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*Note: The views expressed in this issue are those of the authors, and not of Nedbank*

### Capital flight: myth, reality or political manna?

What a nation of congenitally dedicated liars, criminals and frauds this must be for capital flight to occur successfully on a massive scale year after year, despite an elaborate panoply of controls, safeguards and penalties. That would be the logical deduction from calculations of capital flight published in the last year or so.

According to Kahn in his paper *Capital Flight and Exchange Controls in South Africa* (LSE Centre for the Study of the South African Economy and International Finance) capital flight in the period 1970-85 may have exceeded \$30 billion, and according to Smit and Mocke in their paper *Capital Flight from South Africa: Magnitude and Causes* (The South African Journal of Economics, June 1991) capital flight between 1970 and 1988 was a minimum \$12,4 billion and could perhaps have been as high as \$22,8 billion.

These sums, at either end of the range, are of course enormous and must have affected the performance of the South African economy profoundly in the 1970s and 1980s – if they are to be believed.

The care with which the calculations are made and the very high level of impartial academic argument evident in the papers obscure the fact that the basis of the estimates is quite definitely wrong. In essence it turns on

the improper assumption of the errors and omissions in the balance of payments largely reflecting illicit capital flight. The purpose of this article is to discuss the nature of the errors and omissions item and to explain that it cannot be used for spurious calculations of this kind.

An interesting variant of the notion of capital flight is the attention given by the Minister of Finance and the Governor of the Reserve Bank in various speeches to the capital drain from South Africa since the debt Standstill by way of explaining the burden to South Africa of a loss of savings and its enervating consequence. In their speeches they referred to a net capital outflow of R23,7 billion, or nearly R25 billion, in the five-year period to 1990. The figure is arrived at as the sum of surpluses on current account over the years.

Since the debt standstill of 1985 and the reimposition of the financial rand the only capital transactions involving the commercial rand have been debt payments, forward-cover adjustments on rolled-over third-currency transactions, changes in short-term trade financing and changes in reserves. All other capital transactions have taken place within the closed financial rand system and, though these are included in the published balance of payments figures as involving changes in asset and liability structures, they cancel out.

The two major components of actual commercial rand capital transactions were debt repayments and increases in reserves. Over the period net debt redemption amounted to \$4,3 billion which included some \$700 million in redemptions through equity conversions via the financial rand. Taking into account currency fluctuations against the dollar because the debt is denominated in various currencies, the net outflow for redemption purposes probably amounted to some R12 billion in current rands. There was also a net build-up of foreign reserves of R2,4 billion in the five years and a net increase in trade-related assets abroad of R2,7 billion. Accordingly, there was a capital outflow of the order of R17 billion and not R23,7 billion. Does the missing R6 or R7 billion then represent illicit capital



flight – or does it represent an overstatement of current account surpluses? This question is addressed below.

Much space is devoted in the academic papers to the question of what constitutes capital flight, namely whether it should be confined to money fleeing from abnormal risks in the country through illicit unauthorised movements or embrace the wider concept of normal resident and even non-resident outward capital movements. Unfortunately, these distinctions are generally overlooked and published figures are readily construed as referring to illicit movements. However, this is implied in the word flight. The authors did advise circumspection in the use of their figures, but nevertheless the damage has been done following coming out with any figure, which has been conveniently seized upon in certain political quarters as valid because produced by well-respected academics.

However, the contention of this article is that it is impossible to make any calculation whatsoever of what may be construed to have happened using official balance of payments estimates. Furthermore, that the spurious calculations that have been made do not constitute proof of capital flight having taken place at all, as they derive from the unwarranted assumption on the meaning of the errors and omissions item in the balance of payments. This is not to assert that illicit capital movements have never occurred. Rather it is to say that it is impossible to prove such movements have occurred and impossible to estimate their magnitude from official statistics.

It is necessary to go back to basics.

For any enterprise it is possible to set up an identity between transactions of the enterprise with others and the changes in worth of the enterprise in a given period. For example, a newspaper delivery boy would have receipts from his delivery services in a month, less payments for expenses of, say, the repair of his bicycle, and this would be identical with the increase in cash in his piggybank.

The identity can be moved to a higher level of sophistication by shifting from a cash-flow basis of accounting to a transactions basis, allowing for amounts receivable and payable on the transactions account or current account and the left-hand side of the equation, which will have their exact counterpart on the right-hand side of the equation or capital account, with entries for claims due by, or to, others.

The identity is exact but, should there have to be, for any reason, an estimation of any item on either side of the equation, the exact balance will be upset and it will be necessary to introduce an error or balancing term. This is precisely what occurs in the nation's balance of

payments calculations.

The balance of payments refer to all transactions in a period between residents of the country, suitably defined, and non-residents, ie with the rest of the world. There is a myriad of such transactions covering trade, services, travel, income flows, transfers, capital movements, etc. Furthermore the accounting is not on a cash-flow basis, but rather on a transactions basis, which raises many problems of timing of settlements requiring entries in respect of short-term claims due and to. The official statisticians cannot possibly achieve an exact balance in the accounts by having precise returns from every resident. They perforce have to make estimates from whatever information is available or suitable, and much of the information is derived as a by-product of some quite independent administrative purpose, for example customs control.

The official balance of payments accordingly abounds with estimates of vastly varying quality and reliability – for example the estimates of foreign travel receipts from declarations by visitors on Entry/Exit forms, compared with dividend payments abroad derived from exchange control applications and surveys. It thus becomes necessary to have an error term in the accounts, which provides the arithmetic balance between transactions and changes in assets and liabilities. This is the so-called errors and omissions item, and conventionally it is included in the capital account (or right-hand side), but it could just as well be included in the current account with an opposite arithmetic sign (ie on the left-hand side).

The word omissions is added, as there may be transactions affecting foreign exchange balances that have not been accounted for. The essence of the errors and omissions item is that it sweeps up in a single figure all the errors of estimation and omissions. It is thus a net figure and no particular single error or omission can be ascribed to it.

In effect the various efforts at evaluating capital flight rest on the presumption of the net errors and omissions figures being broadly reflective of capital flight as an omitted item.

If there is an illicit capital transfer by way of any distortion of values in documentation, for example overvaluation of imports, this cannot be detected in the balance of payments accounts, because the import documents form the basis of the import figures in the accounts. The over-valuation will be embodied in the import figures, leading to an equal and opposite reduction in foreign balances. Alternative ways have to be sought for establishing such distortions.



The principal channel of opportunity for getting capital out probably lies in foreign trade, and here Kahn thought he could measure capital flight through overvaluation of imports and undervaluation of exports by matching values of trade of South Africa with those of other countries. Thus using the International Monetary Fund *Direction of Trade Statistics Yearbook* he was able to compare country exports to South Africa with imports into South Africa, and similarly for South African export figures.

Unfortunately Kahn took his results at face value and ascribed them to deliberate capital flight through document falsification. On examination, however, his figures must be dismissed, for the following reasons:

Taking imports first there will naturally be differences due to timing of dispatch from the exporting country and clearance as an import in South Africa, and there will be differences of currency valuations, etc. Nevertheless, the differences turned out to be relatively small, amounting to a net \$1,886 million in fifteen years, but largely as underinvoicing rather than overinvoicing. Indeed, in practice, unless there is deliberate intention to defraud, importers will give the minimum value possible to their imports, because of the general practice of *ad valorem* application of duties. The importer will use either the spot exchange rate at the time of dispatch or spot at the time of taking out the forward exchange contract, and not at the time of clearance, which ideally is the requirement for balance of payments purposes.

On the export side the discrepancies were enormous, amounting to \$21,9 billion over fifteen years, and again this was taken by Kahn to represent the extent of underinvoicing of exports. But there is a special problem with South African exports in that a large component of exports, essentially gold bullion, is given no country destination in the IMF statistics. For example, of total exports of \$16,5 billion in 1985, \$7,4 fell in special categories with no country breakdown. Only \$5,5 billion was identified as exported to the seven major trading partners chosen by Kahn for his calculations. Yet they recorded \$9 billion imports from South Africa. To Kahn the difference was due to underinvoicing, a totally unwarranted deduction.

But in any case underinvoicing of exports as a general practice is most unlikely in South Africa because of the dominance in the export field of a limited number of large reputable companies that have nothing to gain, and much to lose, from such malpractice.

As published in the South African Reserve Bank's

*Quarterly Bulletin*, South Africa's balance of payments statistics do not explicitly reveal the balancing errors and omissions item. It is included in short-term capital transactions and indeed the item "short-term capital movements for the private sector" is effectively the balancing item. Reference has to be made to the IMF's *Balance of Payments Statistics* to find explicit errors and omissions figures for South Africa. In the most recent publication available the errors and omissions for the period from 1983 to 1990 varied between a minimum of \$134 million in 1986 and a maximum of \$1 149 million in 1984, but with almost as much in 1985 at \$1 145. Two things stand out: firstly, that the figures are consistently negative; and secondly, that they appear larger at times of rapid currency depreciation.

Errors and omissions are to be found in every country's balance of payments statistics because of the innate universal problems of estimation. As a rule of thumb the IMF suggests that an error of 5 per cent of the gross sum of merchandise imports and exports is acceptable. The South African Reserve Bank in its Occasional Paper *South Africa's balance of payments: Sources, methods and reliability* was able to show its ratio for the period from 1985 to 1988 to be only 2 per cent, which was much better than that of many other countries, for example the United Kingdom and New Zealand at 7,2 per cent and Australia at 3,5 per cent.

The Reserve Bank also noted that the persistent negatives "could mean that the value of exports reported are too high or the value of imports too low, or that errors were made in calculating services, transfers and capital flows...it is also believed that the errors and unrecorded transactions are related to exchange rate movements".

This last observation is most significant, for it does point to valuation problems as a fundamental contributor to errors, and these are likely to predominate with merchandise imports and exports.

Actually, South Africa's accounting problems are more difficult than those of most because of the complexities of the SA Customs Union and the Common Monetary Area. For instance, South Africa's trade figures, which form the starting point for the balance of payments calculations, cover the entire Customs Union, including Namibia, Botswana, Lesotho and Swaziland, and the statisticians have to make separate estimates for trade movements within the Customs Union, as well as for Botswana's direct exports and imports to the outside world, etc, adjusting the overall trade figures appropriately. In addition, there are the problems of timing and valuation in rands, which are particularly acute at times of rapid exchange rate movements.

As the probable principal source of error lies with



merchandise transactions, it is a legitimate line of thought to consider bringing the errors and omissions into the current account, or left-hand side of the equation, and explore the consequences of doing that. The direct effect will be reduce the magnitude of current account surpluses, giving a quite different lower perception of South Africa's total gross domestic savings, and also of capital outflows. In particular in the period from 1985 to 1990 referred to above the current account surpluses, and hence net capital outflow, would be reduced to some R17 billion from the R23,7 billion.

In other words, the figures suggest that there is a tendency to overstate South Africa's current account surpluses, particularly in times of rapid depreciation.

**Edward Osborn**

## **The competitiveness of manufacturing**

This article examines some of the factors that may be inhibiting the international competitiveness of the South African manufacturing sector. In particular, two aspects will be reviewed: firstly, the cost of labour; and secondly, the cost of capital. The article represents only an initial investigation into the subject.

It is extremely difficult to calculate the true competitiveness of a country, as a wide range of influences embracing both marketing and factors of production need to be taken into account. In addition, individual companies are generally able to employ alternative methods of production as well as alternative financial structures, in order to enhance their competitive position.

### **The cost of labour**

The cost of labour can be measured through changes in unit labour costs, being the net effect of changes in labour productivity as well as in wages. For example, if wage increases are accompanied by an equivalent increase in output per employee, unit labour costs remain unchanged.

Labour productivity is calculated by dividing the physical volume of manufacturing production by an appropriate employment index. Over the ten-year period from 1981 to 1990 labour productivity in South Africa's manufacturing sector decreased at an annual average rate of -0,3 per cent, compared with an average annual growth of 3,9 per cent in the United States, 5,8 per cent in Taiwan, 4,0 per cent in Japan, 1,7 per cent in Germany, and 5,0 per cent in the United Kingdom. In contrast, real earnings per worker in South Africa's manufacturing sector increased at an average annual rate of 1,1 per cent, compared with 0,1 per cent in the United States, 1,3 per cent in Taiwan, 2,0 per cent in Japan, 2,1

per cent in Germany, and 1,0 per cent in the United Kingdom.

The declining levels of labour productivity over the period from 1981 to 1990, and persistently high inflation, resulted in unit labour costs rising at an average annual rate of 15,6 per cent in nominal terms in South Africa, compared with 1,1 per cent in the United States, 4,4 per cent in Taiwan, 0,1 per cent in Japan, 2,6 per cent in Germany, and 3,4 per cent in the United Kingdom. South Africa's unit labour cost index reflects the fact of wage demands having consistently exceeded improvements in productivity. For example, in 1982 hourly wages in South Africa's manufacturing sector increased by 20,9 per cent, while output per employee declined by 4,7 per cent.

However, if the unit labour cost index is stated on a common currency basis, for example US dollars, the position is substantially altered. With an index base of 1985 = 100, South Africa's unit labour cost index has, on a US dollar basis, risen to 169,8 index points in 1990, compared with 103,7 for the United States, 163,3 for Japan, 207,8 for Germany, and 160,5 for the United Kingdom. Thus, other than the USA, South Africa would appear to have maintained its relative international competitiveness in manufactured goods through a devaluation of the rand.

The relatively high unit labour cost index for Germany and Japan is a result of the relative strengths of those countries' currencies against the dollar, while in South Africa's case its unit labour cost index is competitive only following a substantial devaluation of the rand. In addition, Germany and Japan have had the benefit of cheaper imported inputs following a currency appreciation, while South Africa has had to contend with relatively expensive imports.

Under these circumstances, calls for a further devaluation of the rand in order for South African exporters to remain competitive may not be advisable. Despite the fact that a devaluation of the rand would immediately place exporters in a more competitive position, the benefits could be short-lived, since future production would have to take place on the basis of relatively expensive imports. The outcome hinges on the extent of dependence on imported inputs. Labour cost competitiveness should be maintained through improvements in labour productivity, and productivity-linked wage increases, rather than through reliance on the exchange rate.

### **The cost of capital**

The weighted average cost of capital can be calculated on the basis of the respective costs of equity capital and borrowing.



The following table indicates the cost of capital for selected countries. Much of the data is derived from Paul Hatty's paper presented to the Capital Expenditure Prospects Conference held in Sandton during March 1992. Some changes have been made. In particular the cost of debt is included as an after-tax item, since interest paid on loan finance is tax-deductible. Furthermore, a uniform debt/equity ratio of 1:2 has been used for all countries for the sake of comparability. It should be recognised that an optimal capital structure is dependent on a number of factors, which will differ from company to company. For example, a company involved in the food sector may choose a much higher debt/equity ratio than one in the construction industry, as the natures of the respective industries imply dissimilar risks.

For calculation purposes, the cost of debt is assumed to be the prime overdraft rate offered by the commercial banks in 1990. The pre-tax cost of equity is based on the rate of return (earnings yield) likely to be expected by the investor. It takes into account the level of risk involved, allowing for a reasonable rate of growth in the investment.

#### Cost of capital per country in 1990

	RSA	Aus- tralia	USA	Japan	Ger- many
Cost of equity %	18,3	8,6	7,8	1,9	6,0
Cost of debt %	21,0	20,3	10,0	6,9	11,5
Corp tax rate %	50	39	34	32	50
Debt/equity ratio	1 : 2	1 : 2	1 : 2	1 : 2	1 : 2
Weighted average cost of capital %	15,4	9,8	7,3	2,9	5,9

During 1990 South Africa's after-tax cost of capital was 15,4 per cent, which is well above the 9,8 per cent for Australia, 7,3 per cent for the United States, 2,9 per cent for Japan, and 5,9 per cent for Germany.

However, companies also have the ability of reducing their cost of borrowing through the use of alternative instruments of credit. For example, in South Africa a company may employ 3-month bankers' acceptances, which are currently traded at 4 percentage points below the prime overdraft rate. Alternatively, it may utilise a range of tax-efficient financial structures, primarily aimed at reducing the particular company's tax liability.

#### Policy implications

Many corporations have argued that South Africa's relatively high cost of capital and rapidly rising unit labour costs, and therefore corresponding lack of international competitiveness, constitute sufficient

justification for the extensive, and in some cases extremely high levels of, import tariffs. Further, it is argued that the high cost of capital is beyond the control of the industrialist, and thus for South Africa's manufacturing sector to become internationally competitive there should, *inter alia*, be a reduction in company taxes, accompanied by additional export incentives and measures effectively reducing the cost of capital. The difficulty with this argument is that it is too simplistic because, as stated earlier, international competitiveness is dependent on a wide range of factors over only some of which the individual company has direct control.

For example, many South African industries are uncompetitive due to the fact that, through import tariffs and surcharges, their input materials are relatively more expensive than those of overseas manufacturers. There is certainly some evidence of the prices of a number of basic material inputs from local suppliers being above international levels. This applies, for example, to pvc, basic iron and steel, synthetic rubber and textiles as well as a number of other primary manufactured products.

Professor Bell of Rhodes University in a recent working paper entitled "*Should South Africa further liberalize its foreign trade?*" makes, *inter alia*, the following points. Firstly, an "analysis of SA's export performance suggests the fundamental obstacles to further export growth have been unrelated to trade policy." Secondly, "it appears there is no systematic relationship between changes in the import penetration ratios of individual sectors and their export growth rates." Thirdly, there are reasons for "doubting whether further trade liberalization, through tariff reductions, is likely to have a significant additional effect on exports."

Furthermore, if the manufacturing sector fails to invest for a number of years, as has been the case in South Africa, it cannot expect to remain internationally competitive, simply because the latest technology is not being utilised. A competitive product is in part dependent on staying abreast of technological changes, as well as undertaking research and development.

The analysis therefore suggests that in order to improve the competitiveness of South Africa's manufacturing sector, a wide range of factors, including labour productivity, levels of research and development, investment incentives, marketing costs, and tax rates need to be investigated and assessed before any calls for further trade liberalisation measures, which may include a general reduction in import tariffs, further devaluation of the currency, and additional export incentives, are acceded to. This issue is therefore not simply one of addressing apparently high unit labour and capital costs.

Kevin Lings



## The TBVC states

The Verwoerdian grand design of apartheid became a reality in the seventies with the establishment of ten territories for black residence. These are Transkei, Bophuthatswana, Venda, Ciskei, Gazankulu, KaNgwane, KwaZulu, Lebowa, and Qwa Qwa. Of these the Transkei, Bophuthatswana, Venda, and Ciskei (often referred to as the TBVC states), opted for independent status in 1976, 1977, 1979, and 1981, respectively. None of the remaining six territories chose to change their regional government status, namely that of self-governing territories. The self-governing territories do not have the same degree of autonomy as the TBVC states and are subject to South African government financial control.

Since the establishment of the TBVC states their social and economic developments have to some extent diverged from those of South Africa. Laws governing these territories, fiscal measures, tax structures and political systems have moved apart over the last decade and a half, but the impending rapid political change in South Africa is expected to bring about the reincorporation of the TBVC states.

Against this background it is worth examining the present status of the TBVC states in terms of various elements of their economies such as population, gdp, fiscal and other tax structures.

In 1991 the population of the TBVC states was estimated at 6,6 million, or about 17 per cent of the total population of South Africa (including the homelands), in an area of 100 218 sq km, or just over 8 per cent of the total area of South Africa. Transkei has the largest population put at 3,2 million, followed by Bophuthatswana with 2,0 million, Ciskei with 0,8 million, and Venda with 0,6 million. In terms of population density (population per sq km) Bophuthatswana is the least densely populated, followed by Transkei and Venda, who are more densely populated. Ciskei is worst off with a population density of 97 people per sq km. South Africa, excluding the TBVC states, had a population density of about 29 people per sq km in 1991.

Bophuthatswana accounts for almost half the gdp of the TBVC states. Venda is the smallest both in terms of population and gdp. However, in terms of per capita income Transkei is the poorest.

In the early eighties these economies recorded a phenomenal real economic growth rate, albeit from a small base. In the first half of the eighties Venda grew the fastest, recording an average of over 17 per cent during 1980-85, followed by Ciskei, Bophuthatswana, and Transkei. Although real economic growth rates of

the homelands, excluding Bophuthatswana, slowed down during 1985-89, they were still remarkable by any standards.

Bophuthatswana's mineral wealth in platinum and its favourable location closer to the economic heartland of South Africa place it in a far stronger position for sustained economic expansion than the other countries. Indeed, in the second half of the eighties real gdp growth rates in Bophuthatswana far surpassed those in the other TBVC states.

### Real gdp growth rates per cent

	1980-85	1985-89
Transkei	5,6	3,1
Bophuthatswana	6,0	18,4
Venda	17,3	11,4
Ciskei	15,5	7,4

The main thrust of economic activity in the post-independence period came from the government sector, largely due to governments embarking on major public works necessary for establishing administrative infrastructures. Total government expenditure as a percentage of gdp remained excessive in the period. In the case of Venda this exceeded total gdp, while in the case of Ciskei it almost equalled gdp. In Transkei total government expenditure rose sharply during the eighties, from 59 per cent in 1980 to 83 per cent in 1989. Only Bophuthatswana seems to have a more balanced and normal type of economy, with government expenditure at about half of gdp. Comparatively, South Africa's state budget amounts to about 30 per cent of gdp.

### Total government expenditure as % of gdp

	1980	1989
Transkei	59	83
Bophuthatswana	50	52
Venda	121	113
Ciskei	96	99

In Transkei, Ciskei, and Venda, the fiscus concentrated on public works and social expenditure, whereas the economic expansion noted failed to make any significant impact on the productive sectors of their economies. Attractive incentives for industrialisation offered to investors, including labour and capital grants, also failed to make any significant impact on their manufacturing sectors. Such incentives were mostly a waste of resources in the absence of adequate accountability and supportive infrastructures. Furthermore, the longer-term outlook of industries established and operating on labour and capital grants available for only a limited period, remain in doubt after the expiry of such incentives and when they become exposed to competition from bigger industries



	Transkei	Bophut- hatswana	Venda	Ciskei	TBVC
Land area (sq km)	43 654	41 526	6 807	8 231	100 218
Population, 1991 estimates (million)	3,2	2,0	0,6	0,8	6,6
Population density (people per sq km)	73	48	88	97	66
Gdp (1989 current prices, at factor cost Rm)	2 784	4 420	688	1 292	9 184
Gdp per capita 1989 (rands)	897	2 301	1 311	1 609	1 391

	Transkei		Bophut- hatswana		Venda		Ciskei	
Origin of gdp (per cent)	1980	1989	1980	1989	1980	1989	1980	1989
Agriculture	21,9	11,5	4,8	4,1	12,8	9,0	6,9	6,8
Mining	–	0,1	50,8	45,3	0,4	1,3	–	–
Manufacturing	8,7	9,1	10,7	12,6	9,1	6,7	16,9	22,1
Electricity, gas and water	7,9	8,2	0,1	0,4	–	2,7	–	0,9
Construction	3,2	5,4	5,9	3,9	4,9	9,6	10,0	8,7
Trade	23,7	16,4	6,5	5,7	8,0	9,8	3,6	3,6
Transport	3,0	3,1	4,9	4,3	2,3	2,6	11,8	8,1
Finance	4,4	5,8	3,8	7,8	8,0	5,4	9,5	4,7
Community and social services	27,3	40,4	12,6	16,1	54,6	52,8	41,4	45,1
of which: Market sector	68,6	78,8	93,1	96,2	78,7	93,9	89,2	96,1
Non-market sector	31,4	21,2	6,9	3,8	21,3	6,1	10,8	3,9

operating on economies of scale in South Africa.

Regarding the origin of gdp the proportionate contribution of the agricultural sector declined in all TBVC states during the eighties. There were few significant improvements in the manufacturing sector, except in the case of Ciskei where manufacturing gdp rose from 17 per cent in 1980 to 22 per cent in 1989. Barring Bophuthatswana, the remaining homelands seem to exhibit a welfare state syndrome, as community and social services account for a large proportion of gdp. In Transkei these rose from 27 per cent of gdp in 1980 to 40 per cent in 1989, and in Ciskei from 41 per cent to 45 per cent, while in Venda they accounted for over half of the gdp. The informal sector is particularly dominant in Transkei.

Upon independence the TBVC states embarked on the creation of a full range of public services and the necessary supportive infrastructures. Large resources were thus diverted at a rapid rate to unproductive sectors of the economy. To cater for the ever-increasing public service, total budgeted expenditure of the TBVC states rose sharply from R834 million in 1980/81 to R6 678 million in 1989/90, a seven-fold increase in the eighties, or an annual growth rate of 26 per cent. By 1991/92 total budgeted expenditure of the TBVC states had risen to R10 054 million. Total salaries, wages and allowances of the TBVC states was budgeted at R3,9 billion in the 1991/92 financial year, which amounted to about 39 per cent of total budgeted expenditure, including development expenditure. If development expenditure is excluded, total salaries, wages and allowances accounted for nearly 43 per cent. Individually, this varied from 33

per cent in Bophuthatswana to 39 per cent in Transkei, 44 per cent in Ciskei, and 46 per cent in Venda.

On a functional classification, budgeted expenditure of the TBVC states on education and health amounted to R3 388 million in 1991/92, ie over one third of total expenditure, while expenditure on defence and police amounted to R818 million, which is more than 8 per cent of total expenditure or about 6 per cent of gdp. Interest charges on public debt were R826 million, just over 8 per cent of expenditure. Individually, interest charges of R379 million budgeted by Transkei ranks first, followed by Ciskei with R293 million, Venda with R114 million, and Bophuthatswana with R40 million.

Not surprisingly, the welfare of the TBVC states increasingly depended on assistance from South Africa to meet their ever-increasing expenditure demands, with their own resources for generating revenue remaining limited. The reliance of the TBVC states on South Africa was crucial, as they were not recognised internationally and therefore could not gain direct access to international aid finance. Direct budgetary grant assistance from South Africa rose sharply in the eighties, from R279 million in 1980/81 to R2 200 million in 1989/90, to accelerate further in the following two years to reach R3 363 million in 1991/92.

In addition to the direct budgetary assistance, there were other transfers, including items such as customs and excise, industrial incentives, and fuel levies. Total transfers of all kinds by South Africa amounted to R5,4 billion in 1991/92, with Transkei ranking first with R2,0 billion, followed by Bophuthatswana with R1,7 billion,



	Transkei	Bophut- hatswana	Venda	Ciskei	TBVC
<b>Budgeted revenue 1991/92 (R million)</b>					
Generated within the territory					
Income tax	78	407	79	75	639
GST/VAT	170	0*	40	77	287
Other revenue from company tax, mines, casinos, etc	591 <sup>#</sup>	928	41	128	1 687
Posts and telecommunications	55	57	9	34	155
Interest and dividends	10	35	1	8	54
<b>Subtotal</b>	<b>904</b>	<b>1 427</b>	<b>170</b>	<b>321</b>	<b>2 822</b>
Transfers from RSA					
Customs and excise	502	814	104	267	1 687
Industrial incentives	20	18	5	31	74
Monetary relations	34	15	5	9	63
Fuel levy	65	80	21	3	169
Budgetary assistance	1 368	724	509	762	3 363
<b>Subtotal</b>	<b>1 989</b>	<b>1 651</b>	<b>645</b>	<b>1072</b>	<b>5 356</b>
<b>TOTAL</b>	<b>2 893</b>	<b>3 078</b>	<b>815</b>	<b>1393</b>	<b>8 178</b>

#### Budgeted expenditure 1991/92 (R million)

Agriculture	168	214	64	60	506
Health	381	234	202	402	1 219
Education	879	612	300	379	2 169
Finance	778	306	205	195	1 484
Defence	92	132	43	75	342
Police	128	205	57	86	476
Local government	17	152	16		185
Posts and telecommunications	72	160	24	30	287
Prisons	96	31	9	23	159
Public works and water affairs	246	636	203	126	1 211
Internal affairs	14	210	6	18	248
Others	1 083	387	29	270	1 769
<b>TOTAL</b>	<b>3 953</b>	<b>3 279</b>	<b>1 158</b>	<b>1 664</b>	<b>10 054</b>

\* Bophuthatswana introduced VAT from October 1991. Prior to that there was no GST.

<sup>#</sup> Of this, R514 million is shown as General Tax in the budget estimates. A substantial part could be transfers from SA.

Ciskei with R1,1 billion and Venda with R0,6 billion. Thus, direct transfers from South Africa make up about two thirds of budgeted revenue of the TBVC states.

Further assistance on development expenditure is also provided through the Development Bank of Southern Africa. The gap between budgeted total expenditure and revenue is filled by borrowing from banking sources, DBSA loans, etc, amounting to R1,9 billion in 1991/92. Total outstanding debt of the TBVC states was estimated at over R4,0 billion in March 1990. Considering the budget deficits in the following years, this figure is likely to have exceeded R7,0 billion by March 1992. In this context it could be argued that the major portion of the structure of the DBSA has been created to render financial assistance to the homelands, bringing further pressure to bear on the South African fiscus through DBSA administrative costs.

As mentioned earlier, since their nominal independence the TBVC states have promulgated various laws

diverging from South Africa's statutes, among which laws governing tax matters. Currently company tax in the TBVC states ranges from 35 per cent in Transkei to 40 per cent in Bophuthatswana and 48 per cent in Venda and Ciskei. Similarly, maximum effective tax rates on individuals vary from 20 per cent in Ciskei above a taxable income of R25 000, to Transkei's 27 percent above R40 000, Bophuthatswana's 35 per cent above R35 000, and Venda's 43 per cent above R80 000. Other taxes, such as withholding taxes on dividends, interest, royalties, management fees and partnership profits, also differ among the TBVC states.

Thus, harmonising various laws and addressing the unification of an army of civil servants, policemen, and soldiers, as well as the under-development of the TBVC states are likely to pose bigger challenges to the future administrators of South Africa than negotiating the reincorporation of these states at the political level.

**Magan Mistry**