People's Budget Comments on Draft 2002 Division of Revenue Bill and Explanatory memorandum

Introduction

These are the comments of the People's Budget - comprising the South African NGO Coalition (SANGOCO), the Congress of South African Trade Unions (COSATU), and the South African Council of Churches (SACC) - on the Draft 2002 Division of Revenue Bill and Explanatory Memorandum. This response should be read in the context of our submission on the 2001 Medium Term Budget Policy Statement (MTBPS), presented to the Joint Budget Committee on 8 November 2001, which deals in more detail with the functional allocation of expenditure.

The People's Budget, and its constituent organisations, have been vocal about the need for a comprehensive overhaul of the budget process to make it more open, democratic, and participatory.[1] In this context we welcome the publication, for the first time, of a Draft Division of Revenue Bill and Explanatory Memorandum in advance of the tabling of the Budget itself. This does open one more window for stakeholders and the public at large to engage with the budget cycle. Unfortunately little time was provided to analyse and respond to the detail of these documents, thus limiting our comments at this stage.

It is not clear how (if at all) comments made on the Medium Term Budget Policy Statement have been factored in to the Draft Bill, or how comments on the gazetted documents will be incorporated to the Budget itself. For the process to be meaningful, there does need to be a sense that inputs are taken seriously by Treasury and changes made where necessary. Moreover, we are concerned that the budget reform process seems to be undertaken in a piecemeal fashion, without public discussion as to how the whole process should be reformed.

This submission firstly explains the character and objectives of the People's Budget. Thereafter we discuss the macroeconomic context in which the Draft Division of Revenue Bill has been published, comment overall on the macroeconomic parameters framing its allocations, and on specific aspects of expenditure. We also pick up on certain aspects of the discussion in the Explanatory Memorandum around recommendations of the Financial and Fiscal

Commission (FFC). Lastly we comment on the reform of the budget process and on future plans of the People's Budget.

The People's Budget

The People's Budget was launched by the SACC, SANGOCO and COSATU in 2000, representing the three key pillars of civil society: the church community, non-governmental organisations, and trade unions. The central objective of the People's Budget is to present alternative Budget proposals which give effect to developmental priorities. At the time of the tabling of government's budget this February we also released proposals of the People's Budget, which covered both macroeconomic parameters and programmatic priorities.

The Peoples Budget attempts to define fiscal strategies that can eradicate poverty, support economic development and ensure greater equity by race, gender and class, by:

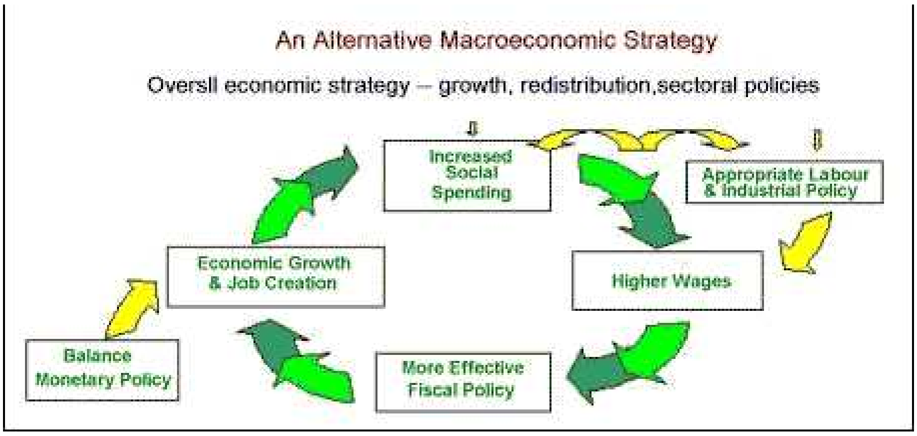
Meeting basic needs, especially by enhancing the public services and social spending;

Ensuring the retention and creation of quality jobs;

Giving the majority of people greater access to assets and skills;

Supporting a deepening of democratic and participatory governance; and

Protecting the environment and ensuring development throughout the Southern African region.



The diagram below depicts a developmental strategy that could break the vicious cycle of poverty. This strategy bolsters the impact of fiscal policy, which will have a greater capacity to promote economic growth and job creation if households have higher living standards and greater access to resources and skills. Higher rates of economic growth also expand the fiscal resource base, supporting even greater levels of social delivery, accelerating the virtuous cycle.

Underpinning this vision is a developmental role for the state. Four major roles are required for the state to fulfil these roles. These are:

The state must drive a growth strategy that focuses on providing strong policy support for sectors to protect and create quality jobs, meet basic needs for the poor, expand production for the domestic market, and expand exports.

The state must provide a social wage that sets a floor of living standards for all South Africans. The social wage comprises government services and grants provided to households in addition to earned income. It should ensure that no one faces absolute poverty. The social wage must:

provide welfare grants, education, health care, policing and housing at a level sufficient to support community development;

accelerate skills development and improve education on a mass scale;

develop more efficient, socialised systems to meet retirement, transport and health needs for working people, which effectively enhance the efficiency of the economy as a whole; and

be designed to support economic growth and employment creation.

The state must also transform itself to strengthen democracy and the public sector through the establishment of systems to permit greater participation by the majority, who historically have been shut out of power, as well as the resourcing of more coherent and effective delivery systems and structures. Steps to achieve this end include establishing participatory procedures for policy development and strengthening Parliament, especially to amend money bills and participate in policy development. They must also include measures to control lobbying by big business and to limit patronage and corruption.

The developmental state must support alternative centres of economic power. All the other strategies can contribute to this aim. They can change the nature of wealth by supporting a stronger state sector, co-operatives and small and micro enterprise, linked in part to land reform, improved housing, and investment in skills development.

Adapting the budget to overcome the poverty trap requires that expenditure increases to support inter alia an effective strategy to restructure the economy, co-ordinated with measures to improve the social wage;

expansion of the social wage in general, with the introduction of a Basic Income Grant, and establishment of National Health Insurance, and stronger measures to combat HIV/AIDS;

a coherent skills development strategy; and

better integration of infrastructure and housing development with the overall growth strategy.[2]

Draft Division of Revenue

Overall macroeconomic analysis

Over the past five years or so the emphasis on fiscal austerity has produced a perverse planning paradigm in which developmental objectives have been supplanted by the secondary objective of reducing the government deficit. The hope that this tight fiscal and monetary policy would attract private investment which in turn would drive economic growth, create jobs, and lead to a more equitable income distribution, has not materialised – in fact the opposite has happened. Instead of leading job creation, private capital has led job shedding and capital disinvestment.

The unresponsiveness of private capital to what was said to be an investor-friendly macroeconomic policy also points to the need for a state-led development path. There seems to be an emerging consensus that investment follows growth, rather than the other way around. Again the emphasis on boosting infrastructure spending is relevant here, in terms of "crowding in" investment.

The People's Budget thus does not share the Treasury's view (expressed in the MTBPS) that the fiscally austere policies of the past few years have in some way provided the basis for a somewhat more expansionary stance, and that the contractionary policies are now beginning to bear fruit.

On the contrary, the cutbacks from about 1996 onwards have had devastating effects on social and economic service delivery in South Africa. Had more resources been invested during this period in the construction of schools, training of teachers, provision of primary healthcare, extension of roads, and so on, we would today be reaping the benefits of these investments.

This would have taken the form, amongst other things, of better skilled school-leavers, a healthier population, and economic infrastructure more conducive to economic growth. Fiscal austerity has also directly reduced rather than built the capacity of the public service to spend allocated resources, resulting in substantial rollovers. The costs of recovering lost time of socio-economic development are greater than if adequate resources had been invested during this period.

Macroeconomic parameters of the Draft Division of Revenue

We believe that the moderately more expansionary stance of the 2001 MTBPS, and which frames the Draft Division of Revenue Bill, is a small but important step towards recovering the "lost years". It is certainly an improvement on the extremely fiscally austere budgets of the late 1990's. However, it is still inadequate to meet the broader goals of alleviating poverty, creating employment and ensuring economic growth.

In terms of the specific macroeconomic parameters reflected in the Draft Division of Revenue, the fact that last year's revised deficit:GDP ratio is lower than had been budgeted for (2.3% as opposed to 2.5%) is of concern. It means that optimum use has not been made of available resources to spend these where they are desperately needed. However inadequate, we nevertheless welcome the increase in the deficit:GDP ratio to 2.3% for 2001/02, 2.6% in 2002/03, although it again falls to 2.4% in 2003/04 and 2.2% in 2004/05. The upward revision of this year's target, for example, will free up over R3 billion for additional spending.

The People's Budget believes that there is further scope for moderate increases in the deficit. If these resources are then invested productively in building social capital and improving infrastructure, the medium- to long-term yields will more than justify this flexibility.[3]

On the revenue side, despite the welcome, although modest, increase in the revenue: GDP ratio, the proposed level is still well below South Africa's taxable capacity. This unnecessarily limits the resources available for spending. Every percentage point increase in the revenue: GDP ratio would free up approximately R10 billion to finance additional expenditure.

Econometric and tax effort analysis has indicated that there is considerable scope for increasing this ratio. Many countries in South Africa's income bracket have ratios of over 30% tax: GDP, as compared to ours of 24.5%.

It is worth noting that revenue targets have been consistently overshot for the last few years. We welcome SARS's efforts in closing tax loopholes, cracking down on tax evaders, and broadening the tax base. However, Treasury's consistent underestimation of revenue collection has the effect of contributing to overly contractionary fiscal policy. Revenue which is not budgeted for is then not allocated to delivery; rather, it ends up reducing the budget deficit more than what had been initially tabled. The pessimistic revenue estimates thus limit resources available for spending. They persist in doing this despite this problem being highlighted in previous years.

Together with under spending by key departments, this goes a long way towards explaining the trend of the past few years of actual deficits being even lower than had been planned. It is surely time for government to start factoring more realistic collection targets into the budget, so that these resources can be channelled to delivery.

When compared against the scenarios set out by the People's Budget for fiscal expansion and economic growth, the Draft Division of Revenue Bill is not nearly as expansionary as what we believe to be appropriate. We would have wanted to see the deficit GDP ratio going up to the region of 4%, and the revenue:GDP ratio going up to about 30%. Not only would this allow considerably expanded expenditure, but projections indicate that it would be conducive to higher and sustainable growth rates.

Specific areas of expenditure

As noted above, the spending plans contained in the Draft Division of Revenue Bill are certainly a moderate improvement on the budgets of recent years, and contribute towards meeting social and economic needs. These shifts permit substantial real per capita growth in spending on health and welfare. Still, in real terms, per-person spending has not yet caught up with 1996 levels. Higher levels of social and infrastructural spending are needed to compensate for the "lost years" of fiscal austerity and to put South Africa on a new growth path.

We will not at this point be analysing the provincial allocations and conditional grants set out in the Draft Division of Revenue. Instead we reiterate some of our comments made in response to the MTBPS which have a bearing of the expenditure aspects of the Draft Division of Revenue.

Social spending

The report of the Committee of Enquiry on Comprehensive Social Security for South Africa is due to be released soon. Whatever its specific recommendations, there will no doubt be significant fiscal implications. While welcoming the increased welfare expenditure proposed in the MTBPS, this would clearly be inadequate to support the introduction of a comprehensive social security system. Of particular concern for the People's Budget is that the health and welfare budgets will not be sufficient to support the introduction of a National Health Insurance or a Basic Income Grant.

There should be an understanding that, subsequent to the Committee's reporting and processes arising from this, the welfare allocations in the MTEF period will need to be fundamentally revised. We note the Minister of Finance's acknowledgement that the has not attempted to anticipate the report of the Committee of Enquiry. The People's Budget will be particularly eager to see sufficient expansion of the health and welfare budgets to support the introduction of a Basic Income Grant and a National Health Insurance scheme.

We do welcome the commitment to protecting the real value of welfare grants in future, after several years of real cuts. Their level however remains inadequate. There needs to be provision for real increases, particularly given their critical role in protecting the poor and vulnerable.

Even with the intention expressed in the MTBPS to double the number of children receiving the Child Support Grant (and the objective in the Draft Division of Revenue to increasing its uptake), this would still mean that less than half of intended beneficiaries would be reached. In general it is those children most in need of this grant who are not receiving it, whether because of a lack of information, not having the correct documentation, or not being able to overcome the bureaucratic hurdles of meeting the means test. For example the poorest provinces, whose children desperately need social protection, actually have the lowest take-up rates. This clearly demonstrates the need for a more comprehensive and universal system of social security.

The "integrated HIV/AIDS strategy", and its funding, is inadequate. The People's Budget has called for additional spending both in terms of prevention and treatment. This would include funding increased condom distribution, as well as awareness raising, and the provision of treatment to prevent mother to child transmission and to improve the quality and length of life of people living with HIV/AIDS.

Education spending overall is expected to fall slightly each year on a per capita basis. This is of great concern given the widespread acknowledgement of the need for increased investment in education and skills development.

Economic services

In terms of economic services, we endorse the commitment to increased infrastructure spending and the small real growth in the agriculture and transport/communication functions. This should have a positive effect both on people's quality of life and on South Africa's economic growth. However, we are very worried that the overall water budget is being cut in real terms, with no reason given. Water is an absolute basic need and is critical for health as well as for any type of productive activity.

We urge government to ensure that funds allocated for infrastructure are indeed spent. Treasury itself has noted the poor spending record in this area. For the intended positive effects of these increased allocations to be realised, it is obviously critical that strong and co-ordinated efforts are made to ensure that infrastructural investments do indeed take place.

The People's Budget also believes that government taking direct and active responsibility for infrastructural projects will be more conducive to effective expenditure. Collaboration with the private sector has been plagued by spending problems, as we show in greater detail below. The People's Budget therefore calls for government to play a more central and active role in the delivery of infrastructure and basic services. This would not preclude some limited involvement of the private sector, under tightly regulated conditions, where it would clearly facilitate access to better services.

Under spending

Examining recent experience of under spending indicates that where under spending occurred, this was mostly in cases where the programmes involved aimed at providing funds to small businesses or otherwise involving the private sector. In contrast, the big social service departments had not had major problems in spending their budgets where this has been through their normal delivery systems.

It was recently reported that the Department of Water Affairs under spent its budget by 75% in the first half of this year. The Minister of Water Affairs and Forestry attributed this in part to strict treasury regulations. The Director General of Water Affairs also pointed to problems which the Division of Revenue Act has created for line departments attempting to deliver services and meet backlogs.[4]

Fiscal control mechanisms must be rigorous enough to deter waste, corruption and mismanagement without erecting unintentional or unnecessary barriers to service delivery – especially for poorly-capacitated provinces and local authorities. If particular regulations or procedures are inhibiting vital and legitimate spending, then these should be reviewed and revised. While public concern over under spending is entirely justified, we must also be vigilant to ensure that government projects are sustainable and capable of achieving genuine development.

Our key proposals for improving spending are:

Revamping conditional grants through overhauling the treasury regulations and building capacity;

A greater reliance on the state itself to directly deliver services and infrastructure, rather that contracting this out; and

Transforming the procurement system. Currently, tender procedures are extremely time-consuming, do not facilitate the acquisition of policy advice and research services, and fail to ensure adequate representation of and support for small and micro enterprises.
FFC Recommendations and Treasury Response

The Costed Norms Approach

The FFC has recommended a shift to a costed norms approach. Treasury is critical of this approach in the Explanatory Memorandum (and in previous documents). The costed norms approach has been summed up by the FFC as "a formula-base method for calculating the financial resources necessary for the provision of basic social service levels, given nationally mandated norms and standards." [5]

The FFC proposed a budgetary methodology whereby "the mandated basic level of service should be determined nationally and should be expressed in terms of norms and standards for each programme area"; and hence "against the norms and standards established, fiscal requirements should be determined by taking account of factors affecting provincial conditions." The FFC argued that this paradigm would hold various advantages, notably the promotion of more efficient resource allocation choices by provincial governments; the provision of an incentive to provincial governments to achieve output goals; increased transparency; improved incentives to gather data on government performance and costs; contributing to determining appropriate fiscal policy; and limiting the reallocation of grants by provinces in ways that are inconsistent with national objectives.

Treasury does acknowledge that the division of revenue should take account of constitutionally mandated obligations, and that constitutionally mandated basic services and other constitutional obligations should be prioritised and progressively implemented. However certain reservations with the costed norms approach are raised, including that it would introduce "moral hazards" for provinces by encouraging them to increase or distort costs or funding levels; that policy norms used to develop cost estimates could be ambitious and unaffordable and generate unrealistic expectations for additional funds; and that a large portion of the required information is not yet available.

The People's Budget has in the past criticised a fiscal approach which takes macroeconomic parameters as a given and allocates these resources to various functions, irrespective of whether or not these resources are adequate to meet people's needs or even sufficient to carry out stated government policy. This approach has had various negative ramifications. While some advances have been made in addressing social backlogs and constantly arising new needs, this has been at a slower pace than would have been the case with more expansionary and flexible macroeconomic parameters, notably with respect to the budget deficit.

Such an This contractionary fiscal approach has also contributed directly to the problem of unfunded mandates, where lower organs of state are given various responsibilities without being allocated the necessary resources to carry these out. Such a situation is an outcome of both poor planning and of the determination of allocations on the basis of macroeconomic objectives without adequate reference to actual resource requirements.

The People's Budget has instead motivated for an approach to budgeting in which programmes inform budgets, in line with a growing consensus across the developing world. This aims to ensures that the strategic objectives of governments are reached. Within this, there is a recognition that some limits will always be present. The shift in emphasis from reaching fiscal targets to linking plans to budgets can assist in quantifying meaningful outcomes. We have proposed that the budgetary process should start by attempting to quantify the remaining social backlogs, calculating the resources needed to meet these backlogs, and from there develop short, medium, and long term strategies for financing the eventual elimination of backlogs. We thus strongly welcome the starting point of the costed norms approach, namely a commitment to meeting the state's constitutional obligations in terms of service delivery, and the recognition that fiscal policy needs to be responsive to and accommodating of this.

A costed norms approach could also potentially improve the democratic and participatory nature of the budget process. Ideally, acceptable norms and standards should be determined not in an abstract, academic manner but on the basis of people's needs. It would be an empowering experience for communities to be given the opportunity to define their own needs and priorities and for this to be fed into the process.

We believe that the costed norms approach will also be favourable in terms of equity issues and the distribution of resources in favour of poorer provinces. In particular, the acknowledgement there are differential costs between provinces which are beyond the influence of provincial authorities (for example, economic and social conditions in a province, which result in higher rates of disease, will increase health costs). Having this recognition built into the formula is likely to work in favour or poorer provinces.

Clearly however, the costed norms approach is no "miracle instrument", but an integral part of an overall system. We also note that for a costed norms framework to be successful, it will need buy-in from all stakeholders and particularly all relevant organs of state, further refinements and concretisation if necessary, as well as an intensive effort towards the gathering and analysis of all required data. As the FFC has noted, the costed norms approach can add value immediately and then be improved on over time.

We do also note Treasury's concerns in terms of adequate and accurate information needed for the successful implementation of a costed norms approach. The People's Budget would see this as a process of moving towards such an approach. Treasury should table a plan, with timeframes, for providing or accessing such relevant information.

The nub of the issue in practice may come arise in terms of the "iterative process". This was defined by the FFC report as "a part of the procedure for dividing national revenue suggested in [the FFC] report, in which policy makers alternate repeatedly between adjusting a costed norms scenario and adjusting macro-priorities set by the MTEF, until a solution is found that brings norms into alignment with the MTEF". Our concern is that in adjusting norms to fit the MTEF – rather than the other way around – the norms and standards identified may become lost in the course of the iterative process and budget allocations may end up not much different from what they might have been in the absence of a costed norms approach.

The People's Budget does acknowledge the need for some mechanism of reconciling the resources needed to meet social and economic needs with an overall macroeconomic policy. Without some way of adjusting the resources required to meet people's needs, macroeconomic management would be very difficult and there would be potential for excessive fiscal expansionism and macroeconomic instability. So whilst we agree on the need for some type of iterative process, we are recommending some modifications of the FFC proposal.

The FFC proposes the establishment of basic social service levels, expressed in the form of norms and standards, for each programme area. There is obviously a degree of subjectivity involved in defining these levels, and actual levels will be further determined through the iterative process. The FFC recommends that alternative national benchmarks be designed, from which national government could choose. It argues that these alternatives would offer a "menu of alternative realisation rates and policy parameters", both in terms of possible norms and standards and about different provincial shares in the vertical division. Such an approach would make explicit the trade-off between different possible levels of national norms and standards, and other fiscal priorities of government.

What the People's Budget proposes with respect to this is that the FFC costs at least two levels of service delivery, as follows:

Minimum Norms: the basic level of norms and standards which would have to be met in terms of the state's (most basic) constitutional and other obligations, legislated policy objectives, and a minimum acceptable standard of living.

Preferred Norms or Intended Norms: these could be one or more menus of service delivery above the standard of the minimum norms.

These different levels would be costed and the actual standards chosen (with their concomitant cost implications) would ultimately be a political decision. Whilst the actual level agreed upon may well fall in between the Minimum Norms and the Preferred Norms as proposed by the FFC, they should not fall below the floor of the minimum norms. This proposal of the People's Budget is intended to avoid a situation where, in the course of the iterative process, macroeconomic parameters squeeze the norms and standards to an excessively low level such that the costed norms approach is rendered meaningless.

Furthermore, for a costed norms approach to be effective, in the long term this paradigm would need to be extended to all spheres of government rather than just the social sector at the provincial level. In the interim, a situation needs to be avoided of distortions and crowding out, which could potentially prejudice certain functions and spheres to which the costed norms approach is not applied (such as the crucial area of economic services).

The FFC has not taken the rationale of the costed norms approach to its logical conclusion: and explicitly recommended the adjustment of macroeconomic parameters in order to fund identified norms and standards in terms ofbased on inter alia the state's constitutional obligations obligations to deliverin services delivery. Final decisions around economic policy are ultimately the decision prerogative of government. , and wExtending the logic of the costed norms approach would imply some flexibility in macroeconomic policy.

Lifeline Tariffs

Treasury also responds to a FFC recommendation around lifeline tariffs and cross-subsidisation of service delivery. The response expresses some scepticism and reservations around a subsidisation approach. The People's Budget is concerned that, two years after the commitment was made to free lifeline services and progressive block tariffs, only certain pilot projects have been implemented.

It will be crucial in the coming year to implement free basic services on a more comprehensive scale. This will require adequate provisions in the 2002 Budget to fund these services through national subsidies, to supplement the cross-subsidies built in through the progressive block tariffs funding model.

Democratising the Budget Process

One of the problems which led to the establishment of the People's Budget was the lack of transparency and opportunities for meaningful participation in Treasury's budget process. We are dismayed about the continued absence of legislation to empower Parliament to amend money bills, as required by the Constitution (at s77). The spirit and letter of the Constitution expressly states that an important aspect of South Africa's democracy is the transformation of the highly secretive and centralised budgetary process inherited from the apartheid regime into a more open and participatory process.

The ANC Elections Manifesto also contained a commitment to ensure that elected representatives in national, provincial and local spheres have the appropriate powers to shape budgets. However, yet again, when this year's budget is tabled elected representatives will not have the opportunity to meaningfully engage with it.

Over and above the legislative challenges of democratising the budget process, there is a need for increased participation – of parliament, Nedlac, and society at large – in the budgetary process.

Through the involvement of the affiliates of our three constituent organisations – churches, NGO's and trade unions – as well as other elements of civil society outside of the coalition itself, we have attempted to bring broader voices into the determination and articulation of budget priorities in the People's Budget. In February, we will be presenting an expanded and revised People's Budget document. We hope that the proposals contained in that document will serve as the basis for further engagement with government to strengthen the budget's capacity to eradicate poverty, create quality jobs, and meet the needs of all of our people.

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1. Discussed further in section 5 below

2. More detailed proposals in each of these areas were set out in the document released by the People's Budget in February 2001 (available at COSATU's website, www.cosatu.org.za).

3. In the document released by the People's Budget in February 2001, three economic scenarios were explored in which deficit and revenue parameters were relaxed to differing degrees; gradual expansion, moderate expansion, and rapid expansion. In each scenario projections indicated that sustainable growth could be achieved at a higher level than if the macroeconomic parameters in the National Budget were followed.

4. Business Day 18 September 2001.

5. FFC (2000) Recommendations: 2001-2004 MTEF cycle p7.