

SOUTH AFRICA FOUNDATION

Viewpoint

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THE BASIC INCOME GRANT

Comments on the report of the Committee of Inquiry into a Comprehensive Social Security System

by

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Introduction:

Before the report of the Committee of Inquiry into a Comprehensive Social Security System, chaired by Prof. Vivienne Taylor, was recently released, a Basic Income Grant (dubbed BIG) was seen as the central plank in the committee's thinking, given its wide airing in public debates and the press. Indeed, in its analysis the Committee enthusiastically supported such a grant: "*Analysis indicates that the Basic Income Grant has the potential, more than any other possible social protection intervention, to reduce poverty and promote human development and sustainable livelihoods*". (p.62) Surprisingly, however, but correctly, the Committee's final recommendations are more realistic, and at least for now do not espouse the BIG as answer to our social security needs. Given its prominence in the debate, and the fact that the committee does seem to hold it out as the ideal type of social security intervention, we should take stock of the limitations of a BIG.

Current South African social security:

The expansion of the embryonic welfare state erected under apartheid to protect whites against various contingencies had put South Africa in a unique situation for a semi-industrial country of having the trappings of a modern welfare state. Social security has two main components:

- **Occupational (social) insurance** includes retirement benefits for many of the formally employed labour force; a somewhat inadequate system of worker compensation against work injuries; a system of unemployment insurance, which cannot address the major unemployment risks associated with structural unemployment; and health insurance for some of the employed. Social insurance is effectively occupational insurance, membership being conditional on contributions by employers and

employees. Most formally employed are ostensibly covered against contingencies as long as their grasp on formal employment remains secure. Unemployment prevents many from contributing, thus automatically excluding them from coverage.

- **Social assistance** consists of categorical transfers (i.e. to specific categories of people), conditional upon recipients qualifying in accordance with a means test¹ to ensure that the grants are targeted at the poor. It has three main pillars; social old age pensions, disability grants and child support grants (for children up to 7). It is funded from general government revenues.

Social insurance reaches mainly the top half of the income distribution, i.e. most of the formally employed. Many who would otherwise have been poor are reached by social assistance, but this is contingent on both being poor and being disabled or at a specific stage in the lifecycle. Social assistance, particularly social pensions, has a considerable impact on especially rural poverty. Many rural households depend on such grants, which also reduce the incentive for young household members to migrate in search of scarce jobs. But many of the poor, particularly the unemployed, remain uncovered by social security arrangements.

The thinking behind a Basic Income Grant:

The Basic Income Grant was proposed as a means of ensuring that all the poor have some social security. In its basic form it would entail a universal grant of R100 per month to every South African (irrespective of economic status or age) to ensure a “basic” income for even the poorest. A *universal* grant is proposed because it is difficult to implement a means test to distinguish the poor from the almost poor, due to clustering of incomes near the poverty line and because accurate information about incomes is difficult to obtain. Abolition of the means test would avoid the disincentive (“poverty trap”) effects of the means test – earning higher income would not affect people’s eligibility for the grant.

¹ A means test is a set of rules which determines whether individuals qualify for receipt of a grant, depending on their economic means (income or assets). Such a test by its very nature encourages a “poverty trap” and can also in certain circumstances lead to perverse incentives

Funding grants through taxes is meant to have the following net distributive effects:

- The poor (those at the bottom of the income range) would gain in net terms
- The less poor (middle income range) would experience no net gains or losses
- The rich (top income group) would carry the net burden

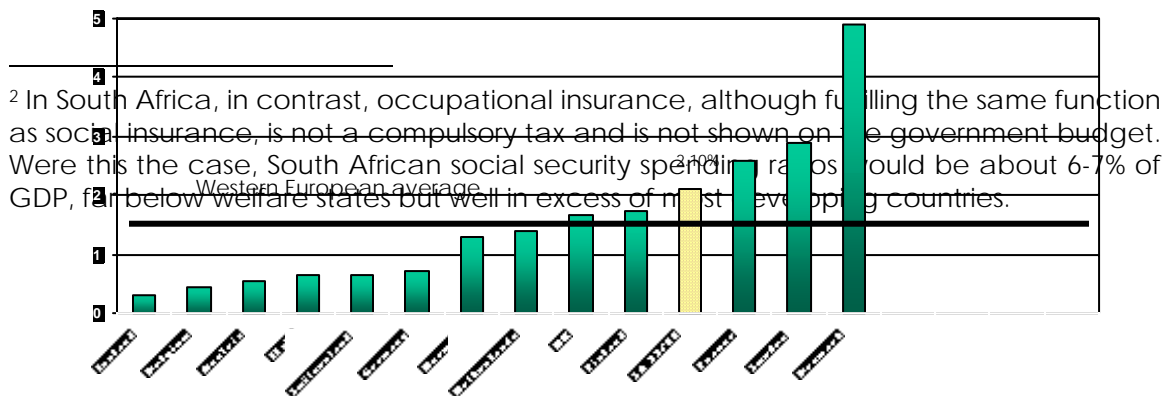
The potential impact of a basic income grant:

The Committee argues that a BIG would reduce poverty, increase the income of many of the poor and allow many to move out of poverty. In fact, its Figure 11 seems to show that everyone gains – a free lunch does exist after all! The problem is that the costs are nowhere even considered. The Committee’s claim that 6.3 million people would be moved out of poverty if a BIG of R100 per person per month is implemented (R815 per year in 1995 Rand values), is not borne out by my own calculations on data from the 1995 October Household Survey – it is more likely to be about half this number. Be that as it may, though more income for the poor is desirable, the real question is whether the BIG is the appropriate way of bringing this about, and what its costs would be.

The cost of a basic income grant:

Presently the state spends about R20 billion, over 2% of GDP, on social assistance transfers (funded directly from the budget). This is a large ratio for a middle-income country. The figure below contrasts this with Western European welfare states in 1980 – the height of the welfare state era- and shows that South Africa spends relatively more than many *developed* welfare states on social assistance. In contrast, welfare states spend a larger share of resources on social insurance, largely paid for by payroll taxes, which often flow through their budgets, unlike in South Africa.²

Social assistance spending ratio (%of GDP)
(Western European data for 1980, SA data 1999)



Thus South Africa already spends relatively much on direct assistance to the poor, but if the BIG were to be implemented, the following costs would have to be added:

- A grant of R100 per month to 45 million individuals, i.e. **R54 billion per annum.**
- A R20 per month, the cost of transferring the funds, to 45 million individuals, i.e. **R10,8 billion per annum.** Some argue electronic payments could reduce this cost, but the present cost of transferring a single grant, even when contracted to the private sector, is just over R20 per grant.³

Thus the BIG added would add about R65 billion (7% of GDP) to the cost of social assistance. One-sixth of this, or about double budgeted annual public spending on housing, would be a dead loss – it would not reach the intended beneficiaries, but is simply the cost of transferring the funds. The State would also need additional personnel to supervise the process, a cost not included above.

Funding a basic income grant:

Proponents say the fiscal costs of BIG can be recouped through higher taxes on the rich, leaving only the poorest as net beneficiaries. The Committee was apparently divided on how to obtain tax revenue, and the report avoids the issue. Various options have been mooted in the debate:

³ Reducing the regularity of grants (e.g. paying R300 per quarter) would make it no longer a basic *income*. Nor would it help to pay a single consolidated grant to a household so as to reduce grant numbers, as household membership is highly fluid and such a policy would reduce individual choice (e.g. for women) as to how to spend their money.

- An increase in VAT would neatly target net benefits – the notion of a “negative income tax” is sometimes referred to. Those who consume more would pay more towards the cost. Present VAT provides tax revenue of R90 billion, thus the VAT rate would have to increase by 10 percentage points from 14% to 24% to fund the BIG. This would have a big inflationary impact, increasing pressure for higher wages. It may take years and much higher interest rates to again contain inflation. A higher VAT rate would also increase tax avoidance and strengthen pressures for special dispensation for zero rating VAT on food, medicines, books, etc.
- An equally simplistic view is that revenue should be raised from personal income tax on the rich (Cosatu’s “solidarity tax”). The personal income tax burden would have to increase by two-thirds to increase PIT revenue from R100 billion to R165 billion. Even if all were to carry this burden proportionately, to obtain the same revenue would require increasing the top marginal tax rate from 40% to 66%! (That taxpayers receive R1200 per person per year from this grant would be little compensation).
- Alternatively, if the tax was imposed on businesses, to protect their profits they would shift the cost onto consumers through price increases, with similar effects as raising VAT, or be less willing to concede to wage increases, thus shifting the cost onto workers).
- A fourth option mooted (one hopes not seriously considered by the Committee) was that government should borrow more to fund the grants, repaying this debt in future through the higher economic growth that BIG would supposedly induce. This populist route, raising the public deficit by 7% of GDP, would harm South Africa’s international creditworthiness and both domestic and foreign investment, undoing overnight the government’s hard won reputation for fiscal discipline.

Thus BIG is not fiscally viable, as no scheme could be that proposes raising tax revenue from about 26% to 33% of GDP. Its negative impact on perceptions and on the economy (e.g. the deadweight losses associated with all taxes, the rekindling of inflation) would be too great and it would undermine long run economic prospects for all South Africans, including the poor. Surprisingly, the Committee appears not to have found any reason to pay any attention to this and is quite dismissive of the difficulties of increasing revenues.

In addition, the BIG would require that, compared to the present 4 million grants paid out by the State or on its behalf by private contractors, another 45 million would have to be added. Multiplying the numbers would multiply existing problems in administering the grants. The Committee's only reference to this when discussing the BIG's feasibility is a single sentence: *"To ensure that every South African has full access to this grant and to avoid any duplication of payment, a reliable identification and verification system will have to be established."* (p.61)

Yet, disconcertingly in the light of the above, the Committee then suddenly (in the final recommendations to Chapter 5) concludes that *"the conditions for an immediate implementation of a Basic Income Grant do not exist. In particular, there is a need to first put in place appropriate capacity and institutional arrangements to ensure effective implementation. Therefore the Committee recommends the gradual development and integrated income support that can underpin South Africa's comprehensive social protection system."* (pp.62-3) However, the Committee still fails to acknowledge that funding the grant is virtually impossible without seriously undermining fiscal and economic stability.

Conclusion and an alternative way forward:

The BIG uses a sledgehammer where this is clearly an inappropriate instrument. To transfer perhaps another R22 billion to the poorest forty percent of the population (already an overly ambitious goal that would stretch fiscal resources), it proposes that another R32 billion be paid to the not so poor, some of whom would then have to pay taxes of R65 billion to fund all of this (including the costs of transfers).

It is some consolation that the Committee's final proposals take cognizance of the constraints and move more into the realm of the feasible (one hears this may have been influenced by the fact that they found an unsympathetic ear in the President's Office and the Treasury). Many who appreciate the role of social security in alleviating poverty would support the suggestion that the Child Support Grant (which receives virtually no attention elsewhere in the report) should be extended.

Two alternatives exist:

- Gradual expansion of this grant to higher ages is administratively relatively easy – all it requires is that children remain on the rolls of beneficiaries beyond age 7 (the present exit age). The downside, though, is that cost of transferring the funds remains a relatively large part of the overall costs. Expanding the grant to all children under 14, say, who qualify under the means test may eventually (with full take-up) add perhaps another 3 million grants, at a cost of R120 per month each, or in the order of R4,3 billion, to which should be added the cost of transferring these funds at R20 per month each, which brings the total required additional social assistance spending to about R5 billion.
- Another alternative is to increase the value of the present child support grants (within fiscal constraints), thus ensuring that the full addition in spending goes to the beneficiaries (no additional transfers would need to take place). If this route is followed, the additional cost for the 3 million presently envisaged grants at full take up would be R4,3 billion, but it would not require additional money to transfer these funds.

The slightly different distributional consequences need investigation once the October Household Survey and the Income and Expenditure Survey for 2000 is at last released. Neither of the above two alternatives would move any households out of poverty, but they would soften the impact of poverty. This may be close to the limits of what can be afforded within the fiscal constraints of a developing country with vast unemployment. The large social security gap left by the extent of unemployment is far too big to cover by fiscal means.

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