Budget 2010

The "swing to the left"

If I were Cosatu I would feel very unhappy, even betrayed.

Both the President and his right hand minister, Collins Chabane, talked up decisions on inflation targeting and the Rand to be announced by finance minister Pravin Gordhan. Then comes budget day and .... there are no changes! Not only does **inflation targeting** remain, the band of 3% to 6% also remains.

On a **fixed rand** the minister states "... we are agreed that we need a stable and competitive real exchange rate, though in today's world this cannot be translated into a straightforward fixed price of the rand." The minister has agreed measures to stabilise the rand with the Governor of the Reserve Bank and they include "accumulate reserves" and "further exchange control reform".

Hardly swing to the left stuff.

However, the minister specifically called for more debate and communication around these issues to enhance the public's understanding of them. So expect many more words but little change to the basics.

By talking the finance minister up and saying he will announce the decisions, the president and minister Chabane built Mr Gordhan's stature. Difficult to go back on those decisions now.

Also, both the president in his state of the nation speech and the minister in his budget speech specifically opened the door for **more private sector involvement** in areas of traditional government monopolies. The president referred to independent power producers to help with electricity and public private partnerships to help in Health. The minister in his budget speech stated "... we will continue with the use of public private partnerships in the health sector, in particular to improve our hospital system."

These sentiments stand in direct contrast to the idea of nationalisation or even an all powerful developmental state that will deliver all range of services.

Then there is the **wage subsidy.** Details will be released later and it is only expected to become effective next year. Treasury has been supporting the idea for a long time. The Harvard Panel suggested it. So did the DA. Cosatu never liked the idea as it would undercut many of the minimum wage arrangements and could in effect create a two-tier labour market. It is now clearly mainstream thinking.

After the State of the Nation speech already Cosatu's Mr. Vavi has thrown his toys out of the cot on these issues. Imagine what he must have felt like after the budget speech.

Populism and the Budget

A close look at the numbers indicates that the other shibolet of recent political commentary, that the Zuma govt will open the taps to repay political favours, simply did not happen.

Overall expenditure is budgeted to rise by 2% p.a. in real terms (i.e. after inflation). This is down from the 5% real which Minister Trevor Manuel proposed in his last budget last February. Of course, the proof of the pudding will be in the eating and we must see whether these numbers are met – but the political intent is there to hold them down.

A lot will depend on public sector **wage increases** as compensation makes up about 1/3 of total expenditure. The minister warned that unions will have to tamper wage expectations.

Social grants, of which the childrens' grant is by far the biggest, increased by 12% p.a. over the last four years. Over the next three years it is set to increase by less than 10% p.a. in spite of an additional 2 million beneficiaries. This is partly achieved by holding back on the increases. This year the childrens' grant increases by only R10 or 4,2% - less than inflation. Old age pensioners do a bit better, they get R70 or 6,9%.

Social grants & Infrastructure

Interestingly, after the above increases in grants and grant beneficiaries, the cost of the grants remain constant at about 3,5% of GDP. Effectively the increases in social grants are being paid for from economic growth.

If one adds other social security spending (Unemployment Insurance Fund, Road Accident Fund and the Compensation Funds) the total social security burden on the economy comes to around 5% of GDP.

This compares with total infrastructure spending of around 9,5% of GDP. So for every R1 we spend on social security we spend R1,90 on infrastructure.

It seems to me to be the right balance between short term poverty relief and investment for the future.

The areas of biggest investment are electricity, transport (incl pipelines), water, housing and hospitals.

We should see, in the ten years after the World Cup, a substantial improvement in the country's infrastructure.

Fixed investment

A most interesting table in the Budget Review sets out the annual growth in fixed investment for the fifty years since 1960.

The golden era was the sixties – fixed investment increased by 7,6% p.a. for the ten years of the decade. The lousy period was the 1980s – fixed investment declined by -1,5% p.a. for ten years. Compound -1,5% over ten years and one ends up with a substantial erosion of one's capital base. The 1990s saw a hesitant recovery – 1,7% p.a. for the decade. For the nine years 2000 the number rose to 9,1% - substantially higher than even the golden sixties.

While some worry about Julius Malema the force that will really change the country, fixed investment, has already taken off. The 9.5% of GDP that the public sector will still spend on infrastructure will help this process along.

Paying for tax relief

The minister granted more personal tax relief than generally expected. He granted R7,2 billion and paid for it with a reduction in the travel allowance benefits (R1,8 billion) and an increase of R6,3 billion in indirect taxes (fuel levy, sin taxes and a new green tax on motor vehicles). The balance he spent on businesses with incentives for industrial policy and energy-efficient savings.

This is a continuation of a trend that has been going on for a few years – raise indirect taxes and give relief on direct taxes and, two years ago, company taxes. VAT is politically too sensitive to increase, so rather go for other indirect taxes. A neat finesse.

Where is the downside?

Two issues stand out.

The first is **slower growth** than the minister assumes (2,3% this fiscal year and 3,5% the next two). If there is a "double dip" in the global economy or a sovereign debt crisis that plays havoc with currencies and interest rates, the minister's numbers will not add up.

The second one is SA's **rising debt levels** – from 23% to 44% of GDP in 2015. For perspective, during the currency crisis of 1996 when GEAR was adopted, we stood at 48% of GDP. So by 2015 we can be back close to pre-GEAR levels.

The issue here is the *primary balance*: the difference between revenue and non-interest expenditure. If there is a surplus, one works the debt down, if there is a deficit, the debt feeds on itself. Currently the primary deficit is negative and remains so through 2013. That is why the debt to GDP ratio is almost doubling.

Economics is all about trade-offs and this is in my view the right one – do not raise taxes overall; keep infrastructure spending high; incur more debt. But it does mean that we are sailing close(r) to the wind. The margin for error gets smaller. (That is perhaps why the minister was so keen to warn that taxes *may* rise).

If a little sovereign debt crisis does hit the world, capital markets revolt and long term interest rates do go sky high (like Greece right now), there is no telling who will be punished. Yes, SA's debt load at 44% will be much smaller than many other countries in the G20. But we have also seen over the years that things do not matter till they matter.