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With Zuma gone...the time has come to fix SA's economy

By Sandy McGregor

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Although he's being dragged kicking and screaming like a petulant two-year-old, President Jacob Zuma has been shown the door, now Cyril Ramaphosa needs to roll up his sleeves to arrest our downward spiral into economic disaster. The economy can be fixed, but this will require resolute and unpopular actions.

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For the past year, the matter of who will succeed President Jacob Zuma has been an all-consuming concern for all South Africans. There has been a struggle within the ANC between two factions. One largely comprises the beneficiaries of Zuma's particular style of patronage politics, who seek to maintain at whatever cost the status quo from which they currently benefit. The other seeks the return of a constitutional order similar to that established by Mandela and Mbeki. As this contest became more heated, the fact that South Africa is facing a serious economic crisis was largely ignored. This is the first challenge the ANC's new leadership must now face.

Is it possible to fix it?

Often we face problems that have no solutions; they simply have outcomes. However, getting South Africa's economy going again should not be one of these. History is full of stories of nations that were in a bad way and successfully made changes for the better. There are well-understood long-term challenges, such as the broken education system, which will take years to put right. However, in recent years, we have lost our way and to put the country back on the path to a better future we need positive leadership. Certain simple things have to be done so that the strengths of business and civil society can be harnessed to tackle these challenges.

A supportive global economy

For the past 18 months, we have experienced one of the strongest periods of synchronous global growth on record. With few exceptions, almost every country is enjoying improving business conditions. In Europe, it looks as if eight years of stagnation are ending. The prospects for Japan seem the most favourable in decades. The slowdown in emerging markets, which commenced in 2011, has come to an end. Growth continues apace in the two economic juggernauts: China and the US. It has become a cliché to observe that only two countries of significance are not growing: South Africa and Venezuela, both of which are suffering the consequences of damaging political leadership.

South Africa has an open economy and normally responds positively to an upward surge in global growth. That it has not done so is witness to economic mismanagement and an extremely low level of business confidence. Our economic crisis is of our own making. However, this can be regarded positively: If we can make the necessary changes domestically, favourable global business conditions will support a rapid economic turnaround.

Fiscal stabilisation requires an increase in the VAT rate

The medium-term budget tabled by Finance Minister Malusi Gigaba in October 2017 presents a bleak picture of a deteriorating fiscal situation. An immediate revenue shortfall of about R50bn is expected in the current fiscal year due to a combination of a weak economy and an erosion in the efficiency of tax collections. Matters have been aggravated by mismanagement of state-owned enterprises (SOEs), such as Eskom and SAA, which cannot remain in business without government support.

Without immediate remedial action, government debt could spiral out of control to unsustainable levels. It is very difficult to cut government spending even in the best of times as it requires strong managerial skills which the public service currently lacks. Accordingly, a rapid stabilisation of government finances will need a tax increase.

There is only one viable option given that personal tax rates have reached levels where further increases will not significantly boost revenues. An increase in the VAT rate from 14% to 16% will generate an additional amount of about R48bn, which should be sufficient to stabilise the nation's finances. Such decisive action will improve investor confidence and promote capital inflows, which will stabilise the rand and reduce the interest rate payable on new debt. Rand stability will keep inflation in check and allow the Reserve Bank to further reduce interest rates. The shock and awe generated by such a move will send a message that government fully intends to put the nation's finances in order.

It is often argued that an increase in VAT places an increased burden on the poor, but in current circumstances, this may not be the case. Theoretically a consumer whose entire expenditure is spent on VATable goods will suffer a 2% increase in their cost of living. On the other hand, failure to stabilise the fiscus would have an adverse impact on the rand – with much greater inflationary consequences. Consumers will be better off paying more in VAT. A simultaneous 2% increase in grants would cost about R3bn a year and would protect the poorest against the cost of a VAT increase. The benefits of an increase in VAT would far outweigh its costs.

Restoring confidence

The markets are no longer willing to finance SOEs that are mismanaged and corrupt. Those who have fiduciary responsibilities cannot fund organisations whose behaviour would in the private sector be the subject of criminal prosecution. The practice of making senior appointments from a small group of people who lack the required skills, but are politically connected, must cease. Ramaphosa has already signalled his intention with the new Eskom board.

South Africa has a private sector rich with talent. It should be possible to find competent individuals who know what needs to be done and can do the job. Installing competent management in the parastatals will help put them in a position where they can borrow on their own credit and no longer be a liability to the state.

In recent years there has also been a serious erosion of managerial competence throughout government. Many departments require a change in leadership. Addressing this issue would go a long way to restore public confidence and create a government that can deliver. The required skills exist. They can be found both in government and in the private sector. Some may have to be recruited from abroad. What is required is the recognition that these skills must be sourced from outside government, and the political world, if necessary.

With business confidence at its lowest level since the early 1990s, it is unsurprising that economic conditions are stagnant. It is the private sector that makes the investments which generate growth. Any programme to get the economy going again must therefore start with restoring both business and consumer confidence. This can be achieved by a few simple steps such as those outlined above. Given current favourable global economic conditions, improved domestic confidence could pay rapid dividends in the form of faster growth.

Will the new ANC leadership be able to make the necessary changes?

Fixing the South African economy requires significant changes in the staffing of the top positions in government. With Zuma's recall, many of those who must be replaced are his appointments and were given their positions because he regarded them as being loyal supporters.

Ramaphosa will face formidable challenges because he will have to rebuild government institutions that have been severely damaged during the Zuma years. He would probably install a new minister of finance, who hopefully will have the political support to increase the VAT rate. Ramaphosa has already shown that he plans to act swiftly to make effective changes, and free South Africa from economic stagnation.

ABOUT THE AUTHOR

Sandy McGregor is a portfolio manager at Allan Gray. He joined the firm as an investment analyst and economist in October 1991. Previously he was employed by Gold Fields of South Africa Limited in a variety of management positions for 22 years, where much of his experience was focused on investment related activities. His current responsibilities include the management of fixed interest and he is a fund manager for the Allan Gray Bond Fund. He was a director of Allan Gray Limited from 1997 to 2006.