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The 2015 Budget

1. Introduction

Finance Minister Nhlanhla Nene released his first budget on February 25th. The Democratic Alliance criticised it, saying that the tax increases it contains would not be necessary if government spent more prudently. The EFF attacked the budget from the left, calling it "in the interest of foreign investment and the protection of private monopoly capital gains."[1] From civil society the left-wing United Front marched on Parliament, demanding a pro-poor, "anti-rich" budget.[2]

Media reaction was mixed, with some newspapers describing it as reasonable or "a mixed bag"[3] and others bemoaning the tax increases. The *Times* was particularly alarmist, plastering the front page of its next edition with a massive (and mendacious) headline proclaiming that South Africans were being "Taxed to Death".[4]

In sorting through these conflicting opinions it is worth beginning with a discussion of the problem of sovereign debt and the fiscal deficit before evaluating the details of some important elements of the budget.

2. Deficits and Debt

A fiscal deficit is the amount of money that the government spends beyond its total revenue. In effect, this is the annual amount of debt incurred by the government. Increases in the deficit add to the national (or public) debt, which is the cumulative amount of debt built up by the government. Carrying some national debt is perfectly normal, and can be quite prudent. Investing in long term infrastructure development or essential short-term payments can be a wise decision. Debt is not automatically bad, and reasonable debt levels can be quite acceptable.

However, an excessively large amount of debt is dangerous. It costs money to service debt. Some of that debt must be paid off, and the greater the debt, the greater the amount that needs to be paid off as it comes due. This expenditure on debt means that a greater slice of government revenues must go to paying off debt, as opposed to paying for new infrastructure or giving grants to the poor or paying police salaries, and so on.

This problem is exacerbated by the fact that interest rates on new debt – the cost of borrowing tend to rise as debt levels rise. Essentially, as governments become more indebted, financial institutions become nervous and will only lend to them at higher interest rates. International ratings agencies, such as Moody's and Standard & Poor, periodically issue statements about the creditworthiness of governments and major corporations. Worse ratings mean that creditors are less likely to lend money (through the purchase of bonds). Indeed, many creditors – pension funds and the like – are prohibited by their internal regulations from buying sub-investment grade or 'junk' bonds.

South Africa has come under serious pressure as a result of international credit rating agencies downgrading our credit worthiness to about one notch above 'junk'. By comparison, Finland is universally rated AAA, or an extremely good credit risk. Botswana generally is a couple of notches above South Africa, and Italy is rated a notch below by most agencies. Ukraine is universally far, far worse off than South Africa.

These issues surrounding credit worthiness and credit ratings highlight the main problem with populist calls for massive deficit spending to finance social programmes. Running up more debt could assist the poor now, but in the long run the government would be severely hampered by its inability to raise money in the future, and by the

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crippling burden of interest payments that would eat up government revenue.

A more nuanced left wing perspective would involve raising taxes on major corporations and the 'super wealthy' in order to fund an increase in social spending. This is usually countered with claims that such taxes would result in corporations moving offshore, and in wealthy individuals going to even greater lengths to shelter their incomes in tax havens and the like. Without delving into this debate, South African fiscal policy has been dominated by orthodox economics, and will likely remain so for the foreseeable future.

3. Debt to GDP

The debt to GDP ratio is often used as a way of evaluating the amount of debt owed by a country. If the Gross Domestic Product (the total value of all goods and services produced in the economy in a year) is R1 trillion, and government debt is R500 billion, then debt to GDP is 50%. This is a useful, but not entirely comprehensive measure intended to allow for apples to apples comparisons between countries. If Switzerland and France have similar debts, but the French economy is 4 times larger, then France is in a better position, because the government will presumably have more ways of raising revenue in the future in order to pay off these debts.

Currently, South African debt to GDP stands at approximately 42%. This is low when compared to many developed nations, such as Germany (80%), Greece (175%) and Japan (over 200%)[5].

However, developing countries tend to be less able to sustain higher debt to GDP ratios. This is because credit ratings take into account factors other than debt to GDP ratios, such as economic and political stability, levels of corruption, and governance issues. In effect, developed countries can carry more debt without alarming international creditors because they are seen as safer long-term prospects. 40% is seen as a reasonable debt-to-GDP ratio for developing countries, and South Africa is currently hovering just above this level. However, when we look at it in rand terms the effect of such debt levels is clear – we spend R150 billion a year, *or R410 million every day*, in interest on our national debt.

4. What This Means for South Africa

When we keep these concepts in mind, it is clear why Minister Nene has been forced to raise taxes and to keep spending throttled back. Given South Africa's economic woes – from the external economic climate, but also from our regular power cuts and other internal problems – Minister Nene has very few avenues for responsibly expanding spending. He cannot risk damaging South Africa's future prosperity for short-term gains.

More aggressive spending might have been acceptable if the economy was growing at a decent rate, since a faster growing economy results in higher tax revenues. However, economic growth is mediocre, hampered by the electricity shortage and wage disputes, and there is little reason to believe that the electricity crisis will be comprehensively dealt with in the near future.

If more money is needed by the government, and the only reliable way to raise it without increasing debt is through raising taxes. Consequently, we come to the current budget. If one were to sum this budget up in one word, 'constraint' would be a good one. Minister Nene had limited options, and he could not give everyone everything they wanted – or even needed.

5. Taxes

The aspect of the Budget that has received the most national attention is the increase in taxes, largely via an increase in personal income tax aimed at the middle and upper classes. Tax will increase by approximately 1% for people making more than R181 900 per year. However, for people who earn less than about R400 000, this increase will be offset by adjusting tax brackets, as well as by rebates on retirement annuities and the like.

The fuel levy has been dramatically increased, by 80.5 cents per litre. Of this, approximately 30 cents will go to general revenue, while the remaining 50 cents will go to the Road Accident Fund, which has accumulated a large amount of liabilities (claims or potential claims) while not increasing its assets by enough to cover these demands.

Despite much speculation in the lead up to the Budget, an increase in Value Added Tax (VAT) was avoided, and probably rightly so. VAT is a highly regressive tax, in that it has a disproportional effect on poorer people – almost everything on the market has VAT attached, and this includes necessities that the poor pay for. Removing VAT on additional items in order to offset this effect would probably have undermined the entire exercise of increasing VAT, and just served to muddy the tax waters.

As usual, sin taxes have gone up. While this is a useful way of earning revenue, it should be remembered that 'grey' imports – particularly of cigarettes – become a better business proposition the higher the taxes are. Very high sin taxes increase the incentive to evade them through smuggling the goods into the country.

Complaints about tax increases are somewhat justified, given that levels of government waste and corruption are a very real problem. However, this is the first direct income tax increase[6] in 20 years, it has been done in a fairly progressive fashion, and the revenue is needed. Minister Nene cannot single-handedly abolish corruption, but he can raise the revenue to fund essential government functions, and keep the country on a stable financial footing.

6. Eskom

One of the key national questions that has not been entirely answered by the Budget is the crisis at Eskom. The government has agreed to bail Eskom out, with some R23 billion of funding, and Mr Nene indicated that the government will sell off 'non-strategic' assets in order to fund this bailout; however, what exactly these assets will be is unclear. Cabinet has given its approval to this process[7], and apparently a review of this issue has been instituted in order to decide which assets should be sold off. More details on this scheme are needed for an informed debate over this kind of privatization. The country cannot afford an overly long and protracted contestation over this topic while Eskom continues to bleed cash.

7. The Public Wage Bill

Another issue that the government has not seriously addressed is the amount spent on public sector wages. Approximately 40% of government non-interest spending – that is, spending that does not include paying off debts – is on the wages of government officials, civil servants, teachers, policemen and other state employees[8]. Minister Nene appealed to civil servants to be patient and understanding in their wage negotiations, but such appeals are unlikely to bear fruit, given that unions are already demanding a 15% increase. In any event, Minister Nene did not send any clear, firm signals on how government spending in this sector could be curtailed.

This is extremely worrying, given that government is clearly in a situation where it does not have additional money to spend. Given the relatively poor performance of many government departments, the fact that the middle class is paying more, and that fact that the poor are still receiving mediocre services in many sectors, it is hard to see how spending additional money on the civil service can be justified.

Unfortunately, at the beginning of 2014 Cabinet and other top government officials took a 5% salary increase. This was against the advice of the Independent Commission for the Remuneration of Public Office Bearers, who recommended no pay rises for anyone in government who earned more than R1 million per year. At the beginning of 2015 they received a similar increase, this time in line with the Commission's recommendations.[9]

5% per annum may not seem to be a lot, but for someone making R1 million per year a 5% increase is an additional R50 000. Additionally, the Cabinet has expanded dramatically in size under President Jacob Zuma, with 35 ministries, some of which have two deputy-ministers, resulting in much higher costs than during previous administrations. This kind of expenditure at the top of government has eroded much of the moral high ground that the executive might have relied on during wage negotiations with civil servants.

8. Social Spending and Social Grants

Social grants have not increased in real terms. Without going over the different amounts, it is worth noting that the increases were at or slightly below inflation. Indeed, because the Consumer Price Index[10] is known to understate how seriously inflation affects poor people, since it does not adequately capture how seriously the poor are affected by food and transport prices, the real position is that recipients of social grants will be getting considerably less this year than last.

It appears that Treasury has little appetite for increasing spending on social grants. Generally, it is safe to say that current rate of spending on social grants is sustainable, absent any major

economic shocks, but that increasing them significantly is not seen as financially viable.
Social spending – that is, the total spending on social issues, including health, education and the like – has increased by 2% in real terms, which is small, but probably all that can be hoped for in the current fiscal situation.

Minister Nene indicated that a funding paper for the National Health Insurance scheme will be released sometime this year, alongside the NHI's White Paper. While it is hard to see where the finances for this endeavour will come from, without seeing the paper it is too early to make any solid judgements on the matter.

9. Conclusion: Value for Money

Mr Nene made it very clear that the government needs to curtail its spending. He talked about improving supply chain management in education, and maintaining a tight grip on government spending on non-core functions, such as events, marketing and consultancies. His message was plain and direct, and should be appreciated. The Minister has done about as well as could be expected with the resources at his disposal and the demands that need to be met.

Whether government will follow through on this remains to be seen. A genuine commitment to efficiency, cutting waste and corruption, and providing better services is needed from government. Various initiatives to support the economy have been put forward, but vigorous implementation is essential.

The economy is like a ship that continues to take on water, and there are deep, fundamental problems with government performance in areas such as service-delivery, education, hospitals, public transport, and job-creation, all of which have been exhaustively and thoroughly documented. In this latest budget the government intends on spending *over R1 trillion* of the South African people's money. Will they get value for that money, or will they continue to receive failing schools, a weak public service, corruption scandals and shoddy houses?

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[1] http://effighters.org.za/eff-statement-on-the-2015-budget-statement-by-minister-nhanhla-nene/
[2] http://mg.co.za/article/2015-02-25-united-front-demand-a-peoples-budget
[3] *The New Age*, 25 Feb 2015
[4] 26 February 2015
[5] Figures are approximate, and are taken from both the International Monetary Fund and the CIA World Factbook.
[6] Until now increases in tax revenue have been accomplished through broadening the tax base and through indirect taxation.
[7] http://www.iol.co.za/news/politics/sale-of-soes-could-help-finance-eskom-1.1825219#.VPg_RvmUeAU
[8] http://www.timeslive.co.za/politics/2015/02/25/public-wage-bill-to-remain-at-around-40-of-government-spending-budget2015
[9] For a summary of the latest numbers, see http://www.citypress.co.za/politics/zuma-public-office-bearers-salary-hikes-approved/. For the older remuneration determinations, see the Commission's website: http://www.remcommission.gov.za/pebble.asp?relid=4381
[10] CPIX is a measure for inflation derived by tracking the prices of a 'basket' of various consumer goods, including higher end products that poor people typically do not purchase.