FISCAL CONSTRAINTS DETERMINE SOUTH AFRICA'S SOCIAL AGENDA

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Can South Africa afford to extend the child support social grant programme?

1. INTRODUCTION

This note argues that fiscal constraints determine the agenda of South Africa's current social policy. After the democratic elections in 1994, South Africa was forced to follow prudent fiscal policies as the deficit before borrowing in the 1993/94 fiscal year amounted to 5.6 percent of gross domestic product (GDP) (SA Reserve Bank, 2013: 33). Calitz et al (2003) assess that this substantial deficit was caused by three factors:

- firstly, the South African government followed expansionary fiscal policy between 1985 and 1995, following the announcement of a moratorium on the repayment of private-sector foreign debt in September 1985 (The Debt Standstill Arrangement), with a concomitant increase in government borrowing and government debt
- secondly, the South African government improved the actuarial funding level of the Government Employees Pension Fund (GEPF). This implied large transfers from the government to the GEPF with a concomitant increase in the deficit before borrowing and government debt
- thirdly, with the merging of the previously "independent" homelands (Transkei, Bophuthatswana, Venda and Ciskei and self-governing territories) with South Africa, the South African government accepted the debt obligations of these countries, with a concomitant increase in the level of government debt.

These three aspects impacted South Africa's overall fiscal position in two ways. Expansionary fiscal policy and the improved funding of the GEPF contributed to an increase in the deficit before borrowing. Naturally this increase in the deficit before borrowing also contributed to an increase of the South African government's debt/GDP ratio, which was further increased with the consolidation of the debt of the homelands and self-governing territories. As a result government debt as percentage of GDP reached a level of 51 percent of GDP in 1995 (Calitz et al, 2003: 8).

Sustained economic growth culminated in an improvement in the fiscal position by 2006/07, with government's fiscal position showing a surplus of 0.7 percent of GDP (SA Reserve Bank, 2013: 34), while government debt as a percentage of GDP amounted to 23 percent in 2007 (Calitz et al, 2003: 8). However, this fortuitous position could not be sustained.

Section Two of this note considers fiscal developments in South Africa since 2008. The third section provides context on the Maastricht conversion criteria for government borrowing. Section Four highlights the close correlation between economic growth in South Africa and the real growth rate in government revenue. Section Five reflects on social grant expenditure and the unaffordability of intended increases in such expenditure. The conclusions follow in Section Six.

2. FISCAL DEVELOPMENTS IN SOUTH AFRICA SINCE 2008

South Africa's fortuitous fiscal position by 2008 (a budget surplus equal to 0.7 percent of GDP and a debt/GDP ratio of 23 percent) was in part the result of rapid domestic economic growth in the years preceding the fiscal crisis of 2008. South Africa's economic growth rate averaged around 4 percent per annum from 2000 to 2007 (see e.g. Industrial Development Corporation, 2013: 1), mainly as a result of high international commodity prices stimulating domestic mining activities. Unfortunately, this fortuitous position was not used to build surplus fiscal capacity by running sustained budget surpluses. This can be contrasted to Chile, a country also heavily dependent on commodity exports, where an annual fiscal surplus rule was adopted in 2000 (see e.g. Kumhof and Laxton, 2009). In South Africa, increased government revenue from tax receipts was used, *inter alia*, to fund an extensive system of social grants that can hardly be sustained during a period of economic downturn, as is explained here.

Following the financial crisis of 2008, South Africa suffered negative economic growth of -1.5 percent in 2009 (SA Reserve Bank, 2015: S-149). Government used fiscal policy to stimulate a lacklustre economy, with concomitant increases in the deficit before borrowing. From the surplus position in the 2006/07 fiscal year, deficits were recorded from 2008/09, peaking at a deficit before borrowing of 5.1 percent of GDP in 2009/10 (ibid.). As a percentage of GDP, the government's net debt has grown from 21.8 percent in the 2008/09 fiscal year to 41.2 percent of GDP at the end of the 2014/15 fiscal year, and is expected to grow to 46.2 percent at the end of the 2018/19 fiscal year (National Treasury, 2016: 92). The budget deficit for the 2015/16 fiscal year was 3.9 percent of GDP (ibid.: 224), considerably higher than the internationally accepted norm of 3 percent of GDP (see below).

At the time of the 2015/16 budget, one consequence of stimulatory fiscal policy in the midst of lacklustre economic growth was the announcement of an increase in personal income tax (National Treasury, 2015), over and above other tax increases. Despite these increases, the deficit before borrowing remained well above 3 percent of GDP. Consequentially, government can no longer use fiscal stimulation in the same way as before, owing to revenue limitations.

The 2015 Medium Term Budget Policy Statement (MTBPS) confirmed that the "domestic GDP growth [projection] ... has again been revised downwards" (Republic of South Africa, 2015: 1). Lower GDP growth limits the government's revenue growth, which in turn impedes growth of the tax base and tax revenue, and therefore expenditure.

The South African government faces two major challenges in expenditure: civil service remuneration and social grant expenditure (the topic covered in this note). The 2015 MTBPS states that "(t)he 2015 public-sector wage agreement resulted in a 10.1 percent increase in the wages and benefits of government employees this year ... Without commensurate improvements in the quality of public services, such increases are not sustainable" (Republic of South Africa, 2015: 5). This increase is well above the prevailing rate of inflation. The civil service remuneration bill amounts to more than 40 percent of government revenue, compared to 33 percent in 2008 (Rossouw et al, 2014), putting government finances in South Africa under pressure.

As the same time, Productivity SA (2014: 10) notes that "(t)he public sector in South Africa faces many challenges including a lack of capacity and trying to balance service delivery with difficult global economic conditions". These problems are exacerbated by the extensive use of consultants. The 2014 Budget Review states that "(t)he escalating costs of compensation of public service employees and funds spent on consultants need to be brought under control as there is no correlation between these costs and the provision of services to the poorest of the poor" (Republic of South Africa, 2014: 113).

MAASTRICHT CONVERSION CRITERIA FOR GOVERNMENT BORROWING

On 9 June 1982, French President Francois Mitterrand announced that 3 percent was an upper limit for budget deficits. This norm was subsequently adopted and applied by the European Union in its Maastricht convergence criteria for eurozone countries (see e.g. Afxentiou, 2000: 249), but there is no sound evidence that its formulation was based on any economic principles. In this regard, Bukowski (2006) states that "it should be borne in mind that introduction of reference values in the form of a 3 percent share of budget deficit in GDP ... is arbitrary".

De Grauwe (2009) opines that the Maastricht criteria "have very little to do with economics, and very much with politics".

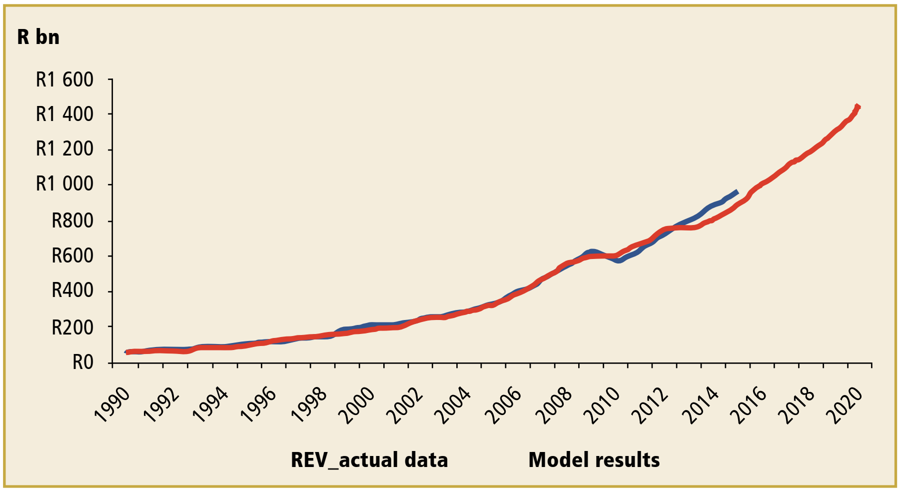
According to Guy Abeille, who worked in the French finance ministry in 1981when Mitterand came into office, the president asked them to formulate a budget deficit rule. As the French budget deficit was in excess of 2 percent of the country's GDP at the time, a 2-percent limit was considered to be too low. Accordingly, officials proposed a limit of 3 percent, which Mitterrand accepted (Le Parisien, 2012; European Tribune, n.d.; also confirmed in Chorafas, 2014: 366).

Some economists believe that this limit was set at 3 percent of GDP because it corresponded with the long-term growth projections of European economies at the time. It would therefore ensure that government debt as a percentage of GDP would not grow if the GDP also grew at 3 percent per annum. Using this explanation, the same figure can be applied as the upper limit in South Africa, as the country's long-term growth potential is set at 3 percent. As highlighted below, this limit will be too high in the near future, as the economy will grow at a slower pace.

ECONOMIC GROWTH AND GOVERNMENT REVENUE

Real increases in government revenue are the result of any combination of economic growth and tax increases. South Africa has seen lacklustre growth since 2008, suffering a recession (two or more quarters of negative economic output changes) in 2009. Future economic growth with concomitant growth in government revenue has to be assessed in order to assess the sustainability of current and future government expenditure plans. For this purpose, we used an econometric model to forecast government revenue expectations for South Africa.[1]

Figure 1. Government revenue forecast: model fit



Source. Own calculations

The government revenue forecast is highlighted in Figure 1, with actual (REV_actual data) and projected (Model results) government revenue showing that slower revenue growth should be expected in coming years. The close correlation to past growth trends confirms slower future growth. This forecast shows that the government should budget for subdued income growth for the foreseeable future. It places a serious constraint on government's ability to increase expenditure for new initiatives.

In the 2015/16 fiscal year, against the background of subdued revenue growth, the government announced increases in personal income tax rates. For example, an individual who earned R528 000 per annum in 2014/15 fiscal year paid R127 348 income tax after the primary rebate. Given an inflation-matching raise of 6 percent during the 2015/16 tax year, compensation increases to R559 680 and personal income tax to R140 091.80. This is equal to an increase of 10 percent in the tax burden of such a taxpayer. The higher tax burden reduces disposable income, resulting in lower consumption expenditure and economic growth in the long run, which will only intensify South Africa's fiscal problem.

SOCIAL GRANTS

Although social grants, the provision for free ("RDP") housing, and the provision of free basic services (water, sewage and electricity) play an important role in addressing skewed income distribution, it also places additional pressure on South Africa's fiscal position. Research by Bosch et al. (2010) shows that South Africa's Gini coefficient decreases from 0.71 to 0.59 when these transfers are included in the calculation of income distribution (see also Marx, 2014; World Bank, 2014). Social grants play an important part in this transfer system, in terms of both value and poverty alleviation. However, it comes at a high cost to the economy.

The South African government expanded social grants with the tabling of the 2002/03 budget. In this budget speech, the minister of finance announced that "(t)he improvement in our fiscal position means that we can substantially increase public spending, thereby increasing the potential of all our people to contribute to social development" (Manuel, 2002: 9). By 2002, 4.2 million people were receiving social grants. In the 2003 Budget Speech, the minster announced the government's policy to gradually increase the age up to which qualifying children could be grant recipients (Manuel, 2015: 12), with a concomitant increase in the number of recipients.

McEwen and Woolard (2010) provide a brief overview of the expansion of the child support grant (CSG). It was introduced in April 1998 to replace the previous State Maintenance Grant, for which only a very limited number of recipients qualified. Initially, only children up to the age of 7 in poor households failing a means test could qualify for the grant. The CSG initially had a low take-up rate, but "the eligibility rules ... were changed in 1999 " (ibid.: 2). The age limit was raised to include children up to the age of 9 in 2003, to age 11 in 2004, to age 15 in 2009, and up to age 16 in 2010 (ibid.). By 2012 it was raised up to the age of 17, with this grant lapsing once eligible children turn 18.

The result was a dramatic increase in both the number of recipients and in social grant expenditure. This expenditure grew rapidly from 2008, following the extension in these grants, as is shown in Figure 2, but has levelled out in recent years in respect of both number of recipients and amount paid out.

Table 1. Grants and qualification criteria

GRANT TYPE	QUALIFICATION CRITERIA
Child support grants (the topic of this note)	Income support to parents and caregivers of children under 18 whose annual earnings are less than R42 000 (single) and R84 000 (married)
Foster care grants	Assistance when taking children in foster care
Social-relief-of-distress grants	Temporary income support, food parcels and other forms of relief to people facing undue hardship
Care dependency grants i.r.o mentally or physically disabled children	Income support to parents and caregivers whose annual earnings are less than R180 000 (single) and R360 000 (married)
Grants for people earning annually less than R69 000 (single) and R138 000 (married) and whose assets do not exceed R990 000 (single) and R1 980 000 (married)	
Old age grants	People aged 60 and above
War veterans grants	People who served in World War II or the Korean War
Disability grants	People with permanent or temporary disabilities
Grant-in-aid	Additional grant to recipients of old age, disability or war veteran grants requiring care owing to their physical or mental condition

Source. Budget 2016: Estimates of National Expenditure 2016, p. 299

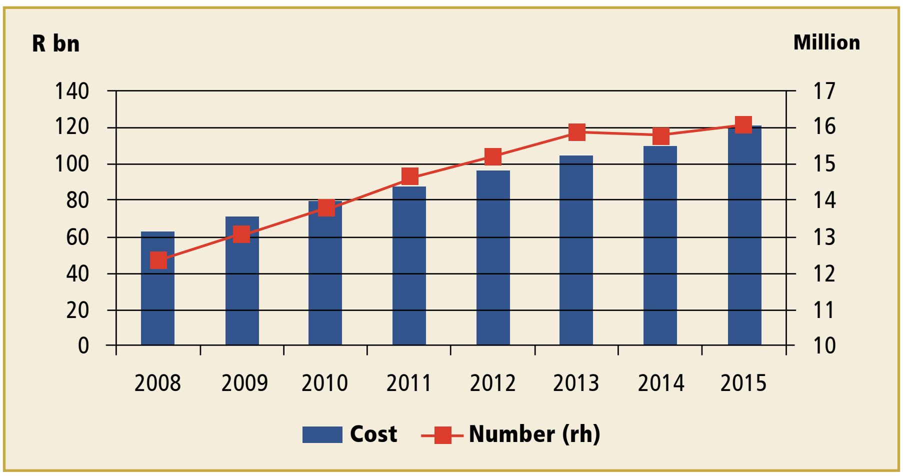
South Africans can qualify for a number of grants, as summarised in Table 1.

From 4.2 million in 2002, the number of grant recipients increased to 16.1 million in 2014/15 and is expected to increase further to 17.5 million in 2017/18. This represents an average growth rate of 9.3 percent p.a. between 2002 and 2018, which shows continued uptake of social grants from 2014/15, albeit at a lower rate than before, even without any further extension of qualifying beneficiaries. Drawing from the estimates of national expenditure in the 2015 and 2016 national budgets, the particulars are as follows:

- 3 541 742 persons older than 60 by 2018/19, from 2 969 933 in 2013/14
- 1 078 898 disabled persons by 2018/19, from 1 120 419 in 2013/14
- 12 843 883 children by 2018/19, from 11 125 946 in 2013/14
- 158 404 children with serious disabilities by 2018/19, from 120 632 in 2013/14
- 470 672 foster children by 2018/19, from 512 055 in 2013/14. (National Treasury, 2015: 300; 2016: 299)

Currently 11.8 million children qualify for child support grants and the budgets for 2016/17, 2017/18 and 2018/19 are based on an assumption that this will increase to 12 843 883 children by 2018/19 (National Treasury, 2016: 299).

Figure 2. Cost and number of recipients



Source. Various national budget documents; own calculations

Social grant expenditure is expected to rise from R140.5 billion (2016/17) to R164.7 billion in 2018/19 (National Treasury, 2016: 291). This is equal to an average growth rate of 5.4 percent p.a. and clearly makes no provision for further extension of beneficiaries of existing grants.

These budgeted expected increases in child grant expenditure and uptake do not take into consideration the the government's recent announcement of its intention to increase CSGs for qualifying children from age 18 to age 21. In parliament, Mr MS Mbatha of the Economic Freedom Fighters asked the minister of social development:

> (1) (a) What is the reason for increasing the age limit of the child social grant recipients to the age of 23 and (b) how much will the additional child grants to people aged between 19 and 23 cost the state annually;
>
> (2) (a) how is her department working with other government departments to ensure that employment is created for the youth of working age instead of making them dependent on grants and (b) what are her department's concrete plans in this regard? (National Assembly, 2015)

The minister responded that the age limit of CSGs has not been increased, but the department plans the extension to age 21 (not 23) to align it with the foster care grant. Currently, CSGs terminate when a child turns 18, irrespective of education status. The intention is to limit the extension to recipients between ages 18 to 21 who are still in education or training. In addition,

> [s]hould the policy be approved, the extension of child support grants to 21 will be introduced in phase format, starting with 18–19 in the first year, 19–20-year-olds in the second year, and finally 20–21-year-olds in the final year. The extension will cost about R1.2 billion in the first year, R2.2 billion in the second year and R3.3 billion in the third year. Overall, about 750 thousand children are set to benefit from extending child support grants". (National Assembly, 2015)

Currently, 11.8 million children up to the age of 18 receive this grant, implying an average of 655 550 per age-year group. The minister's estimate that 750 000 children will benefit from this extension implies an average of 250 000 beneficiaries per age-year group. Her expectation that the beneficiaries per age-year group will drop is apparently based on limiting the extension to those who are engaged in further education and training. It should also be noted that many learners are still in high school at the time of their 18th birthdays and will therefore automatically continue to receive child support grants until they complete matric.

We are of the opinion that the minister uses a too limiting assumption and criterion and that it will not be politically expedient to have grants "terminated abruptly", in the minister's words (National Assembly, 2015), for children aged between 18 and 21 who do not have the opportunity to engage in further study after age 18, but nevertheless qualified for grants until age 18. We therefore argue that the Minister puts forward a skewed picture of limiting grant expenditure that is not achievable with grants extended after the age of 18.

The budget for CSGs for the 2016/17 fiscal year amounts to R52.0 billion, with a projected increasing to R61.0 billion in 2018/19 (National Treasury, 2016: 299). This is considerably lower than the actual increase of 10.1 percent from R43.4 billion in the 2014/15 fiscal year to R47.8 billion in 2015/16 fiscal year, and clearly does not allow for the extension of the grant to 18- to 21-year-old learners. The budget for the next three years only makes provision for increased take-up of CSGs for children aged between birth and 18 (to reach 12.8 million in 2018/19) and for adjustments for inflation. It is therefore necessary to calculate the cost of the grant increase if the tapering off in uptake as envisaged by the minister cannot be achieved after age 18 in the event of grants extended to age 21.

The Minister assumes a maximum of 750 000 beneficiaries after phasing-in as indicated in her answer; we assume 1.97 million beneficiaries as we do not foresee the grants being limited to children in education and training in the event of their extension.

Based on the Minister's assumption, the cost of expanding the child support grant once fully phased in will amount to an additional R3.3 billion, not included in the government's expenditure plans for the next three fiscal years.

Based on our assumption, of 1.97 million additional beneficiaries aged between 18 and 21, and the minster's methodology, the cost of expanding these benefits (once phased in) will amount to some R8.7 billion. A more conservative estimate, based on the current annual grant of R4 200 and 1.97 beneficiaries, results in an estimated additional expenditure of R8.3 billion (not allowing for inflation), which is still well above the minister's estimate.

This cannot be afforded, as South Africa already faces a fiscal cliff (see Breytenbach and Rossouw, 2013; Rossouw, Joubert and Breytenbach, 2014) and government revenue will not grow sufficiently to accommodate additional expenditure, irrespective of whether it amounts to R3.3 billion or R8.7 billion annually.

CONCLUSIONS

The South African economy has shown subdued performance since the financial crisis of 2008. This limits the ability of the government to increase its revenue. Remuneration increases for civil servants that exceed the rate of inflation and their productivity, which were agreed in 2015 for the period to 2017, contribute to the government's fiscal constraint.

The model used in this paper shows that subdued growth in government revenue can be expected for a number of years to come. This limits considerably the government's ability to introduce new expenditure initiatives, particularly initiatives not provided for in the MTBPS tabled in 2015.

Additional expenditure on social grants for children up to the age of 21 has not been provided for in the 2016/17 budget or in budgets until 2018/19. Such additional expenditure can only be afforded by (i) increasing taxes even further than in the 2014/15 and 2015/16-budgets; (ii) reducing expenditure in other areas; or (iii) increasing the deficit before borrowing. All three these alternatives are unattractive and are not recommended. In short, an increase in the number of CSG-qualifying children aged between 18 and 21 can simply not be afforded, irrespective whether the cost amounts to R3.3 billion (the minster's estimate) or R8.7 billion (our estimate).

The implication is clear: inappropriate policies and overly generous expenditure impose a binding constraint on South African fiscal policy. Fiscal constraints currently determine South Africa's social agenda and the government cannot afford an extension of child support to children aged 21. South Africa is paying the price of policy mistakes in the period preceding the financial crisis of 2008 when the government had windfall income gains from temporary higher economic growth rates. NA

NOTES

1. The authors wish to acknowledge the contribution of Mr Fanie Joubert of Unisa to the development of this model. Its specifications are outside the scope of this paper, but are available from the corresponding author.

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