

**Fiscal Policy and Microeconomic Reform in South
Africa**

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PREFACE AND ACKNOWLEDGEMENTS

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ABSTRACT

South Africa has embarked on fiscal policy reforms in an attempt to grow its economy and to resolve the structural problems in the country. The macroeconomic reform that was implemented in 1996 with the introduction of the Growth Employment and Redistribution Policy did not yield the intended results. This attests the notion that the macroeconomic reform is a necessary but not sufficient condition for economic growth. Once the macroeconomic policy is refined to provide an enabling environment for economic activity, then the country must reform its microeconomic policy. South Africa like other developing countries followed in the footsteps of the developed countries and implemented the aforementioned steps in their fiscal policy reforms.

This research appraises the programmes that support the microeconomic reforms in South Africa, and assesses their value in driving growth. The findings reveal that the microeconomic reforms received substantial support from the fiscus and the policies developed are well aligned to addressing the challenges in the South African situation. Although both the process and fiscal framework are in place, the main challenge is effective implementation of the policy framework.

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CHAPTER I

ORIENTATION OF STUDY

1.1 Introduction

Calitz & Siebrits (2001:1) define fiscal policy as national government decisions on the nature, level and composition of government expenditure, taxation and borrowing aimed at pursuing particular goals. This policy is one of the most important components of a government's overall economic policy, and is used in an attempt to maintain, *inter alia*, economic growth rates and high employment levels. There are, however, different views on the way in which fiscal policy influences the economy.

Keynesianism focuses on the expansionary and contractionary effects government spending and taxation have on aggregate demand. Expansionary policy occurs when government believes that its economy is not growing fast enough or that unemployment is too high. By increasing public spending or cutting taxes, the government leaves individuals and business with more money to purchase goods or invest in new equipment. When the purchases are increased, the demand increases. Such an increase requires increased production, creating jobs and generating more spending. The result is higher employment and a growing economy. On the other hand, fiscal policy is contractionary when taxation is increased or public spending is reduced in order to restrict demand and slow down the economy. A tight fiscal policy is likely when inflation is high and such policy reduces the amount of money in the economy available for purchasing goods, thus decreasing spending, demand, and, ultimately, pressure on prices.

International investors and sovereign credit-rating agencies use the neoclassical prescriptions as a measure of the country's risk. According to the neoclassical prescriptions, the sustainable fiscal policy means that the public debt/GDP ratio remains stable over the medium to long term. In a word, if the real interest rate exceeds the real economic growth rate, the neoclassical prescription for fiscal sustainability requires government to run a sufficiently-

sized primary surplus in the medium to long term and not to dis-save on average (Cantor and Parcker, 1996) as quoted by Fourie & Burger (2003:806).

Government must make judgments about a number of factors in order to determine its fiscal policy stance, for example, the level of economic growth or unemployment likely in future and whether to run a budget deficit or not. From the Keynesian or demand-side point of view, fiscal policy mainly operates *via* the various components of domestic demand: private and government consumption; and fixed capital formation or investment (Calitz & Siebrits, 2001:7). Prior to the democratically-elected government the real interest rate far exceeded the GDP growth rate and the country was running a substantial budget deficit, which implies that the South African fiscal policy was unsustainable according to the neoclassical principles. The fiscal reforms of the democratically-elected government strived to create an enabling environment for domestic and foreign investment. Its conservative fiscal policy was part of the process to integrate the new South African economy into the global economy (Fourie & Burger, 2003:806).

The two key policy developments in the South African economy since democracy are the Reconstruction and Development Programme (RDP) and the Growth Employment and Redistribution (GEAR). While the RDP is more inclined towards service delivery to the poor and the creation of an enabling environment for human development, GEAR focuses on the elimination of dissaving to release more resources for public and private investment. Essentially GEAR is a neoclassical macro-economic stabilisation policy along the lines of the so-called Washington Consensus (Fourie & Burger, 2003:810).

The aforementioned policy developments in South Africa attempted to create an environment conducive to growth. Borat & Cassim (2004:7) outline the reform package adopted by the democratically-elected government as consisting of fiscal prudence, trade reforms and the deregulation of various sectors of the economy. However, they emphasize the fact that a country cannot rely on growth alone to reduce poverty and inequality. Growth is dependent on a range of issues beyond macro-economic stability, trade liberalization or labour market flexibility. The economic outcomes also depend on the roles of institutions, micro-economic reforms and governance.

Similarly, Calitz & Siebrits (2001:5) and Roberts (1988:98) support the notion of Borat & Cassim by stating that the alternative to the Keynesianism approach is viewing fiscal policy from the supply-side of the economy. In terms of this approach, fiscal policy affects the rate of economic growth through its impact on the availability of factors of production - mainly labour and capital. Roberts (1988:98) indicates that the micro-reforms or supply-side economics focus on individual incentives to work, invest and save, as well as on the belief that these propensities are strong enough for individuals to have a major economic impact. He further highlights the origin of this economic concept as not being born in academia but in the United States Congress – developed by the advisors of the then president Ronald Reagan. The implementation of this economic concept resulted in positive spin-offs in the United States economy with respect to production, investment, employment and the attempt to reduce inflation. The stagflation that came about as a result of the implementation of the Keynesian model was mitigated by this new model of supply-side economics.

Roberts (1988: 99) draws a distinction between the Keynesian model and the supply-side model as follows: While Keynesianism focused on the supposed relationship between macro-economic aggregates and emphasized the importance of consumer demand in quickening or slowing economic growth, supply-side economics focuses on individual incentive to work, invest and save. This implies that supply-side economics relies more on a micro-economic analysis of market behaviour and less on the macro-economic analysis of statistical aggregates. The change from the Keynesian to the supply-side model represents a fundamental shift in fiscal policy thinking.

Furthermore, the Keynesian theory presupposes that the effect of fiscal change, whether in taxes or government spending, is to alter demand in the economy. For an example, a tax-rate reduction raises the disposable income of consumers, who then spend more. Assuming government spending to be constant, increased consumer spending stimulates supply and moves the economy to a higher level of employment and Gross National Product (GNP).

Given the above situation, if government runs a deficit, the deficit's size determines the amount of stimulus. In contrast, supply-side economics emphasizes that fiscal policy works the way markets work – by changing relative prices and thereby changing individual incentives. High tax-rates are seen as a disincentive regardless of the overall level of

demand. Alternatively, when the tariffs are lifted, no revenues are lost, no budget deficits result, and no money is put into anyone's hands. Yet, clearly, economic activity will expand because a disincentive has been removed. This effect is not captured in Keynesian demand management (Roberts, 1988: 99).

The successes of macro-economic stability in South Africa were achieved as a result of the GEAR Strategy that was developed in 1996 after a review of the country's economic performance. It was then realized that the expected average economic growth would result in an increase in unemployment if there were no improvement in labour absorption. This macro-economic strategy targeted a growth rate of 6 per cent per annum and job creation of 400 000 per annum by the year 2000, concentrating capacity-building on meeting the demands of international competitiveness (Department of Finance, 1996:3).

Calitz & Siebrits (2001:5) highlight the fact that since the implementation of the GEAR Strategy, government has stabilized expenditure, reduced the overall tax burden and decreased government dissaving to (along with tough anti-inflationary policies) crowd-in saving and investment for growth. At the same time, government has been providing basic services to millions of South Africans and has spent more on infrastructure and skills development.

Coetzee & Johnson (2003:2) alludes to the fact that the planning of micro reforms has been in South African minds since 1994. There was, however, no implementation strategy in place. Following undesirable results hailing from the original plan set in the GEAR policy, President Mbeki intervened by announcing an integrated action plan that focused on addressing micro-economic constraints to growth in February 2001. This plan makes critical adjustments designed to increase the rate of growth, employment creation, and development by narrowing the inequalities of wealth and the geographic spread of economic activity. In his 2001 Budget Speech the Minister of Finance, Trevor Manuel, said that his budget "*bring the fruit of macro-economic transition we have undergone...and we can move to the next phase of economic reforms*", as quoted by Coetzee & Johnson (2003:2).

In 2002 the Department of Trade and Industry developed the Micro-economic Reform Strategy. The strategy supports the principles of the GEAR Strategy and was not meant to

replace the GEAR policy but to complement it (Department of Trade and Industry, 2002:3). In 2002 the Minister of Trade and Industry, Alec Erwin, stated that the change in phasing is a necessary measure to boost economic growth. In order to be effective, there is a need to undertake macro-reform, then followed by micro-reform. If a country were to stay with the macro and not push further into micro-reform, it would have a truncated reform process.

The statement by the Minister of Trade and Industry supports the notion by Coetzee & Johnson (2003:2) that macro stability is a necessary condition for economic growth but is not sufficient. The drivers of growth are also, *inter alia*, human capital and technology. In order to influence such aspects through fiscal policy, a micro or supply-side approach will be appropriate.

The Department of Trade and Industry's Micro-economic Reform Strategy seeks to have an impact on six performance areas, namely growth, competitiveness, employment, small business development, black economic employment and the geographic spread of economic activity (Department of Trade and Industry, 2002:27). The purpose of the South African micro-economic reforms is therefore to deepen the structural changes in the economy and strengthen the institutional capacity to deliver services and products that will facilitate social and economic development. The structural changes are designed to increase the levels of saving, investment and job creation. Other micro-economic reforms will further strengthen the efficiency of the economy. In May 2002, approximately two-thirds of the concrete steps contained in the plan were implemented. Drawing on the important lessons learned by the state through this process, additional measures and areas in need of fine-tuning were identified by January 2002 (Department of Trade and Industry, 2002:15).

1.2 Problem Statement

The South African fiscal policy will continue to be supportive of economic growth through public spending, especially on infrastructure and moderate tax relief to business and individuals. Yet, years of under-investment and the micro-economic blockages mean that domestic producers have not been fully able to meet the demands of the growing economy. The examples include a skilled labour-shortage that has a negative impact on economic growth, and there are still regulatory obstacles that prevent the small business from

expanding, namely municipal planning rules, labour legislation, the process of registering a company and access to credit for small entrepreneurs (National Treasury: 2005,2-4).

This research will do an appraisal of the so-called “second generation” or micro-economic reforms for growth government has undertaken, and assess their value in promoting growth.

The macro-reform strategy entails a set of fundamentals which includes:

- Appropriate and efficient economic and social infrastructure,
- Access to finance for productive activities,
- Investment in research and development,
- Innovation and the adoption of new technologies,
- Investment in human capital; and
- An adaptive, flexible workforce (Department of Trade and Industry, 2002:1).

Micro-economic reform in South Africa will also be compared to that of Singapore. Singapore is one of the countries that successfully curbed structural problems through micro-economic reforms. Its focus on a dynamic and entrepreneurial economy addresses issues similar to those in South Africa’s micro-reform strategy (Ministry of Finance-Singapore: 2005, 6 and 12).

The economic priorities of the South African government since 1996 entailed increasing investment in public infrastructure; lowering the costs of doing business, including addressing regulatory concerns of business and simplifying tax arrangements for small business; and producing more skilled people through increased investment in education and technical training, investing in research and development and making it easier to import skilled labour (National Treasury: 2005, 2). The scope of the micro-economic reforms that will be covered in this dissertation is limited to infrastructure development, SMMEs’ support, and investment in human capital.

1.3 Motivation

The reforms in South Africa started with the GEAR policy in 1996 – the macro-economic policy of the democratically-elected government. The implementation of the GEAR policy delivered mixed successes in terms of economic growth and employment creation. Since the

implementation of this macro-economic strategy, the economic growth of the country averaged 3 per cent between 1996 and 2002. The budget deficit improved from -4,6 to -1,4 per cent of GDP between 1995/96 and 2002. On the other hand, the unemployment rate increased from 29 per cent to 31, 2 per cent between 1996 and 2003 [Department of Finance (1997:1.3) and National Treasury (2003:42 & 2005:3)]. The aforementioned shows an improvement in the macro-economic stability of the country. However, economic growth and employment are still lagging at rates far below the targets set in the GEAR strategy.

In 2002, the South African fiscal policy changed focus and concentrated on micro-economic reform. There are a number of government programmes embarked on to advance the objectives of the micro-economic reform. Among others, these include the following: The Department of Public Works through the Emerging Contractors Development Programme focuses on the skills development and capacity-building of emerging contractors with specific attention to women contractors. In addition, the National Treasury has revised tax policies that encourage the creation of Small Micro Medium Enterprise. The departments of Transport, Public Works, Water Affairs and Communications have programmes that advance the infrastructure development objectives. The Department of Education, South African Development Institute and the Sector Education and Training Authorities (SETAs) are involved in skills development and learnership programmes.

Since the introduction of the micro-economic reforms, unemployment declined from 31,2 per cent in 2003 to 27,8 per cent in 2004; and the primary surplus decreased from -1,1 per cent to -0,5 per cent of GDP between the 2002/03 and 2005/06 financial years (National Treasury (2005:3)). Notwithstanding the improvements recorded after the introduction of the micro-economic reforms, the economy still performed below targets set for economic growth and the reduction of unemployment – hence the necessity to appraise the micro-economic reforms. This will map the road ahead for the South African fiscal policy and further reforms to ensure the achievement of set economic targets.

This dissertation's appraisal will benchmark the South African initiatives to those of Singapore. Singapore is selected as the best comparator country not because of the comparability of the economies but due to the fact that the nature of its micro-economic reform is similar to that of South Africa, namely: small medium micro enterprises (SMMEs)

support, human capital development and infrastructural development. Furthermore, Singapore has made strides in implementing their micro-economic reforms.

1.4 Objectives

The general objective of the study is to appraise the micro-economic reforms undertaken by the South African government since 2002. The specific objectives are:

- To undertake a literature review of fiscal policy reforms in South Africa since 1994;
- To examine micro-economic reforms in Singapore; and
- To provide an appraisal of micro-economic reforms in South Africa.

1.5 Method

This study comprises an overview of fiscal reform since 1994 with a focus on the second generation or micro-economic reforms. Specifically, it will outline what the micro-economic reforms are and how they were supposed to address challenges such as low economic growth, high unemployment, poverty and inequality. The micro-economic reforms already underway in South Africa will be appraised by paying special attention to infrastructure, SMMEs and human capital development.

1.5.1 Design of study and data needed

The processing method of the research will be a qualitative approach, with an evaluative case study including quantitative data to analyse the trends on the programmes under review.

1.5.2 Data collection and unit of analysis

The data compilation method will be literature study. The study will encompass a reflective analysis of the achievements of the programmes, which are driving growth from the micro-economic perspective, as opposed to the intent of the micro-economic reforms. A comparative analysis will also be done to benchmark the South African situation with experiences in Singapore.

1.6 Delimitation

The dissertation is structured as follows: Chapter 2 outlines the recent history of fiscal policy in South Africa. It begins with a review of the fiscal policy in South Africa and looks into the development of the economic policy and the outcomes thereof. Chapter 3 examines the successes of the micro-economic reforms in other countries - Singapore is used as a comparator. The developments of both macro- and micro-economic reforms are identified - highlighting the lessons learned by the country during the transition process and the major contributors to the successes. Chapter 4 examines the initiatives of South Africa in pursuit of the micro-economic reforms objectives. It identifies the programmes on which the country embarked to this effect; assesses their value in driving growth; and establishes the major setbacks experienced and the causes thereof. Chapter 5 concludes by communicating the findings of the research, recommending remedial actions to the setbacks identified and proposing further research studies in the field.

CHAPTER II

FISCAL POLICY IN SOUTH AFRICA

2.1 Introduction

Calitz & Siebrits (2001:3-5) acknowledge the major policy developments to counteract the serious fiscal problems towards which South Africa was heading in the early 1990s. However, the turnaround was experienced after the democratically-elected government took over in 1994. The new policy framework adopted by the democratically-elected government to address the structural challenges in the economy was the Reconstruction and Development Programme (RDP). In 1996 government introduced the Growth, Employment and Redistribution (GEAR) Strategy as one of its principal instruments for the realization of the policy objectives contained in the RDP. In turn, the Budget is one of the principal instruments used by government to advance the objectives contained in the policy (Calitz & Siebrits, 2001:3-5).

To address structural problems in the economy, the Budget must balance three conflicting objectives: Firstly, the reduction of the overall tax burden so as to lower the costs of investment and job creation and release household spending power; secondly, meeting the social, development and infrastructural expenditure responsibilities of the State; and lastly, lower interest rates and fiscal sustainability (Department of Finance, 2000:42).

Correspondingly, since 1994 South African fiscal policy intended to support increased investment and sustainable growth in three ways: Firstly, by moderating the level of government consumption spending relative to GDP. This was done by reducing public service personnel expenditure, and enhancing capital formation by general government and public corporations. Secondly, by reducing the level of government dissaving through steady reductions in the budget deficit, stabilizing the level of debt and reducing the debt service costs. Thirdly, by lowering the tax burden on the economy by broadening the tax base and reducing the distorting effects of tax (Department of Finance, 2000:42 - 43).

The Department of Finance (1997:27) highlights the following as objectives set to respond to the challenges facing the fiscal stance of the Republic of South Africa:

- Ensure sound public finances and ensure that government debt does not grow faster than its ability to repay it;
- Ensure that debt service costs decline as a share of expenditure so that these services could be reallocated to the delivery of public services;
- Improve domestic savings to support a higher level of investment and reduce the need to borrow from abroad;
- Ensure that excess consumption does not push up inflation or lead to a deterioration of the trade deficit;
- Support an export-friendly trade and industrial strategy to improve South Africa's competitiveness; and
- Counter-inflationary pressures to prevent interest rates from having to rise.

The objectives outlined above support the GEAR Strategy that was adopted as the macro-economic policy in 1996. The policy developments in South Africa occurred against the backdrop of the fiscal policy stance of the 1990s, which required South Africa to consider the impact of both the international and domestic policy context. This was regarded as important because the 1990s were preceded by two decades of progressively worsening macro-economic performance. The real annual rate of economic growth had dropped from 5,8 per cent to 3 per cent and then 1,7 per cent in the 1960s, 1970s and the 1980s, respectively. Slower economic growth resulted in sharp decline in economic activity and consequently the job creation capacity in the formal sector. The estimated labour force in the formal sector dropped from 68 per cent to 51 per cent between 1960-65 and 1985-90 periods. Furthermore, the average annual rate of change in consumer prices increased from 2,5 per cent in the 1960s to 10,3 per cent in 1970s and to a further high of 14,7 per cent in the 1980s. The distribution of income and wealth remained the most unequal in the world. Furthermore, the public sector claim on resources had also increased sharply over the decades up to 1990s; the total tax burden, as approximated by government tax income, had increased from an average of 15,8 per cent of Gross Domestic Product (GDP) in the 1960s to an average of 22,9 per cent in the 1980s; and public sector resource use had increased from an average

20,8 per cent in the 1960s to an average of 27 per cent in the 1980s (Calitz & Siebrits, 2001:2).

Naidoo (2006:110) attributes the worsening economic situation in South Africa prior to 1994 to the short-term economic problems, namely the after-effects of a severe drought in 1992; a global economic recession; political strife and economic policy uncertainty at home; a large budget deficit; almost no foreign exchange reserves (less than a week of import cover); a private sector creaking under high interest rates; inflation of about 15 per cent; and massive outflows of currency. While the aforesaid short-term issues suggested a crisis mode, the longer-term structural weaknesses in the economy, going back to 1980s, were even more serious and difficult to correct. Investment and employment were in long-term structural decline from the early 1980s. Large monopolies developed behind high tariff walls. Capital became concentrated in relatively few hands. The education system was churning out people totally inappropriately equipped for an industrializing country. A large portion of the industrial sector was built on the back of either military or armament requirements for the Angolan/Namibian war or energy self-sufficiency. The mining sector was in decline due to diminishing gold reserves and delayed investment, the financial service sector was well developed but with very high cost structures, and manufacturing was being decimated.

Calitz & Siebrits (2001:1-2) further observe the role of government in the market economy to be marked by the integration of economic activity in the form of regionalisation and globalisation. The reconsideration of the role of government has focused on reversing the expansion of the public sector that had occurred in most developing countries from the end of World War II. They further noted that many countries adopted the Washington consensus, which was perceived as the best international practice. Its fiscal element included a low budget deficit, strengthening public revenue and expenditure management, restructuring public expenditure to increase the allocation for social spending and infrastructure, tax reforms to broaden the tax base, and reducing marginal rates and the restructuring of institutions in the public sector.

As indicated in Chapter I, the conservative fiscal policy was part of the process to integrate the new South African economy into the global economy. Globalisation and regionalisation boosted international capital flows, but these flows were volatile and several wide-ranging

financial crises occurred during the 1990s. Such volatility further raised the premium on adopting the Washington consensus, as this consensus came to be regarded as a requirement for attracting foreign investment as well as partial protection against the contagion effects of a financial crisis. The autonomy of other countries with respect to fiscal policy-making was further reduced by other aspects of economic globalisation and/or regionalisation, including World Trade Organization agreements to reduce import tariffs, tax harmonization within regional groupings, and the impact of increased international mobility of tax bases on policy choices related to tax rates and tax bases. In addition, on the expenditure side, globalization creates pressure for increased public spending on infrastructure and a social safety net, especially to assist those who lose their jobs or capital due to increased exposure to foreign competition (Calitz & Siebrits:2007,223).

This chapter provides the background of the South African fiscal policy prior to 1994 and outlines the developments in South Africa's fiscal policy in pursuit of improving the economic performance of the country. It delves into the policy development and programmes implemented to operationalize objectives already spelt out in established policies. It further outlines the specific fiscal elements that underwent a change since the development of the new policy by the democratically-elected government, and highlights the critics and successes of the policies. It concludes by summarizing the shortcomings of the new developments – the part that introduces the points of discussions in Chapter III.

2.2 Earlier Keynesian Fiscal Policy and the Basis of Macro-economic Reforms

The traditional view of the role of fiscal policy is to maintain, *inter alia*, economic growth and high employment rates. The Keynesian model puts forward public spending as an exogenous factor that may be used as a policy instrument to influence growth (Ansari *et al*, 1997:543). The illustration below explains the Keynesian ideology.

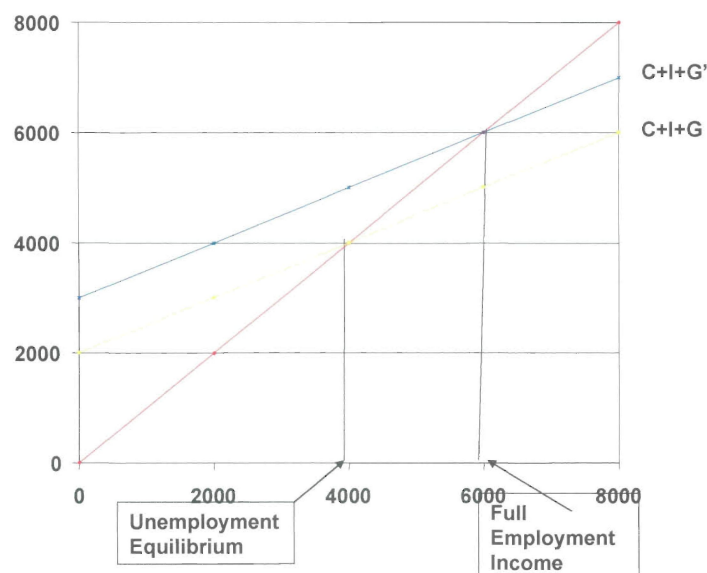
According to King (s.a.:1-2) Keynesian economics understands unemployment as a macro-economic problem - a problem of the economic system as a whole. It therefore must be addressed by the one agency that can have an impact on the economic system as a whole -

the national government. He believes that change in government purchases of goods and services can influence equilibrium in the model economy. An increase in income would mean (*ceteris paribus*) that more people would be employed to produce the income. It therefore makes sense for government to spend more money to stimulate production.

One of the examples he sites is job creation through public works programmes - employing the unemployed for the construction of roads, public buildings, parks, etc. This strategy was adopted by the United States in the 1930s and Japan during its recession of the 1990s. The strategy has a multiplier effect in that it does not only assist the unemployed who are given jobs, but the people hired for public works would spend most of their income and that would create jobs for other people, who would, in turn, create income for still other people. He further states that any decision by the national government on taxation and spending with a view to influencing the level of production and employment is called fiscal policy. According to the Keynesian diagnosis, unemployment is the result of inadequate aggregate demand. Therefore, by increasing government spending, which is part of the aggregate demand, private spending and production will increase by much more than government spending itself.

A graph below illustrates the Keynesian theory of the impact of adjusting government spending to effect full employment:

Figure 2.1: The impact of adjusting government spending to effect full employment



In the graph above $C + I + G$ show the situation before government intervention. Government purchases are at 4 000 and equilibrium production is at 4 000. After the increase in government spending, the government spends 6 000 and the new total expenditure line is $C + I + G'$. This gives the equilibrium at the full employment target income of 6 000.

Figure 2.1 above is a rough representation of the impact of changes in fiscal policy. However, it is argued in Chapter 1 that the use of fiscal policy to manage aggregate demand may not be without consequences. The progressive increase in government spending might compel government to increase their resources through borrowing. Such a shortfall in the budget is a budget deficit. Rosen (1998:457-460) defines a budget deficit as the excess of spending over revenue. He further draws a distinction between a budget deficit and debt - the debt at a given time is a sum of all past budget deficits – i.e. the debt is a cumulative excess of past spending over past receipts. In the neoclassical view, expansionary fiscal policy, budget deficit and debt may engender macro-economic instability and endanger the economic growth it was meant to promote.

As discussed in the previous sections, at the time of the democratic transition South Africa was characterized by macro-economic instability reflected in, among others, the high interest rates, large budget deficits and public debt, coupled with an economy that was growing below the rate of increase of the budget deficit. According to Heyns (1995:1) the South African debt grew substantially from R35 billion or 32 per cent of the 1984 GDP in March 1985 to R234 billion or 54 per cent of the 1994 GDP in 1995. Consequently, the actual interest payment increased from R4,6 billion or 13 per cent of budget outlays to R23,7 billion or 16,9 per cent between the 1985/86 and 1994/95 fiscal years. At the time the main concern was whether the situation represented an irreversible process of ever-increasing debt and interest ratios.

Empirical studies conducted in 1997 revealed that there was no long-run relationship between government expenditure and national income in South Africa (Ansari *et al*, 1997:549). This implies that the Keynesian model illustrated in figure 2.1 does not hold for the South African situation simply because the increased South African government spending was funded by

borrowing, and the fiscal policy was not directed at benefiting all South Africans, but a small population. Similarly, the results of an empirical study conducted on South African sustainability between 1970 and 2001 suggest that the South African fiscal stance was not sustainable (Kalyocu, 2005:957). Fourie & Burger (2003:808) define unsustainable fiscal policy as the situation where the real interest rate exceeds the real economic growth rate, and the surplus that is build by government is not large enough to cover the excess of the real interest rate over the real growth rate.

This situation posed a serious challenge to the newly-elected government. It compelled the government to focus on macro-economic stability to create an enabling environment for economic activity. As stated above, the Washington Consensus was adopted worldwide as the best-practice for growing the economy. The South African macro-economic reforms followed the same path. This is evident from the policy developments effected by the South African government with the objective of enhancing economic growth mechanisms and addressing the structural problems of the country.

The following subsections will outline the macro-economic reform package South Africa adopted in pursuit of the creation of an environment conducive to growth. The package includes policy development, deficit reduction, revenue initiatives and privatization.

2.3 Policy Development

According to Calitz & Siebrits (2001:3) and Weeks (1999:787) the post-apartheid government faced the dilemma of reconciling the imperatives of fiscal discipline necessitated by the macro-economic situation and the prevailing views of best fiscal practice, with the growing demand for government expenditure resulting from political democratization. The following sections outline the policy developments since 1994 and highlight the successes and challenges of the policies adopted by the democratically-elected government.

2.3.1 The Reconstruction and Development Programme

The African National Congress (1994:2) revealed that prior to the democratically-elected government the South African economy was built on systematically enforced racial divisions in every sphere of society. Rural areas were divided into underdeveloped Bantustans and well-developed, white-owned commercial farming areas. Towns and cities were divided into townships without a basic infrastructure for blacks and well-resourced suburbs for whites. Segregation in education, health, welfare, transport and employment left deep scars of inequality and economic inefficiency. Small and medium-sized enterprises were underdeveloped, while highly protected industries under-invested in research, development and training.

The first economic policy proposal of the African National Congress was the Reconstruction and Development Programme (RDP). The RDP is described as an integrated, coherent socio-economic policy framework that seeks to mobilize all the people in the country and its resources towards the final eradication of apartheid and the building of a democratic, non-racial and non-sexist future. The approach was meant to necessitate the reconstruction of the country's situation, which was characterized by both lavish wealth and abject poverty (African National Congress, 1994:1 and Fourie & Burger, 2003:810).

Calitz & Siebrits (2001:3) and Weeks (1999:787) consider the RDP a policy that exhibited socialist leanings. Encarta Encyclopaedia (2007:1-2) defines socialism as a socialist doctrine that demands the state ownership and control of the fundamental means of production and distribution of wealth, to be achieved by the reconstruction of existing capitalist or other political systems in a country through peaceful, democratic and parliamentary means. Further characteristics of socialism are highlighted as a doctrine that specifically advocates the nationalization of natural resources, basic industries, banking and credit facilities, and public utilities. It places special emphasis on the nationalization of monopolized branches of industry and trade, as it views monopolies as inimical to public welfare. It advocates state ownership of a corporation in which the ownership function has passed from stockholder to managerial

personnel. Smaller and less vital enterprises would be left under private ownership and privately-owned cooperatives would be encouraged.

According to Naidoo (2006:111) the African National Congress (ANC) adopted this policy against the backdrop of the successes of the reconstruction of Europe after World War II and the United States of America's turnaround after the Great Depression. In both the aforementioned countries the economic policy used to restart the economy was a demand-driven approach involving large infrastructure programmes, increased public investment, increased public-sector employment and high social security spending. In Europe these investments were facilitated by cheap international finance under both the Marshall Plan and the new International Bank for Reconstruction and Development.

Similarly, Naidoo (2006:111) indicates that the RDP proposed a massive increase in the delivery of social goods - the construction of a million houses; the provision of water and electricity; increased employment in education, health and policing; and rapid land reform. The African National Congress (1994:16 and 18) and Fourie & Burger (2003:810) further identify the basic services that were required to be made available to the previously marginalized as, *inter alia*, land, water and sanitation, education, transport and telecommunication. The creation of jobs through public works programmes was cited as one of the key focal points in addressing the infrastructural disparities. According to Naidoo (2006:112) the RDP assumed that government would either borrow or divert spending away from defence and inefficient state enterprises to drive up domestic demand so that investment would follow and employment would rise – the principles that worked well for both Europe and the United States of America.

The RDP linked reconstruction and development in a process that would lead to growth in all sections of the economy, greater equity through redistribution, and sustainability. Attacking poverty and deprivation was the first priority of a democratic government, and the RDP created a facilitating and enabling environment to this end. The RDP was set to address issues of social, institutional, environmental and macro-economic sustainability in an

integrated manner, with specific attention to affordability (African National Congress, 1994:15).

It is clear from the arguments above that the RDP sought to address the economic problem through redistributing the wealth and government basic services to eliminate disparities existing in society. However, for the South African situation the aforementioned economic strategy had to be tempered for the following four reasons:

- South Africans had a very low savings rate and this gap could not readily be closed by international flows given the recent transition.
- Borrowing from abroad was seen as expensive and risky because of the poor appetite of foreign lenders to extend credit to the new government.
- The capacity of the public service to roll out a massive investment programme fell far short of expectations; and
- The trend existed in the South African economy that when public spending increased and domestic demand rose, domestic suppliers were not able to respond to the increased demand (Naidoo, 2006:112).

Calitz & Siebrits (2001:3) argue that although the economic policy proposals of the African National Congress exhibited socialist leanings, the shift that occurred in the minds of the economists, politicians and business leaders across the globe with regard to the role of government influenced the views of the movement prior to its victory in the 1994 elections. Similarly, faster economic growth was needed to provide the resources to meet the social investment needs. Furthermore, more certainty was needed on the major macro-economic variables, such as inflation, interest rates and tax rates, which determine long-run investment decisions. Consequently, the South African government adopted a non-populist macro-economic strategy on growth, employment and redistribution (GEAR) in 1996 (Calitz & Siebrits, 2001:3; and Naidoo, 2006:112).

2.3.2 The GEAR Policy

2.3.2.1 What it was about

Among other goals the GEAR Strategy envisaged a fast-growing economy which would create jobs for the unemployed and a redistribution of income and opportunities in favour of the poor as the long-term vision. It is also clear from the objective of the strategy that the principles were not that far removed from the RDP (Department of Finance, 1996:1). Different researchers have different views on the GEAR policy. Some believe that it yielded positive results for the economy, while others believed it did not address the inequality problems in the country.

2.3.2.2. What was done

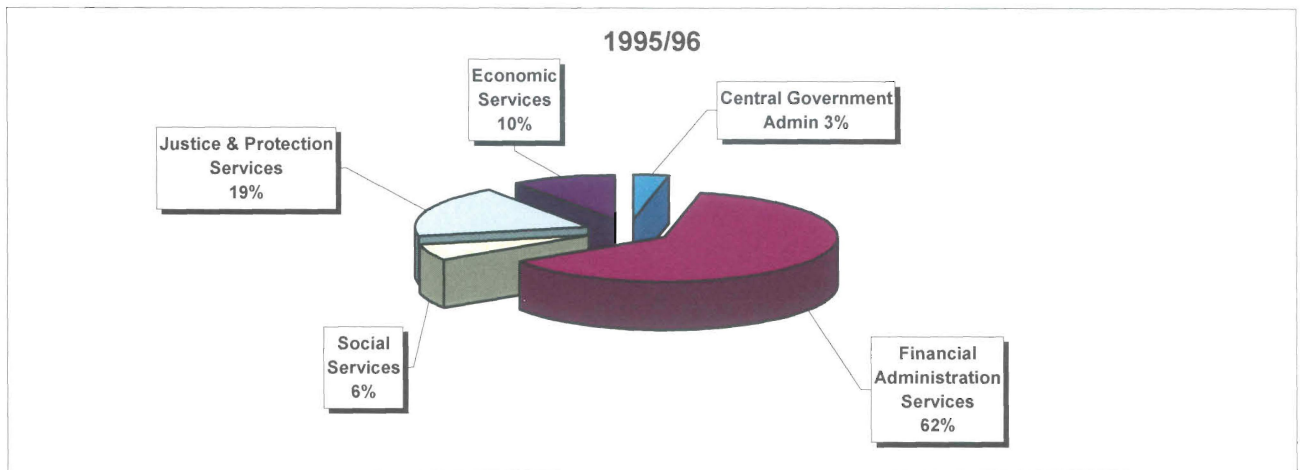
Roux (2004:20-21) states that although the GEAR Strategy was largely preoccupied with growth and creating policies to accelerate growth, the ultimate aim was to see a redistribution of income and an opportunity in favour of the poor. He explains the core elements of the redistribution strategy as comprising employment creation and budget reprioritization. The study on income distribution that was performed by Roux in 2004 demonstrates that the most powerful way of improving the distribution of gross income is through job creation. He also shows that the expenditure side of the budget can have a significant impact on reducing post-budget income inequalities. Naidoo (2006:112) argues that although the GEAR strategy was a macro-economic package, it also had many aspects of micro-economic reform.

The sub-sections below delve into the reprioritization of the budget and the redistribution of wealth; the revenue initiatives that necessitated effective collection of taxes and tax cuts to both the business and individuals; and the attempts to privatize the State-owned assets.

Reprioritisation

The graphs below depict the allocations of government financial resources per cluster between 1995/96 and 2005/06. The grouping of departments in the 1995/96 financial year is synchronized according to the 2005/06 financial year's cluster arrangement.

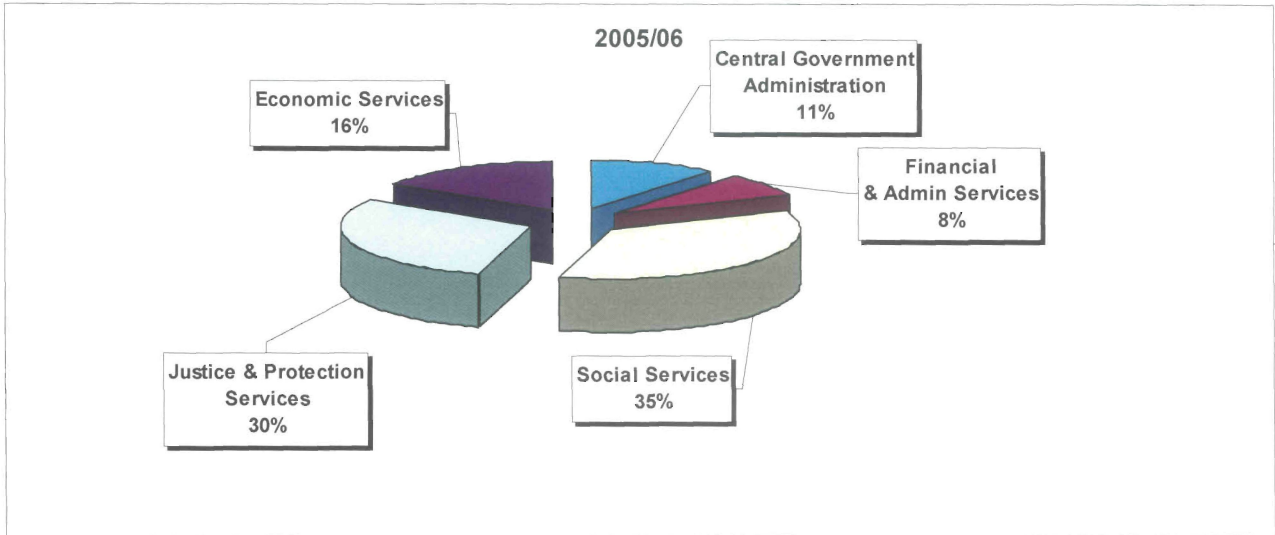
Figure 2.2: Percentage share of budget between clusters – 1995/96 financial year



Source: 1997 Budget Review

Figure 2.2 above displays the distribution of revenue between clusters in the 1995/96 financial year. The cost driver of government spending during the period under review was Financial and Administration Services with 62 per cent; followed by Justice and Protection Services with 19 per cent; Economic Services with 10 per cent; Social Services with 6 per cent; while the Central Government Administration received the lowest share of 3 per cent.

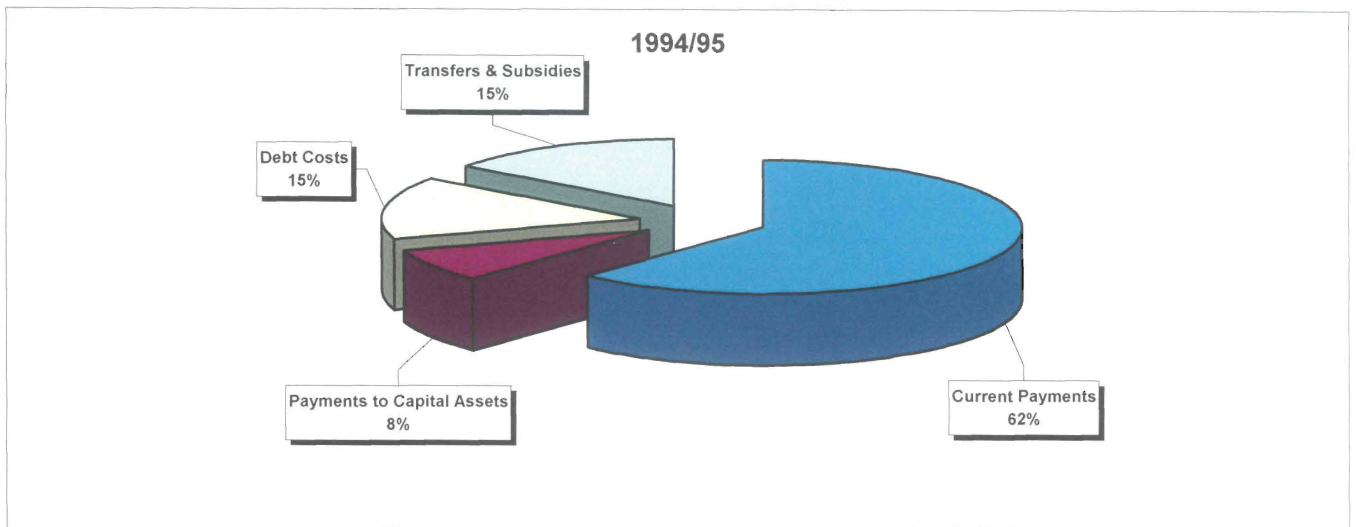
Figure 2.3: Percentage share of budget between clusters – 2005/06 financial year



Source: 2006 Budget Review

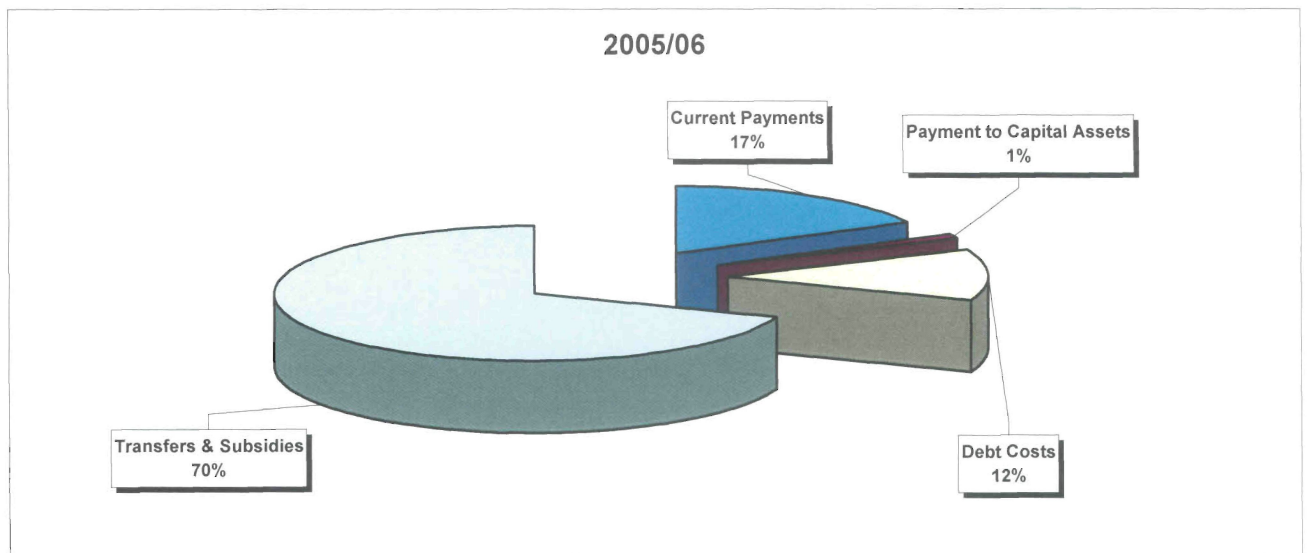
Figure 2.3 above depicts the results of the redistribution of resources as directed by the new policy that has come into effect since 1994. The cluster that receives priority is Social Services with 35 per cent, followed by Justice and Protection Services by 30 per cent, Economic Services by 16 per cent, Central Government and Administration by 11 per cent and, lastly, Financial and Administration Services by 8 per cent. The redistribution of resources follows the major principles of the Washington Census discussed above – i.e. focusing on social services in favour of the poor, accompanied by fiscal discipline. A comparative analysis of the division of expenditure among clusters reveals the success of the redistribution factor of the GEAR policy. The social services moved from the second last priority to the first priority; and the financial and administration services moved from the first priority to the last priority.

Figure 2.4: Percentage share Government Financial Statistics Classification – 1994/05 financial year



Source: 1997 Budget Review

Figure 2.5: Percentage share of budget between Government Financial Statistics Classification – 2005/06 financial year



Source: 2006 Budget Review

Figures 2.4 and 2.5 above illustrate the distribution of spending per government financial statistics classification. Over the period there were changes in classification of government spending that may complicate the analysis of data from the Budget Review documents. Readers are encouraged to also consider the GFS data published by the South African Reserve Bank.

The transfers and subsidies encompass both current and capital transfers. The 1994/95 financial year is selected deliberately as the base year to establish the changes brought about by a new development in the policy. It is clear from the charts that there has been a change in focus in terms of the distribution of government financial resources.

In the 1994/95 financial year current payments were receiving the biggest share of the fiscus – 62 per cent, while transfers and subsidies and the debt service costs received 15 per cent each. The payments to capital assets received the smallest share - 8 per cent. Post-1994, government introduced a new macro-economic policy that changed the focus of funding to redress the imbalances in the economy. Such developments resulted in the redistribution of the government budget in the following manner: during the 2005/06 financial year, transfers and subsidies received the biggest share of 72 per cent – the transfers and subsidies encompass both current and capital transfers; current payments were reduced to 17 per cent; the debt service costs were reduced to 12 per cent and capital assets received 1 per cent of total spending. As mentioned above, the other portion of capital assets is accounted for in transfers and subsidies. Therefore, the move from 8 to 1 per cent does not necessarily represent a reduction in payments to capital assets. For instance, the capital expenditure of provincial and local government forms part of transfers and subsidies. Although the GEAR policy advocated reduction in the recurrent expenditure, it is clear from the graphs above that government's current spending was not reduced, considering the fact that the large portion of the 70 per cent share of transfer payments comprises current payments.

Revenue initiatives

Koch et. al. (2005:190) are of the opinion that the elementary economic analysis of taxation focuses on the tax burden. In most situations, the primary burden of a tax is a decrease in economic activity – referred to as deadweight loss. The taxes on goods and activities reduce the economic activity in every market in the economy. As a result, taxes would be expected to have a negative impact on economic growth. In contrast, they argue that the analysis above ignores the fact that if the collected tax is used towards investment in social goods resulting in external benefits, the economic growth rate could be positively influenced by taxation. If money is transferred from people with low marginal utilities of income to people with high

marginal utilities of income, while revenues are additionally used to fund public investment, the economy can gain from this double-dividend of taxation.

Koch *et al.* (2005: 193 – 194) analyse the developments in the taxation (revenue) aspect of the fiscal policy under two time periods, namely the period preceding 1994 and the period from 1994. Under the former period they observed an increase in defence expenditure in order to stabilize the country through covert military operations. As a result, government expenditure increased from 20 to 27,5 per cent of GDP between 1970 and 1994 and, on the other hand, government taxation increased from 17 to 22 per cent of GDP in the same period. Minimum reserve requirements provided a captive market for borrowing, which alleviated the need to collect additional revenue. Nonetheless, due to a substantial increase in revenue collection, the debt/GDP ratio gradually declined from 43,6 to 29,6 per cent between 1970 to 1982, after which it increased to 43,5 per cent in 1994. He further highlights that during the same period, commissions were appointed to investigate means of improving taxation in South Africa for future application. The Franszen Commission (1970) pointed out the potential negative impact of increased tax burdens. The Margo Commission was subsequently appointed in 1987, and it recommended the same things as the Franszen Commission. The major changes brought about by the Margo Commission consisted of dropping the General Sales Tax in favour of the value-added tax; and the reduction in company tax rate to 35 per cent.

From the period starting in 1994, Koch *et al.* (2005:194-195) observes the redefinition of fiscal policy. In order to assist government with new tax policies, the Katz Commission was appointed. Since 1994 various tax laws have changed and amendments have been effected with the aim of broadening the tax base, reducing government borrowing pressures and improving neutrality of the tax base. All this was done with the single objective of improving economic performance. Other developments in the tax policy included the introduction of a foreign dividend taxation, which successfully extended the tax base to include the foreign source income. The South African government wanted to improve fairness and established a global presence for South African corporations. In addition, the government also pursued the various supply-side policies, allowing for accelerated depreciation allowances and tax

holidays as part of the macro-economic strategy – GEAR. They attributed the reduction of the budget deficit, from 7 to 2,3 per cent of the GDP between 1994 and 2003 primarily to the improvements in revenue collections.

Calitz & Siebrits (2001:8) echo the views of Koch *et al.* (2005) in that they also observe the thrust of South African tax reform broadly to be in line with the international trend towards broadening the tax bases and reducing marginal rates. They cite an effort in broadening the tax base as the elimination of various special tax preference schemes that only benefited particular industries or narrow particular sectoral interests, including tax subsidies for training, health, welfare and general exports incentive schemes, and interest rate subsidies for agriculture and housing. The successes of the tax reforms were made possible by, *inter alia*, the restructuring of the Inland Revenue and Customs and Excise branches of the Department of Finance into an autonomous revenue collection agency – the South African Revenue Services. The internal reorganization of the improvement of information systems and processes established a sound ratio between revenue yields and collection costs; and consistently exceeded its revenue targets – an achievement that contributed significantly to the reduction in the budget deficit. Furthermore, the overhaul of tax collection and administration indirectly broadened the tax base by improving taxpayer compliance.

Privatization

Most of the developing countries embarked on the privatization of state assets with the aim of broadening the tax base and the hope that the privatized state-owned enterprises would be more efficient when operating in a competitive market. In addition, this process relieves government of the subsidies they pay towards the operation of the government monopolies. The monies released could be redirected to other needy areas in the economy. Roux (2004:29) states that if properly done, privatization in an emerging-markets context typically has two major benefits. Firstly, it can lead to productivity gains in what are often major intermediary sectors in the economy, such as transport and telecommunications. Secondly, in many developing countries privatization has been a very important source of foreign direct-investment inflows, which are far more stable than portfolio flows.

However, National Treasury (2004:7) uncovered challenges that impeded the privatization process in other African countries. It is stated that where the regulatory capacity is weak, institutions immature and markets thin, and where government lacks capacity to manage complex contracts, privatization can worsen the economic environment. A typical example is that of Zambia – a case which the World Bank hailed in 1998 as the most successful privatization programme in Africa. Zambia sold 90 per cent of its state-owned enterprises. Since then, in just over a decade, Zambia has had one of the largest reductions in industrial capacity ever observed. Factories have closed down, unemployment has risen and poverty is pervasive.

The topic of privatization was politically sensitive and therefore was underplayed when the GEAR policy was developed. Nevertheless, GEAR envisaged acceleration in the pace of asset-restructuring or privatization, but recognized the necessity of negotiating with the stakeholders before the process could take off. The process of privatization in South Africa has been painfully slow, with the only unambiguous success being the strategic partnership deal for Telkom and, to a lesser extent, the securing of a strategic partner for the Airports Company. Beyond these high-profile deals, government succeeded in selling marginal bits of SABC, some parts of a state-owned forest company and bits of Denel. The public-private partnerships also developed relatively slowly and did not progress much further than a few high-profile deals such as the construction and outsourcing of two prisons (Roux, 2004:29-30). The restructuring of state assets has contributed to a sustainable fiscal framework in that the debt service costs were reduced, largely as a result of exchequer receipts of state assets' restructuring proceeds (Donaldson, 2000:17).

According to Roux (2004:30) none of the usual growth- or productivity-enhancing benefits that come with strong privatization programmes were realized in the South African case, nor did South Africa receive significant inflows of foreign direct investment. The only exceptions are Telkom and the Airports Company, where sizeable investments were undertaken to improve efficiency and prepare the entities for a big expansion in their business volumes.

2.3.2.3 GEAR Critics

There are some researchers who do not hold the opinion that the adoption of GEAR as the macroeconomic policy was the right decision. Among other critics of the GEAR policy, Koelble (2004:58, 59 and 64) states that the GEAR policy was not meant to benefit the poor South African, but to benefit business. According to him this is attested by the fact that the policy approach was spearheaded by the large multinational corporations and those companies that had a significant interest in establishing international market opportunities.

Similarly, Weeks (1999:795-796) identifies the GEAR policy as having interests beyond the country itself, as its macro framework is consistent with global economic realities. He further states that the government embarked upon an ideologically-generated neoliberal policy, which undermines the goal of redressing the gross inequalities of the apartheid period. The neoliberal position was stated in the last major economic policy document of the apartheid government in 1993 and the IMF report, slightly later, in 1994. Notwithstanding the argument by Koelble (2004) above, Weeks (1999) acknowledges the successes of the GEAR policy in the reduction of the budget deficit. He puts emphasis on the failure of the policy to accelerate growth, to reduce unemployment and to redistribute wealth. Weeks (1999:796) attributes GEAR's lack of success to fiscal contraction and excessively high interest rates.

According to Weeks (1999:800), the argument in the GEAR document is that growth is mainly the result of steady increases in fixed investments and manufactured exports. Private investment was targeted to grow at an annual rate of 11,7 per cent and public investment at slightly over 7 per cent. These targets represented increases of more than double in the case of the private sector and almost triple in the public sector compared to the base scenario. Weeks (1999:800) identifies these consequences as a result of slower deficit reduction and fewer supply-side reforms.

Weeks (1999: 798 and 801) attributes the failure of the GEAR policy to meet the set targets of economic growth and unemployment to the fact that the GEAR policy did not mention reducing inequality as a policy goal. Furthermore, he argues that the growth rate projected by the GEAR policy was based on a number of empirically unverified assumptions, namely:

- crowding out was an important phenomenon in South Africa; deficit reduction would result in a fall in interest rates;
- an increased current account deficit would be consistent with a lower interest rate; and
- a lower interest rate is a strong stimulus to private investment.

Fourie & Burger (2003:811-812) identify government and business as supporters of the GEAR policy and the labour community as critics of the policy. On the one hand, government and business view economic growth as the solution to eradicate the past injustices. The benefits of additional growth can then be distributed and put to use in an equitable manner to ensure the overall equitable distribution of resources, income and opportunities. Government believes that the GEAR policy underpins the RDP policy and the pursuance of its development goals. Furthermore, it pursues a sustainable fiscal policy with zero dissaving as a precondition for sustainable development. This implies that government gives primacy to fiscal sustainability relative to development.

On the other hand, the Council of South African Trade Unions (Cosatu) maintains a socialist belief in a larger role for the developmental state in the economy, and favours an activist fiscal and monetary policy. Contrary to government, they argue that a decrease in budget deficit dampens economic growth and the size of the GDP. They consider cutting back on current expenditure as failure to address the social backlog identified by the RDP (Cosatu, 2000b; 2000c; 1998; 1997; SA Labour Movement 1996: section 2.8; 1998:6) - quoted by Fourie & Burger (2003:813).

However, the analysis of the reprioritization on figure 2.2 and 2.3 above revealed that Cosatu's notion does not hold, because the GEAR policy did not necessarily reduce the distribution of resources to address social aspects of the economy. In actual fact, the allocation to social services increased from 17 to 35 per cent of the total budget between the 1995/96 and 2005/06 financial years since the implementation of the GEAR policy. Furthermore, Roux (2004:22) indicates that the reprioritization exercise included cutting some departmental budgets such as Defence, the outright termination of subsidy programmes to certain extra-budgetary institutions such as the arts councils, and a massive switch in votes from spending on services for high-income groups to services targeted at lower-income households. The following sections assess the successes of the GEAR policies in eliminating

challenges that constrained economic growth, namely the current account deficit, the low level of domestic saving, the government deficits, and the tax policies that contributed to low levels of savings.

2.3.2.4 GEAR's Successes

The table below depicts a trend in revenue collection, expenditure and the resultant deficit for the period between the 1996/97 and 2005/06 financial years.

Table 2.1: Trend analysis of revenue collection, government expenditure and the resultant budget deficit – 1996/97 to 2005/06 financial years

R million	1996/97	1997/98	1998/99	1999/2000	2002/03	2003/04	2004/05	2005/06
Total Revenue	146,519	163,492	184,328	196,302	278,508	299,431	347,854	411,085
Percentage of GDP	23.1%	23.4%	24.4%	24.2%	23.2%	23.4%	24.5%	26.4%
Total Expenditure	175,490	189,947	201,534	216,040	291,524	328,709	368,541	418,976
Percentage of GDP	27.7%	27.2%	26.7%	26.7%	24.3%	25.7%	26.0%	26.9%
Deficit	-28,971	-26,455	-17,206	-19,738	-13,016	-29,278	-20,687	-7,891
Percentage of GDP	-4.6%	-3.8%	-2.3%	-2.4%	-1.1%	-2.3%	-1.5%	-0.5%

Source: Budget Review 1997 – 2006

Deficit reduction

Budget deficit is the excess of spending over revenue collected (Rosen, 1998:457). Table 2.1 above illustrates only the budget deficit in all the years under review and does not take into account the principal debt. The revenue collected grew by an annual average rate of 10 per cent; the total expenditure grew at an annual average rate of 7 per cent, and the budget deficit reduced by an annual average rate of 12 per cent for the period under review. It is evident from the table above that the 1996/97 financial year marked a turnaround in the trend of the period from 1985/86 to 1994/95 when deficits and debts escalated as highlighted by Heyns (1995:1).

It is clear from the above that government was supposed to implement the RDP strategy as a matter of urgency, albeit concentrate on accelerating the reduction of the budget deficit. The budget implications were immense and therefore government spending was aggressively reprioritized. As discussed in the previous sections, this exercise included cutting some departmental budgets such as Defence, the outright termination of subsidy programmes to certain extra-budgetary institutions such as the arts councils, and a massive switch in the votes from spending on services for high-income groups to services targeted at lower-income households (Roux, 2004:22).

Government principal debt increased from 32,8 to 56 per cent of GDP between 1986 and the 1995/96 financial year. Rosen (1998:458) defines the principal debt as the sum of all past budget deficits. The efforts to prevent further growth in government principal debt decreased it to 26,7 per cent of GDP in the 2006/07 financial year. The debt service costs consequently reduced from 15 to 10 per cent of the total government expenditure between the 1994/95 and 2007/08 financial years (Department of Finance, 1997:3.6 and National Treasury, 2007:32). The paradigm shift was brought about by macro-economic interventions in the fiscal policy of the country contained in the GEAR strategy, which led to the reprioritization of spending options, increasing effectiveness of South African Revenue Services in collecting the revenue, and the successful privatization of some of the state-owned assets.

Reduction of tax burden

As indicated in the introduction, the reduction of the overall tax burden is one of the objectives the budget is supposed to balance with government's spending responsibilities. The aim of tax reforms is to lower the costs of investment and to release household spending power. The objective of reducing the tax burden yielded remarkable results. Between 1990 and 1999 the income tax on companies was reduced from 50 to 30 per cent. The top marginal rate on the individual's income tax was reduced from 45 to 40 per cent by 1991, but reverted to 45 per cent in 1995. This confirms the notion that at times efficiency considerations had to be subjugated to revenue needs during the deficit-reduction process (Calitz & Siebrits, 2001:8).

On the contrary, Naidoo (2006:112) argues that the GEAR policy did not succeed in reducing the level of taxation in the economy between 1994 and 2001. This was attested by the fact that the tax-to-GDP ratio went up by about 3 per cent of GDP during the period 1994 to 2001.

The further adjustments implemented to effect the tax reforms were announced by the Minister of Finance in his 2005 speech (National Treasury, 2005:26 – 27). He highlighted the income tax relief as benefiting employed and self-employed individuals and micro enterprises – providing stimulus to small business development. Among others, he highlighted the following benefits as effective from the 2006 tax year:

- The income-tax threshold below which income tax is not payable was increased from R32 222 to R35 000. This initiative releases the household's spending power of the low income group;
- The income-tax threshold for income tax payers over the age of 65 was increased from R50 000 to R60 000;
- The transfer-duty threshold was elevated from R150 000 to R190 000. The upper threshold of the same was increased from R320 000 to R330 000. The adjustments were made in the light of growing property prices, and were meant to make properties more affordable;
- Tax laws that set back small business development were revised. Qualifying small companies were set to pay no tax for the first R35 000 of taxable income, 10 per cent on the income range of R35 000 to R250 000; and 29 per cent thereafter. Companies falling under this category were also exempted from skills development levy; and
- Company tax was reduced from 30 to 29 per cent in 2006.

It is clear from the discussion above that the tax reforms in South Africa yielded positive results in terms of ensuring that the public had enough money to spend and save. It also succeeded in supporting the entrepreneurial economy. However, the setback brought about by the reforms was the introduction of capital gains tax that reduced the supply-side benefits of other tax changes (Koch *et al.*, 2005:195).

Although most researchers are confident about the good the GEAR policy has brought about in the South African economy, the Department of Finance (1996:3) states that the GEAR strategy-targeted economic growth was 6 per cent – aimed at absorbing 400 000 per annum unemployed people in the economy by the year 2000. In 2001 the National Treasury (2001:29) reported continued divergent trends in the South African labour market, with weakness in the formal sector contrasting with employment and income growth in the informal sector. The decline in formal sector employment was attributed to adjustments to the new global environment, streamlined production and the rationalisation of government employment. The economic growth was at a low 2,3 per cent against the target of 6 per cent in 2001. The above records show that the objectives of the GEAR strategy were not achieved by the set target date.

Calitz & Siebrits (2001:3) observed that, broadly in line with the Washington Consensus, the GEAR strategy acknowledged that macro-economic stability is a necessary condition for sustained economic growth and job creation, though not a sufficient condition for sustainable poverty eradication and income redistribution. GEAR heavily stressed the redistributive role of fiscal policy, but emphasized that government intended to pursue it in a way that was compatible with macro-economic stability. This approach reflects a conviction that higher economic growth provided the only option for financing the pent-up and growing demand for public services in South Africa in a sustainable manner.

In view of the above the South African government introduced new policy developments in 2002 that would complement the existing macro-economic policy - the Micro-economic Reform Strategy. According to the then Minister of Trade and Industry, the micro-economic reforms were not meant to replace the GEAR strategy, but were the second step of economic reforms that were planned to kick-in once the macro side of the economy had stabilized (Department of Trade and Industry, 2002:3).

2.4 Micro-economic Reforms – Second Generation Reforms

Although rapid interventions at the level of macro-economic policy averted South Africa's potential deindustrialization, brought inflation down to single figures, reduced the budget deficit to levels the industrialized world could often only envy, and set South Africa on a

sustainable growth path, key problems remain. They manifest themselves in areas such as unacceptably high unemployment levels. Micro-economic reform is based on the view that once the basics are in place in terms of macro-economic policies, the next phase of economic reform must focus on removing factors that impede growth by identifying the points of blockage and removing the obstacles to faster economic growth (Department of Trade and Industry, 2002:3).

The micro-economic policy relies more on a micro-economic analysis of market behaviour than on macro-economic demand analysis based on statistical aggregates as in Keynesian economics. Micro-economic reform or supply-side economics is a model that was initiated by President Ronald Reagan's advisors, who took advantage of the emerging supply-side movement of the early 1980s, which eventually had positive results for production, investment, employment and the attempt to reduce inflation (Robberts, 1988:98).

In South Africa the focus of micro-economic reform fell on the development of small medium micro enterprises (SMMEs), skills and infrastructure. Since the Micro-economic Strategy was developed and adopted in 2002, South African economic growth has not been fully responsive to the new developments. Economic growth has remained below the target of 6 per cent and the highest projection target is 5.3 per cent by 2010. Similarly, unemployment remained at 25,5 per cent in March 2007 (National Treasury, 2007:12-13). The employment percentage has improved, but the aforementioned statistics reveal that the economy is not growing fast enough to meet the new millennium development goals of halving unemployment by 2014. Further developments were introduced in 2005 to supplement the Micro-economic Strategy with the so-called Accelerated and Shared Growth Initiative for South Africa. The principles of this initiative are similar to those contained in the Micro-economic Strategy.

The microeconomic reforms will be discussed in detail in Chapter III and IV where the implementation in South Africa will be mapped against Singapore to establish why the micro-economic initiatives in South Africa have not yielded the intended results.

The next sub-section introduces what is called "the third generation reforms". These reforms focus mainly on the regulation of the implementation process of policies and the governance of agencies that are expected to implement the policies.

2.5 Financial and Budget Reforms -Third Generation Reforms

Like other developing countries, South Africa has embarked on financial and budget reforms to enhance the quality of spending by government. Donaldson (2000:17) indicates that budget reform, in turn, is part of the challenge of transforming service delivery. The key financial management reforms, aimed at providing secure foundations for the required structural improvement in public finance over the next decade and beyond, include the introduction of a three-year medium-term expenditure framework, the establishment of cooperative intergovernmental institutions to manage budgetary and financial coordination between the national, provincial and local spheres, the creation of the South African Revenue Service as an autonomous entity, and strengthening the tax structure and its administration. The reforms also entail a framework for state asset restructuring, the introduction of auction marketing arrangements as part of improved debt management, and enactment of the Public Management Act (Department of Finance, 2000:44).

The financial management reforms promote improved economic performance and effective and efficient public services through the restructuring of public enterprises by introducing private capital and skills where appropriate; public-private partnerships in financing infrastructure; as well as improved financial risk management, including stricter governance. The division of revenue among provinces, the distribution of funds to local government, and the Preferential Procurement Policy Framework Act that ensures that government purchases will contribute to redressing historical disadvantages in the provision of goods and services, are strongly redistributive in their impact and therefore promote broader economic participation (Department of Finance, 2000:44 - 45).

The budget process changed drastically with the introduction of processes such as the Medium Term Expenditure Framework (MTEF) – the three-year rolling revenue and expenditure plan, Medium Term Budget Policy Statement (MTBPS), Estimates of National Expenditure (ENE) and the Budget Review. The aforementioned policy documents contribute to the objectives of the newly-developed budget process of effective planning and promoting transparency in the public service. The MTBPS is an operational plan in the sphere of the national budget, designed to give effect to the objectives already spelt out in our established

policy. It explains the economic environment within which the government goals and objectives are being addressed and projects the total level of resources that will be available. It also analyses trade-offs and choices the nation faces in addressing its reconstruction and development priorities; and it invites the nation to share with government the important choices that must be made (Department of Finance, 1997:iii-3).

The MTEF was introduced for the first time in the 1998 budget and its main objectives were the allocation of resources to priority services, more efficient planning and monitoring, a framework within which policy proposals can be assessed, more transparency in government, a reduction in roll-overs and a clear demonstration of how fiscal targets will be met. The changes made to the budget planning process support the reconstruction and development objective (Donaldson, 2000:16).

Donaldson (2000:16) states: "The Department of Finance indicates that because the resources are limited, government has to make choices about the relative priorities of different services. These are political and social choices. In the past, the budgetary process was largely technical, giving political office-bearers insufficient opportunity to shape spending plans. The MTEF changes this. It articulates choices systematically and comprehensively by linking the amount of funds spent on a service with the quality and quantity of the service provided...in this way it empowers government to determine priorities and deliver change."

Donaldson (2000:17) summarizes the MTEF as being about the following:

- *Transparency*: It extends and improves the budget documentation to enable Parliament, citizens and stakeholders to conduct an informed debate on the budget options;
- *Political responsibility for priorities*: Improved budget-planning enables Cabinet and the provincial executive councils to exercise informed judgement on policy priorities and programmes;
- *Clear links between policies and budgets*: The budget process now emphasises changes in spending that relate to shifts in government policy or priorities;
- *Full cost accounting*: Budgeting must still take into account the full costs of services, including projected improvements in conditions of service and the construction and maintenance of physical infrastructure;

- *Wider public finances:* Government agencies and public enterprises are accountable to Parliament and the public and must be subject to clear mandates, full financial disclosure and accountability for performance; and
- *Sound financial policy:* Expenditure planning is conducted within a medium-term fiscal framework that takes into account the broader impact of the public finances on the economy and aims to strengthen long-run growth and development.

Ajam (2000:6) considers the Public Finance Management Act, 1 of 1999 (PFMA) one of the key milestones of the government budget and financial management reform agenda. , Subsequently, the Treasury Regulations were introduced in 2000 - in terms of section 76 of the PFMA, 1999 - to replace the Financial Regulations and the Treasury Instructions issued in terms of the repealed Exchequer Act, 1975 (Nair, 2000:4).

This represents a paradigm shift in the management of public resources - from a rule-driven approach to the one that allows accounting officers to make their own strategic financial decisions, thereby promoting accountability and ownership for such decisions. Due to differing operations among the departments and constitutional institutions, the Treasury regulations were formulated with the intention of providing fundamental best-practice financial management principles rather than outlining prescriptive detail, procedures and processes. This inevitably allows the relevant accounting officer to determine the detailed procedures and processes according to the business needs of his/her department or constitutional institution.

2.6 Conclusion

It is clear from the above discussions that the successes of the GEAR Strategy are the following: stabilized government expenditure, reduced overall tax burden and decreased government dissaving, as well as investment for growth. At the same time, government has been providing basic services to millions of South Africans and spending more on infrastructure and skills development. The successes that are more than anticipated by GEAR are ascribed to the revenue collection that was growing at a significant rate, and the National Treasury's exceptional successes in the prevention of over-expenditure by the national and provincial departments. The latter was not easy as the financial culture that pervaded government departments and even the provincial treasuries in the aftermath of the political

transition was not conducive to expenditure control, because senior officials were impatient to launch new and ambitious programmes and felt that social delivery should take precedence even if it entails expenditure in excess of the budget (Roux, 2004:22).

The down-side, though, is that despite both the macro- and micro-economic reforms embarked on by the South African government, the targets set in 1996 during the development of the GEAR strategy have not been met. The economy grew at an average 3,5 per cent between 1996 and 2006. The highest achieved growth of 5 per cent was realised in 2006. Although unemployment has responded to the growing economy by dropping to 25,6 per cent in March 2006 – a decline of 3,8 percentage points compared to September 2001 - the situation is still not satisfactory (National Treasury, 2006:27). The aforementioned situation suggests that there are still constraints that impede the achievement of set targets.

All the aforementioned developments detailed in this chapter were, in actual fact, highlighting the areas that should be addressed through fiscal policy. Singapore, like other developed countries, embarked on the micro reforms and has experienced resounding success. Chapter III introduces the international successes in this regard. The model of international best-practice is then compared to the South African situation. The latter introduces the topic of discussion in Chapter IV, the chapter that will reveal the impediments to the effective implementation of South African micro-economic reforms.

CHAPTER III

MICRO-REFORMS IN SINGAPORE

3.1 Introduction

As indicated in the previous chapters, macro-economic or the first-generation reforms provide an enabling environment for economic activity. Micro-economic reforms focus on enhancing factors of production to stimulate economic activity and ultimately economic growth. Abel & Bernanke (2001:61) identify the variables that influence an economy's capacity to produce goods and services as critical. In addition, the macro-economic reforms were identified as a necessary but not sufficient precondition for economic growth. This fact is attested to by the failure of most governments to achieve aspired-to economic growth through the implementation of the Keynesian model until the supply-side economic model emerged in the United States (Abel & Bernanke, 2001:61). The change in focus from the Keynesian model to supply-side economics represents a fundamental shift in thinking about fiscal policy.

Abel & Bernanke (2001:234) further highlight government policies that can raise productivity growth, such as improving infrastructure, building human capital, encouraging research and development and industrial policy. The focus of the analysis in this dissertation falls specifically on human capital development, SMME support and infrastructure development.

Research findings suggest a significant link between productivity and the quality of a nation's infrastructure, such as highways, bridges, airports and publicly-owned capital. An example of the interstate highway that was constructed in the United States attests to the findings in that the cost of transporting goods was reduced significantly. The tourism and other industries were stimulated in turn (Abel & Bernanke, 2001:234). Similarly, the Lopez-Claros *et al.* (2006:6) highlights infrastructure as one of the critical aspects that fosters productivity and growth. The three vital components of economic infrastructure are identified as energy, transport and telecommunication.

Canning & Pedroni (2001:1) consider infrastructure capital as an input into aggregate production, but one that comes at the cost of reduced investment in other types of capital.

They observe that the stocks of infrastructure can be at, above or below their growth-maximizing levels. There is an optimum level of infrastructure that maximizes the growth rate. If infrastructure levels are set too high, they divert investment away from the other capital to the point where income growth is reduced. Below the growth-maximizing infrastructural level positive shocks to infrastructure will tend to increase the level of output, while above the optimal level positive infrastructure shocks will tend to reduce the level of output.

Research findings point to a strong connection between productivity growth and human capital. The government influences human capital development through educational policies, worker-training or relocation programmes (Abel & Bernanke, 2001:235). Specific programmes should be examined carefully to see whether benefits exceed costs, but a case may be made for greater commitment to human capital formation as a way to boost productivity growth. The most crucial form of human capital is entrepreneurial skills. People with the ability to build a successful new business or to introduce a new product to the market play a key role in economic growth. It is also believed that productivity growth may increase if government were to remove unnecessary barriers to entrepreneurial activity and give people with such skills greater incentives to use those skills productively (Abel & Bernanke, 2001:235).

Government may also be able to stimulate productivity growth by affecting rates of scientific and technical progress. Most economists support the idea because the benefits of scientific progress, like those of human capital development, spread throughout the economy. Generally, industrial policy is a growth strategy in which the government – using taxes, subsidies, or regulations – attempts to influence the nation's patterns of industrial development. Some advocates of industrial policy argue that government should subsidize and promote "high-tech" industries so as to try to achieve or maintain national leadership in technologically dynamic areas (Abel & Bernanke, 2001:236).

The chapter will examine the role of fiscal policy in economic growth from the perspective of endogenous growth theory. In a word, how fiscal policy drove economic growth from the supply-side economics perspective – specifically in the case of Singapore. The sections below will examine developments in the economic history of Singapore's fiscal policy and the evolution of their micro-economic reforms.

3.2 Singapore's Economic History – Fiscal Policy (1960-2006)

The Singaporean government, like other developed countries, embarked on macro-economic and micro-economic reforms with the aim of improving its economic performance and eliminating structural problems in its economy.

The Ministry of Trade and Industry-Singapore (2007:1-4) highlights the extensive transformation of the whole economy since 1960. The analysis covers five periods, namely 1960-1964, 1965-1978, 1979-1985, 1986-1997 and 1998 to 2006. The country experienced challenges that could be detrimental to the economy. However, strategies were put in place to mitigate the impact. The period 1960 to 1964 was characterized by a lack of natural resources; the small manufacturing base; a small population but growing rapidly; high dependency on entrepot trade and provision to the British military base in Singapore; and little industrial know-how and domestic capital. Among others, the economy industrialized through an import substitution strategy to solve the unemployment problem and diversified away from entrepot trade. Three economic agencies were developed to spearhead the economic development: The Economic Development Board and the Development of Jurong Industrial Estate were established in 1961 and the Singapore Tourism Promotion Board in 1962. These developments resulted in an average Gross Domestic Product growth of 5.1 per cent per annum and the manufacturing sector's share of GDP grew from 11 to 14 per cent during the period under review.

During the period covering 1965 to 1978 the separation from Malaysia caused the import-substitution strategy to be aborted and confrontation with Indonesia threatened Singapore's traditional role as the major trading post of the region. Furthermore, the British withdrew their bases from Singapore, which had employed 400,000 workers, and the unemployment rate reached a high of 10 per cent. To counteract these challenges the Singapore industrialized through an export-oriented strategy by attracting foreign investors to Singapore to develop the manufacturing and financial sectors. The Employment Act that laid down standards of employment to help resolve industrial disputes was enacted and improved the labour climate and investment environment. In addition, the established National Trade Union Council and National Wage Council also helped to promote better labour-management relations. Investment in key infrastructure was increased and the Jurong Town Corporation was

established. The companies in areas where private sector lacked capital and expertise were nationalized – e.g. Singapore Airlines, Neptune Orient Lines, Development Bank of Singapore and Sembawang Shipyard. The aforementioned strategic interventions yielded an annual economic growth rate of 10 per cent, unemployment fell to 3,5 per cent in 1978 and the manufacturing sector's share of GDP increased from 14 per cent to 24 per cent by 1978.

The period between 1979 and 1985 marked a transition from a factor-driven to an efficiency-driven economy. During this period the challenges identified were a tight labour market with upward pressures on wages; the emergence of other lower-cost developing countries in the region, which had become strong contenders for investments; and the need to restructure the economy towards higher-value-added activities. The challenges mentioned above required strategies that would address the productivity of the production factors. Among other things, Lopez-Claros *et al.* (2006:52) cites the imperatives of more productive strategies and operating practices as highly-skilled people, better information, more efficient government processes, improved infrastructure and more advanced research institutions.

Similarly, the development strategies of the Singapore economy during the period under review were aligned to the aforementioned requirements. A three-year wage correction policy was introduced to serve as an incentive for a tight labour market and to induce the use of labour; manpower development through education and training was emphasized; automation, mechanization and computerization were encouraged; and there was a shift towards a higher value-added and skills-intensive investment promotion policy. The interventions achieved an annual economic growth rate of 7,5 per cent. Although the average economic growth rate was lower than the previous period, it was still at a satisfactory level. Furthermore, nominal value added per manufacturing worker grew from \$18 400 to \$27 000, and skilled employment as a share of total employment doubled from 11 per cent to 22 per cent.

Between 1986 and 1997 the Singapore economy migrated from efficiency-driven to innovation-driven growth. It was then a more mature economy with slower growth, resource constraints and faster-rising costs. There was also more intense competition from both developed and developing countries and a relatively low technological base globally. Strategies implemented to counteract the adverse impact of these challenges were the following:

Government taking a lead in catalysing the development of technology. Government committed \$2 billion from 1991 to 1995 under the National Technology Plan and another \$5 billion under the National Science and Technology Plan from 1996 to 2000.

- The industrial strategy was refined to leverage on synergies at the firm and industry levels. Mutually-supporting industries were identified and developed to entrench entire cluster niche areas, e.g. the electronic, petrochemical and engineering industries. By competing at cluster level they could develop cluster development plans with an emphasis on core capabilities that are common to industries within the cluster.
- The government encouraged leveraging on potential Asian markets in order to overcome local resource/market constraints and complement their established links with the Organisation for Economic Co-operation and Development countries. The government also aimed at diversifying its sectoral and market dependency, reduce vulnerability, and promote a broader base for the economy. Services were promoted together with manufacturing as twin pillars of the economy. For this purpose, many incentives were offered to manufacturing investment e.g. pioneer status, and investment allowances were also extended to investment in service sectors.

As a result, the annual economic growth averaged 8,6 per cent; the share of financial and business service sectors in total GDP grew from 21 per cent in 1986 to 26 per cent in 1997; the number of research scientists and engineers grew from 3 361 to 11 302 between 1987 and 1997, and the stock of direct investment abroad increased from \$16,9 billion in 1991 to \$75,8 billion in 1997.

The Singapore economy was hit by a regional crisis that started with the devaluation of the Thai Baht in July 1997. Although the country's financial and economic fundamentals were sound, the rapidly deteriorating external environment adversely affected Singapore due to close linkages with regional economies. The Singapore economy contracted 1,4 per cent in 1998 after achieving growth of 8,3 per cent in 1997. After improving in 1999-2000 the country was hit by another recession in 2001. The synchronised downturn in the major developed economies as well as the global electronic industries led to a sharp deceleration in global growth. The terrorist attack in the United States on 11 September 2001 further aggravated the slowdown. As a result, Singapore economic growth fell by 2,4 per cent from the high of 10 per cent in 2000. In addition, the rise of new players like China and India brought challenges and

opportunities. Today Singapore's developmental strategies are directed at becoming a globalised, entrepreneurial and diversified economy, with economic growth of 4-6 per cent economic growth per annum over the medium term. The key strategies identified to that effect are the following:

- **Expanding external tiers:** embracing globalization through the multilateral trading framework of the World Trade Organisation, regional cooperation and bilateral Free Trade Agreements.
- **Maintaining competitiveness and flexibility:** keeping the burdens of taxes and the Central Provident Fund as low as possible, reviewing the labour market and wage system to make them more flexible, and pricing the factors of production competitively.
- **Promoting entrepreneurship and domestic companies:** encouraging people to be innovative and improving the ability of firms to develop new ideas and business, tap new exports markets and broaden the economic base.
- **Growing manufacturing and service:** upgrading these sectors by improving cost competitiveness, equipping the labour force with relevant skills, and developing new capabilities and industries.
- **Developing human capital:** investing in education, helping workers train and upgrade and welcoming global talent to augment the indigenous talent pool.

It is clear from the history above that the development of the Singapore economy has not been easy. From time to time there was a need to review the developmental needs of the country, identify potential risks, implement preventative measures for such risks and take corrective action against the challenges that arose. During this particular process, the Singaporean government tapped experiences of other developed countries. The developments of Singaporean fiscal policy provided for the external forces of globalization and regionalization.

Section 3.3 below introduces the micro-economic reforms on which the Singaporean government embarked. It delves into the implementation of measures that would respond to the developmental needs of Singapore from the micro-economic perspective, and highlights the achievements.

3.3 Micro-economic Reforms in Singapore

As indicated in the previous chapter, the benefits of supply-side measures have led many countries to align their fiscal policy to this approach, and many have since seen the positive spin-offs in their economies. However, different countries focused on the micro-economic aspects relevant to their country's development needs. Singapore has focused on fostering a conducive business environment through the reduction of personal income taxes across the board and developing key engines of the economy, which include building on core competencies and supporting small business; enhancing the capacity of workers to secure good jobs through re-designing the jobs and re-skilling, as well as enhancing economic infrastructure (Ministry of Finance - Singapore, 2007:12-23 and Department of Trade and Industry, 2002:1).

3.3.1 Investment in Human Capital

Human capital investment is critical to the economy, as it improves productivity of labour. Enhanced labour productivity yields positive spin-offs for outputs and eventually economic growth. Correspondingly, central to the Singaporean strategy is people. The economy is fully reliant on the skills the Singaporeans possess, as the economy is innovation-driven. This explains why education and continuous learning remain a top priority for Singapore. Its approach to human capital development is two-pronged. Firstly, it invests in people to maximize their potential. Secondly, the country invests in Research and Development (R&D) to move the economy up the value curve (Ministry of Finance-Singapore: 2007:12).

According to the Ministry of Finance-Singapore (2007:12-15) several programmes were developed to harness people's potential. The educational or training and development system aimed at effecting this initiative, and is integrated from primary phases to post-tertiary and lifelong learning. Hence positive results are yielded in the process. The first programme developed focused on improving quality in every school. To that effect more teachers are being developed, which leads to more time to plan for quality and to innovate in their teaching. Different styles and methods of teaching are encouraged, thus effecting new quality. As a result, every child in Singapore is given access to a first-rate education.

The Post-Secondary Education Account is the second programme that was developed to assist Singaporeans in pursuing their tertiary education. The intention is to ensure that as many Singaporeans as possible obtain a post-secondary education and are able to contribute to the new innovation-driven economy. This will be enabled by a critical foundation laid at the primary and secondary stage of education. The Singaporean government, however, recognizes that some Singaporeans may miss out on an opportunity to obtain post-secondary education. In that case provision is made for adult education.

The third and last programme is extended beyond post-secondary stage to support lifelong learning. This programme is introduced to make sure that adult workers keep pace with the constantly-changing economy. This intervention is deemed critical as the education acquired in schools and tertiary institutions becomes less relevant over time. Re-training employees help them to remain employable.

Another focal point of the formal programme of education is investment in research and development. This investment develops capabilities that will help drive Singapore's economy in the long run. Targeted investment in such an initiative was expected to grow from 2,4 per cent in 2005 to 3 per cent in 2007. Generally, the approach of the Singapore government in this regard assures quality from the outset by ensuring that Singaporeans get top-rate education. The focus falls on biomedical sciences and other fields of sciences and technology. The scope of the country's investment in research and development is not only restricted to the citizens of Singapore, but is also extended to globally-renowned researchers who have uprooted themselves to go to Singapore in support of the Singaporean government's ambitions. They are attracting world-class corporate research and development laboratories and grooming local research and development firms. Such investments have long-term benefits – many of the economic benefits are likely to be indirect (Ministry of Finance-Singapore, 2007:16).

3.3.2 Supporting Small, Medium and Micro Enterprises (SMMEs) and Business in General

Ministry of Finance-Singapore (2007:6) highlights the two tiers of the Singaporean government's approach in supporting business in general. The first level involves making the

economy more resilient and dynamic, and helping private enterprises to flourish. This is fostered through a free-market economy which operates at maximum flexibility and minimum distortion by keeping the tax burden low and having a competitive tax structure that encourages enterprise and effort, and attracts talent to live and work in the country. The main reason the businesses find Singapore favourable is the low tax burden on the economy – regarded as one of the lowest in the world. This frees resources for the private sector to invest and grow. The second layer concentrates on focusing on important sectors of the economy. The initiative yielded positive results in manufacturing and financial services. The idea of being particular in selecting the critical sectors in the economy is driven by the intention to provide support to industries that have potential and not to protect the sunset industries. In this way the government ensures that the tax incentive is effective in that it rewards success and guards against subsidizing failure.

Over and above a blanket support for business in general, the Singaporean government has a special initiative of supporting the SMMEs. This category of business is key to contributing towards increasing output, economic activity and eventually economic growth. This category *of business employs more workers and is considered an important avenue for entrepreneurship*. In Singapore the SMMEs support larger local companies as part of an integrated production network. They are also key sources of innovation - hence the interest by the Singaporean government to ensure that the SMMEs thrive and grow in the competitive landscape (Ministry of Finance-Singapore, 2005:12).

The Singaporean government continues to introduce further measures that strengthen SMMEs' support. According to the Ministry of Finance-Singapore (2005:13), the 2005 Singaporean budget set out the following three measures that enhanced SMMEs business:

The first measure is the introduction of a package that helps revitalize the retailers to manage the growing risks of over-supplying shops, changes in the shopping and dining-out habits of the Singaporeans, and growing competition from shopping malls and supermarket chains. The package comprises assisting the SMMEs to relocate and restructure if they wish to stay in business, or facilitate their exit if they wish to retire.

The second measure introduced is to provide tax relief for SMMEs to help them cope with cash-flow problems, especially in a cyclical downturn. The existing corporate tax system that allows companies to carry forward business losses to offset future tax liabilities is not adequate for SMMEs, as they lack financial ballast. They are likely to run into cash-flow problems quite soon even if the business is viable over the longer term. The SMMEs have requested a loss carry-back feature in the corporate tax system to help them cope with downturns, and it positions them for growth when the economy recovers. To provide more timely relief for small companies, the Singaporean government allowed a one-year loss carry-back for corporate taxes – subject to a cap of \$100 000 in losses. The losses can be carried forward for one year and any losses exceeding this limit can also be carried forward.

The third intervention is lowering the SMMEs' cost of doing business with the government. The subscription fee for registering with government as a supplier of goods or services was scrapped. The intervention allowed more SMMEs to participate in government procurement projects.

3.3.3 Strengthening Infrastructure Spending

As indicated in the previous chapter, capital formation also plays a critical role in stimulating the economy. The Singapore government has been investing in infrastructure development as a facet of its developmental strategy. As part of its current strategy, the Singaporeans are set to invest in their economic infrastructure to position their economy for the next 15 years. Their investment in economic infrastructure will support the high-value manufacturing and services economy, and catch the next wave of emerging industries. The two areas receiving attention are Information Technology (IT) connectivity, and enhancing their energy hub (Ministry of Finance-Singapore, 2007:23).

In terms of IT connectivity, the Singapore is planning to inject \$4 billion into the Intelligent Nation 2015 Masterplan. This initiative is aimed at making Singapore the centre for creating and commercializing new media technologies, as well as a whole array of digital content and services in areas such as healthcare, education and games-on-demand. To date, development has reached a stage where the roll-out of the Wireless@SG is underway – this will cover most of Singapore. Industry players are responding positively to the initiative and

are putting forward plans for the new National Broadband Network. The pervasive nature of the IT infrastructure will also encourage any Singaporean to take full advantage of connectivity to the world, and even create something new to market. Alternative Energy is an emerging growth industry. The global Alternative Energy market is projected to grow ten-fold, to US \$300 billion, by 2015. Singapore is set to participate in this emerging industry in areas where they can be competitive. To this end they are planning to expand their current role as an oil-refining and trading centre to become the future energy hub. In order to diversify their energy sources, a new billion-dollar Liquefied Natural Gas terminal is set to be ready to supply a third of Singapore's gas demand by 2012. It will also help positioning them as a gas hub in the same way in which they are an oil hub.

Companies from foreign countries have invested in Alternative Energy initiatives in Singapore. To mention a few: Rolls Royce has already invested in a \$100 million fuel cell development project in Singapore; leading foreign solar companies such as Conergy, Solarworld and Solar-Fabrick have based their Asian headquarters in Singapore; and Natural Fuel from Australia is investing \$200 million in what will be the world's largest biodiesel facility in the country. The aforementioned developments attest to Singapore's positioning in riding the next wave of energy technology (Ministry of Finance – Singapore, 2007:24).

Both the macro and micro-economic policies of the Singaporean government are set for the development of the economy to achieve the desired outcomes. However, the implementation of the aforementioned requires an effective governance framework that will regulate the effective implementation thereof. This process is called the third generation reforms. The following section highlights the effectiveness of Singapore's third generation reforms.

3.4 The Third Generation Reforms in Singapore

Once the fiscal policy direction has been established, the next step is to implement the fiscal policy, which is underpinned by the effective implementation of budgets to attain the objectives contained in the fiscal policy framework and, eventually, the developmental goals. Transparency and the sound management of financial resources are critical to the effective implementation of budgets by governments. The Common Wealth (2006:3) emphasized that the societal needs will inevitably be greater than the resources available to government.

Public resources should therefore be used as efficiently as possible with a minimum of government wastage. Efficient public financial management is central to creating a relationship of mutual trust and shared consensus between government and citizens, which is at the core of the development process. Reforms of ineffective public financial management systems, processes and institutions in developing countries are critical in securing long-term economic success, to maximize the efficient use of limited public resources, to create the highest level of transparency and accountability in government finances, and, most importantly, to provide more and better services to the citizens of the country. It further suggests that successful reforms need to take local conditions into account, and should focus on both the process of reform, i.e. how to achieve the correct enabling environment, as well as substantive changes to the fiscal framework.

Singapore is the member state of the Commonwealth Secretariat, which produced the guidelines for public finance management reform – strengthening transparency and accountability in the public sector. These guidelines contributed substantially to the success achieved in public finance, and, in turn, the implementation of the fiscal policy as stipulated in the 2006 Competitiveness Year Book. According to the McKinnon (2006:4) the following aspects were identified as key changes that should be effected to the fiscal framework as part of financial management reform:

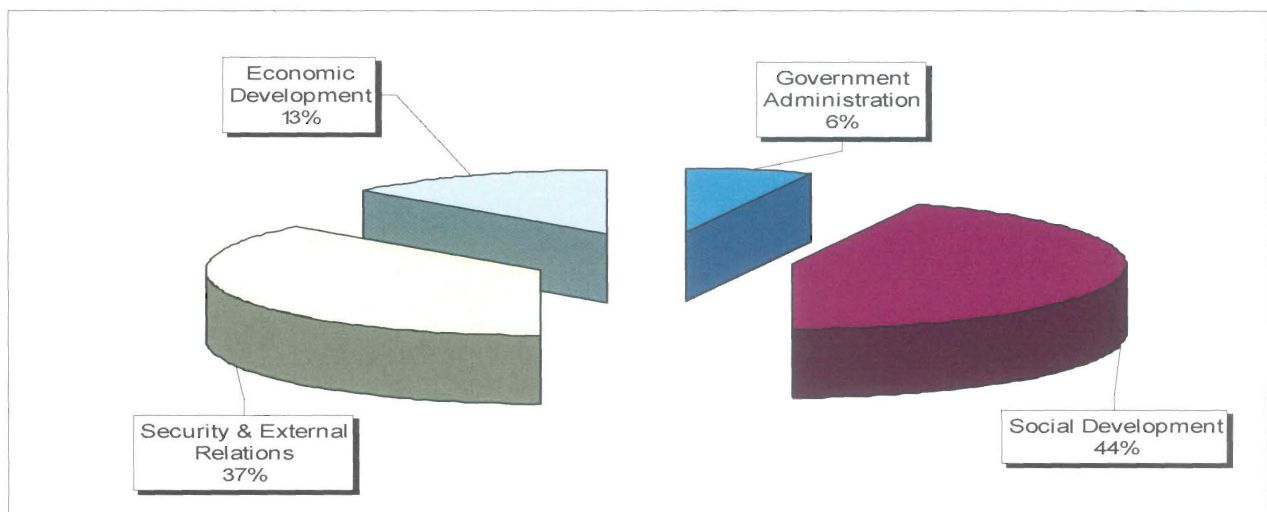
Improving the collection of revenue is critical. No country can be run without revenue. Moreover, tax can help establish government's authority. Tax policy itself is increasingly limited by external forces: in a globalized world, governments' choices are less about the tax rate than about the efficiency with which tax is collected and the reach of the tax net. The revenue services must therefore be properly resourced and motivated to collect tax more efficiently.

Debt and cash must be managed efficiently. In particular, sound principles for deficit funding should be established, efficiencies sought and proper risk management procedures introduced. Proper management of the government's borrowing programme will reduce the cost of funding.

Effective planning and the allocation of resources are key, and government should develop and institutionalize planning processes at all levels of government. The budgeting process must be transparent and inclusive. There should be emphasis on output rather than input-focused implementation, with strong accounting and reporting procedures.

Effective oversight and monitoring are crucial to sound governance and public finance management reform. A well-functioning public finance management system must have clear rules to ensure transparency and reporting, as well as enforceable sanctions for failure. Oversight should be established by internal mechanisms in the national treasury, as well as external oversight: independent parliamentary committees, a public ombudsman, a free media and civil society and an independent auditor-general. The division of the Singaporean fiscus is depicted on the chart below.

Figure 3.1: Percentage share of budget between clusters – 2004/05 financial year



Source MOF-Singapore 2004

Figure 3.1 above depicts the distribution of budget between clusters, with the Social Development Cluster taking the biggest share of the budget, followed by Security and External Relations, then Economic Development and lastly Government Administration. According to the Ministry of Finance–Singapore (2006:11) government expenditure comprises 80 per cent operating expenditure and 20 per cent development expenditure. Recently, the Singapore government’s allocation to social development was diverted from welfare for the first time in 2006, as it is been observed that welfare drains fiscal resources, erodes the work ethic and encourages an entitlement mentality. The social development programme adopted

by Singapore is workforce assistance and has been tried with success by other countries. It seeks to supplement the incomes of low wage workers based on the principle that the best way to help people is to help them find work and stay in work (Ministry of Finance, 2007:28).

3.5 Conclusion

According to the Singapore Department of Finance (2004:1) unemployment was at a low 3,7 per cent in December 2004. In addition, it is clear from the above sections that the Singapore's economy has been growing at satisfactory levels to absorb the unemployed, and the budget has been experiencing a surplus for years. The Singapore's public finance and the government efficiency rating are improving every year. The conclusion that could be drawn from the above is that the fiscal policy developments in Singapore had been effective in driving growth and addressing structural problems in the economy.

The World Competitiveness Year Book analyses and ranks the ability of the nations to create and maintain the environment that sustains the competitiveness of the enterprise. It analyses the nations based on a set of criteria, grouped into four competitiveness factors, namely: economic performance, government efficiency, business efficiency and infrastructure. Government efficiency comprises five sub-factors, namely public finance, fiscal policy, an institutional framework, business legislation and a societal framework. Singapore's ranking in the World Competitiveness Year Book improved from number 8 to number 3 between 2002 and 2006. Its overall ranking regarding government efficiency improved from third to second position between 2003 and 2006 – with public finance improving from 28th in 2005 to 12th in 2006 and the fiscal policy recovering from the 12th to 3rd ranking in the same period (Ministry of Finance-Singapore, 2004:10 and 2006:14).

The next chapter details the micro-economic reform in South Africa compared to Singapore. It will also highlight the grey areas in the South African situation, taking into account the budget allocations to the enablers of the micro-economic reform and the processes of effective implementation of such budgets.

CHAPTER IV

MICRO-REFORMS IN SOUTH AFRICA

4.1 Introduction

Although the Micro-economic Reform Strategy was introduced in 2002, the concept was already in the mind of government during the development of the Growth Employment and Redistribution (GEAR) Strategy. As indicated in Chapter I, it was imperative for South Africa to start with the macro-economic reform before embarking on the second generation or micro-economic reform. The GEAR Strategy adopted in the 1996 as the strategy that ensures fulfilment of the macro-economic policy aspects of South Africa already contained aspects of policy that focused on infrastructure, small medium and micro enterprise and skills development. However, when it was implemented, the emphasis was on ensuring macro-economic stability, which lays the ground for micro-economic reform. Similarly, the aspects of skills development and investment in research and development were contained in the White Paper on Science and Technology that was published in 1996. The Department of Arts, Culture, Science and Technology (1996:2) alluded to human resources and skills in science and technology as essential in the implementation of the growth and development strategy.

The South African micro-economic strategy is premised on three aspects. Firstly, government recognized that job creation and improved living standards require a substantially increased commitment by the business sector to industrial investment and productivity enhancing training. At the time of the development of the GEAR Strategy, the South African government already knew that international indicators show that South African investment in human resource development is inadequate. In addition, government recognized that it has an important role to play in financing education and training activities aimed at the unemployed, the small business sector and in enhancing the quality of technical and vocational education and training. Hence enhancement of the level of effectiveness of training across all employment sectors was central to the strategy. Refocusing of curricula and the organization of formal learning was in progress under the auspices of the education authorities. South African Qualifications Authority was established to ensure co-ordination of standards and

quality assurance. Furthermore, the Department of Labour embarked on the development of the new human resource development strategy, in partnership with all major stakeholders. Central to the strategy is a new financing mechanism and governance framework which aims to increase the aggregate level of effective investment in training. Management training initiatives were already underway in government departments in 1996 (Department of Finance, 1996:20).

Secondly, the strategy also identified the need to invest in social and economic infrastructure so as to increase the productivity of labour and business, and thus the achievement of higher growth rates. In 1996 the National Infrastructure Investment Report revealed that South Africa had the infrastructure backlog of about R170 billion (Department of Finance, 1996:16). In order to address that challenge, the innovative financing strategies and careful prioritization was needed if sufficient progress was to be made. The strategy envisaged a substantial acceleration in government investment spending, together with improved maintenance and operation of public assets. The identified public infrastructure needs included domestic and industrial grid electricity and other energy projects; domestic, industrial and agricultural water supplies; wastewater and stormwater, roads, railways, airports, harbours and pipelines; telecommunication and postal services; urban housing-related infrastructure; rural development; hospitals and clinics; and educational facilities. Progress in the aforementioned areas adds to the quality of life in society and builds productive economic capacity. Government was aware that such demands could not be met from the fiscus. Therefore, it was planned that an alternative application of public-private sector partnerships be explored – based on cost-recovery pricing where this can practically and fairly be effected (Department of Finance, 1996:16-17).

Thirdly, the strategy acknowledges that the promotion of small, medium and micro enterprises (SMMEs) is a key element in government strategy for employment creation and income generation. Findings before the development of the strategy were that the SMMEs sector was severely underdeveloped. Government had to put an effort to operationalize and implement the policies outlined in the White Paper on small business promotion. The policies included the establishment of the Small Business Centre attached to the Department of Trade and Industry. This included Ntsika Enterprise Promotion Agency to provide non-financial assistance, Khula Enterprise Finance Limited for wholesale loans, Khula Credit Guarantee

Limited for loan guarantees, a pre-shipment export finance guarantee facility to expand access to working capital and the Competitiveness Fund for consultancy advice on technology and marketing. A Simplified Regional Industrial Development programme was to be continued in a modified form as a grant programme tailored to the needs of small and medium-sized firms (National Treasury, 2007:711).

It is clear from the previous chapters that the economic successes of the country until 2002 were the result of the macro-economic reforms. Similarly, in his 2001 budget speech the Minister of Finance highlighted the fact that the targets of the macro-economic reforms had been realized. The second generation reforms were required in order to go forward. These would ensure increased economic activity and eventually increased economic growth and reduced unemployment. The Department of Trade and Industry (dti) was subsequently tasked to develop the strategy that specifically guides the supply-side aspects of the economy. The Department of Trade and Industry was further mandated to spear-head the implementation process of the strategy (Department of Trade and Industry, 2002:15).

This chapter provides an outline of the micro-economic reform in South Africa. The outline comprises a comparative analysis of the micro-economic framework of South Africa and Singapore and the major focal areas of the micro-economic reforms in South Africa, as well as the planned activities for the implementation thereof. The chapter is concluded by the identification of the outcomes of the micro-economic reforms in South Africa, and it highlights the shortcomings in the implementation of the action plan.

4.2 Micro-economic Reforms in South Africa

It is clear from Chapter II that the macro-economic reforms had yielded some positive results for the economy (Department of Finance, 1997:3.6 and National Treasury, 2007:32). In its guide to the micro-economic strategy the Department of Trade and Industry (2002:3), echoes the Minister of Finance's suggestion in the 2001 Budget Speech that the need for micro-economic reform is based on the view that the basics are in place in terms of the macro-economic policies, as well as some considerable achievements at a micro level, such as South Africa's motor industry. The next phase of economic reform sought to remove those factors that impede growth.

According to the Department of Trade and Industry (2002:4) the success indicators of the micro-economic reform strategy by 2014, complemented by the macro-economic stability and a process of sustainable social development, were identified as the following: a restructured and adaptive economy characterized by growth, employment and equity, built on the full potential of all persons, communities and geographic areas. In order to achieve the aforementioned success factors the following have to be attained:

- A geographic spread of social and productive investment;
- An integrated manufacturing economy capable of high degrees of value added;
- An intensive ICT and logistics system capable of speed and flexibility;
- A high degree of knowledge and technological capacity;
- Greater diversity of enterprise-type and size;
- Skilled, informed and adaptable citizens; and
- An efficient, strong and responsive state structure.

The South African government will continue to focus on the micro-economic reform strategies to advance the aforementioned objectives, because the majority of the remedies to the factors limiting accelerated growth and development lie within the micro side of the economy. The implementation of the strategy will move from the premise that the South Africa has two economies, namely: the developed economy that suffers from a lack of cost-competitiveness in relation to the global economy; and the underdeveloped economy, which represents the experiences of large proportions of South Africans. This is an arena where economic potential is not being enabled or harnessed due to backlogs and under-investment in social and productive capital (Department of Trade and Industry, 2002:4).

The Department of Trade and Industry (2002:16-24) presents the details of the integrated action plan, announced by the South African president that provided a model for implementing the micro-economic reform strategy. The first step of the action plan encompasses macro-economic fine-tuning, the identification of cross-cutting issues, the identification of the input sectors, and the prioritization of the growth sectors. The second stage is the identification of activities for each focal point mentioned above. Thirdly, identification of the role of government in the process and planning the activities related

thereto; fourthly, the identification of all the processes that will ensure that the benefits are shared among all South Africans; and lastly, assessment of the economic impact.

It is stated that during the time when this plan was developed, apparent progress had been made in a number of areas including a new biotechnology strategy. However, investment in research and development remained low. In addition, good results were observed on the demand side. However, the macro-economic policy still required fine-tuning in order to address the consequences of a volatile and undervalued exchange rate for food and input prices and the inflation rate. The country's current and future competitiveness requires that a set of fundamentals be in place in the economy. These fundamentals include appropriate and efficient economic and social infrastructure; access to finance for productive activities; investment in research and development; innovation and the introduction of new technologies; as well as investment in human capital and an adaptive, flexible workforce. The State has an active and critical role to play in developing appropriate policies and initiating programmes to ensure that these fundamentals of competitiveness are in place in the economy. The transport, energy and telecommunications sectors were identified as being firmly under the ambit of the state's control, as they are dominated by parastatals. The State has to ensure greater access to services by all South Africans, as well as cost competitiveness and efficiency of these services. The mandates of the parastatals were planned to be reviewed to ensure the emphasis is placed on delivering an efficient service rather than profit-seeking for its own sake. Furthermore, government programmes will focus on employment generation, value addition, export growth, small business development and black economic empowerment.

As indicated in the previous chapter, the focal areas of South Africa's micro-economic policy are similar to those of Singapore. The next section outlines the comparative analysis between the Singapore and South African micro-economic reforms, and identifies loops that need to be closed in the South African situation.

4.3 Comparative Analysis of Policy Reforms between Singapore and South Africa

Table 4.1 below compares and contrasts the micro-economic framework of South Africa and that of Singapore. The elements that are compared are human capital development, infrastructure development and Small Medium Micro Enterprises support.

Table 4.1: Analysis of policy reforms between Singapore and South Africa

Supply-side measures/ Endogenous growth approaches	Policy reforms in Singapore	Policy reforms in South Africa
Human capital development	<p>Human capital development</p> <ul style="list-style-type: none"> - Integrated education system from primary to post-tertiary level and lifelong learning. - Teachers’ development programmes are in place to ensure that teachers dedicate more time to plan for quality and to innovate in their teaching. - Post-Secondary Education Account is developed to assist Singaporeans to pursue their tertiary Education. - Programme to support lifelong learning – to make sure that the adult workers keep pace with constantly changing economy. - Investment in research and development to build capabilities that will drive the economy. 	<ul style="list-style-type: none"> - The integration of the education system from primary to post-tertiary is not prevalent in South Africa. - Teacher development programmes are in place in South Africa to develop teachers in science, engineering and technology – Dinaledi Schools, etc. - Bursary programmes for formal education (from primary to tertiary) are co-ordinated at different departments (Education from primary to secondary and other departments for tertiary); training and development programmes are also co-ordinated through different departments, the Sector Education and Training Authorities, the South African Development Institute, etc; Adult Basic Education and Training programmes are available for the adult workers. - SA has research and development investment as one of the priorities, and has set a target of Gross Expenditure on Research and Development at 2 per cent of GDP by 2010.

Supply-side measures/ Endogenous growth approaches	Policy reforms in Singapore	Policy reforms in South Africa
Infrastructure development	<p>Strengthening infrastructure spending</p> <p>The major focal areas in economic infrastructure investment are:</p> <ul style="list-style-type: none"> - Information Technology connectivity: aims at making Singapore the centre for creating and commercializing new media technologies, digital content and services in healthcare, education and games-on-demand. National Broadband Network is also underway. - Enhancing the energy hub: Singapore is set to participate in the alternative energy industry, an emerging growth industry that is projected to grow ten-fold (to US \$300 billion) by 2015. To this end they are planning to expand on their current role of an oil-refining and trading centre to become the future energy hub. In order to diversify their energy sources, a new billion-dollar Liquefied Natural Gas terminal is set to be ready to supply a third of Singapore's gas demand by 2012. 	<p>There are programmes in SA government that are directed at both economic and social infrastructure.</p> <ul style="list-style-type: none"> - Upgrading roads, utilizing new technologies to lower the costs of communication, implementing an integrated energy plan are at the forefront of the activity plan of the micro-economic reforms.

Supply-side measures/ Endogenous growth approaches	Policy reforms in Singapore	Policy reforms in South Africa
Small Medium Micro Enterprise support	<p>Overall Enterprise support – SMMEs also benefit from these benefits:</p> <ul style="list-style-type: none"> - Low tax burdens and having competitive tax structures, which encourages enterprise; - Focusing on important business sectors of their economy to ensure that industries with good potential get support (guard against subsidizing failure) <p>SMMEs specific support:</p> <ul style="list-style-type: none"> - Measures to help revitalize the retailers to manage the growing risk of over-supply of shops, etc. to that effect SMMEs that are willing to stay in business are assisted to relocate, restructure and facilitate their exit if they wish to retire; - SMMEs are allowed a one-year loss carry-back for corporate taxes to help them cope with downturns and position them for growth when the economy recovers; and - Lowering the SMMEs' costs of doing business with government. To that effect, the subscription fee of registering with government as a supplier of goods and services was scrapped. 	<ul style="list-style-type: none"> - The organization that assist in the development of the small businesses were established in SA to focus on offering both financial and non-financial support to small businesses; - Tax relief for small businesses in SA were introduced; - Programmes focusing on business sectors, initiatives to support small businesses with cash-flow management, measures to revitalize the retailers, general lowering the costs of doing business are not prevalent in South Africa.

Supply-side measures/ Endogenous growth approaches	Policy reforms in Singapore	Policy reforms in South Africa
	<p>Third generation – fiscal/budget reforms</p> <p>Guidelines for sound financial management were developed and effectively implemented. These entail:</p> <ul style="list-style-type: none"> - Measures to ensure effective planning and allocation of financial resources (transparent and inclusive budgeting processes, output-focused budget); and - Measures to ensure effective oversight and monitoring for sound governance and public finance management. 	<p>The third generation reforms in South Africa encompasses:</p> <ul style="list-style-type: none"> - Introduction of legislation (the Public Finance Management Act), regulations and guidelines (Treasury Regulations) that ensures sound financial management and governance; - A three-year rolling budget and transparent budget processes; - Guidelines for monitoring public finance management and governance; and - Performance/Output-based budgeting.

Source: Department of Trade and Industry 2002, Institute for Public Finance and Auditing 2000 and Ministry of Finance-Singapore 2005

According to table 4.1 above the framework of the South African government's micro-economic reforms is aligned to that of the Singaporeans. However, some critical activities that are contained in the Singapore's model are not in that of South Africa. Regarding human capital development, the challenge of the quality of education in South Africa is failing the initiative of increasing quality high-end skills and therefore impedes the investment in human capital and knowledge generation. Furthermore, the institutions that are set to assist in skills development are not effective.

Singapore is a relatively small country with a small population and its low unemployment rate suggests that they might have reached full capacity in developing their social and road infrastructure. In contrast, the South African country is relatively large with a large population, most of whom is living in poverty. The unemployment rate is fairly high too. Hence investment in both social and economic infrastructure is a priority in their action plan. South Africa's engagement as far as investment in economic infrastructure is concerned, particularly in energy and telecommunication, is similar to that of Singapore. However, table 4.1 above reveals that the level at which the two countries are engaging in these areas is different. While South Africa is still struggling with these issues domestically, Singapore is set to play in a global arena.

Similarly, the South African initiatives for the SMMEs' support corresponds to elements of those in Singapore – the establishment of institutions that provide support to small and emerging businesses and the introduction of tax relief. Notwithstanding the above, there are those critical elements that are in the Singaporean model but not included in the South African model, or South Africa is not successful in the implementation thereof. The programmes to revitalize the retailers, the cash-flow management problem exemptions, and focusing on business sectors are not included in the South African model. There are no signs of success in an attempt to lower the cost of doing business in South Africa,– because that is still identified as one of the impeding factors in the emerging businesses (Lopez-Claros *et al.*, 2007:345). The third generation reforms, which ensure that the policy framework is effectively implemented in Singapore, compare with those developed in South Africa.

Although the decision on the programmes to be adopted in a country to address challenges in different areas are informed by the nature of the economic and socio-economic challenges of

that particular country, the gaps that are identified in South Africa could have enhanced the South African model to achieve better results.

The next section discusses the focal areas and activities contained in the implementation plan of the South African micro-economic strategy.

4.4 Implementation Plan for the Microeconomic Strategy in South Africa

Table 4.2 below identifies the major focal areas of the micro-economic strategy and the corresponding activities in each focal area. The main areas identified were macro-economic fine-tuning, cross-cutting issues, input sectors and prioritizing growth sectors. The corresponding activities are the steps that need to be taken to ensure achievement of the objectives set in the micro-economic strategy.

Table 4.2: Analysis of activities of focus by the state

Major focus	Activities of focus by state
1. Macro-economic fine-tuning	Attention needed to be paid to government's weak investment performance, for while funds available on budget for capital expenditure have increased, investment performance had not improved.
2. Cross-cutting issues	<p>2.1 Technology</p> <ul style="list-style-type: none"> - Increase funding for biotechnology; - Strengthening research in the private sector; - Addressing issues of intellectual property and indigenous knowledge system; - <i>Coordinating the fragmented management of state-led sciences and technology activities;</i> - Improving the rate of technology take-up by enterprises through technology incubators and venture and seed capital funds; and - Strengthening and extending regional innovation initiatives.

Major focus	Activities of focus by state
	<p data-bbox="607 248 1111 280">2.2 Human resource development</p> <p data-bbox="607 301 2027 387">The human resource development strategy was underway then. However, more work was planned to increase visibility and the impact of such strategy.</p> <p data-bbox="607 464 927 496">2.3 Access to finance</p> <p data-bbox="607 517 2027 603">Enhancing access to finance for small businesses and black economic development through the coordination of the existing financing vehicles.</p> <p data-bbox="607 679 864 711">2.4 Infrastructure</p> <p data-bbox="607 732 2027 818">Several critical infrastructure projects were underway but more work was still required to integrate social and economic infrastructure projects.</p>
3. Input sectors	<p data-bbox="607 900 808 932">3.1 Transport</p> <ul data-bbox="607 952 2027 1257" style="list-style-type: none"> <li data-bbox="607 952 2027 1038">- Developing ports policy and improving the overall competitiveness of freight and wharfage charges and increasing airlines frequencies; <li data-bbox="607 1115 1588 1147">- Upgrading rural roads and prioritizing the taxi recapitalization project; <li data-bbox="607 1224 1957 1256">- Finalizing appropriate restructuring models for Spoornet's coal link general freight business; and <p data-bbox="607 1332 1760 1364">Integrating of the Southern Africa Development Countries (SADC) transport system.</p>

Major focus	Activities of focus by state
	<p>3.2 Telecommunication</p> <ul style="list-style-type: none"> - Increasing the competitiveness of local fixed-line operations, cellular telephone networks, and international telecommunications through legislative and regulatory reforms; - Creating opportunities for black economic empowerment and small business investment opportunities through the managed liberalization of the sector; and - Utilizing new technologies to lower telecommunication costs for underdeveloped regions; and strengthening the role of ICASA.
	<p>3.3 Energy</p> <ul style="list-style-type: none"> - Implementing an integrated energy plan and continue implementing the national electrification programme; - Introducing and encouraging greater utilization of renewable energy sources and implementing the energy-efficient programmes; and - Developing a twenty-year gas master framework and institutionalizing the liquid fuels charter.

Major focus	Activities of focus by state
4. Prioritizing growth sectors	<p>4.1 Exports performance</p> <ul style="list-style-type: none"> - Taking advantage of and expanding market access; - Improving supply chain management and logistics and supporting product design and innovation; - Addressing issues of standards and non-tariff barriers to trade and strengthening and expanding export councils and other sectoral partnerships; - Branding and marketing sectors and clusters; and - Increasing government coordination in the development of sector strategies; and integrating geographic, BEE (Black Economic Empowerment) and small business objectives in sector strategies. - Ensuring new, expanded and restructured national and frontier parks; - Consolidation of investment in and the further development of the Lubombo and Wild Coast spatial development initiatives; and - Improving the standards and quality of tourism products and services.
	<p>4.2 Tourism</p> <ul style="list-style-type: none"> - Implementing projects to maximize the benefits arising from depreciated exchange rate for both increased international visitors and domestic tourism; - Introducing joint marketing strategies to six major tourism markets and focusing on new non-traditional tourism market in Africa, China and Middle East; - Reviewing the role and strategy of the South African Airways with a view to increasing the number of flights to South Africa;

Major focus	Activities of focus by state
	<ul style="list-style-type: none"> - Strengthening human resource development in the sector; promotion of BEE and small business development in the sector; <p>4.3 Agriculture</p> <ul style="list-style-type: none"> - Fast-tracking of the land redistribution and agricultural development programme; support programme for black farmers; - Implementing a risk management strategy; - Expanding and developing organized agriculture and developing domestic and global markets for agricultural products; - Introducing Public-Private-Partnerships in new farmer settlements; - Focusing on high value-added and exports-oriented sectors and promoting competitive supply chains; - Increasing investment in innovation and research and development; - Rehabilitating infrastructure and developing rural financing mechanisms; and - Introducing an agricultural database and information management. <p>4.4 Information and Communication Technology</p> <ul style="list-style-type: none"> - Implementing e-commerce legislation; developing opportunities in online processing and call centres, maximizing the benefits of President's international ICT council; and Introducing small business ICT strategy; - Increasing the number of graduates with ICT skills, learnership programmes, and research and development investment in ICT sector; and - Marketing South Africa as a source of high quality IT products, service and training.

Major focus	Activities of focus by state
	<p data-bbox="607 256 1055 284">4.5 Africa's cultural industries</p> <ul style="list-style-type: none"> <li data-bbox="656 312 1599 339">- Marketing to increase exports and establishing an export council; <li data-bbox="656 363 1984 391">- Improving access to finance for small businesses and improving training in cultural industries; <li data-bbox="656 414 2029 499">- Promoting South African arts festivals and using technology to improve competitiveness of the sector; <li data-bbox="656 523 1182 550">- Establishing a craft emporium; and <li data-bbox="656 574 1547 601">- Developing a strategy on South African audio-visual services.

Source: Department of Trade and Industry 2002

According to the Department of Trade and Industry (2002:24-25) all four pillars of the action plan contribute to the six key performance areas, namely: growth, competitiveness, employment, small business development, black economic empowerment and geographic spread. At the time of the development of the action plan, the strategies for the last four performance areas were already in place. The state's role in advancing the effective implementation of the micro-economic reform strategy in order to attain Vision 2014 includes promoting a coherent policy that promotes growth and employment across government; ensuring that the legislative arrangements conform to the imperatives of growth and employment; narrowing the gap between financial and operational planning with spending and identification of priorities and restructuring government budgets to better reflect and measure this new coordinated approach; improving knowledge management and information sharing; and increasing the capacity of government to spend effectively.

Furthermore, the beneficial impacts of reform on the lives of people and on the changing structure of the economy must be discernable. If they are discernable, they are also measurable. Government would therefore increase the resources available for measuring performance against its objectives and will develop a uniform and integrated measurement system across government. The focus would be on the impact of projects, programmes and policies, not least to ensure timely adaptation of the strategy to meet real needs in the real economy, in the interest of an effective, efficient, flexible and responsive government in South Africa (Department of Trade and Industry, 2002:25).

The section that follows will examine how far South Africa has progressed in implementing the action plan of the micro-economic strategy. It will also identify major impediments in the implementation process.

4.5 The Outcomes of the Micro-economic Reform in South Africa

Although the predetermined outcomes of the micro-economic reforms were targeted at 2014, the progress to date should inform the possibility of the success of the strategy after a set period. By 2005 the regional biotechnology regional innovation centres had been established, the bioinformatics networks were working, and high-potential biotechnology projects got a substantial allocation. The indigenous knowledge system policy was in place; and funds were

made available to secure intellectual property rights, open calls for innovation projects and student innovation initiatives (National Treasury, 2005:780-781). The outcomes of the micro-economic reforms are outlined in detail in the few sub-sections that follow.

4.5.1 Human Capital Development

Government interventions aimed at addressing issues relating to the deficiencies in South African education are, among others, the White Paper on Science Technology released in 1996, the National Skills Development Strategy launched by the Minister of Labour in 2001, the Research and Development Strategy published in 2002, and the recently Joint Initiative on Priority Skills Acquisition (JIPSA) introduced in 2005. According to the South African Yearbook (2005:212) the institutional arrangements underpinning the Research and Development Strategy include the establishment of 25 Sector Education and Training Authorities (SETAs) and the National Skills Fund; and the general reshaping of further and higher education to meet the human resource development needs of the country. The aforementioned strategy ensures integrated human resource planning and implementation, monitored at a national, regional and sectoral level. The key mission of the strategy is to maximize the potential of people in South Africa through the acquisition of knowledge and skills, and to set in place an operational plan and the necessary arrangements to ensure that everyone achieves productivity and work competitively to improve their quality of life.

The Department of Labour (2003:1) confirmed that the SETAs are not effective in implementing their mandate. This is attested to by large balances in their accounts when the demand for training is very high. The Department of Labour (2006:10) revealed that the Tourism Hospitality Education and Training Authority SETA is being investigated for financial mismanagement.

Fedderke (2006:25) acknowledges the major policy achievement of expanding access to education in South Africa. However, he argues that the quality dimension of human capital investment with potentially significant impact on growth has been lacking. Both the school and university systems do not produce the sort of educational outputs required for long-term economic growth. In contrast, what they produce come at relatively high costs. He considers this a great challenge, as innovation is of increasing importance to South African growth.

Research and development and quality human capital formation are central to technical progress in South Africa.

Apparently, the quality of education in South Africa is not the only challenge posed to human capital development. Simpkins (2007:3) and Fedderke (2006:26) reported that the South African schooling system continues to produce far fewer passes in mathematics and science than the country's economy requires. Many university degrees and professional and technical careers require grounding in mathematics and science – the critical shortfall of learners leaving the schooling system with higher grade mathematics and science is a significant constraint on economic growth.

By mid-2006 the South African public education system had 12 million learners, 366 000 educators and about 28 000 schools - including 390 special-needs schools and 1 000 registered private schools. In 2005 the pass rate was 68 per cent, 86 531 attained university endorsement, 32 112 learners passed mathematics in higher grade and 45 652 passed physical science in higher grade.

In addition, the findings of the draft Science, Engineering and Technology (SET) Strategy by the Department of Science and Technology (2008:28) reveal that out of a total of 500 000 students enrolled in higher education in 2004, 135 000 or 27 per cent were enrolled in SET careers. This SET participation rate compares favourably with the national performance target for higher education of achieving a 30 per cent participation rate in the SET field at undergraduate level. However, the SET graduation rate during the same year stood at 33 500 which translates to 6.7 per cent of the total higher education enrolment in 2004. In the same year, of the total 23 000 honours students who graduated across all fields, only 3 200 or 13,9 per cent graduated in SET honours programmes. These participation rates are not impressive considering the fact that they come from an already depleted base of students who have obtained matric exemptions and that they found wherewithal to enrol in higher education institutions. Of utmost importance is the fact that human capital development has a knock-on effect on the two other aspects of micro-economic reform.

4.5.2 Small Micro Medium Enterprise Development

GCIS (2005:173-176) outlines the institutional support framework of the small, micro and medium enterprises - aimed at enhancing the SMMEs' development and sustained growth. These institutions provide financial and non-financial support to the SMMEs. For an example, the Small Enterprise Development Agency (**seda**) renders non-financial support to the SMMEs, while Khula Enterprise Finance provides financial support. Some of the institutions focus on certain critical areas, e.g. the South African Women Network, which assists aspiring women in business; the Technology for Women in Business, which enhances the use of technology by women in business; and the National Empowerment Fund Trust, which promotes and facilitates economic equality and transformation.

The initiatives outlined above have yielded positive results. To mention a few successes, between 1996 and 2003 Ntsika, **seda**'s forerunner, supported a network of 1 299 service-providers and trained 3 028 of their employees. By means of the agency's interventions, 334 000 SMMEs were trained in business skills, counselled and advised. Currently, the set target is that the support service will benefit 170 000 SMMEs between 2004 and 2007. In the 2003/04 financial year Khula Enterprise Finance provided more than 600 000 loan guarantees to the value of R180 million, disbursed loans worth R100 million, and allocated R20 million through its equity fund (GCIS, 2005:173-174). Notwithstanding the above successes, the impact of such could not achieve the desired results.

Ncube (2004:4) identifies the institutional factors that influence the growth of entrepreneurship as government-to-business relations, which is the ability of the Chambers of Commerce and Industry Associations to provide private sector views to government; the availability of educated, trained and skilled manpower; the quality of financial systems; the protection of property rights and general recourse to an objective justice system; reduced corruption; effective government; and efficient administration.

Ncube (2004:7) reveals three important findings on the impact of government regulation on entrepreneurship. Firstly, in low-income countries business faces more regulations than in high-income countries. Businesses in low-income countries face three times the administrative costs and nearly twice the bureaucratic procedures than in high-income

countries. Secondly, in low-income countries the weak property rights protection mechanism and complex regulatory mechanisms compel the small businesses to operate in the informal sector. Finally, the regulatory reforms allow small businesses to spend less time on regulatory issues and more on business issues. He further identifies South Africa as one of the developing economies that was negatively impacted by the aforesaid factors of the institutional environment.

4.5.3 Infrastructure Development

According to GCIS (2005:179) the Department of Public Works has made great strides in the improvement of public service delivery – contributing to economic growth and poverty alleviation. Between 1994 and 2004, the Department of Public Works implemented 7 692 construction-related projects worth R10 billion as part of its core function to provide physical accommodation and other essential infrastructure to government. The above projects sustained about 15 000 workers in the construction industry. The aforementioned successes are attributed to the developments in the construction industry and the introduction of the construction industry support structures. Among other developments, the Construction Industry Development Programme ensures the leadership role of government and the co-ordination of government representation within the construction and property industries. The Emerging Contractor Development Programme focuses on the development of emerging contractors. Contracts to the value of R791 million were awarded to emerging contractors under this programme in 2003/04. The women participation increased from 7 to 10 per cent between 1999 and 2004.

Although the construction industry has recorded successes, access to finance remains a problem for black contractors. Standard Bank, Khula Enterprise Finance and the Industrial Development Corporation have been mobilized by the Department of Public Works for bridging finance and performance guarantees for all qualifying contractors awarded contracts within the Strategic Projects Initiative Programme (GCIS, 2005:179).

According to Perkins *et al.* (2005: 223) the South African public sector investment in economic infrastructure rose as a percentage of GDP between 1960 and 1976, followed by a long-term decline. However, the fixed telephone lines grew rapidly in the 1980s and 1990s in

response to the worldwide revolution in information technology. The mobile phones grew explosively in the 1990s and 21st century. The possibility of inadequate electricity supply was foreseen for 2007.

Bogetic & Fedderke (2006: 2 – 17) analyse and benchmark the social and economic infrastructure performance in South Africa to date in terms of key indicators of access; affordability; pricing; and quality, using the new World Bank database of infrastructure sector-outcome indicators. Generally, in South Africa access to electricity, water and sanitation remains a major challenge - particularly in rural areas; as well as Telkom's performance in services. Transport performance is also identified as less strong than expected. The main implication is that in order for South Africa to catch up with the upper middle-income group countries, it needs to scale-up in the areas without services and improve efficiency in all infrastructural sectors. South Africa provides solid services of reasonable quality compared to the benchmark and other country groupings. In some cases, the country has very competitive prices. However, it is still lagging behind in terms of the pricing of local services. In order for South Africa to strengthen its overall infrastructural performance, it will have to improve the aforementioned dimensions' performance in the sectors faster than the average country in the upper middle-income group. This target is not easy to achieve. However, it could assist in terms of reducing its economic inequalities and poverty rates, and therefore meet the infrastructure-related Millennium Development Goals (Bogetic & Fedderke, 2006: 18).

The National Treasury is set to increase infrastructure spending from 5.2 to 6.7 per cent of GDP between the 2004/05 and 2008/09 financial years. This increase represents a nominal increase from R72 billion to R135 billion. This is important not only for economic growth, but also for equity and poverty reduction. Currently, investment in infrastructure does not appear to lead economic growth in South Africa, either directly or indirectly. There is little evidence of feedback from output to infrastructure (Bogetic & Fedderke, 2005: 3).

4.6 Conclusion

The South African government has made strides in terms of policy developments to ensure that the programmes that are implemented address the economic and socio-economic

challenges facing the country. However, it is clear from the above discussions that a lot still needs to be done to improve the policy framework adopted to this end.

Chapter V concludes the topic being researched. It starts with the communication of findings, establishes the causes of challenges still experienced and, lastly, communicates recommendations for addressing the challenges.

CHAPTER V

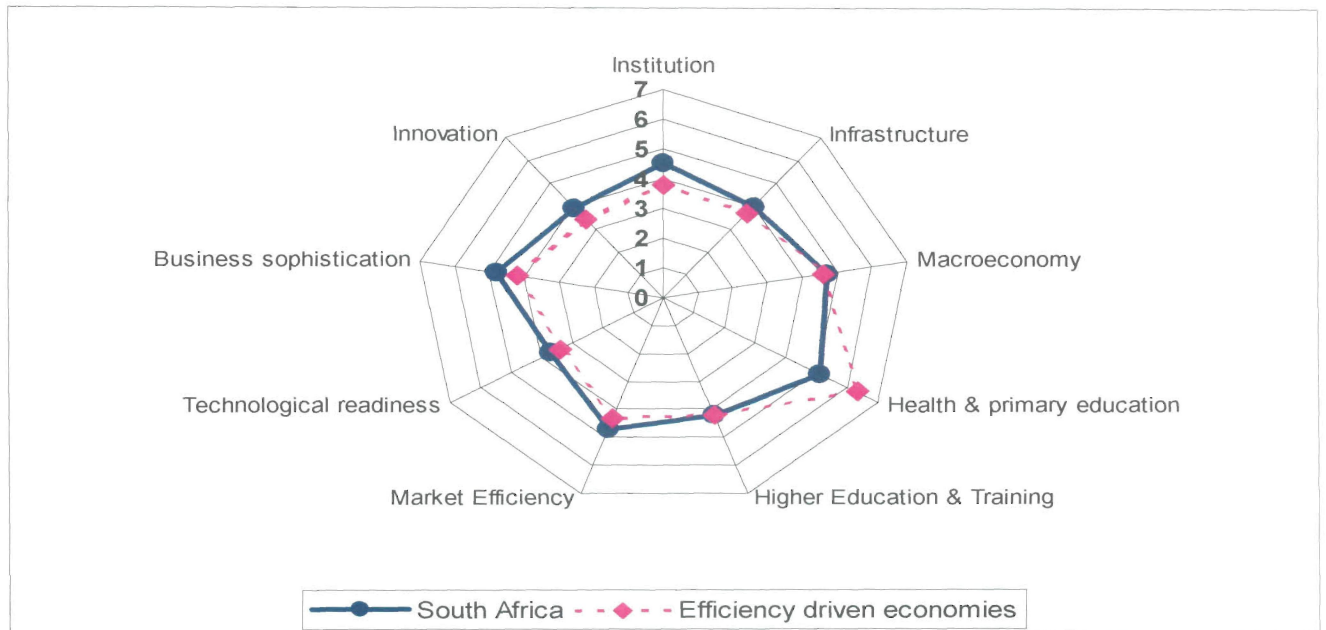
CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

According to Lopez-Claros *et al.* (2007:52) wealth is created in an economy at a micro-economic level in the ability of firms to create valuable goods and services using efficient methods. Therefore, the productivity of a country is ultimately determined by the productivity of its companies. In addition, more productive company strategies and operating practices require, among other things, more highly-skilled people; better information; more efficient government processes; improved infrastructure; better suppliers; more advanced research institutions; and more competitive pressure. The two interrelated areas upon which the micro-economic foundations of productivity rest, are identified as the sophistication and capabilities with which domestic companies or foreign subsidiaries compete, and the quality of the micro-economic business environment in which they operate.

The Lopez-Claros *et al.* (2007: 5 and 344), in their Global Competitiveness Report, classifies South Africa as an efficiency-driven economy. They further identify factors that are critical in driving productivity and competitiveness and group them into nine pillars, namely institutions, infrastructure, macro-economy, health and primary education, higher education and training, market efficiency, technological readiness, business sophistication and innovation. The first four pillars are classified as the basic requirements, the three subsequent ones as efficiency enhancers, and the last two as innovation factors.

Figure 5.1: South African competitiveness compared to other efficiency-driven economies



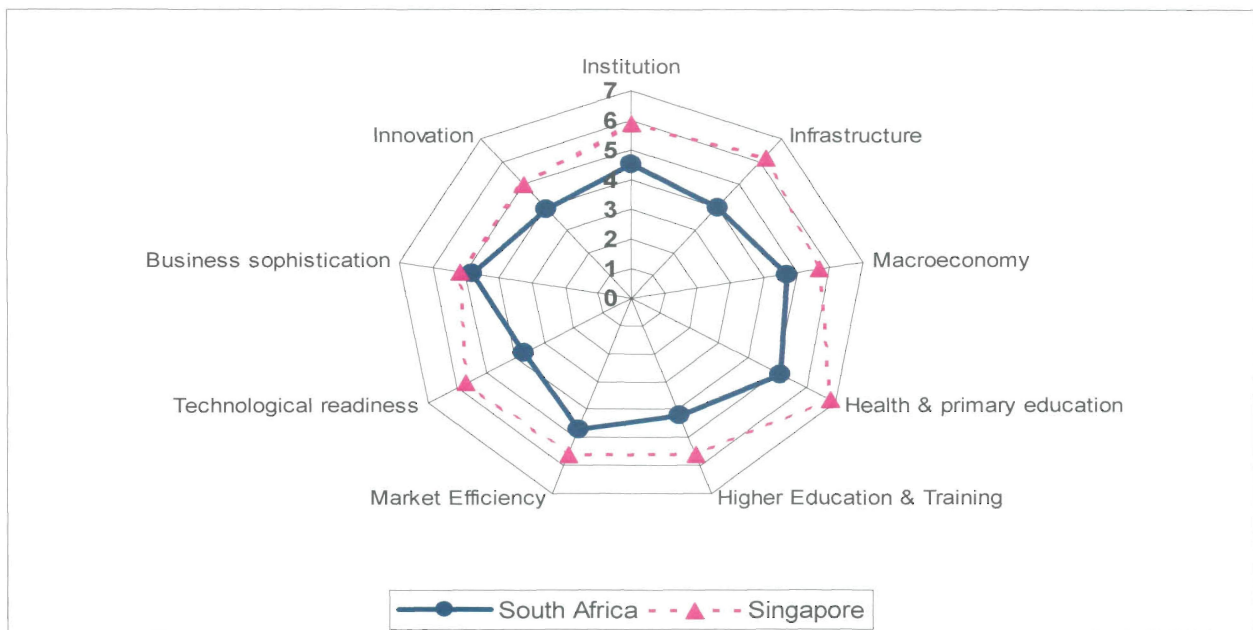
Source: *The Global Competitiveness Report 2006 - 2007*

According to figure 5.1 above South Africa’s competitiveness is above that of the efficiency-driven economies in seven pillars, namely: institutions, infrastructure, macro-economy, market efficiency, technological readiness, business sophistication and innovation. The health and primary education; and the higher education and training pillars scored below the efficiency-driven economies.

Lopez-Claros *et al.* (2007:345) noted South Africa as having competitive disadvantages in, among others, a burden of government compliance, favouritism in decisions by government officials, diversions of public funds, telephone lines, quality of electricity supply, quality of mathematics and science education, availability of scientists and engineers, quality of educational system, time required to start a business, brain drain, pay and productivity. The aforementioned challenges relate to the micro-economic reform the South African economy has embarked on. This suggests that the South African economy has a long way to go to reach the targets of the micro-economic reforms. The section that follows heightens the actual challenges facing the implementation of the South African micro-economic reforms and recommends possible mitigating factors to the impediments identified.

Singapore, is a developed economy and it is an innovation-driven economy. Its success is underpinned by the competitive advantage of, among other areas, wastefulness of government spending; ethical behaviour of firms; diversions of public funds; quality of infrastructure; government surplus; quality of the education system and mathematics and science; pay and productivity; foreign ownership restrictions; time required to start a business; extent and effectiveness of business; technology transfer and firm-level technology absorption; quality of scientific research institutions; and intellectual property protection (Lopez-Claros *et al.*, (2007:338 - 339). Figure 5.2 below compares South Africa to Singapore as regards the same factors illustrated in figure 5.1.

Figure 5.2: South African competitiveness as compared to Singapore



Source: *The Global Competitiveness Report 2006 - 2007*

The figure above shows that Singapore surpasses South Africa by far in all the major elements. The scores for Singapore versus South Africa out of the highest of seven are recorded as follows: basic requirements 6.1 versus 4.6; efficiency enhancers 5.6 versus 4.2; and innovation factors 5.1 versus 4.4. The weakest element for South Africa is efficiency enhancers, which has the lowest score of 4.2.

5.2 Communication of Findings and Recommendations

Generally, the funding of programmes that underpin the development of the South African economy is not cause for concern. This is attested to by the report of the South African Year Book (2007:195) that South Africa has one of the highest rates of government investment in education in the world – 5,5 per cent of the Gross Domestic Product. According to the Department of Science and Technology, by 2007 the research and development expenditure was 0,9 per cent of the GDP – i.e. 0.1 per cent below a target of 1 per cent of the GDP that is planned by 2008.

In addition, it is clear from the discussion in Chapter IV that the development of SMMEs and infrastructure has received noticeable financial and non-financial support from the fiscus. This attests to the fact that government's policies that map out the strategic direction of government initiatives towards micro-economic reform are not an issue either. There are several policy documents that were developed since 1996 to that effect. Similarly, the institutional support framework is also in place in all three aspects of the micro-economic reform that are researched.

One of the challenges facing policy makers in South Africa is the effective implementation of the budget, which is supposed to be enabled by the financial reforms or third-generation reforms outlined in Chapter II. The aforementioned has a spill-over effect on the programmes put in place to advance the desired outcomes of the micro-economic reforms. Hence, the recent initiatives such as the Accelerated and Shared Growth Initiative for South Africa and the Joint Initiative on Priority Skills Acquisition are still emphasizing the same aspects of the micro-economic reforms contained in the Micro-economic Reform Strategy and the resultant Integrated Action Plan.

Similarly, the National Treasury (2007:7) emphasized the reforms that need to take place to attain the 6 per cent growth in, among others, raising the productivity levels and generating more jobs, improving the performance of the public sector and enhancing infrastructure capacity – especially in relation to telecommunications, rail, roads, ports, electricity and water.

It is clear from the above arguments that although South Africa has embarked on these kinds of reforms since 1999, the departments are still struggling with the implementation thereof. McKinnon (2006:3-4) outlines the principles underlying the process of public finance management reform as follows:

- The reforms should be implemented as part of the overall strategy, which should be home-grown and country-led. Although the donors could be allowed to contribute financial resources and skills to the process, the reform strategy itself must be country-owned. The interactive engagement with business, labour, civil society and opposition parties will lend the strategy credence.
- Reforms must start with sound policy formation at a macro-economic level, including defining the purview of the state, the framework of government, key institutional arrangements, and macro-economic policy.
- Financial reform is first and foremost a political process implying political costs and benefits. Therefore, it is imperative that it gets full political backing and must enjoy continuing and unwavering support for the long-term. The Ministry of Finance or an equivalent department must be imbued with the strongest possible political authority to oversee public finance management.
- Key institutions, like Central Bank and Revenue Services, need to be empowered to operate autonomously from government. They should be provided with full legal or constitutional underwriting to do their job without interference, clear and transparent mandates, sufficient financial resources and human capital talent to operate efficiently, and the political space to carry out their work.
- Reforms need to be managed. To that effect, government needs to make use of all available skills. This includes harnessing global best-practice and making use of all available human capital, wherever it may be found, including the existing civil service, the private sector, academic and professional bodies, donor-provided training and technical skills transfer programmes. Reform is made more feasible with timely and accurate data and government must invest in and analytical bodies.
- The progress of reforms must be effectively measured and monitored by setting performance-related benchmarks and indicators vis-à-vis agreed objectives, empirical measurement of these benchmarks, and an analysis thereof by oversight bodies.

The South African government is still grappling with some of the principles outlined above. However, there are some areas in which the South African government has made strides: The South African macro-economic policy has put the country on a good path to advancement of the micro-economic benefits; the process has full political backing; and necessary reforms were effected to ensure autonomy of the South African Reserve Bank and the South African Revenue Services. What seem to be challenging though - looking at the checklist as suggested by the McKinnon – are ensuring skills-transfer from foreign officials who are assisting with the reforms; and effective dealing with the challenges that derail the processes. The aforementioned is aggravated by rent-seeking and non-compliance by the South African government.

The discussion in Chapter III and the analysis of the competitiveness of Singapore in the introduction revealed that the success of the Singaporean government's human capital development is underpinned by the integration of the education system from primary to tertiary education; the focus on the quality of education at the primary and secondary level and the availability of quality scientists and engineers. Even if some of the aforementioned attributes are incorporated in the processes of South African human capital development, their results are not evident at this stage. Instead, the situation is worsening every year. South Africa needs to concentrate on improving the quality of output rather than expanding the pool of learners to meet its growing human capital need, as is currently the case. It is clear from the Singaporean model that the education system must be integrated from the primary level to the tertiary level. The top-end skills development plan will not yield the desired results when the foundation is not well laid. Furthermore, the South African government needs to ensure that all the institutions set up to advance investment in human capital are effective in operationalising the developed strategies.

As far as the SMMEs are concerned, the Singaporean economy is currently at an advanced stage where they are competing at a cluster level and government is supporting this arrangement. Support for SMMEs is effective in that there is continuous support for this category of business, and efforts to this end are evident from their increasing economic activity and low unemployment rate. The issues of information and communication technology and energy are well advanced in the Singapore government.

In the South African situation there are too many institutions that provide support to the SMMEs, some of which provide similar services. For instance, the National Empowerment Fund, the South African Micro Finance Apex Fund and the Khula Enterprise Finance's core function is to provide financial support to the small enterprises. On the other hand, there are other institutions that provide non-financial support like the South African Quality Institute, Small Enterprise Development Agency (**seda**) and other institutions that provide the same service to dedicated groups – like black and women entrepreneurs. Additional to the latter institutions, the National Treasury (2007:715) indicates that **seda** was allocated additional funding to establish offices in the provinces; and there are Industrial Development Corporations in the provinces providing similar services to the enterprises.

According to the National Treasury (2007:684), of the total budget of the Department of Trade and Industry, 81 per cent is allocated to the public entities – most of which are inclined to SMMEs support. It is therefore evident that the SMMEs support receives substantial financial and non-financial backing from the fiscus. However, the support could be better provided in a coordinated way because the existing duplication of services might contribute to ineffective implementation of the government programmes. As a result, the situation renders the monitoring of the implementation process ineffectual.

It is therefore recommended that the institutions that provide non-financial support be consolidated into one institution that will provide support according to the dedicated groups of enterprises – e.g. groups pertaining to small and women enterprise and black economic empowerment. In that way the institution will be easily marketable, fully utilized by interested people and there will be less confusion regarding the services provided by different institutions. It would also be easier for the Accounting Officer of the Department of Trade and Industry to manage the programmes in a more coordinated way to ensure effective implementation thereof.

As far as the social infrastructure is concerned, it is clear from Chapter IV that government made strides in terms of advancing the objectives of the micro-economic reforms by developing policies that ensure that the public works programmes use labour-intensive means to ensure that employment is created. The policies also focus on emerging contractors and black economic empowerment. Failure of the programmes is mainly attributed to favouritism

by government officials when making decisions around procurement of services – one of the weaknesses identified by Lopez-Claros *et al.* (2007:345) as the South African notable competitive disadvantage. Access to finance is also a disconcerting issue. On the economic infrastructure side, information and communication technology is still lagging behind. The cost of doing business in South Africa is regarded as one of the highest in the world. Government intervention in this regard should be eliminating the monopoly of Telkom South Africa. On the energy side, government should expedite the programmes of increasing and improving the quality of electricity and identifying other energy alternatives. The transport infrastructure also needs further attention from the provincial and local governments.

5.3 Conclusion

Although the latest developments suggests that the South African government still has a long way to go to achieve the target of 6 per cent growth and halving unemployment by 2014, all the reforms the South African government has embarked on have stood the country in good stead in achieving such results. The only missing link is the effective implementation of the action plans. The pace at which the processes are initiated also means that time is lost. The adequate funding of the Justice and Protection services cluster seemed to be geared to addressing the problem of crime facing the South African economy, which generates substantial opportunity costs for the country in terms of attracting foreign investors. However, much has to be done to out-root corruption in the South African criminal justice system.

The third generation reforms detailed in Chapter II are very critical in the implementation process. It ensures that the allocated funds are spent on critical programmes. It also ensures that accounting is result-oriented rather than input-oriented. According to Ajam (2000:6) the PFMA essentially locates budget and financial management in a performance management framework. The worrying factor is that the process is not fully implemented – most of the departments cannot comply accordingly due to a lack of understanding of the processes. This attests to the fact that South Africa has a sufficient body of knowledge as far as third generation reform is concerned, but the knowledge is not well-managed to ensure continuity of activities in a case where the incumbents discontinue their service with departments.

The initiatives of knowledge generation and innovation in the economy, supported through the fiscus, will ensure an increased productive capacity and economic activity – and eventually the transition to an innovation-driven economy. The economy could even advance the developmental stage of an innovation-driven economy. However, this will only be achieved if the programmes could be effectively implemented to ensure the desired results.

5.4 Recommendations for Further Research

It is clear from the above discussion that funding and the policy framework, including the activities contained in the implementation plan, are aligned to the solutions of the structural problems in South Africa. However, the implementation seems to be a major challenge. Implementation would include the effectiveness of the tools used to implement the action plans and the governance/monitoring of the processes. Therefore the recommendation for further research is the assessment of the effectiveness of the South African implementation processes and tools. Detailed case studies for the affected government departments would be required in this regard.

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