The Macro Economic Consequences of the Crisis and the Response or Non-Response by Provincial Government: A KwaZulu-Natal Case Study

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Introduction

The province of KwaZulu-Natal did not escape the real economic effects of the global financial and economic crisis. It can be argued that the province was particularly hard hit by the crisis because of its relative reliance on the manufacturing and transport sectors. The crisis affected the provincial economy therefore almost instantaneously and fairly severely. However, it must also be mentioned that the duration of the crisis was fairly short, i.e., less than a year. Unfortunately it seems that the road to recovery is proving to be much more bumpy and swirling than initially estimated.

It can be argued that there was very little that could have been done to have isolated or protected the provincial economy from the crisis. The crisis was exogenous to the provincial economy. Therefore the discussion should rather focus on the response to the crisis and whether or not the response was timely and effective in terms of limiting the impact of the crisis and aiding the recovery. On the other hand we cannot simply assume that the response in fact was mitigating the crisis. In fact the response could have exaggerated the crisis. It must also be stated that no response is also a response.

This paper will in particular focus on the response of the KZN provincial government to the crisis. A study conducted by Imani Development shows very clearly that there was a real expectation for provincial government to have implemented measures and policies to mitigate the impacts of the crisis. The majority however are very critical of provincial government’s role in preventing and mitigating the adverse impacts of the recession. The provincial government response seems in fact to have been a no-response.

Unfortunately as true as this might be it will be argued in the paper that in fact the provincial government could not respond to the crisis even if it really wanted to. At best provincial government could maintain its status quo which in itself is a response although not what as was expected

Macro Economic Consequences of the Crises for KZN

The provincial economy joined the long list of economies in recession during the first quarter of 2009. The KwaZulu-Natal economy experienced a -1.91 percent quarter-on-quarter growth rate during the first quarter of 2009, compared with a -0.48 percent contraction in the fourth quarter of 2008 on a non-seasonal adjusted basis (table 1). The KZN economy recorded a growth rate of about -2.24 percent for 2009 compared to a -1.79 for the national economy and compared to 3.93 percent in 2008 (Stats SA, own calculations).

However, the provincial economy recorded positive growth rates during the third quarter of 2009 signalling the end of the recession. It must however be emphasised that although the provincial economy experienced a positive growth rate during the third quarter of 2009, the economy was still recording negative year-on-year growth rates during the third quarter of 2009 (table 2). Therefore on a quarterly basis the economy recorded positive growth rates during the last two quarters of 2009, but not on an annual or seasonal adjusted basis. The provincial economy only experienced positive growth rates on both a quarterly and annual basis during the 1st quarter of 2010.

Table 1: Seasonally adjusted and annualised quarterly GDP

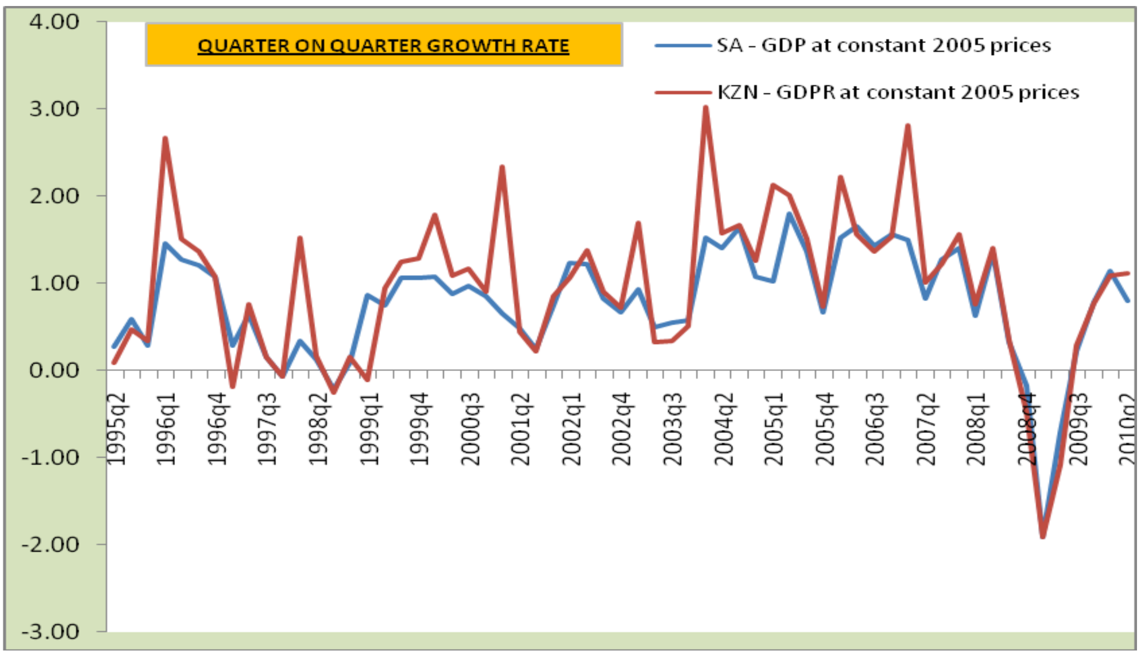
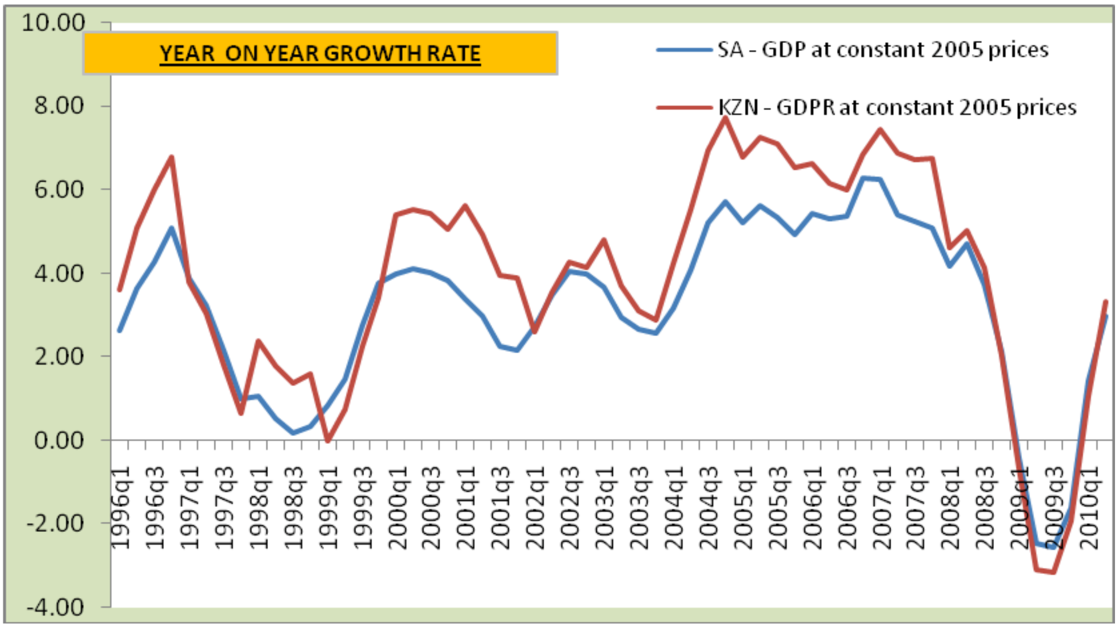


Table 2: Seasonally adjusted and annualised quarterly GDP



It is estimated that the global financial crisis decreased the gross domestic product (GDP) of the province by about R22bn or by about 7 percent of 2008 GDP (Stats SA, own calculations). The biggest losers were the manufacturing, mining and quarrying and wholesale & retail trade; hotels & restaurants sectors (table 3).

Table 3: Yearly Growth Rate per Industry

	2006	2007	2008	2009
Primary Industries	**-0.51**	**4.12**	**5.83**	**-4.11**
Agriculture, forestry and fishing	0.54	4.69	10.00	-3.20
Mining and quarrying	-3.34	2.49	-6.23	**-7.20**
Secondary Industries	**5.94**	**5.66**	**3.13**	**-8.04**
Manufacturing	6.04	5.06	2.64	**-10.70**
Electricity, gas and water	3.30	3.19	0.85	-0.49
Construction	7.60	13.71	9.39	7.84
Tertiary industries	**5.75**	**6.19**	**4.46**	**0.90**
Wholesale & retail trade; hotels & restaurants	6.40	5.59	0.91	**-2.88**
Transport , storage and communication	5.20	6.80	4.20	0.53
Finance, real estate and business services	7.69	7.77	7.79	1.27
Personal services	5.30	5.50	3.34	2.67
General government services	2.98	4.20	4.37	4.23
KZN - GDPR at constant 2005 prices	**6.39**	**6.93**	**3.93**	**-2.24**

(Stats SA, Own calculations)

The losses in the manufacturing sector are especially problematic because of the absolute and relevant significance and multiplier effect, i.e., the KwaZulu-Natal economy is highly dependent on its manufacturing base supporting employment and income generating activities throughout the province. The other sector that the province has a competitive advantage in, i.e., the transport sector, also did not escape the wrath of the crisis. The KZN economy was therefore particularly hard hit by the crisis.

The social costs of the global financial crisis were even greater. The province of KwaZulu-Natal experienced a significant in-migration of about 283 000 people (table 4) during the crisis. The majority of these people migrated out of the province and in most cases from rural areas in the province in search of work in other provinces, most notably the Gauteng province. However with the scarcity of work and uncertainties as a result of the crisis they decided to migrate back to KwaZulu-Natal, but significantly to the urban regions of the province adding to the urbanization phenomenon experienced in the province (Stats SA, own calculations).

Table 4: KZN Population Estimates

	Medium mid-year population estimates by year	Year-on-Year	Change in Year-on-Year
2001	9,557,165		
2002	9,659,485	1.07	
2003	9,752,211	0.96	-0.11
2004	9,835,710	0.86	-0.10
2005	9,910,636	0.76	-0.09
2006	9,974,344	0.64	-0.12
2007	10,045,594	0.71	0.07
2008	10,105,436	0.60	-0.05
2009	10,449,300	**3.40**	**2.69**
2010	10,645,400	1.88	1.28

(Stats SA, Own calculations)

The provincial economy lost about 220 000 jobs since the fall-out of the crises and up to the 4th quarter of 2009. This represents about 8 percent of the total number of people employed in 2008. More significantly the number of discouraged work seekers increased by about 266 000 over the same period (table 5). The unemployment rate (expanded definition) increased from 27.52 percent during the 4th quarter of 2008 to 34.39 per cent during the 4th quarter of 2009. The majority of job losses occurred in the private households, manufacturing, and agriculture and transport sectors. The number of people not economically active also increased over the period (by 420 000 people) (Stats SA, own calculations).

Table 5: KZN Labour Market Dynamics

	Population of working age (15–64 years)	Labour Force	Employed	Unemployed	Not Economically Active	Discourage Work Seekers
Q1 2008	6,250,000	3,315,000	2,562,000	753,000	2,935,000	183,000
Q2 2008	6,273,000	3,359,000	2,614,000	745,000	2,914,000	167,000
Q3 2008	6,295,000	3,312,000	2,583,000	729,000	2,983,000	186,000
Q4 2008	6,318,000	3,321,000	2,631,000	690,000	2,997,000	224,000
Q1 2009	6,340,000	3,248,000	2,514,000	733,000	3,093,000	271,000
Q2 2009	6,362,000	3,043,000	2,457,000	586,000	3,319,000	448,000
Q3 2009	6,384,000	3,024,000	2,458,000	566,000	3,360,000	480,999
Q4 2009	6,405,000	2,983,000	2,409,000	574,000	3,422,000	452,000
Q1 2010	6,426,000	2,998,000	2,418,000	580,000	3,428,000	484,000
Q2 2010	6,439,000	2,984,000	**2,362,000**	622,000	3,455,000	**487,000**

(Stats SA, Own calculations)

What is both very interesting and surprising is that the number of people involved in the informal sector actually decreased during the crisis from a high of 531 000 in the 2nd quarter of 2008 to 408 000 during the 1st quarter of 2010. This is counter to popular belief and is most probably because of the significant amount of people involved in private households who lost their jobs (table 6).

Table 6: KZN Labour Market Dynamics per Industry

	Formal sector (Non-agricultural)	Informal sector (Non-agricultural)	Agriculture	Private households	Total
Q1 2008	1,708,000	497,000	129,000	229,000	2,563,000
Q2 2008	1,688,000	531,000	165,000	230,000	2,614,000
Q3 2008	1,674,000	493,000	151,000	265,000	2,583,000
Q4 2008	1,695,000	490,000	163,000	283,000	2,631,000
Q1 2009	1,627,000	471,000	134,000	283,000	2,515,000
Q2 2009	1,662,000	447,000	103,000	245,000	2,457,000
Q3 2009	1,653,000	458,000	113,000	234,000	2,458,000
Q4 2009	1,649,000	431,000	105,000	224,000	2,409,000
Q1 2010	1,672,000	408,000	115,000	223,000	2,418,000
Q2 2010	**1,627,000**	**407,000**	109,000	**220,000**	2,363,000

(Stats SA, Own calculations)

Statistics from CIPRO suggest that about 8 000 companies and close corporations closed down during 2009 in KZN. There are also numerous provincial macroeconomic indicators that highlight the effects of the crisis on the provincial economy (table 8, 9, 10, 11, 12 and 13) for example the number of people in financial indebtedness was on average approximately 1 300 per month more during 2009 compared to 2008 and the value of the recorded building plans passed by municipalities by type of building decreased by 16 percent for the same period.

Table 7: Number of Active CO and CC Entities per Province

Region	2003	2004	2005	2006	2007	2008	2009
Eastern Cape	3,152	581	1,366	3,529	6,060	15,315	13,536
Free State	1,914	2,592	3,650	5,238	7,108	10,515	7,673
Gauteng	41,486	63,195	81,878	83,044	91,465	146,012	109,513
Kwa-Zulu Natal	9,917	12,994	19,708	24,638	26,160	39,364	31,299
Limpopo	3,906	371	2,325	8,557	10,323	18,242	13,832
Mpumalanga	8,024	536	2,958	10,286	12,771	16,562	11,058
North West	1,299	352	1,922	5,344	5,805	10,389	7,959
Northern Cape	548	95	316	755	1,128	2,044	1,605
Western Cape	11,243	17,801	22,136	23,627	26,343	32,688	25,060
Total SA	81,489	98,517	136,259	165,018	187,163	291,131	221,535
KZN as a % of SA	12.17	13.19	14.46	14.93	13.98	13.52	14.13
SA PA Growth	4.84	20.90	38.31	21.11	13.42	55.55	-23.91
KZN PA Growth	14.59	31.03	51.67	25.02	6.18	50.47	-20.49

Table 8: Civil Cases Recorded and Summonses Issued for Debt

	Pietermaritzburg	Durban
Average 2003	2,513	10,993
Average 2004	1,610	10,124
Average 2005	1,674	6,456
Average 2006	1,508	5,792
Average 2007	1,452	6,418
Average 2008	1,607	6,508
Average 2009	**1,802**	**7,598**
Average 2010	2,084	7,738

(Stats SA, Own calculations)

Table 9: Electricity Generated and Available For Distribution - Gigawatt-Hours

	KwaZulu-Natal
Average 2003	3,269
Average 2004	3,522
Average 2005	3,587
Average 2006	3,598
Average 2007	3,599
Average 2008	**3,437**
Average 2009	**3,507**
Average 2010	3,521

(Stats SA, Own calculations)

Table 10: Cementitious Sales - Tons

	KwaZulu-Natal
Average 2003	120,020
Average 2004	134,766
Average 2005	154,524
Average 2006	165,973
Average 2007	176,982
Average 2008	179,747
Average 2009	**175,125**

(CNCI, Own calculations)

Table 11: House Purchase Prices - Smoothed Rand

	KwaZulu-Natal
Average 2003	413,507
Average 2004	549,575
Average 2005	683,645
Average 2006	817,657
Average 2007	881,408
Average 2008	853,514
Average 2009	844,989
Average 2010	969,782

(ABSA, Own calculations)

Table 12: Vehicle Sales by MAN Trucks and Toyota - number of vehicles

Market	Manufacturer	2006	2007	2008	2009
KZN	MAN	584	460	438	292
	Toyota	21,159	21,000	15,958	10,533
National	MAN	2,511	2,552	2,496	1,269
	Toyota	151,055	155,247	128,911	90,711
Overseas-exports	MAN	64	53	41	98
	Toyota	49,142	59,378	127,453	55,598
	All	112,350	111,800	188,399	108,573

(Naamsa, Own calculations)

Table 13: Value of Recorded Building Plans Passed and Reported as Completed in KZN by Type of Building, R millions - constant prices

	2006	2007	2008	2009
Building plans passed				
Residential	5,390	6,591	8,586	6,151
Non-residential	2,412	2,871	5,025	4,213
Additions and alterations	3,182	4,170	5,404	4,956
Total	**10,984**	**13,632**	**19,015**	**15,320**
Buildings completed				
Residential	3,404	4,107	4,807	5,971
Non-residential	1,121	1,881	2,403	3,844
Additions and alterations	1,235	1,947	2,580	3,520
Total	**5,760**	**7,934**	**9,789**	**13,335**

(Stats SA, Own calculations)

Given the above, it should not be surprising that poverty levels and inequality increased in the province during 2009. GDP per capita decreased from R 20,793 in 2008 to R 19,545 in 2009, for example. (Stats SA, own calculations). There was an estimated 497 914 people living in poverty in the province before the crisis, according to Global Insight, whereas there is an estimated 570 000 number living in poverty in the province at the end of 2009 (own calculations). The Gini coefficient before the crisis was estimated at 0.67 before the crisis, according to Global Insight, and it is estimated to have worsened as a result of the crisis but only marginally.

Other social consequences, according to a recent study by Imani Development on the impact of the global recession on the Kwazulu-Natal economy include, for example:

- More children begging in the streets, especially in urban centres
- Increased number of elderly people seeking assistance
- Declining level of financial support to welfare organisations (around 36%) as well as to their clients
- Increase in applications for any form of grants, even at primary school levels
- Increases in the incidence of drug taking
- A high incidence of teenage pregnancies, sexual abuse and child prostitution
- Increase in violent crimes in the category of aggravated robbery, which include robbery of business premises and residential premises as well as car-jacking
- Increase in cases of diarrhoea both with and without dehydration

The resulting social deterioration resulted in for example, the total number of grant beneficiaries in KZN increasing by 7.5 percent from 4,4 million in 2008 to 4,7 million in 2009 (SASSA, own calculations).

Provincial Government Response

The economic crisis or economic shock prompted an immediate response by national governments to avoid a collapse of the financial and banking systems and limit the economic effects of the credit crunch. Such policies were aimed at stabilising the economy and initiating a rapid recovery. National governments were very quick to put policies and measures in place to mitigate and limit the impact of the economic downturns and adopted macroeconomic stimulus measures drawing on Keynes's demand management theory.

The Chinese government for example quickly increased public infrastructure spending and lowered taxes. The Chinese government also put in place incentives to boost purchases of consumer durables whilst also increasing pensions, social transfers, healthcare and education spending. The Australian governmental response included prioritising or reprioritising investments in employment intensive infrastructure maintenance and rural growth as well as support for structural reform to support rapid and sustainable economic recovery. Other measures that the Australian government introduced included the following:

- conditional cash transfer programs, such as payments made to parents for children attending school;
- nutrition and feeding programs in schools or for pregnant and lactating women and infants; and
- micro-insurance programs to support informal sector livelihoods

Some governments went much further and actually bailed out a variety of firms incurring large financial obligations. To date, various U.S. government agencies have for example committed or spent trillions of dollars in loans, asset purchases, guarantees, and direct spending. The US government also introduced rebates for lower-income families; incentives for business investment; and a broadening of the mortgages eligible for purchase by households.

The European recovery plan implemented measures to fund cross-border projects, including investments in clean energy and upgraded telecommunications infrastructure. Germany implemented amongst other the following:

- Additional infrastructure expenditure, tax cuts, child bonus, increase in some social benefits, $3,250 incentive for trading in cars more than nine years old for a new or slightly used car.

The United Kingdom package included for example the following:

- a 2.5% cut in the value added tax for 13 months, a postponement of corporate tax increases, government guarantees for loans to small and midsize businesses, spending on public works, including public housing and energy efficiency. Plan includes an increase in income taxes on those making more than $225,000 and increase National Insurance contribution for all but the lowest income workers.

What seems very evident is that the government responses were designed and implemented from a national level. The role of sub national government (state, province, district, etc governments) appears to have been irrelevant or not incorporated in the design and implementation of the various macroeconomic stimulus measures and packages. The focus was one hundred percent on national governments.

The focus in SA, as was the case internationally, was also squarely on national government whilst neglecting or ignoring the role or potential role of provincial and local government. Was it because it was assumed that provincial and local government had no role to play or was it because the actual or potential role of provincial and local government in the provincial economy and policy was or is not well understood? What is very certain, however, is that both provincial and local government were severely affected by the crises. Provincial and local government by no means were isolated from the effects of the crisis, for example the fiscal demands (social and economic demands) on provincial government increased significantly whereas the cash flow position of many local governments weakened significantly.

It seems that provincial and local government behaved more like actors than directors during the financial crisis with national government monopolizing the role of the director. However there was a view and perception by communities and businesses in the province that the provincial and local government should have been directors rather than just actors. This was also a real and significant view and perception and not just a wish or marginal view or perception. Whether or not this was also the case in the other provinces is debatable, but intuitively it would not be unsurprising. Why then does it appear that the provincial government was made an actor rather than a director?

The audited outcome of the provincial government budget for 2006/07, 2007/08 and 2008/09 financial years were R36,881,397, 000, R44,482,953, 000 and R55,533,549,000 representing a 13.5 percent and 14.3 percent increase in real terms, respectively. The main appropriation for the 2009/10 financial year was R59, 586,426,000 representing a real increase of only 0.2 percent. The main appropriation was adjusted in November by an amount of R2,320,353,000. The audited actual for the 2009/10 financial year was R63,809,285,000 bringing the total increase in the budget to R8,275,736,000, representing an increase of 7.8 percent in real terms (table 14).

Table 14: Total of provincial payments and estimates

R thousand		Budget	Nominal Change	Inflation Rate	Real Change
2006/07	Audited	36,881,397		4.70	
2007/08	Audited	44,482,953	20.61	7.10	13.51
2008/09	Audited	55,533,549	24.84	10.56	14.28
2009/10	Main Appropriation	**59,586,426**	7.30	7.10	0.20
2009/10	Adjusted Appropriation	**61,906,779**	11.48	7.10	4.38
2009/10	Revised Estimate	**63,809,285**	14.90	7.10	7.80
2010/11	Medium-term Estimates	69,077,363	8.26		
2011/12	Medium-term Estimates	74,660,884	8.08		
2012/13	Medium-term Estimates	78,877,814	5.65		

(KZN Treasury, own calculations)

It is clear that the real increase in the budget allocation in the crisis period was significantly lower or at best very similar to the allocations in the prior years (table 15).

Table 15: Yearly Provincial Expenditure

	KZN Budget	Nominal Change	Inflation	Real Change
2000	21,799,650,000			
2001	25,061,194,000	14.96	5.70	9.26
2002	22,429,241,000	-10.50	9.20	-19.70
2003	25,476,494,000	13.59	5.80	7.79
2004	28,014,475,000	9.96	1.40	8.56
2005	33,307,079,000	18.89	3.40	15.49
2006	36,881,349,000	10.73	4.70	6.03
2007	44,482,953,000	20.61	7.10	13.51
2008	55,533,749,000	24.84	10.56	14.28
2009	**63,809,285,000**	**14.90**	**7.10**	**7.80**
2010	69,077,363,000	8.26		

(KZN Treasury, own calculations)

To understand why the provincial government could not significantly or optimally increase its expenditure before, during and/or after the crisis (external economic shock) it is important to take cognisance of the revenue limitations placed on provincial government. Provincial government receives about 97% of its revenue from national government and thus its ability to respond is limited to its receipts from the national government. Provincial government can thus only respond to the extent that it is allowed to respond (table 16).

Motor vehicle licenses account for about 53% of provincial own receipts. Casino taxes accounts for 15% with the sale of goods and services other than capital assets accounting for about 19% of provincial government receipts. It can be argued that none of the own receipts can really be seen as an instrument of economic policy.

Table 16: Provincial Government Receipts

	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
Equitable share	28,477,198	32,052,488	37,427,646	44,223,509	51,972,804
Conditional grants	3,313,802	3,980,430	5,117,868	7,266,953	9,072,659
Provincial own receipts	1,241,557	1,433,163	1,557,284	1,698,357	1,771,513
Total	33,032,557	37,466,081	44,102,798	53,188,819	62,816,976
As a % of Total					
Equitable share	**0.86**	**0.86**	**0.85**	**0.83**	**0.83**
Conditional grants	0.10	0.11	0.12	0.14	0.14
Provincial own receipts	0.04	0.04	0.04	0.03	0.03
Nominal Change					
Equitable share		12.55	16.77	18.16	17.52
Conditional grants		20.12	28.58	41.99	24.85
Provincial own receipts		15.43	8.66	9.06	4.31
Inflation		4.70	7.10	10.56	7.10
Real Change					
Equitable share		7.85	9.67	7.60	10.42
Conditional grants		15.42	21.48	31.43	17.75
Provincial own receipts		10.73	1.56	-1.50	-2.79

(KZN Treasury, own calculations)

It is also important to understand the structure of the provincial government's budget in discussing its ability to respond to external economic shocks. The KZN provincial government has 16 votes as indicated in table 17. The table clearly indicates that about 74% of the total budget is allocated to the departments of health and education, i.e., national priorities and mandates. This leaves the provincial government with little room to reallocate or reprioritize funds or expenditures. It also seems fairly evident that government expenditure is largely directed towards social services and not economic services in the narrow sense, although expenditure on health and education has an economic impact even if the impact is long term rather than short term.

Table 17: KZN Provincial Government Budget Structure

	Audited	Audited	Audited	Revised Estimate	Medium-term Estimates		
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
1. Office of the Premier	0.82	0.89	0.84	0.68	0.61	0.54	0.54
2. Provincial Legislature	0.44	0.47	0.45	0.48	0.47	0.47	0.48
3. Agriculture, Environmental Affairs and Rural Development	3.50	2.82	3.16	3.09	3.19	3.17	3.15
4. Economic Development and Tourism	1.38	3.40	3.19	3.86	2.37	1.98	1.97
5. Education	**43.98**	**41.38**	**41.40**	**40.74**	**42.11**	**42.33**	**42.21**
6. Provincial Treasury	1.37	0.85	1.25	1.04	0.94	0.89	0.87
7. Health	**31.63**	**33.63**	**30.80**	**32.01**	**31.49**	**31.59**	**31.77**
8. Human Settlements	3.40	3.42	3.38	3.99	4.35	4.60	4.60
9. Community Safety and Liaison	0.16	0.18	0.20	0.19	0.21	0.20	0.20
10. The Royal Household	0.10	0.09	0.09	0.06	0.06	0.06	0.06
11. Co-operative Governance and Traditional Affairs	1.77	1.67	1.84	1.63	1.55	1.52	1.51
12. Transport	6.88	7.02	9.05	8.07	7.98	7.96	7.96
13. Social Development	2.55	2.28	2.22	2.11	2.43	2.51	2.50
14. Public Works	1.22	1.08	1.32	1.23	1.27	1.24	1.23
15. Arts and Culture	0.49	0.46	0.46	0.41	0.52	0.44	0.45
16. Sport and Recreation	0.31	0.36	0.38	0.41	0.45	0.49	0.49

(KZN Treasury, own calculations)

The table below (table 18) indicates the provincial government expenditure and change thereof per economic classification for the stated periods. It is clear that compensations (salaries and wages) are the single biggest expenditure item. Expenditure on goods and services and infrastructure accounts for less than 50% of the total provincial government expenditure, however a significant proportion of the 50% is fixed expenditure in terms of multiyear and contracted commitments. It therefore seems that about 70% of the total expenditure is committed and therefore non discretionary.

Table 18: KZN Provincial Government Budget Allocation per Economic Classification

	Compensation of Employees	Goods and Services Expenditure	Current Transfers and Subsidies	Payment of Capital Assets	Infrastructure Expenditure
	Total Expenditure (R'000)				
2006-07	21,758,145	7,991,427	4,055,105	3,010,744	3,714,307
2007-08	25,794,246	9,639,386	5,420,173	3,457,985	8,619,564
2008-09	31,062,640	12,480,481	6,897,173	4,890,684	14,049,865
2009-10	36,333,061	12,950,886	8,693,802	5,204,701	10,482,444
	Year-on-Year Real Percentage Change				
2007-08	11.45	13.52	26.56	7.75	124.96
2008-09	9.86	18.91	16.69	30.87	52.44
2009-10	9.87	-3.33	18.95	-0.68	-32.49
	Percentage of Total Expenditure				
2006-07	**55.85**	20.51	10.41	7.73	9.53
2007-08	**46.85**	17.51	9.85	6.28	15.66
2008-09	**47.53**	19.10	10.55	7.48	21.50
2009-10	**53.44**	19.05	12.79	7.66	15.42

(KZN Treasury, own calculations)

The table below (table 19) indicates the provincial government expenditure on infrastructure per classification. It seems intuitively that relatively very little spending occurred on “green fields” developments over the period. It however is intuitively plausible for the provincial government to significantly and rapidly increase its expenditure on “green fields” infrastructure especially in reaction to external economic shocks as many governments indeed did. However it did not occur in KZN because of some of the reasons already mentioned.

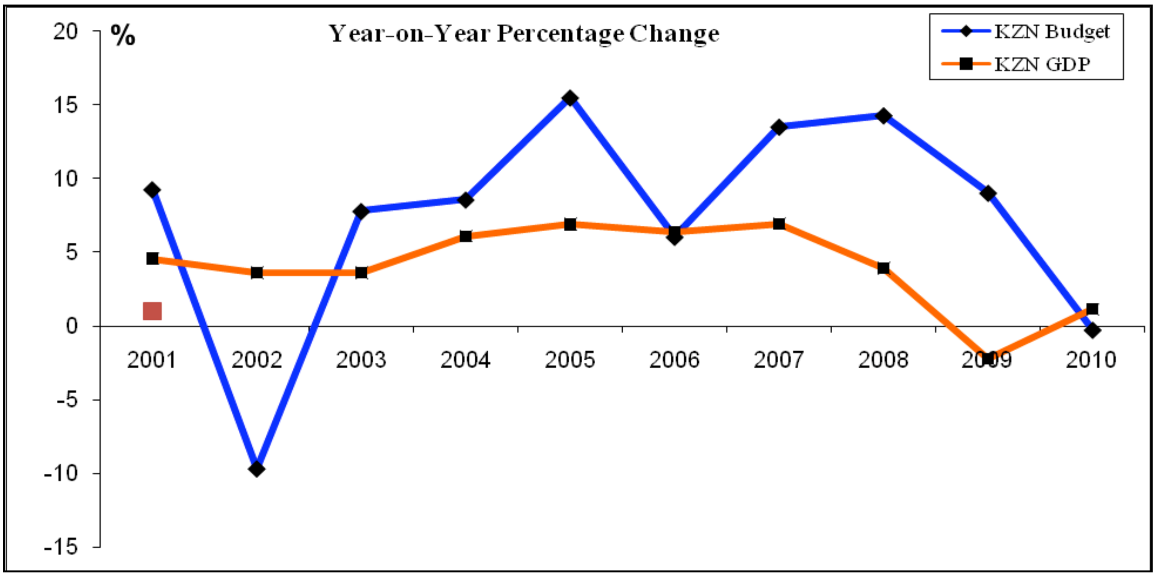
Table 19: Infrastructure Allocations

R'000	2006/07.	2007/08.	2008/09.	2009/10.
New and replacement assets	942,112	1,508,070	1,318,680	1,486,305
Existing infrastructure assets	2,909,460	2,962,274	5,346,617	5,170,396
Upgrades and additions	1,124,826	804,047	2,394,240	2,359,476
Rehabilitation ,renovations and refurbishments	511,457	572,797	468,463	603,628
Maintenance and repairs	1,273,177	1,585,430	2,483,914	2,207,292

(KZN Treasury, own calculations)

The below graph indicates the year-on-year growth rate in provincial government expenditure and the provincial economy. It appears as if the two variables shared a cyclical relationship rather than a counter cycling relationship. What is unfortunately uncertain is the directions of the relationship, i.e., does provincial government expenditure lead or lag the provincial economy? The correlation coefficient of 0.3 suggests that in fact the two variables had very little in common. Intuitively this makes sense given the source of receipts and structure of the provincial government budget.

Graph 1: KZN Provincial Government Expenditure and Economic Growth Rate



(KZN Treasury, own calculations)

Economic Policy and Instruments

Jan Tinbergen, a famous Dutch economist, taught us that for economic policy to work there needs to be at least as many policy instruments as there are policy goals. This principle is however difficult to implement in a world of multiple objectives and imposing constraints. Nobel Prize winning economist, Robert Mundell, helped carry this principle forward in the early 1960s when he articulated the idea of "assigning" each instrument of macroeconomic policy to different policy objectives in an effort to achieve internal and external balance at the same time. As William Branson observed many years later, the Mundellian framework normally assigned fiscal policy to internal balance, by which was meant the reduction of inflation, while exchange rate policy was assigned to the trade balance or the current account, and monetary policy was assigned to foreign exchange reserves or the capital account (Bradford, Prioritizing Economic Growth: Enhancing Macroeconomic Policy Choice, 2003).

Economic instruments encompass a range of policy tools. The common element of all economic instruments is that they effect change or influence behaviour through their impact on market signals. Economic instruments are a means of considering "external costs," i.e. costs to the public incurred during production, exchange or transport of various goods and services, so as to convey more accurate market signals. Economic instruments, according to Ayres and Weaver (Eco-restructuring: Implications for sustainable development, 1998), are market based in the sense that they influence indirectly the quantitative supply and demand decisions through altered cost-price relations. Ayres and Weaver goes further and state that economic instruments are often contrasted to regulatory instruments, which refer to direct controls through quotas or bans in conformity with legislated standards and enforceable through administrative sanctions and/or litigation. The two mechanisms can in theory be used to equivalent effect.

Macroeconomic policy instruments fall within the realm of Macroeconomics policy. The latter can be divided into two subsets: a) Monetary policy and b) Fiscal policy. Monetary policy instruments consist in managing short-term rates and changing reserve requirements for commercial banks. Fiscal policy consists in managing the national Budget and its financing so as to influence economic activity.

Trade policy instruments refers to tariffs, duties, quotas, export taxes or subsidies, voluntary export restraints, domestic content provisions, trade agreements and the international institutions that govern them. The Industrial Policy plan of a nation "denotes a nation's declared official, total strategic effort to influence sectoral development and, thus, national industry portfolio." These interventionist measures comprise "policies that stimulate specific activities and promote structural change". Industrial policy instruments include product support, competition support, innovation and research support, subsidies, etc. Exchange rate policy largely refers to the degree of flexibility of the exchange rate. Labour Market instruments include minimum wage arrangements, employment subsidies, training schemes and public employment services such as job search centres.

Section 125 of the Constitution requires provinces to implement national legislation within functional areas listed in Schedules 4 and 5 of the Constitution and despite regional planning and development being listed as a concurrent function no policy clarifies the role of provinces in economic development and growth. Provinces as clearly evident from the discussions so far have little discretion over the allocation of their budgets as social services are closely regulated through national legislation and the non-delivery of non-social services will have serious socio-economic and political consequences. Therefore even though provinces raise a small amount of own revenues and receive unconditional transfers, they, according to Carter from the National Treasury, have limited discretion over the allocation of their budgets to use on economic development and/or growth projects.

It should also be evident that provinces have no or very little economic policy instruments at its disposal other than its expenditure or budget. Provincial governments have no fiscal policy instruments, i.e. they cannot set tax rates or implement subsidies, nor can they borrow money (except under very stringent conditions). Provincial governments obviously have no monetary policy influence. Trade, exchange rate, labour market policy instruments are exclusively the domain of national governments as well.

Provincial government to some extent has some industrial policy instruments at its disposal, although it's again related to its ability to direct expenditure towards its industrial policy objectives. Provincial governments have no non-direct expenditure instruments at their disposal for example the ability to offer subsidies or incentives, implement protection measures and so on. Provincial industrial policy is therefore limited to the infrastructure development in the province.

It therefore seems evident that the provincial government only has a handful of economic policy instruments at its disposal therefore limiting the number of actual policy goals. The provincial economy is therefore predominantly a policy taker and not a policy maker.

Conclusion

The above analysis seems to suggest that the provincial government had only a very limited response to the crisis, i.e., maintaining expenditure rather than increasing expenditure. On the other hand the study by Imani Development indicates that there was and is a role, and indeed a need, for the provincial government in implementing measures that would mitigate the impact of such events. In fact many of the respondents were critical of provincial government's role in preventing and mitigating the adverse impacts of the recession. However, the focal point for developing and implementing economic policy, including policy on sectors and economic activities, is national government. Provincial government plays in the majority of cases only an adjunctive role in assisting the national government in economic development and growth.

To illustrate the above point further provincial own revenue accounts for only 3 percent of total revenue suggesting that provincial government simply lacks access to revenue to effectively respond to a crisis. This includes the possibility or ability to access loan funding either through entering into loan agreements or the issuing of government bonds.

The paper therefore suggests that the crisis severely impacted on the economy of the province with significant social costs. The provincial government simply could not respond to the crisis for two basic reasons. Firstly, it simply lacks the financial independence to respond and secondly provincial governments have almost no economic policy instruments or powers to their disposal.

However, the non-response or the maintenance of the status quo should been seen in context of the mandate of provincial governments. Provincial governments should therefore be honest in acknowledging their limitations in the development and growth of their economy. Provincial governments should rather focus to implement rigorous cost reduction programs, increase operational efficiencies, improve cost and management controls, and discover new ways to do more for less, which in turn will spark innovation. The biggest contribution that a provincial government can make to its economy is to increase its efficiency in its expenditure.

To this end the KZN provincial government took amongst others the following steps:

- freezing of all vacant posts;
- a moratorium on purchasing of furniture;
- rationalisation of overseas trips;
- cancelling performance bonuses for the 2010/11 financial year;
- using government facilities for meetings (instead of hotels);
- no team-building exercises and Christmas parties;

- reduction of cell phone expenditures; and
- limiting business class travel to members of the executive council (MECs) and heads of department (HODs) only