Budget 2016

What is different?

SA works with three year budget cycles that are updated twice a year – in February at the time of the main budget and again in October. It is thus useful to compare the numbers now to what was expected in October.

The budget updates us on the likely outcome of the current year, which ends in a month's time on 31 March.

Growth

The big difference in this budget from last October is the lower economic growth rate. In October growth for 2016 was expected to be 1.7% - now 0.9% is expected. For 2017 growth of 2.6% was expected, now it is 1.7%; for 2018 2.8% and 2.4%. These are substantial declines, particularly in the immediate years, and the bottom line is lower tax revenue.

In any case who knows what will happen in 24 or 36 months' time! In the current uncertain climate it is better to treat 2017 and 2018 forecasts cautiously.

As it is, the expected growth rate for the coming year (0.9%) is slightly higher than most private sector economists' forecast(around 0.5%). That may generate questions about the credibility of Treasury's numbers.

The deficit

For the current year (to March) this all-important number will be marginally higher than budgeted in October – 3.9% of GDP rather than 3.8% previously envisaged. This is despite lower tax growth in the past year rendering less tax receipts and indicates the control over expenditure. In my opinion it is hardly a train smash, but the rating agencies may feel differently.

For the coming year (2016/17) the deficit will be 3.2% against the 3.3% envisaged last October. This is despite lower growth and expenditure not budgeted for in October of R11.8 billion, mainly on higher education and SA's contribution to the BRICS Bank. Unforeseen expenditure and less income, but a slightly lower deficit – how come? Other expense items are cut to pay for the "unforeseens" and taxes will increase by R18 billion.

In further years the deficit is expected to decline to 2.8% and 2.4% of GDP, against October's 3.2% and 3%. The smaller deficit in later years, in spite of lower growth, is the result of expenditure cuts from what was budgeted in October and another R15 billion in tax increases in 2018/19.

The main risks to the Treasury's plans are slower growth than forecast; higher inflation due to food inflation and Eskom tariff increases; and the state-owned enterprises needing help. All sounds very familiar.

Where are the cuts?

Three main areas stand out.

Salaries

R25 billion will be cut from salary budgets. Salaries will still increase by 8.5% as per the wage agreement negotiated with unions, but growth in the compensation bill will only be 7.4%. The R25 billion will be cut over two years through the following steps:

- A block on appointments to non-critical posts. Frontline staff like teachers, doctors, nurse and police officers will be excluded from the block. The axe will fall on administrative and managerial staff.
- Appointments will only take place after departments have submitted revised human resource plans which reduce personnel head counts.
- The appointment of contract staff will be limited; and organisational structures will be aligned with budgets.

Reprioritisation

An indication of the budget discipline that exists is that R32 billion of unforeseen spending (expenses not foreseen last October) will be paid for by cutting other expense and re-allocating the money. This is a very powerful tool indicating how much the budget can adjust to changing circumstances.

In the coming year unforeseen expenditure will be R11.8 billion and over the next three years R32 billion. It includes nearly R17 billion for higher education (#Feesmustfall); R11.75 billion for the BRICS bank; R475 million for small business development and R300 million for Planning, Monitoring & Evaluation (of which the Planning Commission is a part).

Against that, R33 billion has been reprioritised: R7.2 billion from salaries (not included in the R25 billion discussed above); R5 billion from goods and services (including R1.6 billion from travel and accommodation and cars bought for political office bearers); nearly R6 billion from transfers to public entities and R1.2 billion from other items. Transfers to provinces and local governments will be cut by R13.6 billion.

Spending efficiency

This is not a headline generating item and it is not politically sexy, but perhaps the most vital step in fiscal management. Steps taken in previous years are beginning to yield results.

The Chief Procurement Officer, an initiative of Mr Gordhan's during his first term as finance minister, is achieving results. Technology is employed to regulate procurement – everybody wanting to do businesses with government must register on a central database, which allows for transparency and tax compliance; centrally negotiated contracts regulating prices are in place, enabling automatic ordering and bulk discounts; use of the eTenders portal will become mandatory. The portal has already published 2 500 tenders worth R35 billion.

Not from the budget, but from the President's reply to the SONA debate: "Statistics show that these procurement reforms are already bearing fruits and are saving the state hundreds of millions of rands. For example, school building designs have been standardized nationally and costed. We will no longer be building schools at costs above thirty million rand." Very practical outcomes.

Government is also holding discussions with its top 100 suppliers to reduce prices; leases are being renegotiated; and Mr Gordhan has set the Chief Procurement Officer the target to save R25 billion from the annual R500 billion procurement budget by 2018/19, some 5%. Serious money and 5% looks like a do-able target.

A Public Procurement Bill is being finalised which will consolidate the fragmented legal and regulatory landscape on public procurement, align procurement with sec 217 of the Constitution and modernise procurement rules. I expect spending efficiency to improve over coming year – rather than going the Nkandla way.

Which taxes?

For the coming year 2016/17 R18.1 billion will be raised from the following:

- Higher income earners will not receive much compensation for "bracket creep" – where one enjoys a higher income and gets pushed into a higher tax bracket, but due to inflation there is no real increase in income, only an increase in the tax one pays. Full relief would have cost R13.1 billion, but only R5.5 billion was given, leaving a net take of about R7.6 billion. This is a tax increase in disguise and is mainly paid by higher income earners.
- The old stalwarts – petrol and sin taxes – will again contribute the bulk of the increase, some R9 billion.
- The plastic bag levy, motor vehicle emissions tax, and incandescent globe levies will be increased; and a new tyre levy to "encourage reuse and recycling" will be introduced. In total this will contribute nearly R0.5 billion.
- Capital gains inclusion rates increase from 33.3% for individuals to 40% and from 66.6% to 80% for companies and trusts. Effectively the tax rate moves from 13.6% for individuals on the top marginal rate to 16.4%; and for trusts from 27.3% to 32.8%. Companies go from an effective rate of 18.6% to 22.4%. This will yield nearly R2 billion.
- Transfer duties on property transfers above R10 million will increase from 11% to 13%, yielding a hardly noticeable R100 million.
- A sugar tax will be introduced in 2017.
- These add up to R19.1 billion from which one must deduct a R1 billion concession for higher medical tax credits, leaving a net increase of R18.1 bil.

Debt to GDP ratio

This all-critical number rises due to the depreciation of the Rand and lower GDP growth. The Rand value of foreign debt has increased by R45 billion due to depreciation. Last October the ratio was projected to stabilise at 45.7% in 2019/20. Now it will already reach 46.2% in 2017/18 – about 0.5% more two years earlier.

Infrastracuture

A most gratifying number is R870 billion over three years for infrastructure programmes. This is 6% of GDP and compares to the 6.2% of GDP which was envisaged last year. It still sits well within the 2% to 4% that emerging markets spend on infrastructure (except China). The minister quoted my favourite economist, Dani Rodrik, as saying that in countries which still grow in spite of the global headwinds, investment was the cause of growth. Clearly this budget tries to do the same. (Glad he reads Rodrik!)

What is not there?

There were no dramatic announcements on privatisation of SOEs, although a very clear statement about "private equity partners"; no statements about retrenchments of civil servants; no dramatic tax changes to spur growth…. Some will feel the budget is not dramatic enough for the dangerous times in which we find ourselves.

The bond market was not impressed with the budget and moved from about 9.11% on the ten year bond to 9.31% - a decline of 20 pts or 0.2%. The currency declined from around R15,20 to R15.63 – about 2.8%. We must see how they react in the coming days.

Also not included were various taxes widely mooted in pre-budget speculation: a wealth tax; increases in dividend or company taxes; increase in VAT; a special hit on high income earners (more than bracket creep discussed above).

It was a very "S'Efrican" budget – balancing act, middle of the road, muddle along.

Will it be enough to keep the ratings agencies at bay? I do not know. They cannot really fault the fiscal numbers, but they may be upset about the low growth. We will see in June.

Beyond the numbers, what about politics?

- The minister clearly signalled that a "minority equity partner" will be sought for a merged SAA and SA Express; and that "effective co-funding arrangements" between the State "and other investors" are required. He specifically denied that it is "privatisation"; maybe, but it looks like the role of the private sector is set to grow.
- He referred to India as an example of a country achieving high growth rates because it pursued structural reform particularly the promotion of skilled immigration, urban investment, labour-intensive manufacturing and agri-processing. Indicative of changes we will see?

So what?

- Economically the minister is between a rock and a hard place and the budget is in my view a good balancing act. Tax increases are not severe; expenditure is manifestly under control with unforeseen items paid for by re-prioritisation; and the big item of salaries is being tackled.
- Unglamorous administrative reforms are improving the efficiency of spending and saving money and will save more in future years.
- Read with the President's State of the Nation speech the door has been opened to tackle state entities and expand the role of the private sector.
- No easy answers, just a systematic plodding along, knowing where you are going.