</td>
<td>248,4</td>
<td>275,7</td>
<td>304,5</td>
<td>331,0</td>
<td>361,2</td>
</tr>
<tr>
<td>Main budget expenditure</td>
<td>235,0</td>
<td>262,6</td>
<td>291,8</td>
<td>334,0</td>
<td>363,3</td>
<td>395,6</td>
</tr>
<tr>
<td>Main budget deficit</td>
<td>-18,3</td>
<td>-14,6</td>
<td>-16,1</td>
<td>-29,5</td>
<td>-32,4</td>
<td>-34,4</td>
</tr>
<tr>
<td>Deficit as per cent of GDP</td>
<td>2,0 per cent</td>
<td>1,5 per cent</td>
<td>1,4 per cent</td>
<td>2,4 per cent</td>
<td>2,4 per cent</td>
<td>2,3 per cent</td>
</tr>
<tr>
<td>State debt cost</td>
<td>46,3</td>
<td>47,5</td>
<td>47,3</td>
<td>51,0</td>
<td>53,1</td>
<td>55,1</td>
</tr>
</tbody>
</table>

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1 Projected figures for forthcoming reporting periods of 2003/2004 to 2005/2006 under the MTEF.
As the above figures show, government has apparently succeeded in its stated goal of fiscal stabilisation and consolidation within the GEAR macro-economic framework, with the budget deficit gradually being reduced from 4,6 per cent of GDP in 1996/1997 to 1,4 per cent in 2002/2003. Another indicator of this successful commitment to fiscal austerity is the drive to reduce the debt burden faced by the state. State debt costs as a percentage of GDP have shrunk from 5,5 per cent in 1999/2000 to a projected figure of 4,1 per cent in 2003/2004, a reduction that is expected to release an additional R10 billion in potential spending. This spending restraint is an effort to move South Africa away from a reliance on borrowing, and to reduce the legacy of excessive borrowing that characterised the latter years of the Apartheid state. Servicing the debt absorbed 16-18 per cent of the available budget in 2001 and 2002. However, the cost of a targeted debt reduction strategy under GEAR has been deferred poverty alleviation, with spending on services and delivery taking second place to fiscal austerity.

What is of interest is to examine the apparent ‘growth-oriented’ nature of the annual budgets since 2000/2001, which marked the start of a supposedly more expansionary budget process, although the expansion has been tightly controlled and limited, and which continued through the 2001/2002 and 2002/2003 budgets. This has been characterised by a commitment in principle to improved spending, increases in infrastructure allocations and ongoing tax reform.

It was expected that with GEAR, growth rates would climb steadily toward the 6 per cent mark by the year 2000. This has not happened, and a sluggish growth rate that had reached only 3,4 per cent by 2000/2001, has given rise to increasing rather than decreasing poverty and joblessness. Within this context increased spending may have been mooted, and expansion has been limited to the space afforded the Finance Ministry through improved revenue collection by the South African Revenue Service (SARS). In other words, the state has not relaxed fiscal discipline, with
ongoing efforts to cap the deficit at under 3 per cent. Critics question the wisdom or necessity of pursuing such Eurozone spending restraints in the face of significant unemployment and poverty within the South African scenario.

In short, although the budget has been labelled as expansionary, it is only expansionary in the sense that the additional revenue created by increased tax collection has been earmarked for social spending rather than further debt reduction. It must be noted, though, that a sizeable percentage of the increased revenue has been allocated to tax relief, which is expansionary for demand but does not strictly fall under poverty relief. The underlying premise of cost management and deficit reduction has been maintained, and this approach has inherent limitations of sustainability (since revenue may not maintain the same rate of increase) and inflexibility (since expansionary projects such as a universal poverty grant are disallowed). Furthermore, many of the increases are only just above inflation, meaning that increased spending in real terms is slight.

**Investment**

Since 1994, there has been much discussion about the need to attract Foreign Direct Investment (FDI) and at times this quest is pursued as if it is an end in itself. Both business and government have been emphatic about the need to secure foreign investment and the accompanying need to establish a secure and stable investment climate. South Africa’s need for FDI is underscored by the fact that it has a poor savings rate of 16 per cent of GDP (2001), which falls far short of the kind of investment needed to support sustained growth. With reference to GEAR, government had indicated that in order to achieve six per cent GDP growth a year, South Africa required FDI of four to five per cent of GDP (or R22-R28 billion in 1997 alone). Real levels of FDI have, however, fallen far below these expectations (Soyode, TIPS, 2001), averaging around one per cent a year.

What is not often mentioned is that FDI usually plays a secondary role in the development case studies of fast-growing developing countries. FDI usually does not exceed even 10 per cent of total investment, while the average is often around 5 per cent, and in most cases, the country concerned has succeeded in first promoting and harnessing domestic investment. The issue of FDI is important in terms of access to new technology, production processes and management styles but must not be misconstrued as a universal panacea. Chief economist of Standard Bank, Iraj Abedian, contends that countries such as South Africa should rather concentrate on improving the environment for investment and functioning of markets (Business Day, 6/2/2003). Investment follows growth, and is attracted by the positive returns that growth of over 5 per cent can provide. How this growth is achieved in respect of policy and politics is often of secondary concern, as is evidenced by the flood of investment to China, where the state has a policy of directly underwriting the debt of certain key sectors of industry, along with a number of other highly interventionist
practices. While such policies directly contradict GEAR’s prescriptions and indeed those of neo-liberal economics as a whole, this has not deterred investors from neo-liberal economies such as the United States and the United Kingdom from investing heavily in the Chinese market. China’s ongoing rapid growth rate promises good returns, regardless of policy bias. Another example is the fact that South Africa attracted FDI right up until disinvestment campaigns curtailed it in the 1980s, yet the National Party’s economic policies were highly interventionist and badly managed compared to South Africa’s current fiscal oversight and regulatory regime. The lesson here is that strictly adhering to GEAR-type strategies is not a magnet for investment, but rather perhaps an enabling environment for securing cheap international credit, thus leveraging borrowing rather than FDI or rapid domestic growth.

Probably the largest source of current and future FDI in South Africa is leveraged FDI, such as through the arms offset deals (these deals were for industrial offsets tied to the purchase of arms by the South African government) and the privatisation of state assets. Both are short-term methods of securing FDI, and neither inherently drives sustainable GDP growth. Abedian observes that the country needs skilled people far more than it needs FDI, and that a country cannot afford to base its economic growth on FDI alone, as this type of investment is fickle and highly dependent on the self-interest and shifting priorities of the would-be investors. It often constitutes speculative investment in equities, government bonds and currency trading, rather than fixed investment in industry, services or agriculture.

Current inflows of FDI are also due in part to the prevalence of high interest rates during the review period. High interest rates attract foreign capital, and South Africa’s interest rates remained higher than those of its main trading partners during 2001 and 2002. These high interest rates strengthened the Rand, and were in part maintained in order to stabilise the currency as well as reduce inflationary pressures so that the Reserve Bank’s inflation targets of 3-6 per cent could be met. In much the same fashion, the government hopes that its continuing relaxation of exchange controls will lead to increased investment, because investors seemingly have fewer restrictions imposed on their withdrawing capital from the country, and so feel more comfortable in investing. However, this is no guarantee of investment and often merely increases the vulnerability of a country to rapid changes in largely speculative investment. The Treasury itself notes in its 2002 overview that international financial volatility is ongoing. A good example of the negative impact on a national economy by sudden reversals in FDI is seen in the East Asian crisis of 1998, demonstrating that exchange controls do not deter investors – low rates of growth do.

A further upgrade in the nation’s international investment rating was announced during 2001/2002, but investor perceptions around long-term stability are interlinked with current levels of poverty and social ills such as HIV/AIDS and crime. Without determined efforts to reduce the impact of these issues, both domestic
and foreign investment may remain low. This is due to the fact that rates of return on fixed investment are only secured over fairly lengthy periods, for example, three to ten years and for such returns to be consistent, social stability is required.

South Africa has re-entered the international economy at a time of growing competitiveness for investment flows, with increased globalisation expanding investment opportunities internationally for South African firms. Government’s willingness over the review period to allow some of South Africa’s largest multinationals to secure primary listings in foreign stock exchanges contributed to a decrease in available investment. Such primary listings are a form of regulated capital flight, and although dividend payouts to South African shareholders may lead to increased inflows of return investment, it is likely that by 2003 levels of capital outflows linked to these listings will put pressure on the national balance of payments (as shown in Table 3 below) as levels of ownership by foreign nationals in these enterprises increase (Walters and Prinsloo, 2002:6). South Africa will have to export more in order to cover the payments shortfall, thus undermining the benefits of GEAR’s export-led growth premise. The net result is that government allows big capital’s interests to override GEAR’s rules when it helps big business, but refuses the flexibility needed to help the poor.

**TABLE 3: INTERNATIONAL DIVIDEND FLOWS OF SA COMPANIES LISTED IN LONDON**

<table>
<thead>
<tr>
<th>Period</th>
<th>Paid*</th>
<th>Received**</th>
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<tbody>
<tr>
<td>1998</td>
<td>592</td>
<td>136</td>
</tr>
<tr>
<td>1999</td>
<td>2 131</td>
<td>2 131</td>
</tr>
<tr>
<td>2000</td>
<td>9 849</td>
<td>4 992</td>
</tr>
<tr>
<td>2001</td>
<td>13 183</td>
<td>6 091</td>
</tr>
</tbody>
</table>

* Dividends declared by South African subsidiary companies to their London-listed parent companies.  
** Dividends declared by London-listed companies to their South African shareholders.  

Source: Walters and Prinsloo:2002

There is disagreement as to whether continued low levels of domestic investment constitute an ‘investment strike’, or reflect an unavailability of investment opportunities. That the funds for investment exist is evidenced by the fact that South African companies invested approximately R77 billion in outward investment (outside of South Africa) between 1994 and 1998, while simultaneously domestic

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4 Foreign ownership had grown to an average of 63 per cent for these large listings in 2001.  
5 Some estimates place this as high as R92 billion between 1991 and 2001.
fixed private sector capital formation experienced a slump. Towards the end of the review period, there was a call from Labour for a reintroduction of prescribed assets of around 5 per cent within the financial sector, in order to direct existing investment toward fixed assets rather than equities. This is not a new phenomenon, as the Apartheid government introduced prescribed assets of up to 25 per cent in order to stabilise government bonds.

Inflation targeting

In the course of 2002, the CPIX, which is the inflation rate that defines government's inflation targets, rose by 11.8 per cent in the year to September, up from 5.8 per cent in September 2001. Producer price inflation, which reflects increases in the prices of goods in domestic production, rose by 15.4 per cent in the year to September 2002, up from 7.8 per cent in September 2001. This was a set-back for the inflation reduction objectives agreed upon by government and the Reserve Bank (National Treasury, 2002:21), and in response, the Reserve Bank raised interest rates by four percentage points during 2002.

The rise in interest rates was largely due to imported inflationary pressures following the sharp depreciation of the Rand in the fourth quarter of 2001. The Rand, however, surged more than 34 per cent in 2002, making it the world's best-performing currency, after a fall of more than 37 per cent the previous year, when it was the worst performing currency after the Turkish lira (The Star, 12/12/2002). Figures released by Statistics South Africa in February 2003 indicate that inflation peaked in November 2002 and was expected to fall sharply during 2003 to almost within the 3-6 per cent band on the strength of the recovery in the exchange rate, lower food prices, and moderate real demand trends in the economy (Treasury Budget Overview, 2003:6). Furthermore, a positive trend in the Producer Price Index (PPI) showed in December 2002 a year-on-year increase of 12.4 per cent compared with 13.9 per cent in November of the same year, while PPI for 2002 was 14.2 per cent (Mail & Guardian, 31/01-6/02/2003).

Government’s efforts at inflation targeting have met with a mixed response, with some analysts hailing what they see as a determined effort to bring stability and predictability to prices. The Reserve Bank states that inflation targeting provides long-term interest rate stability, cost continuity, wage stability and certainty in the market. Critics note that inflation targeting has meant the introduction and maintenance of high interest rates in order to curb inflationary pressures. Critics further note that there is no proven link between inflation rates being forced below

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6 The Rand depreciated dramatically by 33.3 per cent against the dollar from 30 June 2001 to 31 December 2001 (South African Reserve Bank, Quarterly Bulletin, June 2002:48) and apparently remains under-valued.
10 per cent, and improved economic growth (World Bank, 1994, cited in Marais, 2001:216). It appears that the ongoing commitment to low inflation is more a function of economic theory purism and a desire for IMF/WB approval than an holistic strategy. An unintentional but negative side-effect of the current fixation with low inflation is that the high interest rates (among the highest in the world) increase the debt repayment costs of South Africa’s domestic and foreign debt, forcing government to focus on cost-cutting and debt reduction to compensate. The question that must be asked is whether low inflation through restrictive monetary policy is more desirable than increased social spending on poverty and infrastructure. It must be noted that high interest rates reduce the rate of return (and therefore attractiveness) of domestic investment, but provide good returns for foreign portfolio investors. Thus the current inflation targeting strategy favours marginal FDI over possible significant domestic investment.

**Savings**

International experience shows that countries with high rates of capital formation grow more rapidly, and that a high level of domestic saving is necessary for more rapid growth in capital stock. International capital flows, such as foreign direct investment, can supplement domestic saving, but the volatile character of the global capital market undermines the suitability and likelihood of cross-border capital inflows.

An international study on the competitiveness of various countries suggests that there is no case on record of a country consistently achieving a top growth rate without also logging a high rate of investment, financed by high domestic savings. Foreign savings, as reflected in current account deficits, usually remain low relative to the amount of investment required for better-than-average economic growth. (UBS, 1996:3, cited in Prinsloo, 2000:3). South Africa’s savings rate fell from 23 per cent in 1982 to 16 per cent in 2002.

In an effort to partially counter this, government has moved to decrease dissavings in the national government, which occurs when current expenditure exceeds current income. Dissaving continued to decline during 2001 as capital spending strengthened and a strong revenue performance reduced the budget deficit. Based on the first three quarters of 2001, government dissaving fell to 0,8 per cent of GDP and by 2002 it had fallen to 0,4 per cent, and is expected to be eliminated completely by 2003 (Treasury, 2002:3). This reversal (which was at 4,6 per cent of GDP in 1997) will in theory allow the state to contribute to national savings and increase spending on priorities, due to the increased efficiency of revenue management.

With regard to measures to increase the savings rate, the Reserve Bank decided that a macro-economic climate favouring low inflation, together with an elimination of government dissaving, were the mechanisms most likely to ensure a sustained increase in national savings. Tax cuts and tax incentives for saving were unlikely to deliver
more than a ‘savings spike’. What is not clear is the level of inflation that can be considered acceptable, and whether government can still deliver social services at an adequate level within a drive to eliminate dissaving.

Debt
A significant achievement within the GEAR paradigm has been the progress made by government on all fronts in reducing overall debt costs, thus freeing up funds to be spent on other budgetary allocations. These gains, however, have only been possible through a stringent policy of cost curtailment within the budget and within government institutions, prioritising fiscal discipline above spending priorities, and thus preventing government from embarking on a programme of wholesale poverty relief and job creation. This period of fiscal discipline and consolidation from 1996 has allowed government to gradually spend more on social and infrastructure needs. Although likely to allow for increasing social and infrastructural spending, it is unlikely that poverty will be significantly reduced within the next decade if the current mix of fiscal discipline and only moderate spending increases is continued.

As a result of these steps, interest costs on public debt (debt servicing or debt costs) have decreased from 6,1 per cent of GDP in 1997 to 4,9 per cent of GDP in 2002, with a further decline to 4,2 per cent of GDP expected by 2005. By limiting spending in the context of slow but steady economic growth, the state has been able to reduce debt costs slightly by direct payment of debt, but also by simply allowing the ratio to fall as a ratio to overall GDP. In theory, this will increasingly release additional finances to slowly pay for social development. The problem is that by not spending significantly on social development now, the scale of poverty and its generational impact over time will increase, thus creating a greater problem to be addressed in the future.

Government’s fiscal position
The overall fiscal context leading up to the review period can be summarised as follows:

- A period up to the democratic transition in 1994, of high expenditure and insufficient revenue collection, with deficits above 7,0 per cent of GDP;
- A period of consolidation and stabilisation under GEAR between 1996/1997 and 2000/2001, which focused on expenditure moderation, and consistent primary surpluses (revenue less non-interest expenditure), accompanied by efforts to shrink the deficit;
A phase of limited expansionary fiscal policy from 2001/2002, which forms the backdrop to the 2003 Budget.

In its comments on the 2001 budget, the National Treasury outlined its fiscal position as one of spending growth in real terms for the duration of the MTEF. This spending growth was focused on supplementary allocations for investment and maintenance of infrastructure with the aim of support for growth and industrial development, reinforcing of crime prevention, skills development funding increases and programmes aimed at overcoming poverty. In this budget, the National Treasury noted that the emphasis in fiscal policy had shifted to improving the efficiency of spending, increasing capital expenditure and ongoing tax reform, while maintaining the fiscal stability achieved in recent years (Treasury, 2001:3).

The Treasury's 2001 budget review stated that the underlying fiscal policy goals were economic growth and employment creation, improved public services and an equitable distribution of income. In pursuing these aims, the budget framework sought to balance several broad objectives:

- providing for social and developmental expenditure to overcome poverty and ensure safety and security;
- raising investment in infrastructure and maintenance of government’s capital stock;
- reducing the overall burden of tax, so as to lower the costs of investment and job creation while releasing household spending power;
- stabilising the level of debt and reducing the budget deficit to contribute to lower interest rates and fiscal sustainability.

Fiscal policy, industrial restructuring, trade reform and financial liberalisation constitute the principal tools of the structural transformation of the South African economy over the past decade.

Tax measures and the increase in overall government expenditure

Government's commitment, both on paper and politically, to increased overall spending and indeed social expenditure was evident and repeatedly emphasised in the 2000/2001, and 2002/2003 budgets.

Tax relief has been a feature of these growth-oriented budgets since 2000/2001, implemented as a growth strategy in the belief that by increasing the household spending power and disposable income of low and middle income earners, domestic

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MTEF refers to the Medium Term Expenditure Framework planning tool, which establishes budgetary guidelines and estimates of spending for three year rolling periods.
demand will be stimulated. These tax cuts are forfeited spending, in that the monies could have been used to further cut state debt, or offer poverty relief, but were ‘spent’ by being allocated from total revenue. The tax reforms implemented in the late 1990s have provided the revenue needed for such tax cuts, and indeed for most of the additional spending on social services seen in the 2000/2001, 2001/2002 and 2002/2003 budgets. Critics do not want to encourage a ‘tax and spend’ scenario, but rather wish to take advantage of a short-term opportunity to bolster social spending. This is crucial to building momentum in the medium-term for a planned long-term poverty eradication programme.

The increased tax revenue is, however, one of the success stories of improved regulation and efficiency in the public sector since the transition to democracy. Since 1994, the integrity and structure of the tax system has undergone radical improvements, as have revenue administration and collection, and this increased revenue has been used for fiscal and macroeconomic initiatives aimed at encouraging growth and social development.

The tax highlights of the 2001/2002 budget included personal income tax cuts, incentives to encourage employment and learnerships, investment incentives for strategic industrial projects; and an accelerated depreciation regime for small businesses.

Following on from this, the tax highlights in the 2002/2003 budget were income tax cuts mainly benefiting low and middle income workers, personal income exemption for senior citizens and low-wage earners, implementation of a residence-based income tax as announced in the 2000 Budget, and implementation of the capital gains tax which largely targeted the middle and upper classes.

These tax measures stimulated domestic demand at a time of increased sluggishness in the global economy, and it was also hoped that they would contribute to an increase in the savings rate. While the benefit of the lower taxes was partially offset by the four interest rate hikes in 2002, decreased debt through the tax cuts may underpin increased savings from 2002 onwards.

The effect of personal tax relief over the three budgets was as follows, with tax relief in the 2003/04 budget expected to mirror the 2002/2003 year:

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<td>R 9,9 billion</td>
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Such tax cuts, however, do not have a direct impact on poverty reduction. Although reduced tax for low income earners has a spillover effect to dependent households, the large number of South Africans who are unemployed and do not pay tax will not benefit directly from the tax cuts. Tax cuts strengthen the formal sector, and only indirectly the informal sector through increased disposable income in the economy. Once again, the prevailing philosophy is one of strengthening the established formal sector and utilising increased tax revenue produced by a stronger revenue base to fund poverty relief measures and improve public services, in essence a ‘trickle-down’ philosophy. The weakness of this at a developmental level lies in the fact that poverty reduction is seen as a gradual process, with rapid, large-scale poverty reduction ruled out. In addition, the reduction of poverty is assumed, rather than planned. Should the efforts of SARS yield diminishing returns as tax collection efficiency reaches its optimum, government will, under the current spending paradigm, experience reduced access to funds for increases in social services, reinforced by the tax to GDP ratio. The result would be that the money available for increased spending on social services would be very limited.

We now turn to an examination of overall government expenditure. The 2001/2002 budget listed the following as spending highlights:

- R7.8 billion increased infrastructure spending directed towards repairing flood-damaged infrastructure, new investments in school buildings, roads, water and sanitation projects, and rural development initiatives;
- R16 billion in additional money to provinces to strengthen social service delivery and enhance the capacity of provinces to deal with HIV/AIDS;
- R4 billion to the criminal justice sector for an improved salary dispensation and other efficiency-enhancing initiatives;
- R2 billion to administrative departments including SARS aimed at improved tax administration, and to Home Affairs to build technical capacity;
- R2.6 billion additional to local government for infrastructure and to support the provision of free basic services.

The 2002/2003 budget was promoted by Treasury as focusing on accelerated social and infrastructure spending, together with tax relief for individuals and encouragement of business investment, enhanced government capacity to deliver services, and investment in skills. The objectives of the budget were:

- to increase the resources available for social spending, with particular emphasis on responding to poverty and vulnerability;
- to provide for increased investment in infrastructure, focusing on extending service delivery and economic opportunities to poor communities;
to ensure sustainable real increases in government spending by maintaining a check on the level of debt service payments;

- to reduce tax rates for all, with substantial relief to low- and middle-income earners, and

- to reduce the costs of employment and boost consumer spending.

The main spending highlights in the 2002/2003 budget were:

- real spending to grow by 4,1 per cent a year over the MTEF period, while interest on debt falls from 4,8 per cent of GDP in 2001/2002 to 4,1 per cent in 2004/2005;

- education spending rising to R59,5 billion next year, or 24 per cent of non-interest expenditure;

- R31,8 billion to Police, Justice and Correctional Services in 2002/2003, while R20,6 billion is allocated to Defence and intelligence services; and

- provinces receive R132,4 billion, or 56 per cent of the national Budget, including:
  - improved funding of tertiary hospital services and an enhanced response to HIV/AIDS; increases in old age and disability grants (8,8 per cent) and child support grants (18 per cent) brought forward to April; and additional funding for roads, schools, clinics and rural development;
  - assistance for municipalities growing by 18 per cent a year, including support for water and sanitation, electrification, free basic services and local economic development.

State expenditure grew by 12,2 per cent between the 2000/2001 and 2001/2002 budget years, and by 11 per cent from the 2001/2002 and 2002/2003 budget years. What is of interest is that the expenditure was held within a tight band as a percentage of GDP (e.g. 25-26 percent), which is now slightly relaxed in MTEF projections to 2005/2006, at 27 per cent, while remaining highly controlled. Of further interest is that this expenditure is financed from a revenue (mainly taxes) to GDP ratio that also falls within a tight band (around 23-24 per cent). This means that although spending is increasing, it is not increasing significantly. The estimates for the MTEF for 2003/2004 to 2005/2006 are within similar bands, but the overall amounts increase faster, due to expected GDP growth and a slightly relaxed deficit, around 2,4 per cent of GDP in the 2003/2004 to 2005/2006 MTEF. This means that although government spending is increasing, it is still strictly linked to GDP growth and fixed percentages of GDP.

This indicates that increases in spending, although higher, are still modest, and it would therefore not be correct to state that GEAR has been sidelined, since social
funding is coming from cost-cutting, and not from expansion. The improved revenue collection, however, is a process independent of GEAR and is more closely linked to specific tax reforms and efficiencies than macro-economic strategy. Even though it must be noted that fiscal control measures would in any event have been necessary to prevent South Africa sliding into a debt trap, these measures could have been partially achieved by increased internal efficiencies within government departments along the lines of the internal reforms within SARS.

A further concern is that poverty and joblessness cannot be eliminated by a programme of improving the efficiency and competitiveness of the state and formal sectors alone. This is because South Africa’s unemployment problems are structural rather than a question of inefficiency. Increased spending on social expenditure must at some point embrace direct poverty relief along the lines and scope of the proposed Basic Income Grant. This is because the majority of South Africa’s unemployed may never be absorbed into the formal sector, as a result of the increasing drive for competitiveness which is reducing labour demand in that sector. The nature of employment within manufacturing and agriculture has changed and is now less labour-intensive and more skills-based than before, as COSATU and its research affiliate NALEDI show in research conducted on the agricultural and metal and engineering sectors. Where employment growth has occurred, it has been largely through increased casualisation of the workforce.

In a similar fashion, the much-lauded privatisation of state assets, although useful in reducing debt, has not had a significant effect on poverty or unemployment. If anything, it has funded the controversial expenditure on arms and increased poverty by promoting further retrenchments. The process of privatisation usually incurs significant expenditure in improving efficiency, in order to improve revenue streams and saleability of the asset, and an obvious question which must be asked is why such measures could not equally well be implemented in order to retain the asset. Retention of state assets allows for a form of poverty reduction, in that the costs are passed on to the taxpayer, who then essentially subsidises services enjoyed by unemployed non-taxpayers. Only the most profitable segments of state assets are usually sold, leaving the bulk of the inefficiencies as a cost to be borne by the taxpayer, along with a reduced income stream for the state. This is not to say that gross inefficiencies in the public assets should be tolerated, but that alternatives to ‘knee-jerk’ privatisation should be explored.

Thus privatisation is less an exercise in cost reduction than an exercise that passes public assets cheaply onto the asset-buying sector of society and reinforces the dualistic nature of the South African economy. Privatisation or “restructuring” has therefore been fiercely contested as a viable economic strategy by organisations such as COSATU and the Anti-Privatisation Forum. The sales price of such an asset does not include the cost of building the asset, but merely reflects the revenue-generating potential
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of the asset. Ironically, the increased fees and cost recovery that accompany the
privatisation of utilities may also directly undermine the competitiveness of South
African industry, which has long enjoyed favourable cost ceilings in these areas.

Now that financial stabilisation has been achieved, further fiscal restraint will not
introduce social benefits greater than those to be gained from poverty reduction. It
is indefensible that macroeconomic planning and service delivery strategies remain
‘non-negotiable’ in the context of increasing poverty, and it is furthermore inexplicable
that significant arms spending is financially and politically legitimate in a context
of fiscal austerity that disallows necessary social expenditure. As an example, the
2001 Budget Review listed a government allocation of R4.6 billion to poverty relief
and job creation between 2001/2002 and 2003/2004, and an allocation of R15.1
billion to defence spending.

Commitment to social expenditure
Commitment to social expenditure exists, but it is commitment to a gradualist,
incremental spending regime which appears to be located within the paradigm of
GEAR. The argument in this chapter is not that fiscal austerity has been fruitless, but
rather that such measures should be temporary in nature, and that their long-term
benefits for poverty reduction are very weak, as has been evidenced by the structural
adjustment experiences of other African countries. Likewise, this is not a call for
profligate spending, but a bold revision of economic models and ceilings, benchmarked
to viable international cases outside of the British-American model.

**TABLE 5:** CONSOLIDATED EXPENDITURE GROWTH 2000/2001 AND 2001/2002

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<tr>
<td>Education</td>
<td>52.8</td>
<td>58.5</td>
<td>5.5</td>
</tr>
<tr>
<td>Health and Welfare</td>
<td>57.6</td>
<td>61.3</td>
<td>7.3</td>
</tr>
<tr>
<td>Housing &amp; Other social services</td>
<td>6.2</td>
<td>6.5</td>
<td>-6.5</td>
</tr>
<tr>
<td>Police, Prisons &amp; Justice</td>
<td>25.7</td>
<td>28.5</td>
<td>10.2</td>
</tr>
<tr>
<td>Defence &amp; Intelligence</td>
<td>15.2</td>
<td>17.3</td>
<td>8.3</td>
</tr>
<tr>
<td>Water, Agriculture &amp; Forestry</td>
<td>7.5</td>
<td>8.0</td>
<td>7.1</td>
</tr>
<tr>
<td>Transport, Communication &amp; Other economic services</td>
<td>12.0</td>
<td>14.6</td>
<td>0.2</td>
</tr>
<tr>
<td>General administration</td>
<td>22.3</td>
<td>25.2</td>
<td>9.8</td>
</tr>
</tbody>
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continued on page 53
What can be seen in Table 5 above is that spending on education, housing and other social services grew faster during the 2000/2001 to 2002/2003 period than during the 1997/1998 to 2000/2001 period. However, health and welfare spending decreased over the same period. If we examine the current review period, we can see that the projected growth rates for the immediate MTEF (2001/2002-2004/2005) have risen in the case of health and welfare, but dropped slightly in the areas of education, housing and other social services.

Spending on social services rose moderately during the review period, but not significantly. The provision of free basic services such as water and electricity continues, with a R2,6 billion allocation in the 2001/2002 budget and further allocations in the 2002/2003 budget. Although these expenditures will gradually assist in reducing poverty, they may well be offset by continuing retrenchments and ongoing poverty in the rural areas, and also, as some critics have noted, by the negative impact of cost recovery electricity and water cut-offs. Provincial government is once again seen as the primary agent of expenditure, with a serious division between local and provincial government, even though local government allocations grew by 11 per cent in the review period.

Further examples of government’s commitment to social expenditure can be seen in the 2002 interim budget, which announced the following measures:

- pensions and disability grants increased;
- doubling of spending on schools and other feeding schemes;
- additional spending on the prevention of mother-to-child-transmission of HIV/AIDS;
- a further R3,3 billion over the next 3 years to combat HIV/AIDS;
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- upgrading or rebuilding of 27 hospitals over the next 3 years;
- additional spending on policing to increase personnel by 5,000 a year for the next four years, with extra allocation to improve the administration of the courts (The Star, 30/10/2002).

That such spending may be insufficient is shown by the fact that the old age and disability pensions only rose by around 5 per cent after inflation, although this measure is currently the closest item to a Basic Income Grant, with many poor, unemployed families surviving on pension grants alone. Food inflation was also largely not budgeted for, although this affects poor communities more than wealthy communities, due to the higher proportion of income spent on food. In 2002, food inflation accounted for an average of 42.8 per cent of the rise in CPIX, compared with 20.5 per cent in 2001. Given household expenditure patterns, food inflation reduces the real incomes of lower income households to a greater extent than others. Government has announced an enquiry into food prices as a result, but was only able to allocate R400 million in additional funds over three years. Thus, although progress is being made in allocating funds to poverty reduction, events on the ground often outstrip the moderate increases allocated.

Capital and infrastructure expenditure performance

As can be seen from Table 5 above, capital expenditure has increased since the late 1990s. The rate of spending growth showed a greater increase during the 2000/2001 to 2002/2003 period than during the 1997/1998 to 2000/2001 period. Capital spending over the review period grew on average by just over 20 per cent, while the projections for the 2001/2002 to 2004/2005 MTEF period stand at 18 per cent, and in the National Treasury vote, provision is made for grants earmarked for provincial infrastructure investment and maintenance. This has contributed to growth in provincial capital spending of 28 per cent a year since 1999/2000 and about 17 per cent a year for the 2002/2003-2005/2006 MTEF period (Treasury, 2003:18).

Capital expenditure is necessary for ongoing service delivery, while infrastructure expenditure by the state is often the only form of investment in poverty-stricken urban and rural areas. Social development and improved economic performance often depend on gains in public sector delivery and more vigorous capital formation. What has been of concern to government and analysts, however, has been the inability of the state to spend these capital budgets and infrastructure allocations.

In order to address issues of capacity constraints and related economic management, government introduced the Public Finance Management Act in 2001, as part of a new public management framework, aimed at improving the quality of spending, tracking service delivery performance, and reinforcing a culture of accountability and improved service delivery. In addition, with the demarcation of 284 new local...
authorities, a reform of municipal governance and finance is under way. The Municipal Finance Management Bill, three year budgeting, the codifying of municipal accounting practices, a framework for municipal borrowing and new financial reporting standards are among the key elements of this transformation.

Public-private partnerships, through which the private sector provides the initial finance for public infrastructure, and takes on the operational responsibility and risks associated with service provision, are also increasing and are seen by the state as a means to overcome current capacity constraints and roll out infrastructure projects faster.

Unemployment

The official unemployment rate in South Africa rose from 26,4 per cent in February 2001 to 30,5 per cent in September 2002. The expanded definition, which includes those who have not sought work in the previous month, rose from 37 per cent in February 2001 to 41,8 per cent in September 2002. Job losses have been ongoing since the mid-1990s, with 1,9 million people unemployed in 1995; by 2002 the number stood at 4,9 million in official figures and 8,1 million in expanded figures. Economist Sampie Terreblanche notes, however, that greater changes may be required than simply trying to expand the formal sector; and both he and others have stated that the labour-absorptive capacity of the formal sector has been exaggerated. With changes to production and processing in the manufacturing and agricultural sectors, and the poor performance of commodity prices, it is unlikely that even large-scale expansion in these sectors can generate enough employment, while skills shortages further continue to restrict job growth.

Trends in employment

The rapid rise in unemployment already noted has led to an equally rapid rise in the size of the informal sector, as retrenched workers have turned to survivalist and micro-enterprise activities in order to sustain themselves. The informal sector was estimated to comprise 200 000 people in 1995, but had risen to 1,7 million by 2001 (Mail and Guardian, 2003:16 June). Private sector employment numbers continued to contract in 2001, but the pace of job-shedding slowed down from a year-to-year rate of 2,0 per cent in 2000 to 1,3 per cent in 2001. Employment losses continued in almost all areas of the private sector in 2001, but were most pronounced in the manufacturing, construction and gold mining sectors. Some sectors, however, saw a slight increase, namely the mining (apart from gold mining) sector; the trade, catering and accommodation services sector; and the transport, storage and communication sector.

Growth in manufacturing production has been underpinned by a rise in labour productivity growth – not employment numbers – and a rise in the capital intensity of production processes. Manufacturers also retrench workers to increase
As can be seen from the above graph, the sectors most negatively affected by loss of employment were agriculture, trade and domestic employment, with the main beneficiaries in employment the finance, community and manufacturing sectors.

Another factor which must be noted is the rise in atypical forms of employment (casual, temporary or outsourced labour) during the review period. In a study into employment conducted by NALEDI, it was noted that in a growing number of sectors most new employment takes the form of atypical employment, and indicates uncertainty regarding the extent to which previously retrenched workers are being
reabsorbed into their respective industries. Employers seem to be utilising this form of employment for a number of reasons, such as cost reductions, cyclical volumes of work and fear of the unions. COSATU strongly opposes the increase in this form of employment, as these workers do not often qualify for pension, medical aid and leave benefits, nor do they qualify for skills development training. This will obviously place an added burden on the state and the taxpayer to meet health, training and retirement needs.

**Government’s ability to address unemployment**

Government cannot directly create jobs unless it hires more public sector employees on an annual basis. Alternatively it must ensure effective support measures and an enabling environment for job creation, such as addressing the critical issue of skills shortages, which contributes to the ongoing inability of the economy to create jobs.

The role of government is seen as ensuring an enabling environment for jobs to be created by the private sector. GEAR attempts to do this by raising interest rates until inflation is under control, while reducing debt in order to provide the space for more investment capital in the market. The difficulty is that the economy is not as labour-absorptive as it was ten years ago. Furthermore, recent moves to establish a sectoral wage determination for domestic and agricultural workers may lead to further retrenchments, even though the proposed minimum wage range is under R900 per month. Workers in the retail and wholesale sector may also be paid minimum wages with effect from February 2003 (Sowetan, 20/12/2002).

COSATU has voiced a concern that the Department of Trade and Industry’s new Integrated Manufacturing Strategy (IMS) will not reduce unemployment significantly, and has called for discussions around a revised industrial strategy.

**Poverty and inequality**

The ongoing repercussions of the legacy of apartheid social engineering that systematically disempowered and impoverished the non-white population are still in evidence. Poverty and inequality are serious challenges confronting the country and cannot be sustainably addressed through *ad hoc* interventions. A good indication of the increase in poverty is the increase in malnutrition, and studies conducted by the Department of Health clearly show a rise in the number of malnourished children between 1995 and 1999.

Government responds to criticism of GEAR by stating that no credible economic alternative exists. However, the People’s Budget, drawn up by a coalition consisting of COSATU, the South African NGO Coalition (SANGOCO) and the South African Council of Churches (SACC) provides such an alternative. This initiative aims to stimulate debate, discussion and critical comment on South Africa’s development
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path in order to provide a structured input around the budget formulation process. To translate these proposals into reality, the People’s Budget in 2001/2002 called for increased social investment, with the main objectives being to:

- provide all people with a basic income grant – a small amount of money, between R100 and R200 per month must be provided to all persons, with the potential to lift 80 per cent of the poor out of poverty;
- implement National Health Insurance – in terms of this scheme, insurance paid as a levy would be pooled and distributed to service providers and institutions. This would substantially reduce the costs of medical care. The two-tier health system (private and public) would be rationalised;
- extend the provision of free basic services;
- increase spending on skills development;
- increase spending on land redistribution; and
- implement an integrated treatment and prevention plan for HIV/AIDS.

The People’s Budget emphasises the developmental role of the state, and believes that the state should drive a growth strategy; provide a social wage in the form of improved social security and public sector service delivery; and strengthen democracy and the public sector. Economic debates are seen as political, and not only economic.

To fund such activities, it is proposed that government agrees to change the current macro-economic parameters, with higher levels of taxation and a higher deficit. An additional amount of R90-R120 billion can be raised through moderate increases in tax and the deficit (NALEDI, 2001). Further funds could be realised from restructuring the Government Employees’ Pension Fund (GEPF), a defined benefit fund, which means that employee benefits are guaranteed. Returning this to a Pay As You Go system, as it was prior to 1994, would effectively reduce the state’s debt obligations. Redirecting military spending and introducing higher VAT rates on luxury goods (in order to offset zero-rating on basic goods) would raise additional resources.

Poverty and joblessness have become further entrenched under the post-1994 democracy. The structural poverty of Apartheid has increased and cannot be reversed without significant proactive intervention, with the situation being exacerbated by an inappropriate generic economic model. As Blade Nzimande of the South African Communist Party (SACP) has noted, socio-economic transformation has ironically taken place in South Africa parallel with worsening poverty and inequality. Nzimande notes that in 1995 the poorest 20 per cent of households received a mere 1,9 per cent of the total income in South Africa. By 2000, this share had dropped still further to 1,6 per cent of total income. The poorer 50 per cent of the country’s households also slipped backwards in these five years relative to the wealthier 50
per cent. The poverty divide remained racially-based to a large extent – for example, in 1995 the average white household earned four times as much as its average African counterpart, and by 2000 the average white household was earning six times the average African household.

The influence of GEAR is unfortunately also evident in the problems of nutrition and food insecurity, in that the negative trends in agriculture appear related to a strong ideological commitment to freeing up agricultural markets, except for support for land reform and smallholders. By contrast, most industrialised countries make some effort to stabilise prices, usually through a system of stockpiling. The full liberalisation of agricultural markets in South Africa has led to rising food inflation (Watkinson, 2002:15). Workers typically spend more than a third of their income on food, while the very poor spend over 50 per cent of their income on food and up to 20 per cent on maize alone (NIEP, 1995, cited in Watkinson, 2002:3).

The Department of Agriculture’s 2001 Strategic Plan for South African Agriculture indicates that the shift to free markets has caused a serious fall in investment and employment in commercial agriculture. The rapid process of deregulation and liberalisation, along with greater exposure to international competition in the past decade, has forced farmers to adjust rapidly to market changes and has reduced competitiveness rather than boosting it, contrary to the expectations of neo-liberal economics. Many small farmers and farm systems are failing and being bought out by mainstream agriculture (Watkinson, 2002:16).

The Basic Income Grant (BIG) proposal is another civil society initiative which has not been taken up by government, although a Committee of Inquiry into a Comprehensive System of Social Security was set up during 2001/2002. The BIG would in effect be paid directly to most – if not all – South Africans through the Post Office banking system, and would most likely be set at R100-R150 per month, with the tax system being used to claim back the BIG paid to wealthy individuals. Current social welfare grants, although reaching millions, are seen by many as inadequate, especially given the increasing overlap between poverty and unemployment. The BIG is unique in that it will positively impact on the unemployed directly. In practice the grant could either be fixed or on a sliding scale, and would make a significant difference in very poor households, where the monthly income is often as little as R500. In these circumstances, a BIG would raise the monthly income by 20 per cent. Economic models demonstrate that a BIG would have strong multiplier effects within poor communities, contributing to increased informal sector trading and eventually greater self-sufficiency. A direct impact of such cash transfers into households would be the increase and stabilisation of demand, consumption and savings. Local and especially rural markets would benefit greatly from these transfers and would then have the potential to kick-start the economy in the underdeveloped rural areas (Haarmann:2001).
Bhoorat further suggests that poverty relief could be increased by lowering the qualification age for the state pension. While unemployed youth are seen as a job creation issue, the older unemployed are seen instead as a poverty alleviation issue, as these workers are unlikely to find employment. A social safety net for the poor is therefore most effective when focused on those workers who are so marginalised that no form of labour market intervention will assist them out of poverty. Current economic policy and growth assumptions are not relevant to this group, and this is why efficiency-based arguments are unrealistic and fundamentally simplistic in the South African context. The impact of such a reduction in the pensionable age would lie somewhere between the poverty reduction effects of a R50 versus R100 income grant. The main concern raised by government has been the cost of, and difficulty in administering, such a provision. Bhoorat concurs with these valid concerns, since total cost for payments and administration was estimated at R61 billion in 1999, R65 billion in 2000 and R75 billion in 2001 (or 30 per cent of total government expenditure in each of the three years). Other estimates, however, indicate that the BIG would cost only R43,8 billion, with the potential of reducing costs by half through solidarity taxes for wealthier groups, along with reclaiming through tax the grant amounts paid to those not in need of such a grant. The Value Added Tax raised through the increased household expenditure would also raise further funds. In any event, these costs would be outweighed by the investment and sustainable development potential of such a scheme, and would address the deficits in the current social security system (People’s Budget, 2002:15).

Poverty, apart from being morally and politically unacceptable, is also an economic impediment to national development, since many economists believe that a concentration of wealth results in a pattern of demand that restricts the size of the market. In addition, poorer households spend a greater proportion of their income on labour-intensive goods. Development without first addressing issues of poverty and its causes is likely to result in slower growth rates. Carter, May and Padayachee argue that South Africa’s sluggish growth may well be rooted in its high and increasing income inequality, since unequal distribution of income and wealth becomes
economically costly and growth-reducing when a large proportion of a country’s population is unable or unwilling to engage in entrepreneurial activity, save and invest, and meet the costs of provision of essential services.

The socio-economic ‘drag’ of poverty’s overarching effects acts as a brake on development, in effect cancelling out most of the gains of an incremental GEAR approach. In essence, South Africa faces a poverty trap, in that massive inequalities and related poverty prevent growth and development, which in turn deepen poverty. Poverty lowers the productivity of the labour force by making skills acquisition harder and increasing social fragmentation. This reduces household incomes, which then results in limited domestic markets (People’s Budget, 2002:4).

Carter, May and Padayachee suggest that measures to counteract these effects would require micro-reforms to eliminate the conditions that create poverty traps and to improve both access to and information about markets, in addition to focusing on the way in which markets reward the efforts of those who are poor. At the same time, macroeconomic policies must be re-examined to assess their impact on production, investment and consumption behaviour, especially that of the unemployed and the poor (Carter, May and Padayachee, 2002:1).

However, these authors note that such interventions cannot do more than dent the structural legacy of poverty inherited from Apartheid’s irrational plans. The scale of the problem in South Africa is unusual, even for a developing country. As noted in the 2002/2003 People’s Budget, providing limited services and development is not enough to support sustained economic activity amongst poor citizens, or improve the productive capacities of the poor (People’s Budget, 2002:10).

Conclusion

It can be seen that the picture which emerges of the state of economic development during the review period of 2001 and 2002 is complex. It is not simply a picture of a rampant GEAR trampling the poor in order to serve the rich, but rather a question of a macro-economic strategy that in its implementation to date is largely only concerned with the long-term efficiency and productive path of the economy. The overarching aim of GEAR is to make South Africa financially stable and well-positioned for many decades of growth. It seems, however, that its potential impact on the poor and working classes was not given due consideration, and that appropriate mechanisms were not incorporated to offset the negative spin-offs. Within this drive for debt reduction and the establishment of a firm, sustainable framework for economic growth, the government has been compelled since the 2000/2001 budget, as a result of growing criticism, to increase transfers to social services and poverty relief where possible within the limits of the increased revenue collection.
GEAR’s efforts to reduce government borrowing, debt, dissavings and inefficiencies are indeed laudable, and it is possible that without these, there would have been only a brief spending boom followed by years of even harsher cutbacks. However, it is the negative impacts of GEAR on poverty and employment that have mobilised popular anger against its prescriptions. Opposition to GEAR has been strengthened by the global ideological assertions around trade, financial liberalisation, privatisation, poverty and welfare dependency which come from its proponents at the highest levels, and which reveal political underpinnings that clash with the publicly promoted image of a neutral, technocratic programme that simply wants the best for the nation. The cost of the arms expenditure package right in the middle of arguments around the unaffordability of large-scale poverty relief contradicts the claims that GEAR’s targets and methods are non-negotiable. The prescriptions of GEAR essentially serve to concentrate and reinforce economic power, rather than disperse it. GEAR places added strains on the social fabric of society, whilst indulging in short-term economic transfers of wealth by default to the already wealthy sectors of society, and can therefore be seen as a form of institutionalised neglect of citizens.

What is worth noting is the existence of alternative economic models in many other parts of the world, such as the social democratic model of mainland Europe, home to some of the world’s largest economies. The application of policies similar to GEAR across the developing world, in the form of structural adjustment packages, have to date (after two decades) failed to deliver clear evidence of their social desirability and economic growth benefits. This means that GEAR’s precedents have failed even while alternatives exist, and as the review period shows, GEAR, even in an expansionary phase, is harsh on the poor and weak and is unable to provide innovative solutions to the dualistic nature of South Africa’s society and economy. The long-term effect of this is to entrench poverty and social alienation, which will in all likelihood severely destabilise the economic platforms laid down by GEAR, as well as undermining its gains.

GEAR’s ‘non-negotiable’ status may, however, be weakening. Global debate around the continued relevance and rightness of the Washington Consensus is growing, and demonstrators globally have shown their opposition to it. Secondly, policy debates critical of neo-liberal orthodoxy have followed in the wake of the 1997/1998 global financial crisis. Thirdly, pressure is growing from within the ANC alliance for a review of GEAR along the lines set out in pre-GEAR alliance discourse. In the face of increasing evidence of failure to meet targets for growth, employment, social infrastructural development, redistribution and poverty reduction, the push for more inclusive strategising is growing.

Ambitious micro-economic reforms and interventions must include measures that improve the access of the poor to productive assets such as land reform, infrastructure and financial services, along with measures that reduce the costs of production,
including transaction and information costs. Where such policies do exist in a limited form in South Africa, implementation has been slow, such as with land reform, or the benefits have largely been captured by the non-poor, as in privatisation. For such policies to work effectively and to the benefit of the poor, they must be located within the context of an enabling, supportive and complementary macroeconomic framework, which seeks to address issues such as industrial and labour market policy, coupled with an integrated urban and rural infrastructural development programme, increased social security and investment in infrastructure and the delivery of essential services (Carter, May and Padayachee, 2002:16-17).

In addition, new sector strategies that will build sustainable and expansive industries to support job creation must be developed. Meaningful change requires key progressive social formations to build an effective united front to break the economic transformation deadlock. Government and progressive social formations need to reach a ‘National Agreement’ on a new growth path, which can underpin a more assertive role for the state and counter-balance the power of concentrated and conservative capital (NALEDI: 2001). Allied to this would be efforts to build the political and technical capacity of the state to implement such developmental policies.

Increased revenue collection efforts by SARS have managed to partially conceal the depth of the contradictions within current policy, but the predicted rise in inequality may soon prove to be too explosive for even GEAR and its supporters to manage. Political courage is needed, and a demonstration of will by the democratic state to act independently and fulfil its constitutional and political mandate of uplifting all South Africans and addressing the legacies of the past.

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