Budget 2009

Growth rate: predictions, guestimates and credibility

The budget provides for growth of 1,2% this year, 3% in 2010 and 4% in 2011. It is impossible to make a call about 2010 and 2011, as the global crisis is still unfolding. How credible are the numbers for 2009?

The minister assumes that household consumption (62% of the economy) will decline this year. Given the tax relief which has been announced and declining interest rates, both of which will stimulate household spending, this is a conservative assumption. He is probably keeping the numbers conservative to provide for job losses.

Both imports and exports are budgeted to decline. Essentially the minister is betting on growth from government consumption spending and higher investment. Given the increase in these two items, the numbers strike me as prudent.

But these are uncertain times and we will have to watch events as they unfold.

Real credibility test in 2010 and 2011

The minister has budgeted for a deficit of 3,8% of GDP in the coming year, up from the 1% deficit in the current year and a reverse of the surpluses run over the previous three years. By recent standards a 3,8% deficit is high. However, the capital market (where most of the money will be borrowed) seems to be taking it in its stride.

The minister has budgeted for the deficit to decline to 3,2% in 2010 and 1,9% in 2011. That will be the real test. He has an ace up his sleeve in Eskom funding. If that is not repeated after 2010, deficit reduction will be easier.

Reducing deficits is of course a test that awaits all decision-makers in the world – authorities are currently throwing fantastic amounts of money at the global crisis. Will they have the guts to pull back when required? We will only know the answer in two or three years' time. At least here at home Minister Manuel has produced a road map back to fiscal probity. That is much more than many other countries can claim.

Extra spending – where is it going?

Total government spending is budgeted to rise by a whopping R113 billion or 16% this year. This will of course help drive the 1,2% growth the minister expects for 2009/2010.

By far the biggest increase in spending is an innocent sounding item, "*economic services"*, which increases by R53 billion or 42%. The bulk goes to Eskom to build new power stations, with the Gautrain (R4,2 billion) and SAA (R1,56 billion) sharing in some of the spoils. A total of R60 billion is going to Eskom over the three years ending in 2010.

The remaining R60 billion of this year's increase in expenditure will go to (in descending order) *education*, *social protection* (i.e. social allowances), *housing & community amenities*, *crime/criminal justice*, and *health,* with a contingency reserve of R6 billion.

The item *community amenities* includes R1 billion to install or rehabilitate 71 bulk water and sanitation schemes. Water is moving onto the radar screen.

Infrastructure spending

The single biggest increase over the next 3 years is infrastructure spending, which grows by R94 billion. Total infrastructure spending by the public sector will now amount to R787 billion over three years (up from R693 billion) or an astonishing 9,6% of GDP. This compares to the 8% of GDP the minister foresaw as recently as October 2008 when he presented his mini-budget. He is clearly pushing the envelope on infrastructure spending.

Social welfare vs Investment

In this budget total social spending, including UIF (Unemployment Insurance Fund), the Road Accident Fund, various compensation funds and the 13 million allowances paid every month, comes to 4,8% of GDP. Four years ago, in 2005/06, that figure was 4,6%. Social welfare is largely paid for from economic growth.

Compare that to the 9,6% of GDP that the public sector is spending on infrastructure. For every R1 from the public purse that goes to welfare, R2 goes to investment.

It is also interesting to note that the 3,8% deficit amounts to R94 billion. Yet R61 billion is spent on the acquisition of capital assets. The Eskom loan (which is effectively also for the acquisition of assets, i.e. new power stations) comes to R30 billion. Thus R91 billion of the R94 billion deficit is spent on capital assets.

It effectively means that all SA's current expenditure, including interest payments, are covered by current income. The deficit, or money being borrowed, covers the acquisition of capital assets.

It seems to me the balance between poverty relief today and investment for tomorrow is satisfactory.

There is a populist argument going around that "5,5 million taxpayers cannot pay for 13 million welfare beneficiaries". Nice line, but two facts contradict it: personal income tax is paid by 9 million taxpayers; and personal income tax contributes only 35% of total taxes. (See paragraph below on indirect taxes.)

Jobs

The budget clearly supports the view that job creation is not a goal in itself, but the result of continued growth and better infrastructure, both of which are important features of the budget. Furthermore, the very successful Public Works Programme will get an addition R4,1 billion (precisely the amount Manuel provided for last October in the mini-budget).

From personal to indirect taxes

The most interesting part of the political economy of this budget is the re-configuration of taxes.

Personal income taxes decline by R13,5 billion, essentially relief from inflation. Yet indirect taxes are up by almost R10 billion. So one pays for the other. The biggest part of the increase is the fuel levy. Taxes now make up about 1/3 of the pump price of petrol. (Next time graciously make way for that taxi, they are wonderful tax collectors!)

From this year on, about one quarter (23%) of the petrol levy will go to metro municipalities as an extra source of income. Thus, the taxis have now become local government taxpayers!

Increasing indirect taxes to pay for direct tax relief continues a trend seen in the last few years – last year the 1% cut in company tax was almost fully paid for by the increase in indirect taxes.

VAT, the petrol levy, sin taxes and the new electricity levy make up 35% of total tax revenue. Personal income taxes come to 32% and company taxes (including STC and skills levy) 29%. The rest comes from property taxes (estate & transfer duties) and user charges.

South Africa now has about 9,3 million individual taxpayers. 5,3 million are registered and assessed. A further 4 million are not assessed, but pay tax under the SITE system. The number of registered tax payers has been growing at about 9% p.a. in recent years.

About 1,5 million companies and nearly 400 000 trusts are registered for tax, and 740 000 vendors for VAT. The latter figure has increased by almost 50% over the last 6 years.

Many governments are too scared to go down the route of indirect taxes. The examples range from the US with high oil consumption and a complete resistance to a tax on petrol, to struggling third world countries that do not want to introduce VAT. SA, on the other hand, has now gone quite far down this road.

So What?

The ANC’s election manifesto calls for an increase in the ratio of investment to GDP. That has certainly happened in this budget. The manifesto also calls for a stimulus package – the announced tax relief combined with higher infrastructure spending and declining interest rates certainly deliver on that. Lastly, four of the five priorities in the manifesto got substantially more money: crime, health, education and jobs. It is only at land/agricultural reform where the increase is more pedestrian – R1,8 billion over 3 years.

One can certainly reconcile the budget with the ANC election manifesto. More importantly, the budget can be reconciled with fiscal probity and sound economic policy. That should bring some stability in the political economy.

With a 3,8% deficit Manuel is pushing the envelope as far as he can to keep growth going. Now we'll have to see how the depression in the developed world impacts on us.