

Changing Gear? The 2001 budget and economic policy in South Africa¹

Vishnu Padayachee and Imraan Valodia

In an article published last year (Padayachee et al 2000), we argued that the 2000 budget and the broader ANC economic policy stance since the democratic elections in South Africa has been 'a typical market-friendly, supply-side policy... (which has failed to) stimulate the economy, and thereby create a virtuous cycle of growth and employment creation so critical to meeting South Africa's development challenges' (2000:1361). We argued further that there was little of substance in the economic policy package to address the dire poverty in South Africa and to improve service delivery to the poor and the marginalised. Economic policy, we argued, was focused too much on faith in a private sector investment response to a market friendly environment characterised by tax relief to the middle and upper classes, low corporate tax rates, and a low and falling budget-deficit.

The 2001 budget, announced by Minister of Finance Trevor Manuel on February 21, 2001, suggests the emergence of a significantly different economic policy stance by the South African government. The budget and a number of other recent events may herald the beginning of a shift in economic policy toward a more Keynesian type approach with the state playing a more active role in directing the economy onto a new growth trajectory, one that holds more promise for meeting the development challenges facing South Africa.

Shifts, albeit still small, in the global economic policy debate, palpable failure with its previous 1996 strategy based largely on private sector investment, and concerns within the ruling party over electoral apathy among its significant youth constituency and from minority groups in the 1999 general and 2000 local government election, may all have combined to bring about a reassessment of its policy stance. An

important input into this rethinking appears to have been the closed-door workshop involving cabinet ministers, state bureaucrats, senior World Bank and IMF officials, and a number of prominent US and British academic economists, which took place in South Africa in late 2000.

We begin by summarising the nature of ANC economic policy thinking in the post-1994 period. Thereafter we outline and discuss the features of the 2001 budget and link this to recent debates on the nature and efficacy of the post-1994 policy stance. We conclude that, although it may be too early to tell, the ANC has acknowledged tacitly that its market friendly approach, though pleasing international capital, has not successfully addressed the economic challenges facing South Africa. This is not to suggest that we believe that there has been a decisive shift in the underlying thrust and character of ANC economic policy. Rather, we argue that, in the face of the failure of its orthodox policies, we are beginning to see the emergence of unorthodox and more interventionist economic policy ideas within the ANC government – a trend which may potentially, though not inevitably, herald the beginnings of a more progressive economic policy stance.

The nature of post-1994 economic policy²

The economic strategy of the government was codified in June 1996 (at a time when the South African currency was under great pressure) with the publication of the 'Growth, Employment and Redistribution: A Macroeconomic Strategy' (GEAR). GEAR established targets of a 6.1 per cent growth rate and the creation of 409,000 jobs per annum by the year 2000, and it proposed an accelerated programme of privatisation, deregulation, and fiscal restraint. Foreign exchange was liberalised even further by increasing the proportion of assets that could be swapped by local financial institutions. Fiscal restraint was to be achieved through the rationalisation of the public sector, the elimination and scaling down of some social services, budgetary reform, overhaul of the tax structure, and the establishment of more efficient mechanisms for revenue collection (Department of Finance 1996:9-12).

The then new macroeconomic strategy professed a commitment to, and continuity with, the Reconstruction and Development Programme (RDP), the ANC's pre-1994 election manifesto (Department of Finance 1996:1), which arguably had a stronger developmental/social democratic foundation. But some (see for example, Michie and Padayachee 1997) have argued that

GEAR's emphasis on containing government expenditure, lower fiscal deficits, lower inflation, deregulation, privatisation, and minimalist state intervention are in fundamental opposition to the basic policies and developmental thrust of the RDP. In the context of South Africa in the late 1990s, the core of the government's economic strategy was essentially neo-liberal in character (the liberalisation of trade and finance relations, privatisation, fast-track deficit reduction programme, a 'crowding-out' approach to government expenditure, cuts in state support for economic services, a narrow focus on inflation, etc).

It is true that some counter-trends exist. The commitment to unbundling the conglomerates, and the passage of the National Qualifications Framework (NQF) and the Labour Relations Act (LRA), were consistent with recommendations of Macroeconomic Research Group (MERG) and the RDP. But these initiatives, other than the LRA, were not necessarily incompatible with neo-liberal economic strategies most often associated with the IMF and the World Bank. The existence of corporatist policy-making, state initiatives to facilitate black economic empowerment, and the relatively 'high' level of state expenditure on social services do not, in our view, negate the essentially neo-liberal character of the economic programme.

It is now possible to examine GEAR's projections and outcomes against actual performance. Seidman-Magketla (2001) has neatly captured the essential data for the period 1996-1999 in Table 1 below. What is striking about this data is the fact that government policy appears to have been remarkably successful in the areas of fiscal restraint, tariff reductions, and inflation control (all typical favourites of neo-liberal advice) and significantly off the mark on the real economy (growth and employment). Significantly, real interest rates remained higher and private sector investment lower, than that projected on average for the period.

There are various developments which appear to have created a climate in which a rethinking of South Africa's macroeconomic policy becomes more attractive (see Fine and Padayachee forthcoming 2001). The first is global, and relates to the debate about the relevance of the Washington consensus. The second, also global, relates to policy debates that have followed in the wake of the 1997/8 global financial crisis. The third is local and stems from the growing pressure from within the ANC alliance for a rethink of GEAR (Fine and Padayachee forthcoming 2001), in the wake of palpable failure in meeting targets for growth, employment, social

infrastructural development, and redistribution, along lines set out in pre-Gear alliance thinking.

Table 1 Gear projections and actual achievements, 1996-99		
	Annual average, 1996-99	
	Projected in GEAR	Actual
Projections:		
Fiscal deficit as % of GDP	3.7	3.1
Real govt consumption as % of GDP	19.0	19.6
Average tariff as % of imports	7.6	4.4
Real bank rate	4.4	12.3
Real private sector investment growth	11.7	1.2
Real non-export growth	8.4	6.7
Outcomes:		
GDP growth	4.2	2.4
Inflation (CPI)	8.2	6.6
Annual change in formal, non-agricultural employment	270 000	-125 200

Source: Seidman-Magketla (2001)

In presenting the latest budget (explicitly described as 'expansionary'), Finance Minister Trevor Manuel, argued that the ANC-led government, having corrected (albeit with some pain) the key macroeconomic balances which were the legacy of the apartheid state, is only now in a position to set out a budget focusing on the broader issues of social and economic transformation which underpinned its 1994 and 1999 election mandates. Implicit in this view is the argument that GEAR was an essential first phase of stabilisation upon which a more expansionary second phase programme of social and economic change, had to be based. Also implicit in this argument is the view that South Africa's macroeconomic balances, especially on the budget deficit, inflation and external balances, are now (irreversibly) stable. Finally, and for reasons that may have been intended to draw attention away from any suggestion that the government is coming round to a more interventionist development strategy, most of the new policy proposals, are being described as 'microeconomic' in nature, ie related to reducing input prices. These are matters we will return to examine later.

The 2001 Budget

Table 2 below shows the budgetary aggregates. The overall budget shows an increase in expenditure which is more than matched by increased revenues, thereby reducing the budget deficit over the period. The increases in revenues are a critical dimension of the budget. Since 1994, improved tax collection has allowed the treasury to increase expenditure without increasing the budget deficit.

Table 2 Budget Aggregates, Billions of Rands				
	2000	2001	2002	2003
Revenue	213.4	233.4	252.9	273.1
Expenditure	235.0	258.3	277.3	297.5
Main budget deficit	-21.7	-24.9	-24.5	-24.4
Deficit as a % of GDP	2.4	2.5	2.3	2.1

Source: Department of Finance 2001

In presenting the budget, Minister Manuel has argued that the emphasis in the 2001 budget is on economic policy shifts, from macroeconomic stabilisation to microeconomic reforms aimed at promoting growth and strengthening investment, while at the same time addressing issues of poverty and security. A number of key mechanisms are outlined in the budget to meet these objectives.

Revenue Issues

On the revenue side, the budget provides for a reduction in personal income taxes. Although all taxpayers benefit from this, low and middle-income earners benefit most from the reductions in personal income taxes. Another important revenue measure aimed at the poor is the zero-rating, for VAT purposes, of illuminating paraffin (IP). IP is a primary source of energy for low-income households, especially in the rural areas. A number of studies (see, for example, James and Simmonds 1997), including one by the national Treasury, have found that the zero-rating of IP will significantly increase the incomes of poor households, and thereby counter the effect of rising fuel prices in recent years.

Also on the revenue side, the government announced two new measures aimed at increasing employment and attracting investment. R600 million has been set aside this year for a tax-based wage subsidy, ie qualifying employers will, in effect, pay less taxes. Although details of how the subsidy is to be operationalised have not been announced, it does mark an important change in employment policy since this is the first instance of

government intervening, directly, in employment creation (outside of public works programmes). The subsidy scheme offers government the mechanism to reduce labour costs and subsidise employment, without undermining collective bargaining systems, and without conflict with the trade union movement around wage costs.

A further provision of R3 billion over four years has been made for investment incentives in *strategic industrial projects*. Again, although much of the detail of the investment incentives has not been announced, this marks government's first attempt at 'picking winners', and is a significant shift in industrial policy which up to now has been based entirely on supply-side support measures. These incentives will afford government the opportunity to impact on, and to shape, the industrial growth trajectory of the South African economy, in contrast to the more market-based programme since 1994.

In similar fashion, the budget provides for an accelerated depreciation regime for small business to improve their profitability and diesel fuel concessions to farmers in order to reduce their inputs costs, and thereby improve the competitiveness of the primary sector.

These tax proposals mark a significant change from tax provisions in recent budgets, which have tended to reduce corporate taxes as a means to attract investment. Whilst government has for some years now been consistently reducing personal income taxes, this year's provisions are novel in that the benefits flow disproportionately to low and middle-income earners, and corporate rates remain unchanged. Interestingly, the Treasury seems determined to proceed with capital gains taxes (CGT), despite pleas from business and those wealthy taxpayers who are likely to be affected by such taxes. Also, the Minister announced measures to review the taxation of banks whom, he argued, are able to avoid taxes by using derivative financial products and structured, asset-based finance techniques, among other devices.

Expenditure measures

A number of the expenditure measures proposed in the 2001 budget are also linked to issues of investment, employment and poverty. A major infrastructural investment programme is one of the features of the budget. R7.8 billion has been set aside for infrastructure expenditure, including new investments in roads, water, sanitation, rural development projects, and for repairing flood-damaged infrastructure. These investments in

infrastructure will both alleviate poverty and should also attract investment from the private sector thereby promoting a virtuous cycle of growth.

An amount of R16 billion has been budgeted for provincial governments to strengthen and improve social services delivery and to address the HIV/Aids pandemic. Local governments have been allocated an additional R2.6 billion to support the provision of basic services such as water.

An additional amount of R4 billion has been allocated to the criminal justice system for increased personnel and additional resources, and to improve the salaries of the police. The South African Revenue Services has been allocated additional funds to improve tax administration.

Although these expenditure measures do go some way toward addressing issues of poverty and meeting the dire social services backlogs, it may be argued that the government (again) missed an opportunity to target sufficient resources to addressing poverty. The old age and disability grant were increased by a miserly 5%, from R540 per month to R570 per month, while the child support grant was increased to only R110 per month, from R100. Millions of those in dire poverty are heavily dependent on these grants. Krafchik and Streak (2001) argue that the government's strategy for addressing poverty is still based almost entirely on growth to combat poverty. They argue that the resources available in the budget may have been usefully applied to a minimum social safety net for the poorest.

Does the 2001 Budget mark a change in economic policy?

President Mbeki's speech (2000) at the opening of Parliament set the scene for the budget. The speech outlined a new programme of action for government with a refocusing on economic policy issues being a key component of the programme. In the speech the President concedes that '...our growth rate is still too low as are the aggregate savings and investment rates. Similarly, the levels of poverty, unemployment and underdevelopment in some parts of our country are too high'. He argues that 'while [government will] continue to focus on the maintenance of correct macro-economic balances, we have decided to pay detailed attention to the critical microeconomic issues. In particular we have decided that this year the government itself, in all its spheres, and the public sector as a whole, must make a decisive and integrated contribution towards meeting the economic challenges the country faces'. He states further that the 'objectives we seek to achieve are moving the economy onto a high-growth path, increasing its competitiveness and efficiency, raising employment levels and reducing poverty and persistent inequalities. To improve our

competitiveness, we must lower input costs throughout the economy' (2000:7). A number of programmes, including liberalisation of energy, transport and telecommunications, new public investment in ports, the application of new technology in education, health, commerce and government, a presidential commission on information technology, targeted industrial policy measures, skills development, among others were announced by the President.

In similar fashion, Minister Manuel's budget speech argues that 'moving our economy onto an expansion path means moving beyond the macroeconomic stabilisation we have achieved. This budget sets out a number of fiscal interventions in support of the broader economic reforms we seek - measures that enhance the volume and quality of investment, that encourage employment creation and promote skills development, and measures that will improve efficiency of asset use' (2001:5)

There are, in our view, certainly indications that the Budget and President Mbeki's speech at the opening of parliament suggest a new emphasis on the part of government at addressing growth in the South African economy. Importantly, these outline a very different approach to the determinants of investment, employment and economic growth. Whereas the post-1994 policy package has focused on supply-side approaches to growth, we are beginning to witness a more active role for the state in the economy generally, and more specifically in the areas of employment creation, industrial policy, economic growth and poverty alleviation.

These changes in policy are explained, by both the President and the Finance Minister, as a shift in focus, from macro-balance and stabilisation issues to microeconomic reform. The government therefore argues that the policy measures announced in the budget are consistent with previous policy, encapsulated by GEAR. The view, outlined in the Budget speech and the President's speech, suggests that the sequencing of economic policy is an important feature of government thinking. The argument that they put across goes something like this: *at the time of the political transition, South Africa was faced with a precarious and unstable macroeconomic situation, which unless addressed would have resulted in de-industrialisation. Hence, the focus of economic policy was on achieving macro-balance. This is what the objective of GEAR was. Having successfully addressed the macro-balance issues, government can now begin to address the critical challenges of growth, employment and poverty through microeconomic reforms, which are outlined in the budget.*

We would, for a number of reasons outlined below, argue that, on the contrary, the policy changes are more an outcome of the failure of GEAR and its related policies to address the most critical challenges on the economic front. Further, while aspects of the policy may be consistent over time, the budget speech suggests a fundamentally different approach to economic policy, one which we believe holds more promise for achieving growth, equity and employment in South Africa.

GEAR was not simply a programme designed to achieve macroeconomic balance. Its very name unambiguously suggests that real economy goals were central to it. It was put forward as an integrated, even expansionary, strategy for economic growth, employment creation and redistribution. This would take place at the very same time, and in the same process, as accelerated fiscal, monetary, exchange rate, trade and industrial policy reform would be carried out. The GEAR document does not suggest that a two-phase programme – ie stabilisation followed five years later by growth and expansion was envisaged. Note the language of GEAR:

The package will establish a stable platform for a powerful expansionary thrust, with non-gold export growth rising to 10 percent per annum over the period. Against the background of this expansion and supported by the proposed investment incentives, as well as the integrity of the package as a whole, private sector investment can be expected to continue its strong upward momentum... Accelerating public sector investment growth, driven by public corporations and local authorities ... will complement the demand stimulus of stronger non-gold exports and private investment performance. In aggregate, these developments are expected to provide sufficient impetus for GDP growth to climb to the targeted 6 percent by the year 2000. (Department of Finance 1996:6, our emphasis)

Given this, it would be fair to criticise GEAR for failing to realise its real economy targets. This kind of analysis has already been done adequately and will not be recounted here (see, for example, Michie and Padayachee 1998, Padayachee et al 2000, Adelzadeh 1996).

We would argue that, apart from structural imbalances on the external account (the Achilles heel of the economy for over 100 years ago), South Africa's macroeconomic balances at the time of democratic elections could not be characterised as being fundamentally unsound or unstable. It was not 'precarious' in 1994 as the Finance Minister observed in the latest budget speech. In that context even the World Bank observed that a deficit of about six per cent of GDP was sustainable under conditions of moderate

real growth (quoted in MERG 1993:62). This argument has been developed fully elsewhere by Michie and Padayachee who concluded that:

With inflation under control, and with both the budget and foreign debts at acceptably low levels, the initial conditions of the South African economy in 1994, viewed from a macroeconomic balance perspective, were not those of extreme instability of the kind which had characterized some developing countries at the point of their economic and political transition. (1997:16)

We support the argument made by Haggard and Kaufman, based on a study of 12 transitional economies, that those countries which had achieved a reasonable degree of macroeconomic stability at the beginning of their economic and political reform ought to give greater attention to policy options other than orthodox, neo-liberal ones (Haggard and Kaufman 1995:310-6).

If macroeconomic balance issues in South Africa were not serious enough in 1994 to have constrained a relatively expansionary growth path then, as Table 1 demonstrates they are even less of an issue now. But are they stable enough from the point of view of orthodox, neo-liberal prescriptions? We would argue that they are not. The budget deficit targets could be derailed by failure to realise estimates of privatisation proceeds, and they do not factor in a still relatively large Net Open Foreign Book which is ultimately a government obligation. Furthermore, the sheer size of the government's expenditure on the highly controversial arms deal (R43b according to this budget) and its long repayment cycle – during which time the Rand may continue to depreciate – may generate unexpectedly negative consequences for meeting government's budget deficit to GDP targets. Although the Reserve Bank has achieved notable success on the way to meeting its three to six per cent inflation target by year end 2002 (calculated as the average for that year), there are, as for most emerging market economies, constant threats arising from unpredictable external supply side shocks. The first of the SARB's Monetary Policy Reviews published in March 2001 makes the point that external factors, including volatile oil prices and uncertainty over US growth prospects, means that the chances of meeting the set inflation target are only 60 per cent (*Business Report*, March 20, 2001). The external trade balance remains volatile, short-term capital flows are erratic, direct foreign capital inflows are still far too low. All these factors contribute to overall balance of payments and currency instability.

If a new expansionary growth path is envisaged, as evident by the State of the Nation address and the 2001 budget, this would have more to do with GEAR's failure to realise real economy targets, than the achievement of orthodox prescriptions for macroeconomic stability and balance. Though somewhat late, we would support this state-led initiative.

We remain somewhat puzzled though by why the government insists on calling its new programmes microeconomic. Manuel, echoing the President, made the point that 'public spending could now – based on the harvest of years of careful fiscal and other framework planning and restructuring – focus on microeconomic reform' (in *Financial Mail*, February 23, 2001:13). How can the core growth and developmental components of the budget (the R7.8 billion of expenditure on an integrated infrastructural development programme; the R3 billion for support of targeted industries, etc) be described as microeconomic? They appear to be policies and instruments precisely designed to influence the levels of national income and *aggregate* resource allocation. They are not matters related to price determination at household and firm level, which classic microeconomic texts like Henderson and Quandt (1971:2-4) taught us are the stuff of microeconomics. Even if the state's objective is to influence (lower) input prices (eg via privatisation of state utilities), these lower prices simply become exogenous variables in the decision-making process which households and firms engage in all the time, in much the same fashion as interest rates. So is the idea behind this labelling designed to draw attention away from what is so obviously an increased role for the national state?

Conclusion

Whilst there are some elements that are consistent with the past, the 2001 budget, we contend, marks some change in the thrust and emphasis of economic policy in post-apartheid South Africa, and in particular in the relative roles of the state and the private sector. The government understandably likes to emphasise continuity with past strategy (both RDP and GEAR). It also sells the approach as a logical next step in its unfolding policy (stabilisation, then growth), and given the globally-dominant market-oriented strategies for development, it prefers to label its new interventions 'microeconomic' in nature. Whatever the 'marketing' logic, this paper has tried to show that there are indeed elements in this budget that do mark, however hesitatingly and covertly, some change in the intellectual tradition and roots of the policy framework.

Two developments are worth emphasising again. First, we are witnessing for the first time since the RDP, an economic growth strategy which in some notable ways stands in contrast to the dominant Washington Consensus thinking of the kind incorporated in GEAR. Secondly, and more specifically, the economic strategy in areas like the integrated infrastructural development programme, industrial policy and labour market interventions, is beginning to show some strategic initiative from the state to shape the nature of industrial growth, employment creation and poverty alleviation in the South African economy. These state initiatives should be welcomed and arguments in support of their further expansion and refinement must be encouraged if the legacy of South Africa's past is truly to be eradicated.

Notes

1. The first part of this section draws on Habib and Padayachee (2000).
2. Thanks to Caroline Skinner for comments on an earlier draft of this paper.

References

- Adelzadeh, A (1996) 'From the RDP to GEAR: The gradual embracing of neo-liberalism in economic policy', *Transformation* 31.
- Department of Finance (1996) 'Growth, employment and redistribution: a macroeconomic strategy for South Africa', Pretoria: Government Printer.
- Fine, B (1994) 'Politics and economics in ANC economic policy: an alternative assessment', *Transformation* 25.
- Habib, A and V Padayachee (2000) 'Economic policy and power relations in South Africa's transition to democracy', *World Development* 28(2).
- Haggard, S and RR Kaufman (1995) *The Political Economy of Democratic Transition*. Princeton: Princeton University Press.
- James, B and G Simmonds (1997) 'Energy', in D Budlender (ed), *The Second Women's Budget*. Cape Town: IDASA.
- Krafchik, W and J Streak (2001) 'The poor get poorer', www.idasa.org.za
- Manuel, T (2001) 'Budget Speech', February 21, 2001, www.treasury.gov.za.
- Mbeki, T (2001) 'State of the Nation address at the opening of parliament', February 9, 2001, www.gov.za.
- MERG (1993) *Making Democracy Work: a framework for macroeconomic policy in South Africa*. Bellville: CDS Publication.
- Michie, J and V Padayachee (1997) *The Political Economy of South Africa's Transition: policy perspectives in the late 1990s*. London: Dryden Press.

- (1998) 'Three years after apartheid: growth, employment and redistribution?', *Cambridge Journal of Economics* 22(5).
- Padayachee, V, T Smith and I Valodia (2000) 'New directions in economic policy?', *Economic and Political Weekly* XXXV (16).
- Seidman-Magketla, N (2001) 'Overview of the economy'. Unpublished paper.

