Social Welfare: Social stasis

Johannes Fedderke is Professor of Economics at the University of Cape Town. He is currently the Director of Economic Research Southern Africa (ERSA). His research interests centre on the determinants of economic growth, with a special interest in the role of institutions in long run economic development.

South Africa's democratic transition in 1994 was not only a transformative change to political institutions and political process. It brought with it a fundamental change in the way economic policy has been framed. The change is dramatic enough that we might term it a virtually untested experiment in how to approach the problem of long term economic development. In a nutshell, the experiment placed the targeting of social welfare intervention in order to redress what were perceived to be fundamental social inequities at the centre of the economic policy agenda. The formulation of an economic growth strategy has been of secondary importance at best, and realistically has never been proactively pursued.

In this sense the policy framework of South Africa over the past one and a half decades might be argued to be consistent, though not coterminous, with Amartya Sen's conception that development, equality and justice are not separable.

The question addressed by this paper is 'has this strategy has been successful?'.

The general prescription for achieving a long-term improvement in the average level of a nation's welfare is to realize economic growth. And growth is the key not only for the realisation of higher aggregate – and hence per capita – levels of output, but also for the amelioration of both poverty and income inequality, as well as improvements in human development indicators more broadly defined.[1] Growth is simply the *sine qua non* for any developmental goal if sustainability is part of the objective.

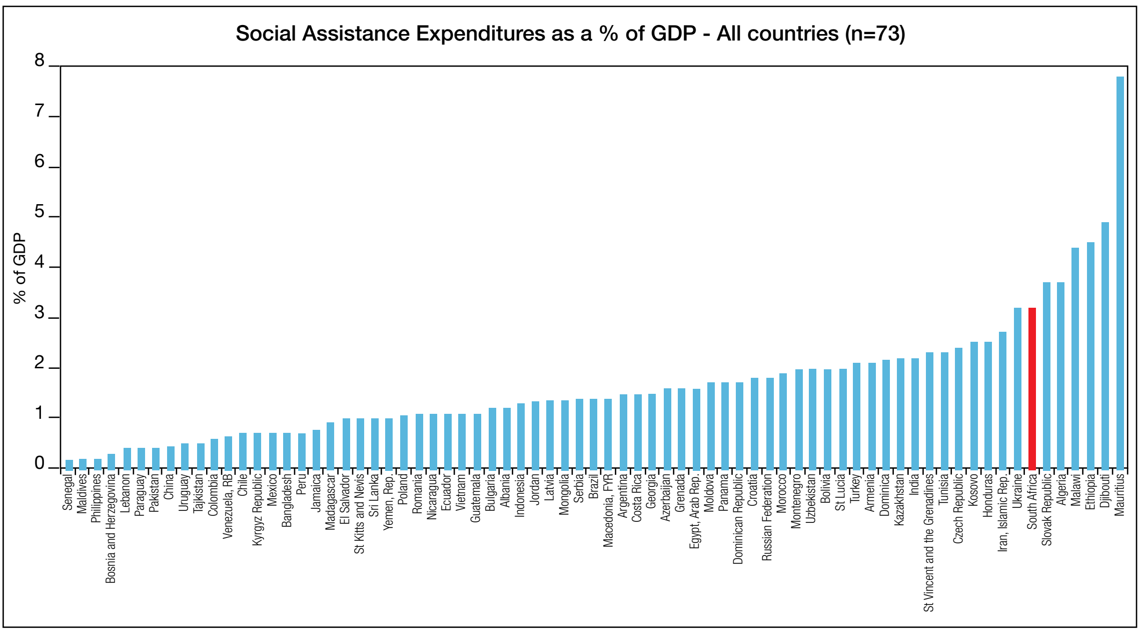
To give but one striking example of the centrality of growth: world income inequality had been steadily widening over the 1800-1950 period. Since then it has stabilised at worst, and shows at least some signs of improvement – thanks substantially to the growth performance of the Chinese and Indian economies.[2]

Countries that have successfully moved to higher levels of per capita income have done so through sustained periods of economic expansion. This is as true of Western Europe and North America in the nineteenth century, as it is of the newly industrialised nations of East Asia.

In the process, the developing nations relied on the three pillars on which growth rests – capital accumulation, expanding the demand for labour to maintain as close to full employment as is feasible, and a steady growth in technology and the efficiency with which the factors of production are employed. Typically, the growth strategies of developing nations target sustained capital accumulation (investment) – financed by substantial savings and foreign capital inflows in the first instance – in order to raise the capital – labour ratio of production, and hence the productivity of labour. Once the capital labour ratio of the developing country approaches that of already industrialised nations, greater emphasis is then placed on technological advancement.

In South Africa, the approach to the developmental challenges has been dramatically different. The focus of economic policy since 1994 was not the pursuit of the core elements of a growth strategy, but instead the development of a social welfare system. In short, the economic strategy of South Africa's first democratic government placed the attainment of greater equity and redistribution ahead of the achievement of faster economic growth. Ironically enough, consideration of the public debate surrounding economic policy in South Africa would have one believe the opposite: that economic policy has been characterised by the ruthless pursuit of the neoliberal agenda of the Washington Consensus. As the evidence below indicates, this is empirically false, and simply ignores the evidence.

Figure 1: Social Safety Net Expenditure (% of GDP, Selected Countries and Years)



Source: World Bank (2009), Weigand and Grosh (2008).
Note: Social safety net expenditure defined as sum of social insurance and social assistance payments

The results of this policy orientation have been a dramatic transformation of the policy landscape. In Figure 1 we report the proportion of Gross Domestic Product (GDP) spent on social safety nets, which in the case of South Africa are made up largely of pensions, child grants, disability payments, war veterans' grants, foster care, grant in aid, care dependency and the unemployment insurance fund (UIF). What emerges is that South Africa now spends slightly more than 4% of GDP on social welfare. This expenditure places it amongst the most generous of all developing countries in terms of social welfare payments.

What is more, this level of welfare expenditure is the result of a dramatic and sustained increase over time, matched by no other category of government expenditure. In Figures 2, 3 and 4 we report the proportion of GDP spent on defence and public safety, social infrastructure and welfare expenditures, and a range of economic and cultural services, respectively.

The evidence is startling.

First, the category of expenditure that has attracted the most dramatic and sustained public scrutiny in terms of wastefulness, Defence, has been subject to a strong decline after the highs of the 1980s, from approximately 3.5% of GDP, to 1.5% of GDP, with no sign of revival despite the much debated arms deal. Such a level of expenditure places South Africa easily amongst the best-practice countries in terms of military expenditure.[3] (See Figure 2).

Second, the most dramatic single increase in government expenditure is attributable to social security and welfare, which shows a fourfold increase from approximately 1% of GDP to the more than 4% of GDP already noted in comparative terms above. (See Figure 3).

Third, it is worth noting that the fiscal space for this dramatic expansion in social welfare has, in substantial measure, been made possible since declining requirements of debt servicing have lowered the proportion of GDP spent on interest payments servicing government debt, from more than 5% of GDP toward the end of the 1990s, to less than 3% of GDP in 2008. Far from impeding the ability of the state to pay attention to welfare, therefore, prudent monetary and fiscal policy has in fact created the fiscal space to be able to develop a welfare system in the first place.

What is more, the choice to prioritise the expansion of social welfare, like any choice, entails trade-offs. The dramatic expansion of the social welfare payments has meant that other forms of expenditure have been constrained.

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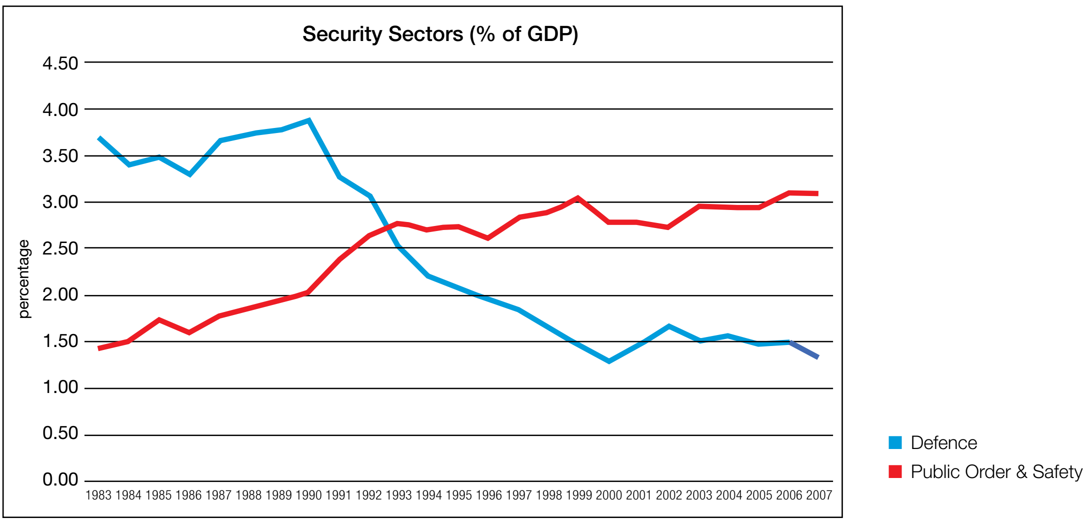
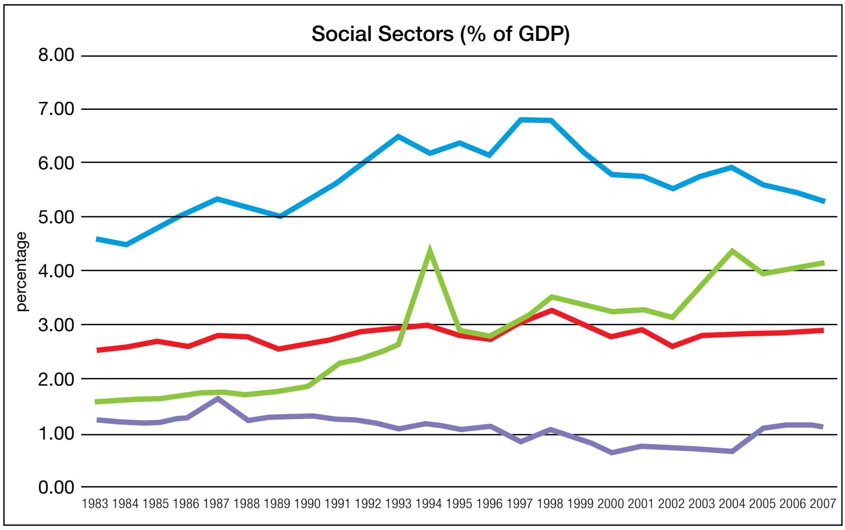
Figure 2: Government Expenditure (% of GDP)



Source: South African Reserve Bank[4].

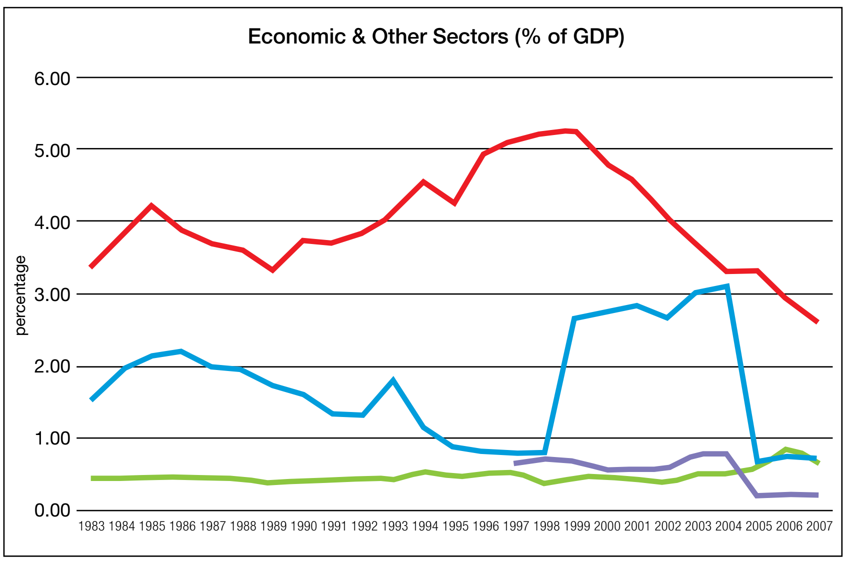
Figure 3: Government Expenditure (% of GDP)



Source: South African Reserve Bank[5].

Thus, despite the fact that South Africa faces crime at an intensity and a level of violence that places it at the top of any international crime ranking, and despite the fact that it is the poor that face the disproportionate burden of the incidence of crime, expenditure on public order and safety has not increased appreciably as a proportion of GDP (approximately 3%) since 1999, arguably 1997.

Figure 4: Government Expenditure (% of GDP)



Source: South African Reserve Bank[6].

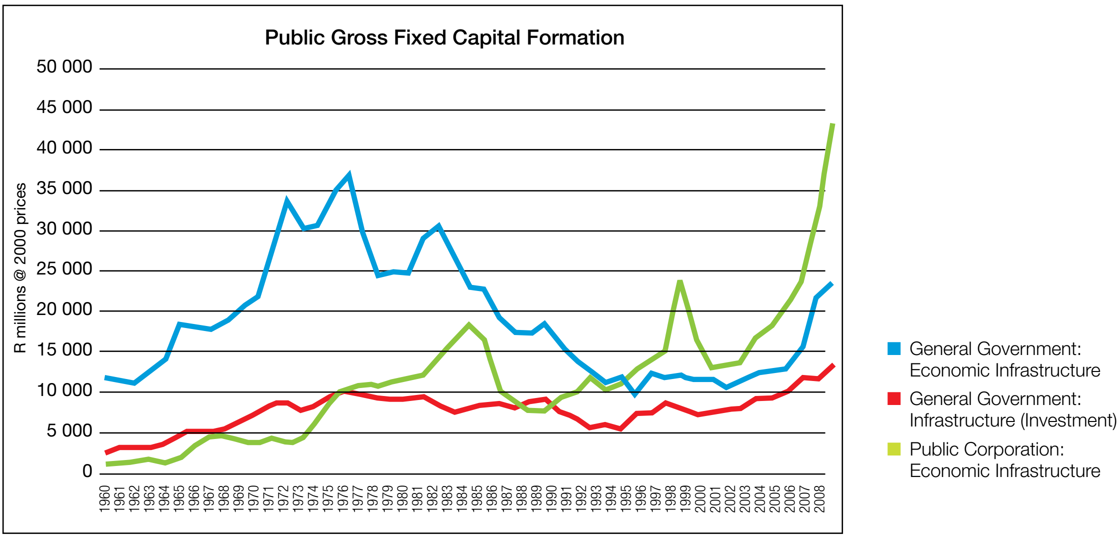
Despite the fact that improvements in human capital are widely recognised to be amongst the single most effective ways of lowering poverty counts, improving income inequality and above all that it constitutes a central platform for the realisation of economic growth, the proportion of GDP spent on education (while high in international comparative terms) in fact peaked only three years into the democratic dispensation at 7% of GDP, and has been on a steady decline over the whole of the past decade, now standing at 5% of GDP.

Despite the fact that South Africa faces serious challenges in the provision of health services, for instance as indicated by the impact of the HIV/AIDS pandemic on the average life expectancy in South Africa (which falls from a 1990-99 average of 57 years to a 2000s average of 46 years) since 1994, expenditure on health has remained essentially constant at 3% of GDP.

Despite the often identified backlog in housing, expenditure on housing services has remained essentially constant at 1% of GDP.

The evidence extends further. One of the now well-documented aspects of the South African growth performance of the last three decades of the twentieth century was a very strong decline in public infrastructure investment, leading to a decline in per capita public infrastructure. This is true for both economic infrastructure, as well as social infrastructure. Figure 5 illustrates.[7] What is more, it is now well documented that both in aggregate terms,[8] as well as on sectoral economic data[9] infrastructure across a wide range of measures,[10] is both an important determinant of economic growth, and itself comes to be driven by demand factors that arise under conditions of rapid economic expansion.

Figure 5: Infrastructure Investment



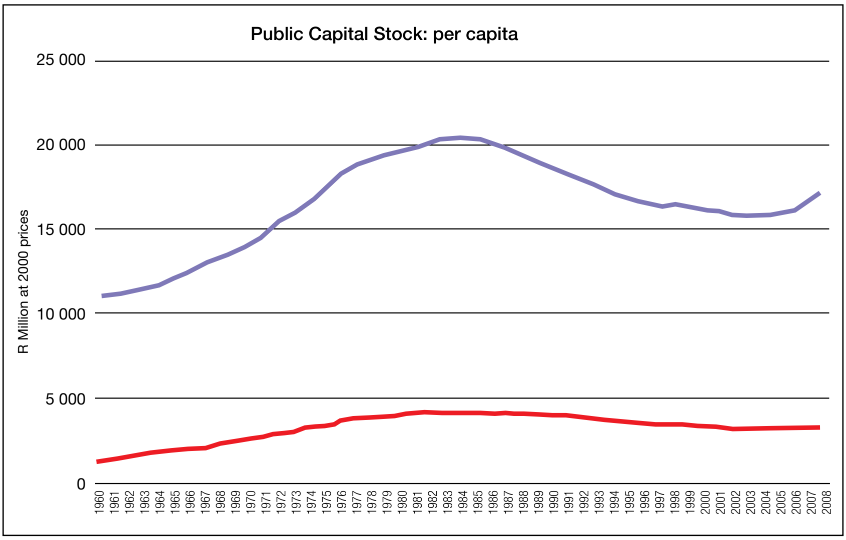
Source: South African Reserve Bank[11].

The good news is that the long term decline in infrastructure expenditure that characterised the 1975-2000 period, has been reversed in the 2000s. As Figure 5 illustrates the trend for both economic and social infrastructure expenditure by general government has been upward since approximately 2000. In the case of public corporations, the trend has been sharply upward.[12]

Unfortunately, there is too little by way of good news. The recovery in infrastructure expenditure, as Figure 6 shows, has not been sufficient to do more than generate a small reversal in the steady downward trend in per capita public capital stock in economic infrastructure. In the case of social infrastructure, the increased investment expenditure in infrastructure has not even been sufficient to reverse the negative trend in per capita social infrastructure over time.

The moral of the story is the same as with the preceding evidence. The strong increase in social welfare expenditure has closed the fiscal space available for an expansion of the core forms of public capital crucially required for sustained economic growth, and hence for a sustainable resolution of the problems of poverty and inequality in the South African economy.

Figure 6: Per Capita Infrastructure Stock



Source: South African Reserve Bank[13].

One indicator of the ability of the schooling system to generate quality human capital is the performance of scholars in standardised mathematics and science assessments.

Evidence from human capital creation in South Africa tells an even more damning story. We know from empirical evidence that what drives productivity growth in South Africa is not investment in human capital per se, but investment in quality human capital.[14] One indicator of the ability of the schooling system to generate quality human capital is the performance of scholars in standardised mathematics and science assessments. It remains a source of deep concern that the ability of South Africa's schooling system to provide internationally competitive training in mathematics and science remains severely circumscribed. In Table 1 we report results from the ongoing international comparative study in mathematics and science performance (TIMSS) of eighth graders, over the 1995-2003 period. South Africa has consistently ranked bottom of the participating countries, with scores approximately half that of the TIMSS scale average of 500. What is more, South Africa's performance declined on the TIMSS scale over the 1995-2003 period, even though the decrease is not statistically significant.[15]

Thus, the South African state is simply not delivering to its citizens what is arguably the single most effective means of addressing long term disadvantage, and poverty in particular.

The significance of all of this evidence is twofold:

Most significantly, the dramatic increase in social welfare expenditure has closed the fiscal space for an expansion of expenditure in other dimensions, such as education, health, policing and housing. Of course, the evidence of Figures 2 through 4 is reported as the proportion of GDP. While this is consistent with real increases in absolute terms in all categories of expenditure, it also serves to highlight the rate and magnitude of increase in social welfare payments even more dramatically.

Second, it serves to emphasise just how disconnected from the fundamental evidence the public debate on economic policy has become. Despite the repeated claims that public policy has been targeted rigidly at the achievement of stringent fiscal and monetary austerity at the expense of the development of an adequate social security system, precisely the reverse is true. The development of the social security system has been possible only because fiscal and monetary policy created the fiscal space to raise welfare payments; and it has been the rising fiscal burden of the welfare payments that has squeezed the ability of the state to address the delivery of vital services in education, health, policing and housing.

Table 1: Trends in International Mathematics and Science Study (TIMSS)

Country	1995	1999	2003	Difference	
				(2003-1995)	2003-1999
Singapore	609	604	605	-3	1
Korea, Republic of	581	587	589	8^	2
Hong Kong SAR	569	582	586	17^	4
Chinese Taipei	—	585	585	+	#
Japan	581	579	570	-11~	-9~
Belgium-Flemish	550	558	537	-13~	-21~
Netherlands	529	540	536	7	-4
Hungary	527	532	529	3	-2
Malaysia	—	519	508	+	-11
Russian Federation	524	526	508	-16~	-18~
Slovak Republic	534	534	508	-26~	-26~
Latvia-LSS	488	505	505	17^	#
Australia	509	—	505	-4	+
United States	492	502	504	12^	3
Lithuania	472	482	502	30^	20^
Sweden	540	—	499	-41~	+
Scotland	493	—	498	4	+
Israel	—	466	496	+	29^
New Zealand	501	491	494	-7	3
Slovenia	494	—	493	-2	+
Italy	—	479	484	+	4
Bulgaria	527	511	476	-51~	-34~
Romania	474	472	475	2	3
Norway	498	—	461	-37~	+
Moldova, Republic of	—	469	460	+	-9
Cyprus	468	476	459	-8~	-17~
Macedonia, Republic of	—	447	435	+	-12~
Jordan	—	428	424	+	-3
Iran, Islamic Republic of	418	422	411	-7	-11~
Indonesia	—	403	411	+	8
Tunisia	—	448	410	+	-38~
Chile	—	392	387	+	-6
Philippines	—	345	378	+	33^
South Africa	—	275	264	+	-11

SOURCE: International Association for the Evaluation of Educational Achievement (IEA), Trends in International Mathematics and Science Study (TIMSS), 1995, 1999, and 2003.

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— Not available.
\+ Not applicable.
\# Rounds to zero.
^ p<.05, denotes a significant increase.
~ p<.05, denotes a significant decrease.

Two obvious questions arise at this juncture:

Has the South African strategy of prioritising its first order objective of lowering inequality and poverty worked? After all, postponement of growth oriented policy interventions might well be eminently desirable if the strong social welfare commitment has served to redress the legacy of strong social inequities as reflected in the levels of poverty and inequality.

Secondly, will the strategy prove sustainable?

In terms of the first question, the increase in social welfare intervention has been dramatic (a fourfold increase) and sustained. So if redistribution is a successful strategy of redress for poverty and inequality, it really should be visible in the South African instance. Yet strikingly, according to South Africa's leading researchers on poverty and inequality, this has not been the case. Instead they suggest that the best inference from the evidence is that inequality has remained constant over time at best, and that it may possibly have worsened.[16] Equally, as of 2005 more than 34% of South Africa's population is claimed to remain below the World Bank's poverty line of subsisting on less than $2 per day. (See Table 2.) As the comparative evidence makes clear, this places us in the same category as China in 2005.

South Africa has been pursuing an aggressive welfare based programme aimed at redressing inequality and poverty at the expense of an economic growth policy.

All this, despite a fourfold increase in social welfare payments.

Table 2: Poverty Counts in Comparative Perspective

	Poverty headcount ratio at $1 a day (PPP) (% of population)			Poverty headcount ratio at $2 a day (PPP) (% of population)		
	1980-89	1990-99	2000-05	1980-89	1990-99	2000-05
Brazil	13	9	8	33	25	22
China	44	24	12	79	61	38
India	46	42	34	87	85	80
South Africa	-	8	11	-	33	34
Argentina	2	2	6	2	9	18
Chile	6	2	2	25	11	8
Mexico	14	7	4	40	26	18
Venezuela, RB	6	11	14	21	28	34

Source: World Development Indicators

The Chinese comparison is instructive both in dynamic terms (over time) as well as in terms of comparisons with other countries. As I have argued above, South Africa has been pursuing an aggressive welfare based programme aimed at redressing inequality and poverty at the expense of an economic growth policy. China, famously, has been pursuing an aggressive growth policy, with welfare interventions as a remedial afterthought at best. Yet as the evidence of Table 2 makes clear, it is China that has been able to reduce its poverty, and dramatically so, over the past two decades. South Africa's poverty count by the official data has remained static at best – and possibly has worsened.

What is more, the comparative evidence further strengthens the suggestive insight. Those countries that have focused on raising growth (Chile, Brazil and Mexico over the period reported) have shown strong decreases in poverty counts. Those whose focus has been in the first instance on redistribution (Argentina, Venezuela, South Africa) have achieved worsening poverty counts.

This leads to the question of sustainability.

One argument in favour of the strategy adopted by South Africa might be that it is a Keynesian response to what is clearly a disequilibrium in the economy: an unemployment rate that is a significant brake on development prospects, since a large proportion of potentially productive factors of production lie fallow. The obvious means of resolving this constraint is then through standard demand side stimulus, raising demand in the economy in order to bring the factors of production into full employment.

But there are two considerations that render this response spurious.

First, even on its own terms, Keynesian demand management is a short run countercyclical intervention designed to counter temporary deviations from full employment due to a shortage of effective demand. South African unemployment is long-term and structural in nature, and has self-evidently hardly budged despite the substantial stimulus to the demand side of the economy over a fifteen year period provided through the welfare channel of the government accounts. The problem of unemployment is a supply-side one, of a rigid labour market that is unable to show a price response to a substantial market disequilibrium,[17] and of a schooling system that is unable to provide the skills that labour market entrants require in order to be competitive at the prices that are administratively and rigidly set in our labour markets.

Second, it is not a sustainable response. It renders the fiscus vulnerable to external shocks in the extreme. The current world recession is a case in point. The negative shock to the demand side of the economy has immediately opened up a deficit on the government accounts of 7.6% of GDP (on current estimates). Under such a weight of borrowing the fiscal space created by the reduction in government debt of the past fifteen years for the expansion of welfare payments, will fast dissipate, and force the need for difficult choices across spending programmes. And who will front up to the political challenge of making the choice between pensions, schools, hospitals or low income housing?

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In short, Keynes is best left out of considerations relating to growth strategy, and should be reserved for where he belongs.

But could a strategy such as that adopted by South Africa conceivably work as a means of sustainably addressing rising and expanding welfare aspirations of an inclusively defined population?

The answer is probably (or perhaps better: possibly) yes, but not unconditionally so. The right circumstances must prevail if it is to have the desired effect of bringing in an ever greater proportion of the population into the formal economy, employment, and hence out of poverty.

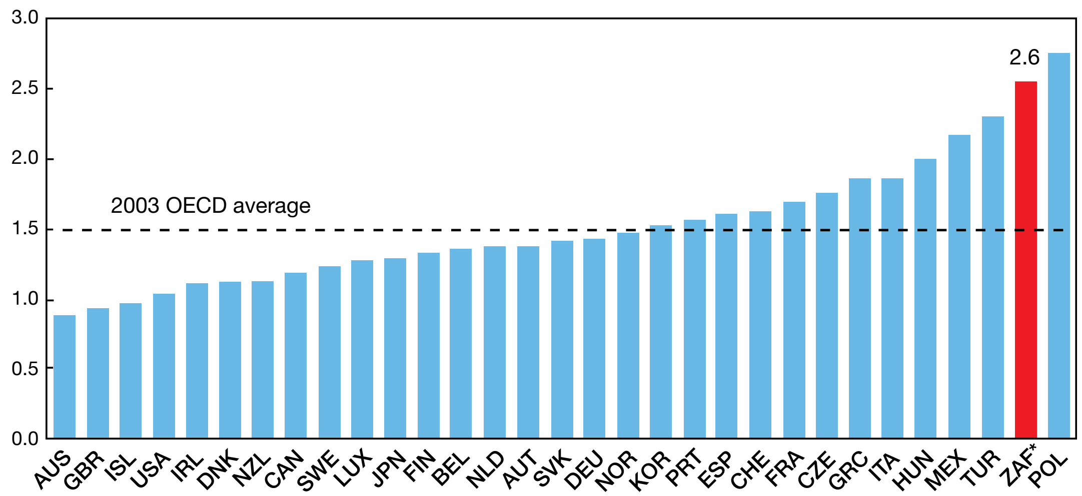
But a word of caution is necessary. Reliance on raising the income of the poor and disadvantaged of society to raise the economic performance of the economy as a whole, will be successful if, and only if, the stimulus that the high propensity of the poor to consume[18] will generate for demand, is accompanied by a supply side response that allows resources to be allocated efficiently to the productive capacity that can meet the expanded demand. But this in turn requires an increased flexibility of markets, in order to allow an efficient reallocation of resources to their most productive use. This would enable labour markets to allow the creation of jobs across a wide spectrum of skills and experience levels, including low skilled employment in markets that service the part of the economy receiving the strongest proportional stimulus in demand (the poor). But equally, such flexibility would be required in output markets, where the distribution of productive activity in the economy is determined.

Yet for South Africa, policy intervention has pointed in the opposite direction.

Labour market legislation has not only rendered the real wage rigid, but has introduced a wide range of labour market regulation that has raised the non-wage cost of labour in addition to the wage cost.

In output markets, there is evidence of substantial pricing power,[19] which carries substantial costs in the form of foregone productivity growth.[20] But significantly, the intensity of output market regulation in South Africa is much higher in South Africa than even developed OECD-type economies maintain (see Figure 7), such that incumbent firms in South African markets have been able to benefit from non-tariff barriers to competition despite a liberalisation of the trade regime.[21]

Figure 7: Aggregate product-market regulation indicator



* = SA

Source: OECD (2008).

In effect, both labour and output markets are overregulated and too inflexible in order for the reliance on the demand side intervention that is associated with an expansion of the welfare system to stand any chance of success in addressing the demand of long run sustainable development.

Sen's dictum that justice and fairness are indivisible from what it means to realise the development of life prospects, in both the sustainable and the complete sense of the word, is certainly attractive. It may also be true.

However, as South Africa's experience shows, paying attention to social justice is no substitute for addressing the hard supply side issues that determine the productivity of factors of production in the long run. This requires hard choices to forego short term consumption in order to raise productive capacity in the economy sustainably through hard work and investment in the quantity and quality of capital, be it human, physical or financial.

To meet the welfare needs of its citizens and its poor and disadvantaged, it is time that South Africa adopted a growth policy in substance as well as in name.

NOTES

1. The evidence suggests that economic growth is much more effective at reducing poverty than income redistribution. For instance (Ravallion et al, 1997) find that a 10% increase in average incomes per year will reduce the proportion of the population living on less than $1 a day by 30% per year. For economic growth to worsen poverty, the distribution of income would have to become more unequal as incomes rise. There is no evidence to suggest that this happens, instead (Dollar and Kraay, 2002) find that a 1% increase in the average income of society translates one-for-one into a 1% increase in the incomes of the poorest part of society
2. See the sophisticated analysis and discussion in Bourguignon and Morrisson (2002)
3. This is not to say that the arms deal was not beset by impropriety. But from a fiscal sustainability point of view there is simply no issue here
4. KBP4371F, KBP4372F, KBP6006J
5. KBP4372F, KBP4374F, KBP4375F, KBP4376F, KBP6006J
6. KBP4377F, KBP4378F, KBP4379F, KBP4380F, KBP4381F, KBP4382F, KBP4383F, KBP4384F, KBP4387F, KBP6006J
7. See also the extensive discussion of the evidence in Perkins et al (2005)
8. See Fedderke et al (2006)
9. See Fedderke and Bogetic (2009)
10. The studies employ measures of railway, road, port and air transportation, power generation, as well as telephone communication capacity.
11. KBP6101Y, KBP6102Y, KBP6107Y
12. This is predominantly driven by the increase in the investment for power generation by Eskom.
13. KBP6132Y, KBP6133Y, KBP6135Y and Statistics South Africa for population estimates: medium mid-year population estimates
14. See the extensive discussion and evidence in Fedderke (2006)
15. The discussion of the quality of the South African educational system has been ongoing over the past decade. See for instance Fedderke et al (2000) for an early discussion of concerns about South African schooling quality across a range of dimensions. Simkins (2005b) provides further comparative evidence, while Simkins (2005c) considers evidence from South African household surveys. Fedderke et al (2003) consider further evidence from the tertiary educational sector, while Simkins (2005a) extends the evidentiary base
16. See Bhorat et al (2009), and Leibbrandt (2009)
17. See the clear discussion in Banerjee et al (2008:725) who show that there is no downward adjustment in the real wage of labour in South Africa, despite substantial (and arguably rising) unemployment. This is simply not the response of a flexible market under any characterisation. Current wage settlements, well in double digits, in the face of a world recession, negative output growth rates, continued high unemployment, and an inflation rate fast approaching the upper bound of the inflation target of 6%, similarly speak of very considerable bargaining power on the part of organised labour inevitably leading to yet more pronounced disequilibria in the labour market
18. The poor tend to consume higher proportions of their income as opposed to the rich whose proportional consumption lessens as income increases. Ed
19. See Fedderke et al (2007) and Aghion et al (2008) – the estimate is that the pricing power of South African producers is two to three times that of US producers
20. See Aghion et al (2008)
21. Note that the proportional liberalisation of other emerging markets have been far more substantial – see for instance the proportional reduction in tariff barriers in India and China relative to that of South Africa. In addition, GDP-weighted reductions in effective protection rates suggest that South Africa's liberalisation has been less complete than the reduction in nominal tariff rates suggest

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