Fortune favours the cautious

By Professor André Roux

21 Feb 2017

First, the good news: The macro-economic backdrop to this year's budget speech is not quite as intimidating as a year ago. Internationally, commodity prices are heading northwards (albeit off a low base); a moderate improvement in global growth is on the cards; and emerging economies are looking more appealing than a few months ago.

Here at home, there are indications that the inflation rate, and possibly short-term interest rates, have peaked; the severe drought conditions have abated to some extent; and the tour de force displayed of late by the Rand exchange rate has surprised many. All in all, after probably failing to breach the 0,5% mark in 2016, GDP growth could approach 1,5% this year.

Major economic tremors

However, this relatively sanguine prognosis assumes the absence of any major economic tremors – and this might be a very brave assumption. The world and domestic financial and economic systems remain brittle, and could react negatively, sharply and quickly to any one or more of a number of shocks. These include the outcome of protectionist/ anti-globalisation sentiments in the USA, Britain, and the European Union; the unknown magnitude and effect of growing debt levels in China; and the impact of rising interest rates in the USA.

In South Africa, a less benign global outcome would be aggravated by a renewed weakening of the rand exchange rate; a stubbornly high inflation rate; stagnating commodity prices; and, above all, political and policy "noise." Thus, while the contextual environment is somewhat more favourable than this time last year, the finance minister still has very limited fiscal manoeuvrability.

Different expectations

Different stakeholders (vested interests) have different expectations, hopes and desires when they reflect upon the ramifications of the annual budget speech. Some embattled political leaders and millions of cash-strapped, highly indebted consumers are no doubt hoping for an expansionary budget – the former (politicians) to curry favour with disillusioned voters, and the latter to improve their standard of living and quality of life.

However, those in favour of fiscal austerity would lament a populist approach, and point out that this would plunge the country ever-deeper into a cesspool of unsustainable and unpayable debt, and an ultimate systems breakdown.

Somewhere between these two extremes is the call for fiscal prudence. The arguments for constraint are compelling: The sword of Damocles ("junk" bond status) continues to hang over our collective heads. Regardless of the esteem in which they are held, a downgrading by the credit ratings agencies of South Africa's public debt to sub-investment status, will emasculate the economy in a far-reaching and long-lasting way.

Minister Gordhan and Team SA did sterling work last year in deflecting such a verdict, but the last thing we need now is complacency. A fiscal framework that does not maintain fiscal rectitude would virtually guarantee economic stagnation and prolonged socio-economic suffering.

Real predicament

At the same time, it would be politically untenable to turn a blind eye to the very real predicament facing millions of South Africans – poverty, unemployment, and disillusionment. The notion of actually reducing government outlays on, for instance, education, social grants, and health care, is, in the circumstances, a ludicrous one.

The challenge, therefore, is to budget for a modest increase in public spending that favours the poor, without raising the public debt to a level that would trigger a credit downgrade (also read: bring the budget deficit as close as possible to 3% of GDP). In actual fact, we know from the 2016 medium-term budget statement that the bulk of the increase in government spending this year (an estimated R28bn) is to be financed from tax adjustments. With modest economic growth, organic growth in tax collections will also be modest.

What we do not know is the nature of these tax adjustments. The usual increase in "sin tax" rates, and the proposed controversial sugar tax will not be sufficient. The most efficient mechanism would be a one percentage point increase in the VAT rate, which could yield an additional R15bn to R20bn.

This idea has, however, been met with insurmountable political resistance over the last two decades, even though the burden on the poor could be relieved by, for instance, raising social grants and/or expanding the range of essential goods that are taxed at 0%.

Failing this, the brunt of the higher tax burden is bound to fall on the private sector – specifically through a lifting of the maximum marginal rates of tax on personal income, and possibly the introduction of a "wealth tax". Higher corporate tax rates might also be considered.

Other "headline" issues that need to be addressed include the ownership structure of state-owned enterprises, the nuclear energy deal, the potential of savings by clamping down on mismanagement, wastage, and inefficiencies within and by the public sector, and the financial predicament of many of our university students (and universities). And, one would also like to see that the longer term objectives as embodied in the National Development Plan are recognised.

The elephant in the room

In sum: We can expect the minister to present a fiscally prudent budget that admits the need to appease the concerns of nervous investors, but without bludgeoning a fragile and hesitant economic recovery to death. However, “there ain’t no such thing as a free lunch” – somebody has to pay the price; and that somebody is most likely to be the more affluent members of society. Fortunately, this blow could be mitigated to some extent by a slight softening in monetary policy later in the fiscal year.

The elephant in the room is the future of Minister Gordhan. If he should be removed from office after the budget speech, then very few, if any, of the positive sentiments expressed above will come to fruition.

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