The Macroeconomics of Budget Justice

The neoliberal view

- There is no alternative to globalization.
- To compete in the global economy, national governments need to make their economies as competitive as possible.
- States and the public sector are inefficient. They must get out of the way and let the free market allocate resources in the most efficient way possible.

The neoliberal view

- This means liberalization and de-regulation (of trade, the financial sector etc).
- It means privatization.
- It means state austerity: keep taxation to a minimum and attempt to keep a balance budget.
- “Budget *Justice*” is an anathema to most mainstream economists.

The argument for austerity

- With globalization capital and people are highly mobile. Raising taxes will simply chase capital abroad.

- Government is like a household: if you live beyond your means your debt burden will grow and pretty soon you will not be able to make your interest payments and will have to default.

BUT: Government is not like a household!

- The spending decisions of a single household have no effect on the macroeconomy. Government expenditure typically makes up 30% of GDP.

Deficits and growth

- Government spending drives up aggregate demand. The increase in demand can lead to an increase in investment, employment and incomes. Higher incomes lead to greater tax revenue for the government.
- What matters therefore is not the absolute size of the debt but the *relative* size
- As long as the economy is growing sufficiently, debt will not become unsustainable.

What debt/GDP ratio is sustainable?

- There is no consensus on this.
- Japan's debt:GDP is around 215%.
- Many capitalist economies have had even higher debt:GDP during their most prodigious periods of growth.
- The US, Greece and Portugal's is around 100%.
- Reinhart/Rogoff scandal – in fact no evidence for a "90% threshold".

Crowding out?

- Neoliberals argue that increased deficit spending will not increase growth because it will simply lead to a higher interest rate.
- The higher interest rate will "crowd-out" private investment.
- But the interest rate will only increase in response to greater spending if the economy is at or near full capacity.
- The normal situation is capitalist economies is far below full capacity (especially in South Africa, with 36% unemployment).
- Capitalism is, by and large, a demand constrained system.

Deficits and inflation targeting

- This also assumes that is committed and able to effect a constant money supply.
- If the money supply is "endogenous" created by the banking system via the demand for credit this will not hold.
- If South Africa's CB wasn't committed to inflation targeting we could fund greater government spending through "printing money".
- This may be lead to higher inflation – but there is no evidence the the argument that inflation must be within a narrow (2-6%) band in order to achieve growth.

Deficits and consumption patterns

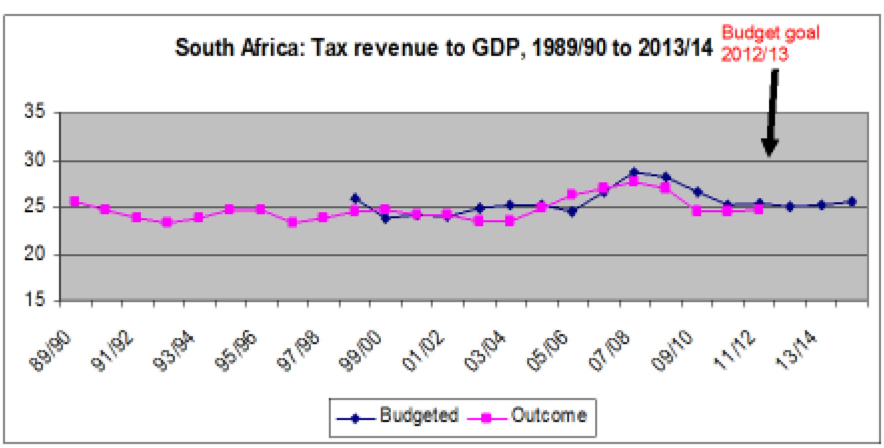
- Milton Friedman and others have also argued against deficit spending on the basis that it would have no effect on demand because consumers would predict a higher future tax rate (in order to pay for the deficit) and decrease consumption accordingly ("permanent income hypothesis").
- But this is based on nonsense assumptions of perfect information and rationality.
- A related concern is that increase government deficits merely increase the consumption of imports and the current account deficit.
- Properly targeting social spending in South Africa could free up income that would create demand for consumer durables upon which a domestic, labour intensive manufacturing industry could be based.

Austerity in practice

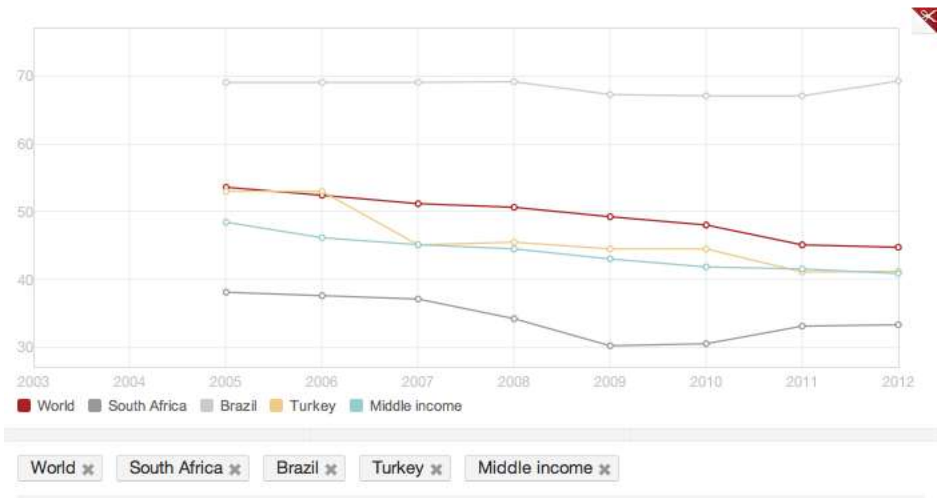
- Austerity has had disastrous effects in Europe and elsewhere.
- As every sensible economist predicted, austerity slowed down crisis torn economies which meant a drop in revenue and no decrease in debt/GDP ratios.

Tax revenue to GDP, 1989/90-2013/14:

Basically unchanged since apartheid



Total tax rate (% commercial profits)



The January 2012 interview with SARS's Jonas Makwakwa and the leaked reserach paper.

- After one year's investigation, SARS found **9300** HNWs who declared too little in income (2300) or who were not in the registers at all (7000).
- estimated loss in Taxable Income was "R48bn".
  A 39% tax on R48bn amounts to R18bn odd.
- In addition, and when contacting one (1) financial institution, SARS found **20 000 individuals** who are able to invest R1mn per year. Mr Jonas Makwakwa assumed that they have an income of R10mn per year to do that.

Growing spending but not revenue…

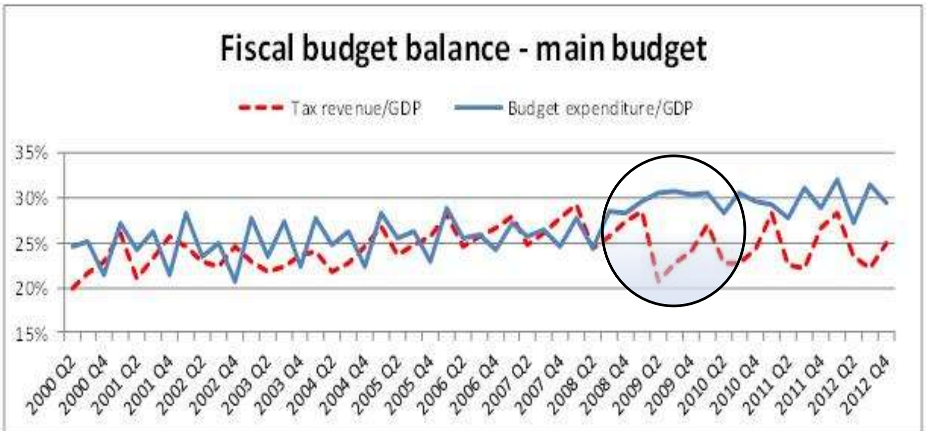


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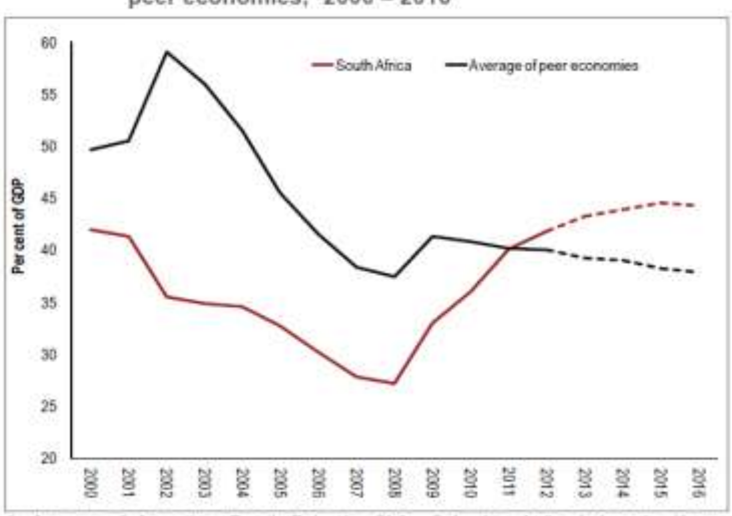
Figure 3.3 South Africa's gross debt-to-GDP ratio compared with peer economies,[1] 2000 – 2016



1. Average of Argentina, Brazil, Bulgaria, Chile, Colombia, India, Indonesia, Kenya, Latvia, Lithuania, Malaysia, Mexico, Morocco, Peru, Poland, Russia, Thailand, Turkey and Uruguay

Source: International Monetary Fund, National Treasury, South African data is for fiscal years

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Neoliberalism has not worked

- "Marco-economic stability" was undermined by financial instability.
- Investment has been poor and concentrated in Minerals-Energy Complex and some service sectors (de-industrialization).
- SA remains highly unequal, half the population remains mired in poverty with poor access to services.
- Real wages for most workers have stagnated.
- Unemployment remains severe at around 36%.

Budget 2013: more of the same?

Budget deficit: expenditure > revenue

Table 1.2 Consolidated government fiscal framework

R billion	2012/13 Revised estimate	2013/14	2014/15	2015/16
		Medium-term estimates		
Revenue	887.8	985.7	1 091.1	1 199.8
Percentage of GDP	27.7%	28.0%	28.1%	28.1%
Expenditure	1 055.9	1 149.4	1 244.3	1 334.1
Percentage of GDP	32.9%	32.7%	32.1%	31.2%
Budget balance	-168.0	-163.7	-153.2	-134.4
Percentage of GDP	-5.2%	-4.6%	-3.9%	-3.1%
Gross domestic product	3 209.1	3 520.3	3 880.4	4 270.8

- Slow domestic and global growth → slow revenue growth.
- Revenues to rise more than expenditure.
- Exp/GDP and Rev/GDP ratios remain constant.

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Fiscal response

- Aims to stabilize government debt and debt costs.
- Reduces spending growth: R10.4 billion over next 3 years.
  1. Reduce allocations mainly to national departments.
  2. Cut 'contingency reserve' by R23.5billion over next 3 years ('unallocated' spending).
- Real non-interest expenditure growing by 2.3 percent (down from 2.9% in 2012 MTBS).

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Debt…

- Even with moderation, government debt rising relative to GDP.
- Net debt rising R192bn per year (Kantor 2013)
- "Debt position deteriorating both in absolute and relative terms" (Kantor 2013)

Table 1.4 Projected state debt and debt-service costs

R billion	2012/13	2013/14	2014/15	2015/16
Net loan debt	**1 165.1**	**1 357.3**	**1 544.5**	**1 719.8**
Percentage of GDP	*36.3%*	*38.6%*	*39.8%*	*40.3%*
Debt-service costs	**88.3**	**99.7**	**108.7**	**118.2**
Percentage of GDP	*2.8%*	*2.8%*	*2.8%*	*2.8%*

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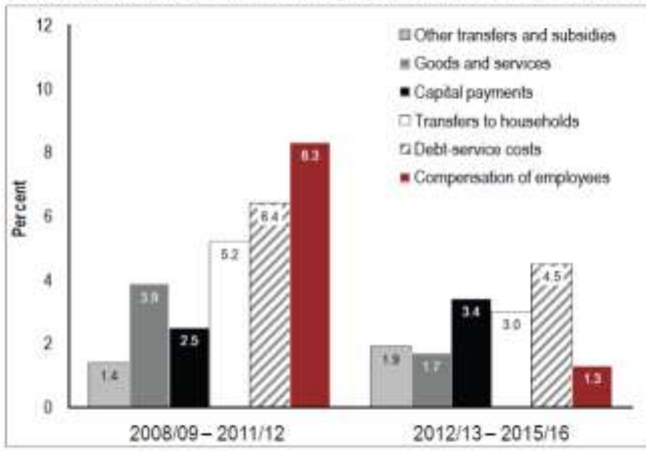
Expenditure composition (2)

Figure 3.2 Real growth in expenditure by economic classification, outcomes for 2008/09 – 2011/12 and projections for 2012/13 – 2015/16



Source: National Treasury

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Budget 2013: more of the same?

Table 3.3 Total tax and budget revenue, 2011/12 – 2013/14

R million	2011/12 Outcome	2012/13 Budget	2012/13 Revised Estimates	2012/13 Difference	2013/14
Persons and individuals	250 389	285 970	282 000	-3 970	312 450
Companies	151 563	167 839	166 100	-1 739	185 322
Value-added tax	191 014	209 675	212 000	2 325	233 620
Secondary tax on companies/ dividend withholding tax	21 965	19 050	18 800	-250	20 980
Specific excise duties	25 450	28 772	28 500	-272	29 410
Fuel levy	36 589	42 776	41 000	-1 776	42 310
Custom duties	34 173	36 160	38 000	1 840	39 550
Other	31 508	36 160	35 001	-1 159	37 749
Total tax revenue	**742 651**	**826 401**	**821 401**	**-5 000**	**901 392**
Non tax revenue	19 193	15 091	15 183	92	16 597
of which mineral royalties	*5 612*	*6 510*	*5 900*	*-610*	*6 490*
Estimate of SACU payments[1]	-21 760	-42 151	-42 151	–	-43 700
Provinces, social security and selected public entities	96 922	105 489	106 204	714	113 284
Repayment of Gautrain loan[2]	–	–	–	–	-1 521
Total budget revenue	**837 007**	**904 830**	**900 637**	**-4 194**	**986 052**

1. Estimates are based on National Treasury projections. Actual payments will be determined by outcomes of customs and excise revenue collections in line with the SACU agreement

2. Netting of repayment of Gautrain loan included in non tax revenue

Table 1.4 Consolidated government expenditure, 2012/13 – 2015/16

R billion	2012/13 Revised estimate	2013/14	2014/15 Budget estimate	2015/16	Average annual growth 2012/13 – 2015/16
General public services	53.3	56.0	59.6	62.1	5.2%
Defence and state security	42.0	44.7	47.4	50.2	6.1%
Public order and safety	99.7	107.0	113.2	119.7	6.3%
Transport, energy and communication	83.5	91.5	98.8	105.1	7.9%
Economic services	44.6	48.1	50.4	52.6	5.6%
Local government, housing and community amenities	121.7	132.5	144.5	157.5	9.0%
Health and social protection	246.2	267.8	287.5	306.4	7.6%
Education and related functions	220.0	234.0	250.5	268.9	6.9%
Employment and social security	43.0	48.6	53.9	55.9	9.1%
Science and technology	14.1	14.5	15.4	16.0	4.1%
Contingency reserve	–	4.0	10.0	30.0	
Non-interest expenditure	**968.3**	**1 048.8**	**1 131.3**	**1 224.2**	**8.1%**
State debt cost	88.8	98.6	106.8	114.8	8.9%
Total expenditure	**1 057.1**	**1 147.4**	**1 238.1**	**1 339.0**	**8.2%**