POLICY ISSUES

5 November 1999

Missed opportunity

Government has missed an opportunity to go for a fiscal policy that will contribute to growth and job creation. It announced last week that it plans to keep the Budget deficit at between 2.7% and 2.4% of GDP over the next three years. It should rather have aimed at achieving a balanced Budget by the end of Parliament's term.

Government deserves praise for its remarkable progress in reducing the deficit, now 2.8% of GDP, down from 7.3% in 1993. It is also below the target of 3% set in 1996; a record of which it can be proud.

But the deficit should be reduced further for four reasons.

Firstly, Budget deficits consume the nation's savings, leaving less money for investment and economic growth. Current savings are 14% - 15% of GDP, far short of the 25% of GDP needed for unemployment-beating growth.

Government dissaving, as a result of deficit spending, amounts to more than 3% of GDP. Eliminate that and savings would be 3% closer to the desired 25%. Higher savings would make room for lower interest rates, which would in turn boost growth.

SA does not have an economic crisis, but it certainly has a jobs crisis. Social spending (the main argument for deficit spending) will not create jobs. Only sustainable growth will do so. And growth depends on savings and investment. More savings as a result of a balanced Budget support a scenario of higher growth and more jobs.

Secondly, the missed opportunity is all the more disappointing because several factors are combining to make deficit cuts easier. Growth is poised to average 3% over the next few years. It is better than the 2% we had to live with since the mid-Seventies. Part of that extra growth can be used to further reduce the deficit.

Also, more that 55% of total State expenditure is spent on interest and salaries. On both counts, the Mbeki Government has taken action to improve matters. Privatisation is ready to accelerate. The proceeds from this will repay debt and reduce interest payments. The civil service is also primed for re-structing - which could keep a lid on the salary bill. Curtailing those two items will create space for deficit cutting.

Consequently, there's an opportunity to reduce the deficit. We should do so.

Thirdly, there is the bigger picture. Developing countries like SA are reducing deficits. Argentina has just passed legislation to have a balanced budget by 2003. Brazil's government is striving mightily to reduce that country's deficit, though a rebellious parliament is not really co-operating (SA does not have this problem!) Social democrats in the UK are running Budget surpluses and efforts are under way to reduce Germany's deficit. The world is moving towards balanced budgets. So should SA.

Fourthly, a balanced Budget will provide Government with spare ammunition. Deficit spending can be used to stimulate growth when the economic cycle turns negative.

However, it is difficult to do that if the deficit is already at 2.4%. Once can do it by moving from a balanced Budget to say a 2% deficit. Staying at 2.4% means we have no ammunition with which to fight an economic downturn.

A balanced Budget will help launch SA on a virtuous cycle of lower interest rates, more capital formation, higher growth and more jobs. Carpe diem.

Originally published:
Finance Week - Comment
5 November 1999

POLICY ISSUES

12 November 1999

The cost of slow change

A discrepancy has emerged between Government's restructuring of the economy and the labour market.

On the larger economic front, privatisation has accelerated since June, with 20% of SAA sold and the full privatisation of Safcol under way. A R8b privatisation deal between Denel and British Aerospace is in the offing.

Management contracts for Alexcor and Aventura have been concluded with private companies: once these organisations turn profitable, they should fetch much more in a sell-off. And bigger portions of Telkom will be sold by mid-2000.

The Finance Ministry has restored fiscal discipline while Trade & Industry is opening the economy, boosting productivity. Not a bad record.

In the labour market, however, restructuring has been much more timid.

Last week, the Labour Minister announced modest exemptions that will bring relief to businesses employing fewer than 10 people. Those who employ more will not benefit; yet it is investment by these businesses that will determine growth and job creation.

Investment in guest houses, spaza shops and other small businesses is well and good. But they are unlikely to provide the investment equal to 25% of GDP that is needed to beat unemployment. Investments in larger projects are what will drive growth and job creation.

There's overwhelming evidence that people view labour market regulation as a key obstacle to investment. Last week's announcement did not address this.

Two crucial issues remain: wage setting and inflexibility over dismissals.

Wages are set through centralised bargaining and industry-wide determination. These processes are unwieldy and do not fully take into account the specific conditions of individual enterprises.

Moreover, centralised bargaining groups workers from dissimilar industries with varying skills requirements and different profit margins together in the same bargaining units.

Bargaining should be more closely linked to the income statements of particular businesses. That means more enterprise-based bargaining. It also implies that the current practice of extending agreements to non-parties should be curtailed.

Developed countries like Britain and Germany have introduced several regimens to make the dismissal of non-performing employees easier. This reduces the cost of getting rid of poor performers and so increases the propensity to employ new workers.

SA needs investment to achieve growth and create jobs. Many factors influence investment, not just labour laws. Some of these (crime, Aids and the lack of skills) cannot be solved in the short term. Others can be tackled relatively easily - opening the economy, privatising, maintaining fiscal discipline and amending labour laws. We must change what we can to make up for what we cannot.

Labour laws, by scaring away investors, join crime, Aids and the lack of skills to erect a formidable barrier to investment, growth and job creation. That is the true cost of timidity with labour law reform.

Originally published:
Finance Week - Comment

12 November 1999

POLICY ISSUES

4 February 2000

High transaction costs a curse

A Texas oil magnate once said "a billion here, a billion there and before you know it, you'll be talking real money". The same goes for transaction costs in the economy. In isolation, the cost of a telephone call, the price of a litre of petrol or the fees of banking services should not break the camel's back. But add them all together and you'll have something to cry about.

Companies that need to compete internationally find that transaction costs have a severe impact on their cost structures. Small business also suffers, causing this vital sector of the economy to grow much more slowly than would otherwise have been the case. The disposable income of families is squeezed and their living standards drop. This in turn has a shrinking effect on thousands of businesses. In other words, there's a domino effect.

That's why we welcome Government's decision to remove the equalisation fund levy from the petrol prices. This means an immediate reduction in the petrol price.

Telkom would do well to subscribe to the same cost-saving drive. Telkom's monopoly is driving transaction costs sky-high. Telecommunications, like petrol, is a basic commodity, causing costs of "a billion here, a billion there" in the rest of the economy. The ripple effect extends far beyond mere telephone costs.

The most vital business medium of the new age, the Internet, is dependent on telecommunications infrastructure. Excessive costs in this arena simply exclude more people and businesses from the Net.

The evidence worldwide is overwhelming. Success will be enjoyed by those countries and businesses linked to the Internet. People are being excluded from participation thanks to Telkom's antics.

The argument that Telkom should remain in State hands to provide socio-economic services to the poor does not hold water. There are better options. For instance, Parliament could authorise a subsidy for families in need so that they could have telephone services, along the same lines as subsidies for low-cost housing. Or telephone companies could be forced by licensing conditions to provide socio-economic services to the poor. This strategy succeeded in India with the privatisation of electricity services.

In any event, experience elsewhere has shown that competition leads to an extension of infrastructure in the quest to reach, and profit from, dealings with ever-greater numbers of people. The cellphone industry reflects this principle at work in SA; initially regarded as rich men's toys, cellphones now enjoy widespread use.

Such options are much less costly than the "billion here, billion there" approach synonymous with high transaction costs. The Telkom monopoly must be terminated so that cheaper services can be extended to more people.

Originally published:
Finance Week - Comment

4 February 2000

POLICY ISSUES

24 March 2000

Telkom's monopoly trips up SA

The infrastructure of the 20th Century revolved around decent roads, proper ports, well run airports and reliable railways. Telecommunications is the infrastructure that is needed for development and growth in the 21st Century.

Either you are "wired" to the world or you are marginalised. And to be wired you are wholly dependent on cheap and efficient telecommunications.

That cannot be achieved while Telkom's monopoly lasts - it's due to expire only in 2002 with a chance of it being extended to 2003. Telkom's monopoly undermines the development of the infrastructure needed for the 21st Century.

In many cities worldwide, from Hong Kong to Boston, local telephone calls are free. That means you can connect to the Internet free. In SA, local charges have been increased to make up for lower charges on international calls (where competition has forced Telkom to cut its prices).

Furthermore, in a growing number of countries Internet services are provided free. In this country, these services are still beyond the reach of most South Africans - creating a new class of haves and have-nots.

Lastly, as our cover story indicates, the lack of bandwidth supplied by Telkom is clearly an obstacle to making our industries more competitive.

Supporters of the monopoly will no doubt argue that its purpose is to ensure the delivery of basic telephone services to the previously disadvantaged and rural poor. That is a laudable goal and we support it. However, better mechanisms than granting a monopoly exist to achieve such goals. For instance, all telecommunications suppliers can be obliged to minimum social delivery targets much the way Telkom has been obliged to meet such targets.

The way of the current impasse is a three-pronged process. Firstly, award a second landline telephone licence as quickly as possible. The aim must be to have a second operator up and running the minute Telkom's monopoly expires in 2002.

Secondly, to ensure a monopoly is not replaced by a duopoly, telecommunications must be deregulated to allow new players, technology and investments. If, for example, a large bank or insurance company has more infrastructure than it needs, it should be allowed to offer this on the market.

Thirdly, Government should extricate itself from Telkom by listing the utility and reducing it shareholding substantially. These measures will subject Telkom to commercial and financial market pressures. Then the scene will be set for SA to become wired for the 21st Century.

Originally published:
Finance Week - Comment
24 March 2000

POLICY ISSUES

21 July 2000

The three deficits

Budget deficit became part of the SA vocabulary after 1996 when Government committed itself to reducing it to 3% of GDP. That has since been achieved (it is now around 2.5% of GDP) and a new target has been set: a deficit that will result in zero Government dissaving, to be attained by 2001. That implies a deficit of 2% of GDP.

Cosatu resisted the push for a lower budget deficit by introducing the concept of a social deficit, referring to the huge backlogs in education, health services and high levels of poverty in general. It used the social deficit as argument that the Budget deficit should be allowed to go much higher.

Clearly, Government has not paid too much attention. Rather it is taking the alternative route of tackling the social deficit through economic growth and investment.

It is becoming clear, however, that SA suffers from a third deficit - an efficiency one. SA's spending on education is among the highest in the world for its income category. It spends 8% of GDP on education - 60% more than the world average. Yet its children are rated bottom of the class on maths and science competencies. Only 8% of children who start school finish with a matric exemption. Only half of those who get to matric actually pass it.

Money is clearly not the problem. Much poorer countries in Africa are doing better. The problem is the efficiency of that spending.

Likewise, SA's spending on health services is ranked 151 out of 191 in the world, but is rated 175th in terms of overall efficiency. Huge amounts are spent on medicines, many of which simply disappear from the public health system.

Only better and more efficient management will cure this efficiency deficit. But more efficient management cannot come about in inefficient structures. No manager worth is salt will work in an environment where he or she cannot control reward and remuneration, where there is virtually total labour inflexibility and where there is no reward for efficiency gains.

The structure of the public service itself must be changed.

Successful change was achieved with the conversation of the Receiver of Revenue from a State department to an independent management entity. Tax collection improved dramatically; partly paving the way for a reduced budget deficit.

Similar models can be explored for health and education. Grants for each child can enhance efficiencies in education and improve school conditions for millions of children.

Many functions in public hospitals can be run by public-private partnerships, which are guaranteed to improve efficiencies.

Now that the Budget deficit is under control, the social deficit must be resolved, at least in part, by tackling the efficiency deficit. The best way to do that is to change the public service structure.

Originally published:
Finance Week - Comment

21 July 2000

POLICY ISSUES

22 September 2000

Limit petrol increases

Diesel looks likely to go up by at lest 35c/litre in October - the amount of price under-recovery at the pumps. The cost is determined by various factors, of which world crude prices and the rand-dollar exchange rate are perhaps most important.

Above all, though, profit margins for local distributors and retailers are fixed to guarantee them a minimum return on their investments. No other business in SA has the privilege of getting a fixed price for its products and a guaranteed minimum return on capital.

The system served SA well in the past six years. And it is certainly an improvement on the one it replaced. Fuel has always been available, and price increases have been small and manageable.

But the system bears no relation to supply and demand. It ignores market forces and places an extra cost burden on the economy.

The principle of price fixing harks back to the agricultural control boards where the bigger the surplus, the more local prices rose to subsidise loss-making exports.

This is what happened in the first six months of the year. About 550m litres of diesel - 20% of SA's production - were exported in the first six months at under 120c/litre. Yet the local price is well on its way to 350c/litre.

Considering nearly half of its liquid fuel requirements come from its own resources, which were developed largely using taxpayers' money, the pending 35c/litre increase looks all the more unacceptable.

The mess can be fixed only by deregulating the industry and allowing free market forces to take effect. The minister's argument that job losses would result and therefore regulation has to stay simply isn't good enough.

As with any restructuring, job losses are unavoidable - but so are guarantees of higher productivity, growth, and the job opportunities elsewhere in the economy. After all, this is the logic behind Government's restructuring of public corporations. What applies to them also holds for fuel and its pricing.

If the current oil crises make SA change to a more rational system of fuel pricing, some good will have come of it.

Originally published:
Finance Week
22 September 2000