Tough and credible

More income through higher taxes

As he warned last year already, the finance minister is raising R28 bil from extra taxes: R16 bil from higher income tax; about R7 bil from a higher dividend tax (20% against 15%); and R5 bil from higher indirect taxes on petrol, tobacco and alcohol.

R4.4 bil of extra income tax comes from a new, higher marginal tax of 45% on taxable incomes above R1.5 mil (we expected this measure last year already, but were a year too early); and a net R12 bil from fiscal drag or bracket creep – i.e. where the fiscus collects more by not giving taxpayers relief from inflation. Such relief has been given to lower incomes, putting the pressure on higher income earners. Tax on trusts also rises to 45%.

There is no provision for income from a sugar tax, nor from carbon tax; but government indicated that the sugar tax will be finalised later in the year. When introduced, this will count towards the R15 bil in extra taxes government has warned it would need to raise in 2018.

The obvious losers in this budget are shareholders, who will not like the higher dividend tax of 20%; higher income earners, who are not compensated for inflation; the 100 000 South Africans who have a taxable income of more than R1.5 mil a year; and motorists, who will not enjoy the 39c per litre extra petrol tax. Smokers and drinkers are perennial losers but they are probably used to the annual punishment!

About the only winners are new or smaller home purchasers: the amount free of duty transfer was increased from R750 000 to R900 000, implying a saving of about R15 000 on the cost of a house of R900 000. This will make homeownership of smaller properties, for first-time buyers and people downscaling, a bit more affordable. Of course all South Africans win from more sustainable public finances (more below).

Grip on expenditure

On the expenditure side R11 bil has been cut from the current year's expenditure figure, R10 bil is to be cut from next year's figure (2017/18), and R16 bil in 2018/19.

The cuts are achieved by trimming non-core goods and services budgets, compensation budgets (salaries) and by pushing some expenditure to future years. Compensation budgets are cut by R1.4 billion over three years. On-going procurement reform by the Office of the Chief Procurement Officer has rendered huge savings. There is more reform in the pipeline. Expect the patronage politicians to squeal like hell.

A further R30 billion has been cut from several budgets, but is being spent elsewhere. Higher education gets the bulk of this amount – R16 billion.

How credible the cuts?

Expenditure ceilings were introduced in 2013 and as the name suggests they set a ceiling to be adhered to over the next three years. These ceiling have been adhered to, and in fact bettered, in each and every financial year since then. I am going to write that again: these ceilings have been adhered to, and in fact bettered, each and every year since 2013 – four years now.

This simple fact demolishes the political myths that Treasury does not have the ability to hold the line on expenditure and that populist demands from politicians undermine Treasury's management. It simply has not happened. Clearly the administrative processes, budget management and sufficient political backing exist to keep expenditure within the budget ceilings – in fact to even better them slightly every year.

I am not suggesting for a moment it is not a titanic fight or that Treasury does not have to work hard to hold their corner, but the evidence suggests that they are very successful at the effort. Contrary to what the mythmakers say.

Budget balance and fiscal sustainability

The combination of higher taxes and controlled expenditure will reduce the budget deficit to 3.1% of GDP, from 3.4% this year, and reduce it to less than 3% over the three-year budget period. This is happening in spite of poor economic growth and is no mean achievement.

Of particular importance is the **primary balance** – the difference between income and expenditure before any interest payments. The cuts in expenditure and increases in taxes of the last few years have reduced the primary balance from -1.6% of GDP in 2013 to -0.5% in the current year to -0.1% for the coming year and it is now estimated to go into surplus (0.2%) next year. It is an important measurement of a country's long term sustainability.

Overall government debt is now 50.7% of GDP and set to decline to less than 50% of GDP over the next three years.

These numbers should calm the ratings agencies and will certainly help to avoid a downgrade *sans* any funny political moves. This makes all South Africans winners from the budget, even if they pay higher taxes.

Infrastructure

Critical for SA's economic and social development is more infrastructure. Over the last 17 years public sector infrastructure spending reached R2.5 trillion – about half of which was spent by SOEs. Over the next three years almost another R1 trillion will be spent on infrastructure – R947.2 billion to be exact. This amounts to more than 6% of GDP, a healthy ratio when compared to the 4% to 6% range of emerging economies.

An interesting feature of the spending is that Treasury regulations have been changed to compel 8% of infrastructure spend to go towards maintenance. Infrastructure is not just about having new stuff, keeping the old stuff in good nick is equally important.

Growth

The budget foresees a slow improvement in economic growth from an expected 0.5% in 2016/17 (still to be confirmed) to 2% by 2019/20. It effectively means that SA would have had stagnant or declining per capita incomes for a period of 4 years – from 2014 to 2017. Growth will only exceed population growth again by 2018. One can call it "austerity lite".

From a growth perspective an increase in dividend tax is preferable to an increase in company tax. This is in line with the minister's promise last year when he warned about raising the extra R28 bil – it will not undermine growth, which a rise in company tax would do.

The budget and politics

Radical economic transformation

The opening statement of the Budget Review reads "SA needs transformation that opens a path to inclusive economic growth and development. Growth without transformation would only reinforce (inequality) inherited from the past. Transformation without economic growth would be narrow and unsustainable." The Treasury clearly disagrees with the commentator who complained that Mr Gordhan used the word transformation "fifty times" in his speech.

Minister Gordhan's speech indeed closely followed the theme of "radical economic transformation" which Mr Zuma has been punting. In some respects they shared the same thrust, for example in arguing that state procurement should be used to promote small business and emphasising that wider participation in the economy must be effected. On inclusion and opening up opportunities they certainly agree.

But whereas Mr Zuma emphasised Black ownership of the economy, Mr Gordhan emphasised investment "in social capabilities through better outcomes in health and education and skills development and through more inclusive and responsive institutions". He also emphasised that sound public finances is part and parcel of a transformation path.

There is a difference between the two nuances and both viewpoints reside in the ANC. Expect the different nuances to be emphasised by different groups as part of the on-going infighting in the ANC.

Popular people

It was noticeable that both Mr Gordhan and his deputy got enthusiastic receptions from the House; even the EFF got to their feet and applauded loudly. It was in contrast to some in the ANC benches who did not stand to applaud. An ANC twitterer pointed to them as "the captured ones". Despite the seated ones it is clear that minister Gordhan, unlike his predecessor Mr Nene, has built up an independent political base in and outside the ANC. Removing him would be difficult and costly, also to the ANC itself.

A novel incident during the budget session was a praise singer who got up in the public gallery to sing Mr Gordhan's praises. Whoever organised it, it is quite an endorsement by the traditionalists of a modernist finance minister. Perhaps the patronage politicians do not have the hold on the traditionalists they thought…?

So what?

- National Treasury has for several years now been successful in keeping expenditure by departments and provinces within pre-determined expenditure ceilings, despite political pressures and noise.
- Through a combination of this spending discipline and tax increases the primary balance is swinging back into surplus, reinforcing the long-term sustainability of SA's public finances.

- These achievements should really be enough to avoid a downgrade and retain SA's investment grade status (provided there are no political funnies).
- Infrastructure spending remains above 6% of GDP and is set to reach nearly R1 trillion over three years. This is quietly expanding SA's infrastructure base, laying the foundation for future growth and socio-economic progress.
- For the medium term, however, SA is in a phase of "austerity lite": higher taxes, constrained spending, stagnating per capita incomes. Only economic growth can relieve this pressure and that will only come by 2019 or so. We will thus go into the 2019 election with a population which has experienced five years of "austerity lite" – watch this space.