

# Policy Analysis

*“No policy – no matter how ingenious – has any chance of success if it is born in the minds of few and carried in the hearts of none.” – Henry A. Kissinger*



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# Objectives of this session

**At the end of this session you should be able to demonstrate a greater level of understanding of the following:**

- Fundamental principles underpinning public sector economics
- The dynamic relationship between the state, the market & the public opinion (in a democracy)
- The necessary role of government
- Principles & functions of taxation
- Fiscal policy objectives
- Fiscal policy instruments
- The dangers of excessive government interference

# What are we covering?

Day 1: Financial  
statement  
analysis

Day 2: Overview  
of public sector  
budgeting

Day 3: Soft skills

Day 4: Policy  
analysis



# Policy analysis roadmap

*Fiscal policy objectives*

*Empirical analysis, Assessment & Policy adjustment*

*Fiscal policy instruments*

*Public finance Principles & concepts*



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# Introduction & agenda

## Fiscal Policy Analysis

08h30	Recap and introduction	Mr Crispin Swart
09h00	Introduction to public sector economics	Dr Roelof Botha
10h30	<i>Tea break</i>	
10h45	Fiscal policy objectives & instruments	
12h30	<i>Lunch break</i>	
13h15	The political/economic cycle & policy trade-offs	
14h45	<i>Lunch break</i>	
15h00	Ranking SA's competitiveness (group exercise)	
15h50	Closing	Mr Crispin Swart





# Key elements of public sector economics

- The spread of democracy
- The concept of "mixed economies"
- Identifying the necessary role of the state
- Functions of taxation
- Principles of taxation
- The political/economic cycle
- Fiscal policy
- The dangers of excessive government intervention

# Definition of fiscal policy

- *Fiscal policy involves the deliberate adjustment of state expenditures, the base & rates of taxation and public debt financing by a government for the purpose of pursuing economic and socio-political policy objectives.*
- It runs parallel to monetary policy, through which a country's central bank influences the money supply. In developing countries, these two policies are usually supplemented by trade and industrial policies (in various combinations), in order to direct economic policies.

# Intelligent approach to policy analysis

- *Forming an intelligent opinion about fiscal policy analysis requires more than a particular political philosophy, namely a clear understanding of what a government is actually supposed to do, how its activities can be financed and the effects thereof on the economy*
- These effects should be measured by the policy impact on :
  - Economic output (GDP)
  - Employment
  - Price stability
  - Balance of payments stability
  - Income distribution
  - Capacity building for future growth
  - Socio-political stability in general



# Selected findings of research on fiscal policy analysis

## Easterly & Rebelo

- ✓ A strong association exists between the development level & the fiscal structure
- ✓ Poor countries rely heavily on customs duties, while income taxes are only important in developed economies
- ✓ Fiscal policy is influenced by the scale of the economy, measured by its population
- ✓ Investment in transport & communication is consistently correlated with growth
- ✓ The effects of taxation are difficult to isolate empirically

# Selected findings of research on fiscal policy analysis

## Botha & Lockwood

- ✓ A strong association exists between transport infrastructure spending & economic multiplier effects
- ✓ A user charge for urban road transport systems has a vastly superior effect on equity objectives
- ✓ Non-selective indirect taxation is more efficient than direct taxation
- ✓ The youth wage subsidy represents a highly effective method to broaden the tax base via indirect taxes
- ✓ A basic income grant will cost a fraction of the proposed NHI

# Selected findings of research on fiscal policy analysis

## Baxter & King

- ✓ Permanent changes in government purchases can lead to short-run & long-run output multipliers that exceed unity
- ✓ Permanent changes in government purchases induce larger effects than temporary changes
- ✓ Public investment has dramatic effects on private output & investment

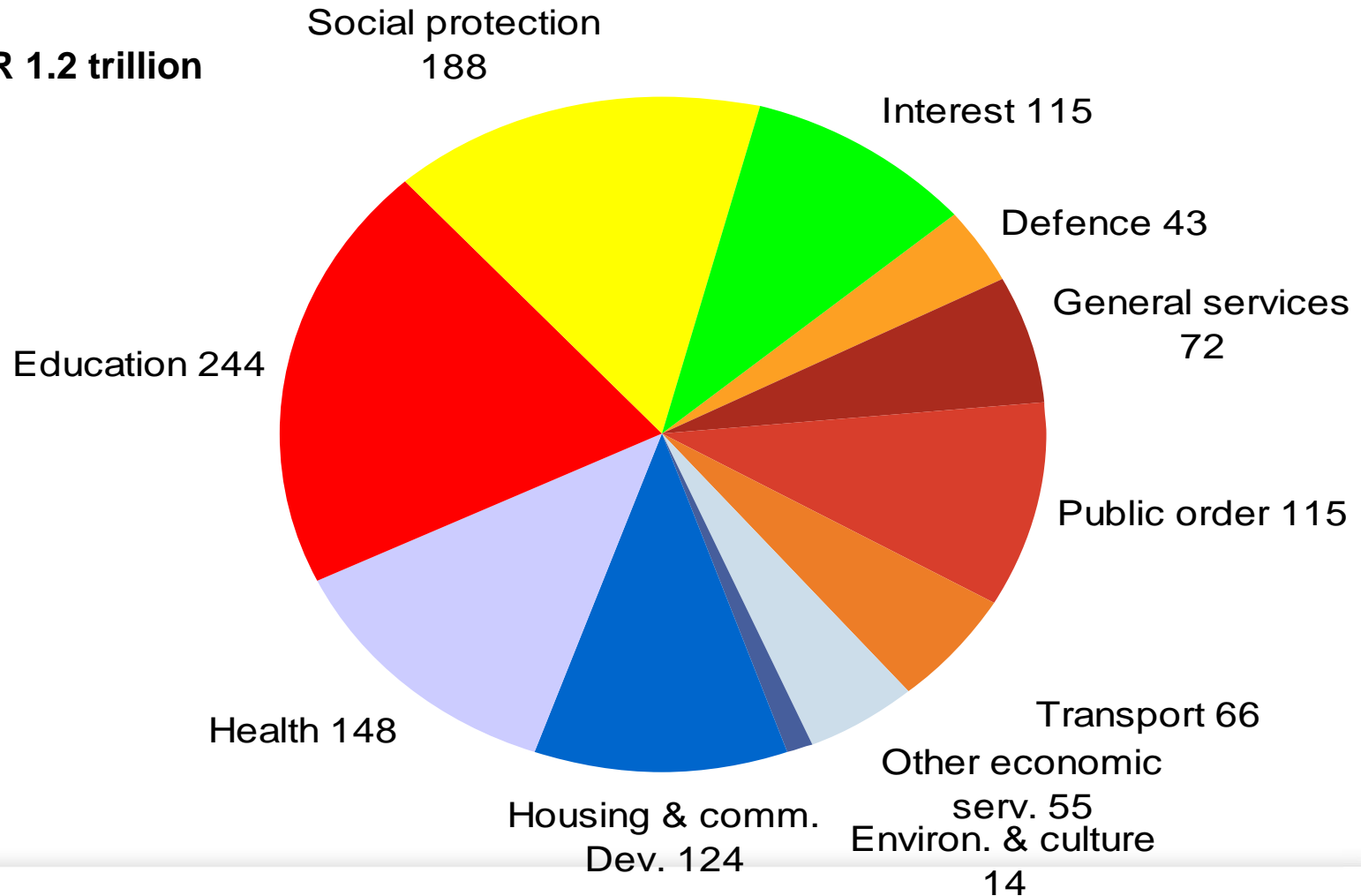
*These findings stem from important dynamic interactions of capital & labour*

# Types of public expenditures

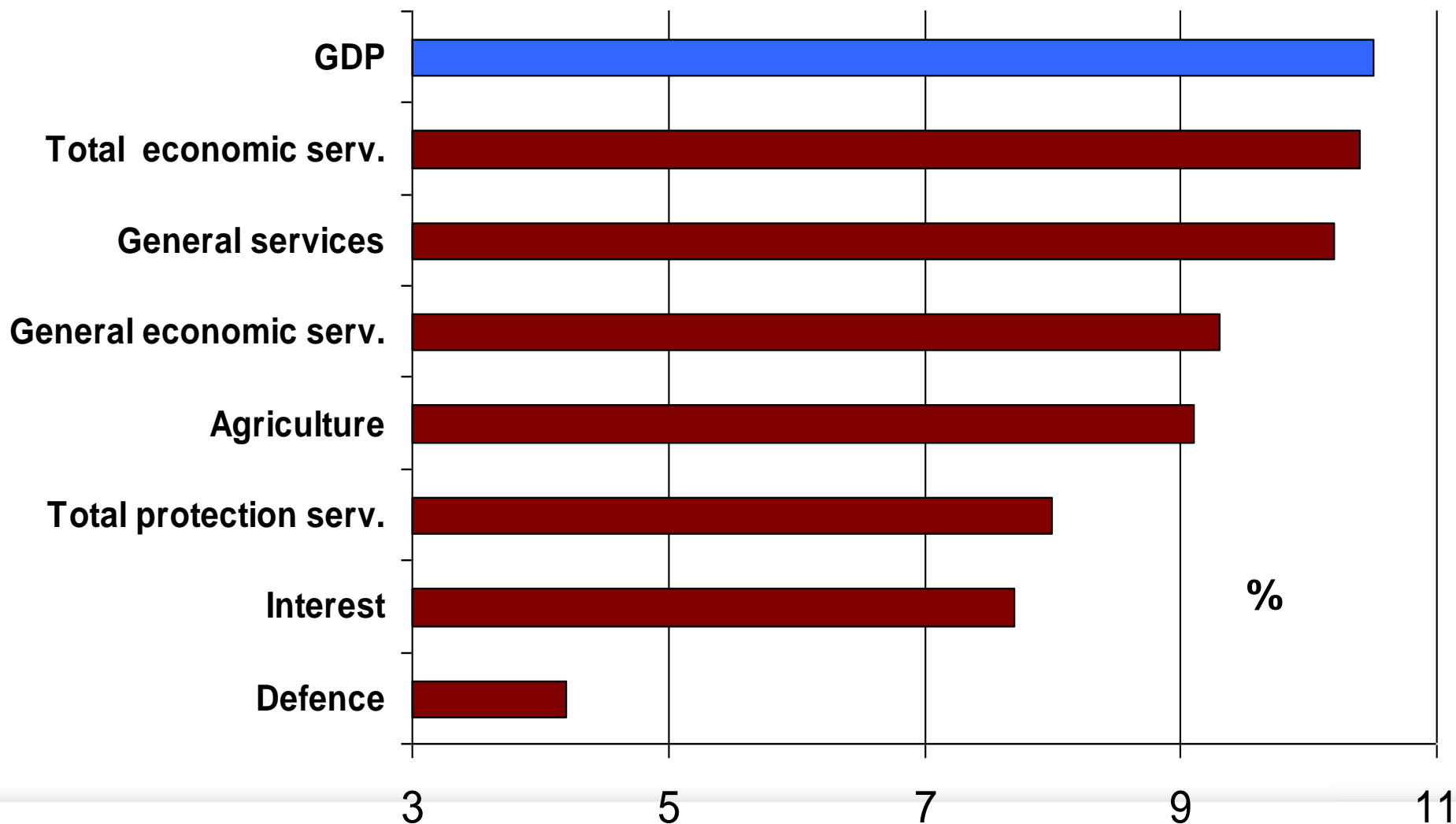
- Consumption expenditure (goods & services)
- Capital expenditure
- Infrastructure
- Salaries
- Welfare programmes
- Intergovernmental transfers
- Interest payments
- Customs union transfers

# Composition of government expenditure (functional classification) FY 2013/14 (Rb)

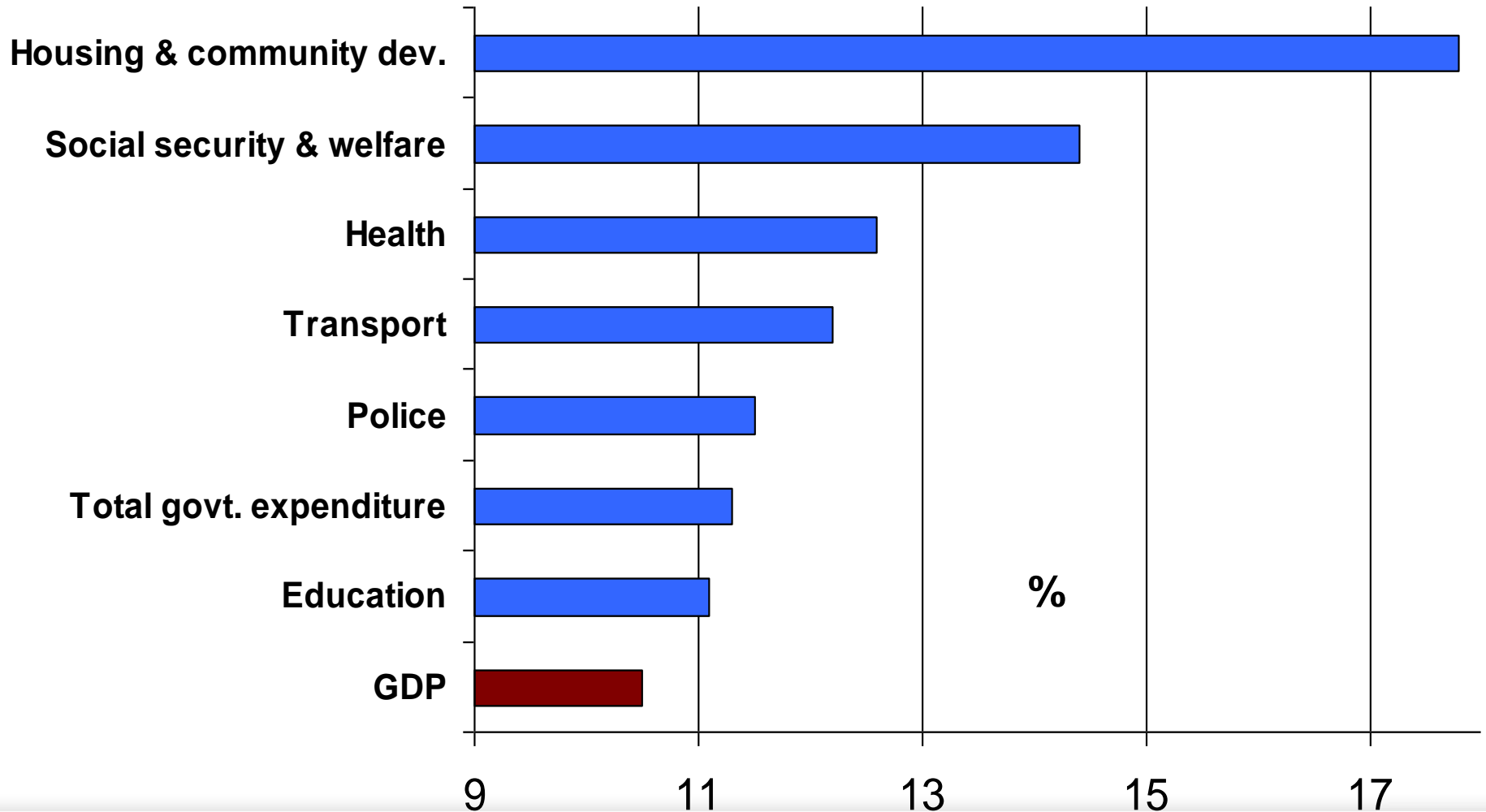
Total R 1.2 trillion



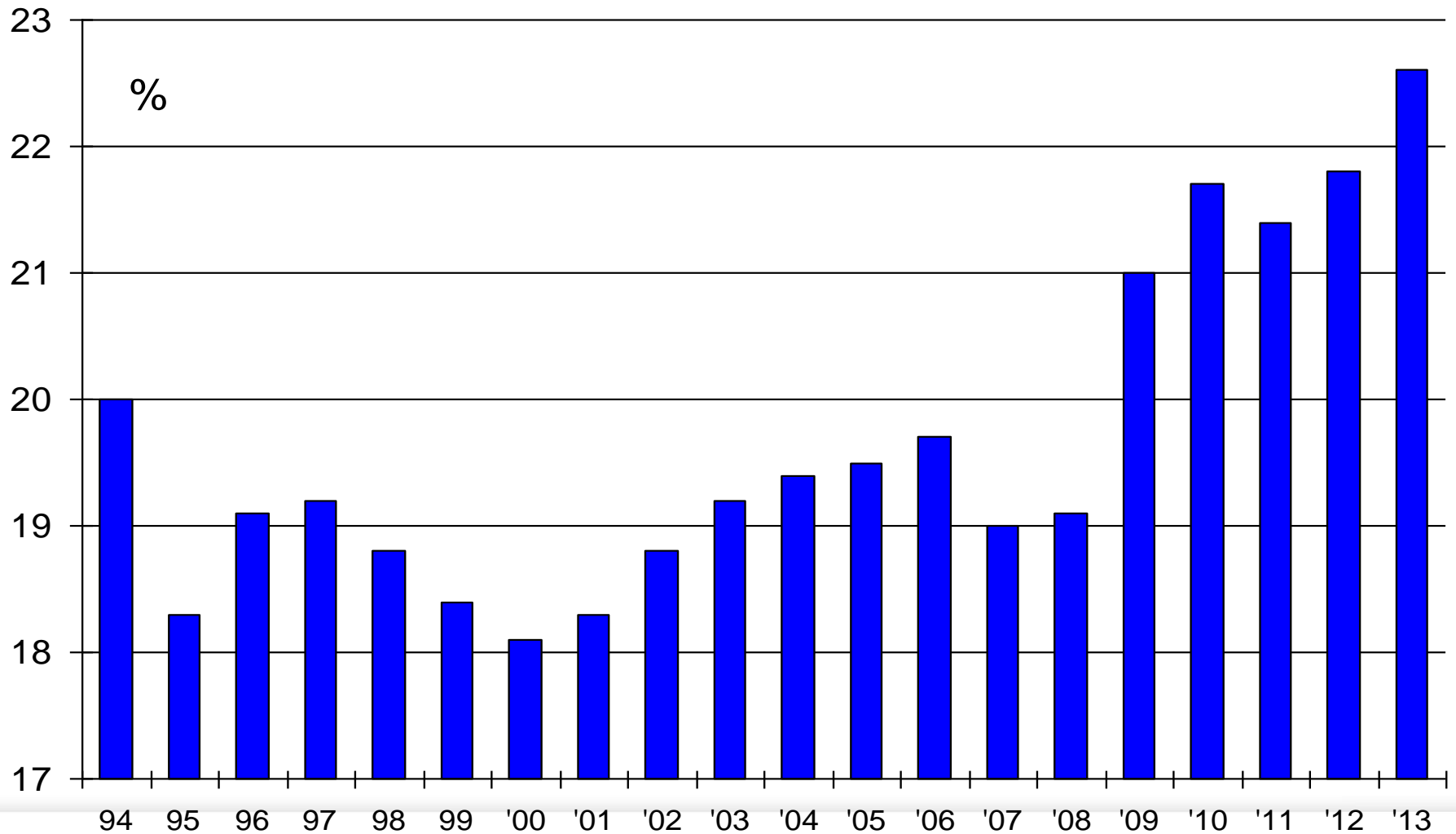
# Average annual nominal growth in government expenditure & GDP - 1996 to 2014 - the laggards



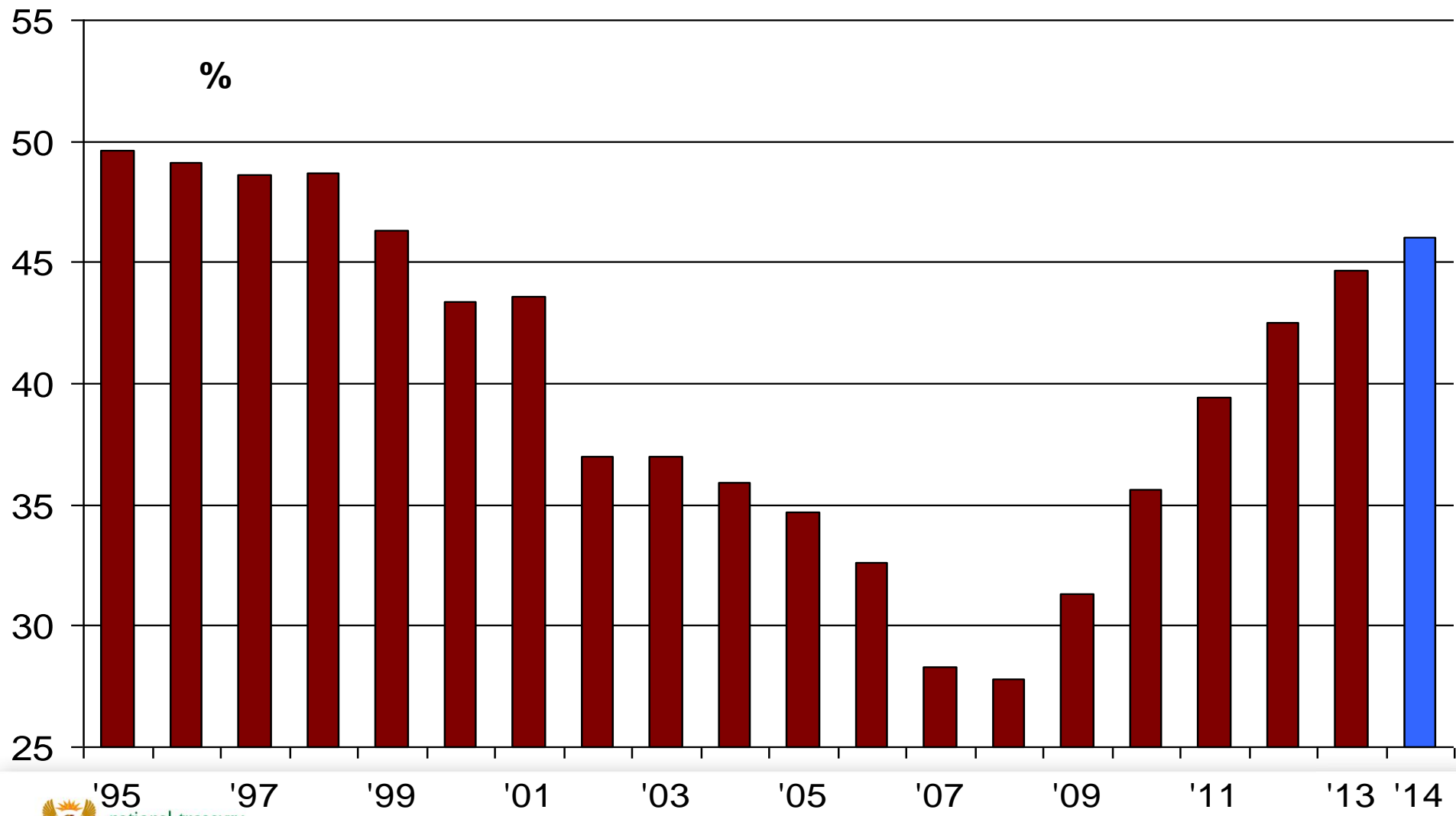
# Average annual nominal growth in government expenditure & GDP - 1996 to 2014 - the leaders



# Current government expenditure as % of GDP – too many regulations?

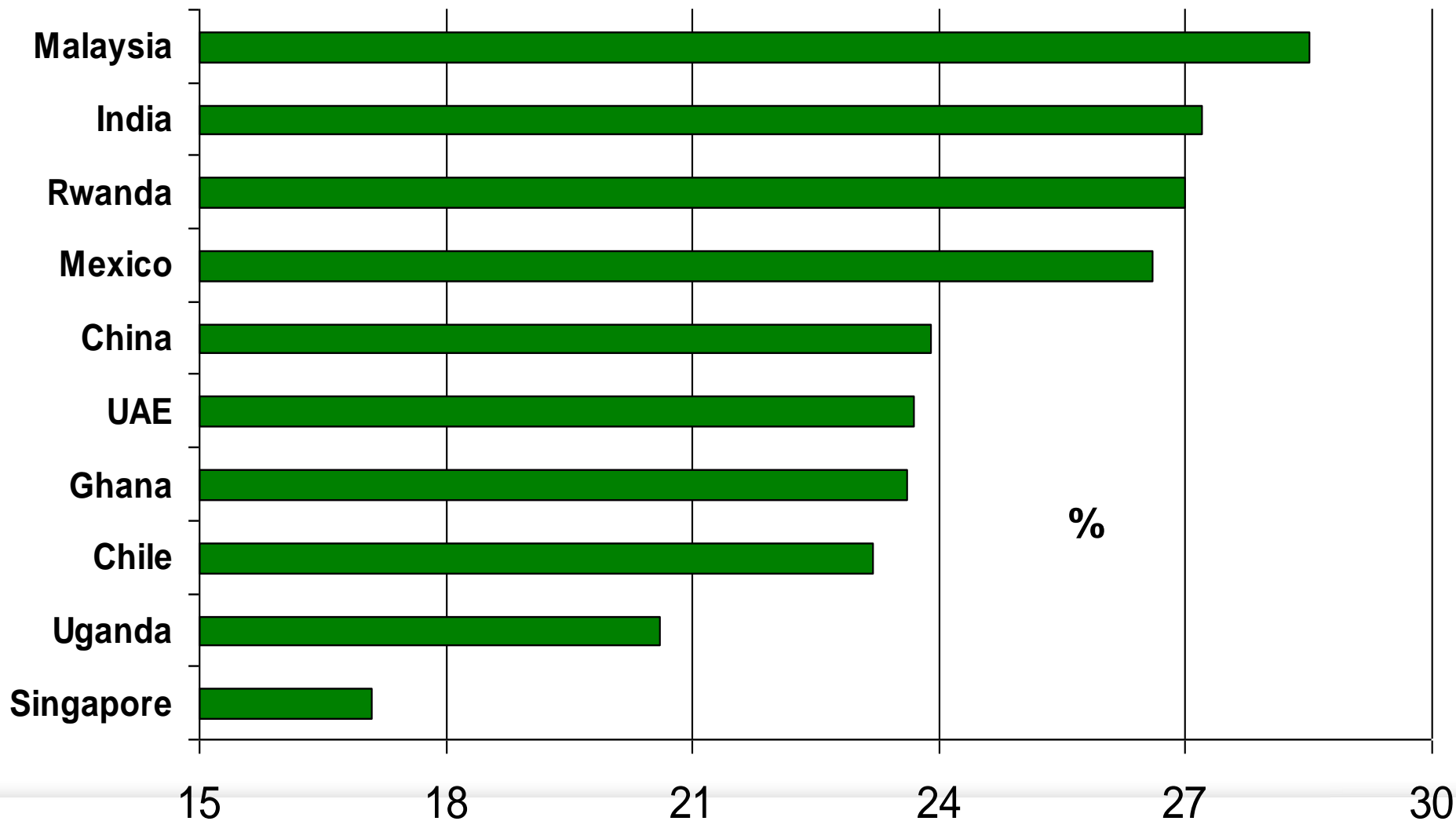


# Total public sector gross debt as % of GDP



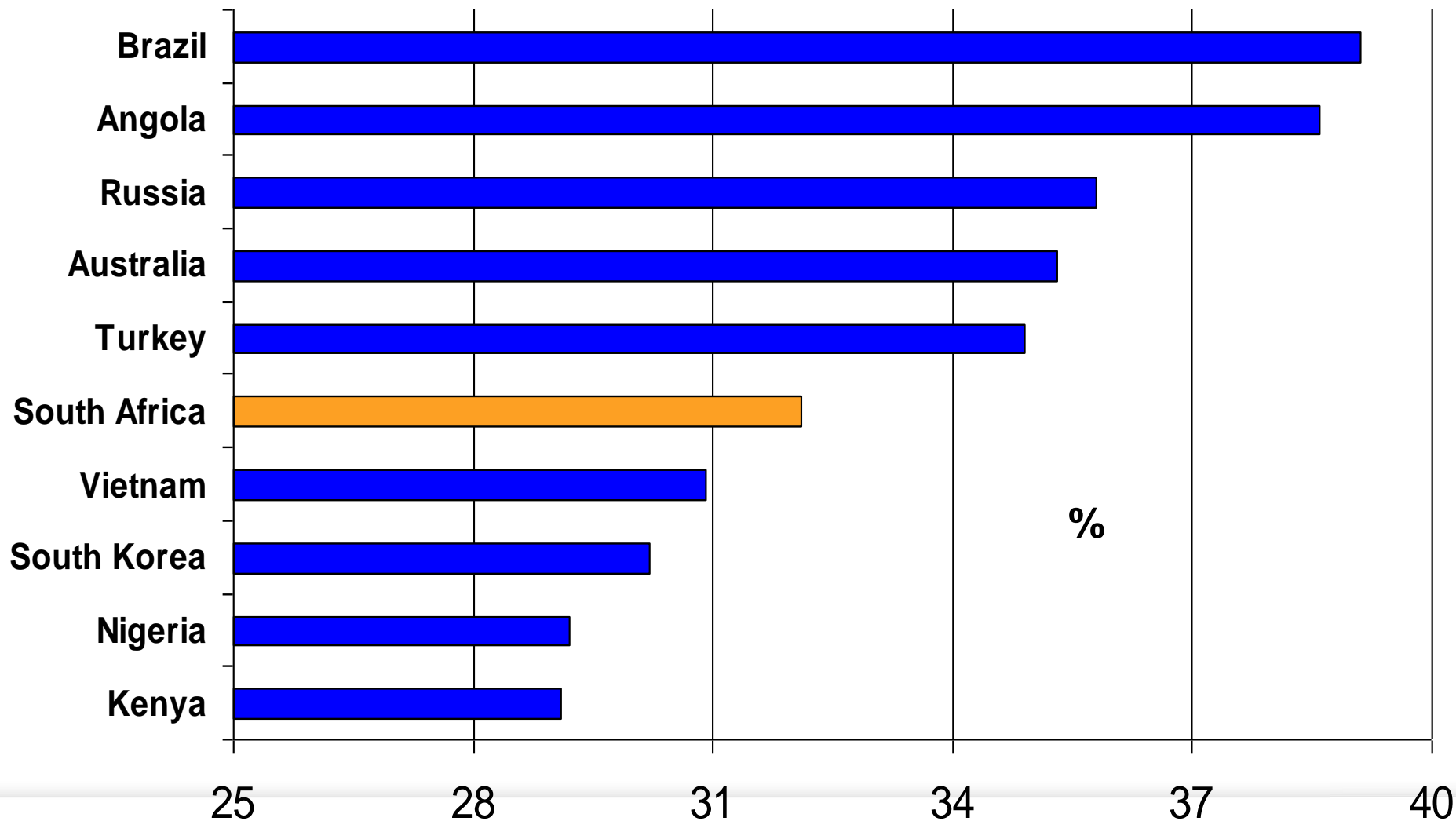
# Government spending/GDP ratios – selected countries

(lowest)



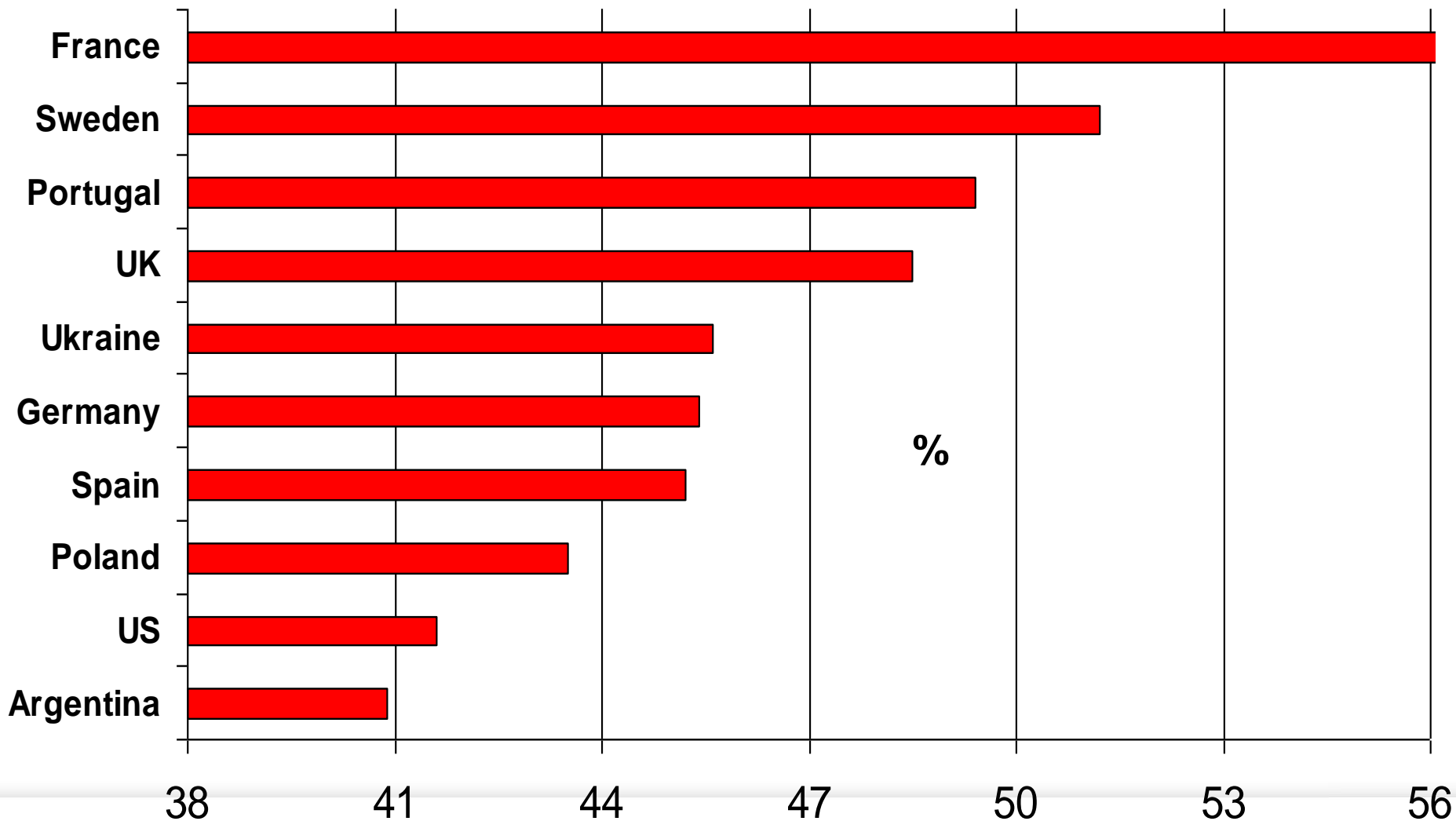
# Government spending/GDP ratios – selected countries

(middle group)



# Government spending/GDP ratios – selected countries

(highest)



# 2014 Budget – summary of criticism

- Actual & budget deviations between individual expenditure votes
- Higher deficit/GDP ratio
- Insufficient detail on practical anti-corruption measures
- Inadequate alignment with NDP growth policies
- Large increase in public sector salaries
- Key obstacles to higher growth largely ignored
- Under-expenditure on economic services
- No action plan on dysfunctional local authorities
- Agriculture receives a paltry 1% of total budget vote
- Excessive reliance on narrow tax base
- Huge subsidisation of SACU partners
- Increased excise duties on beer & whisky



# Identifying the necessary role of the state

- National defence
- Law & order
- Public goods
- Rectifying externalities
- Promotion of competition
- Maintenance of standards
- General regulatory framework
- Stabilisation policies
- Development policies
- Natural monopolies



# Taxation terminology

Tax avoidance

Tax evasion

Tax burden

Tax base

Tax impact

Tax incidence

Progressive tax

Regressive tax

Proportional tax

Unit tax

Ad valorem tax

Double taxation

Direct taxes

Indirect taxes

Excess burden of taxation



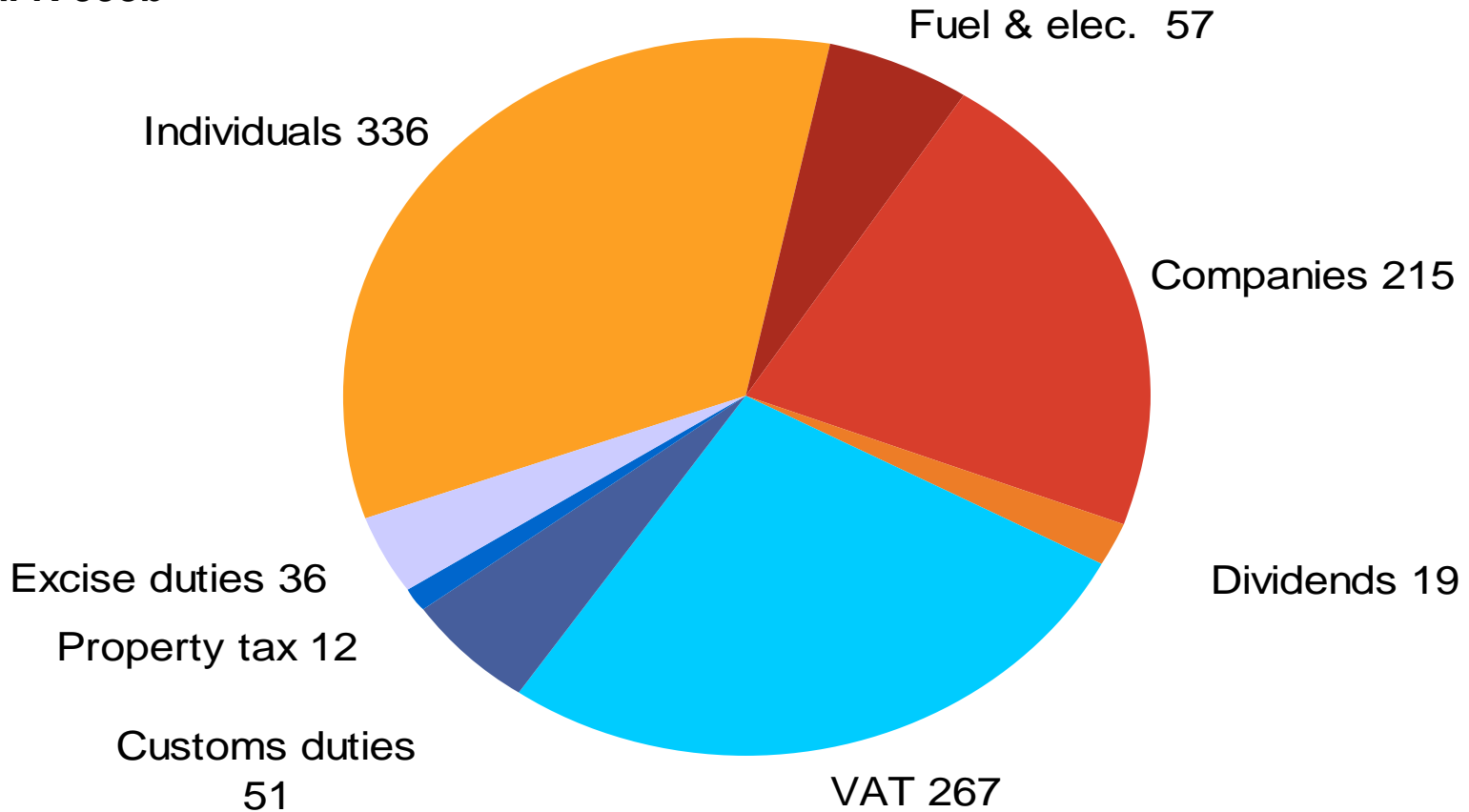
# Functions of taxation

- Source of state revenue
- Equity
- Influencing demand patterns
- Influencing the allocation of resources
- Influencing the regional distribution of economic activity
- Influencing the level of savings

# Composition of government revenue

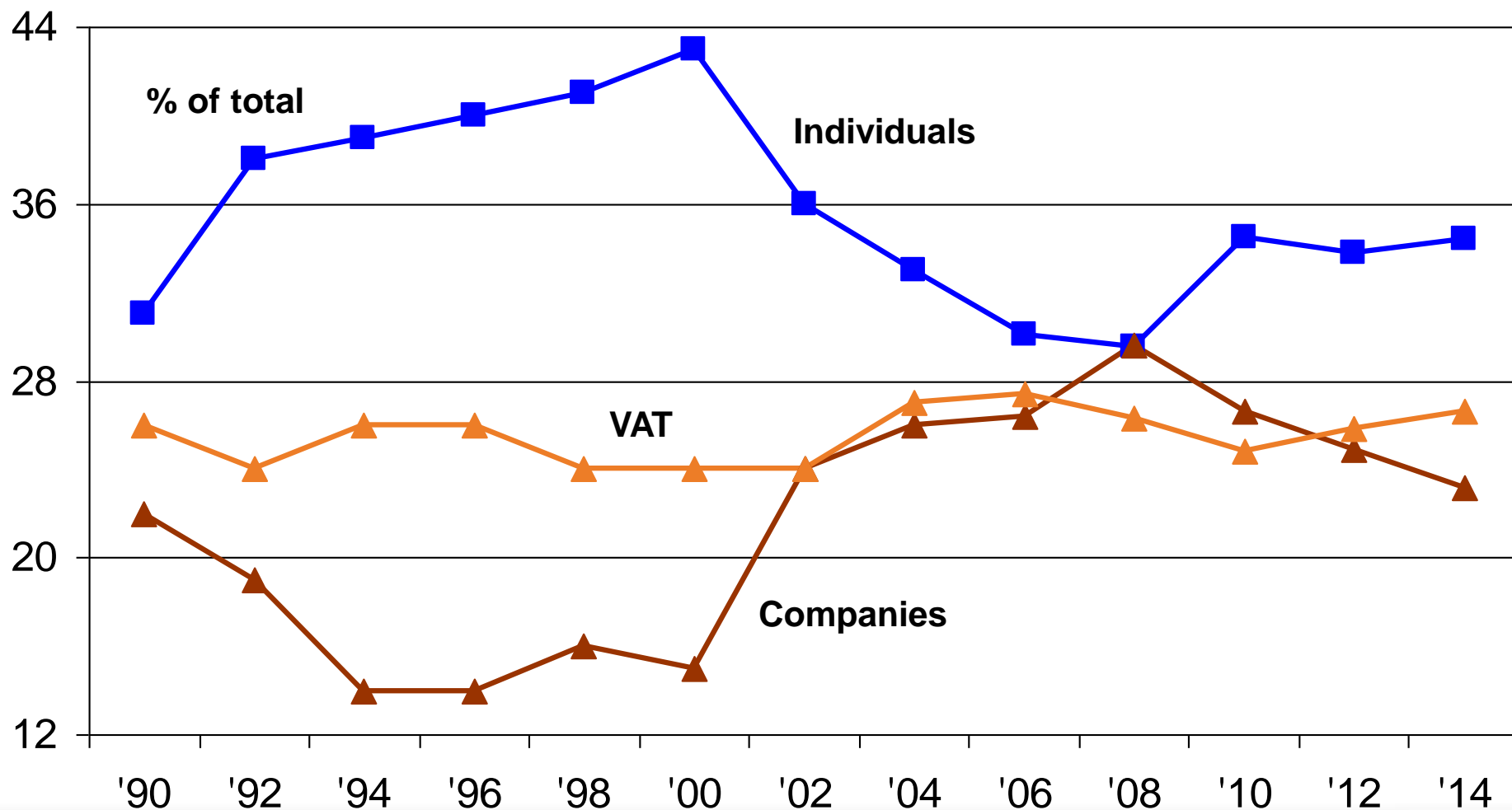
FY 2014/15 (Rb)

**Total R 993b**

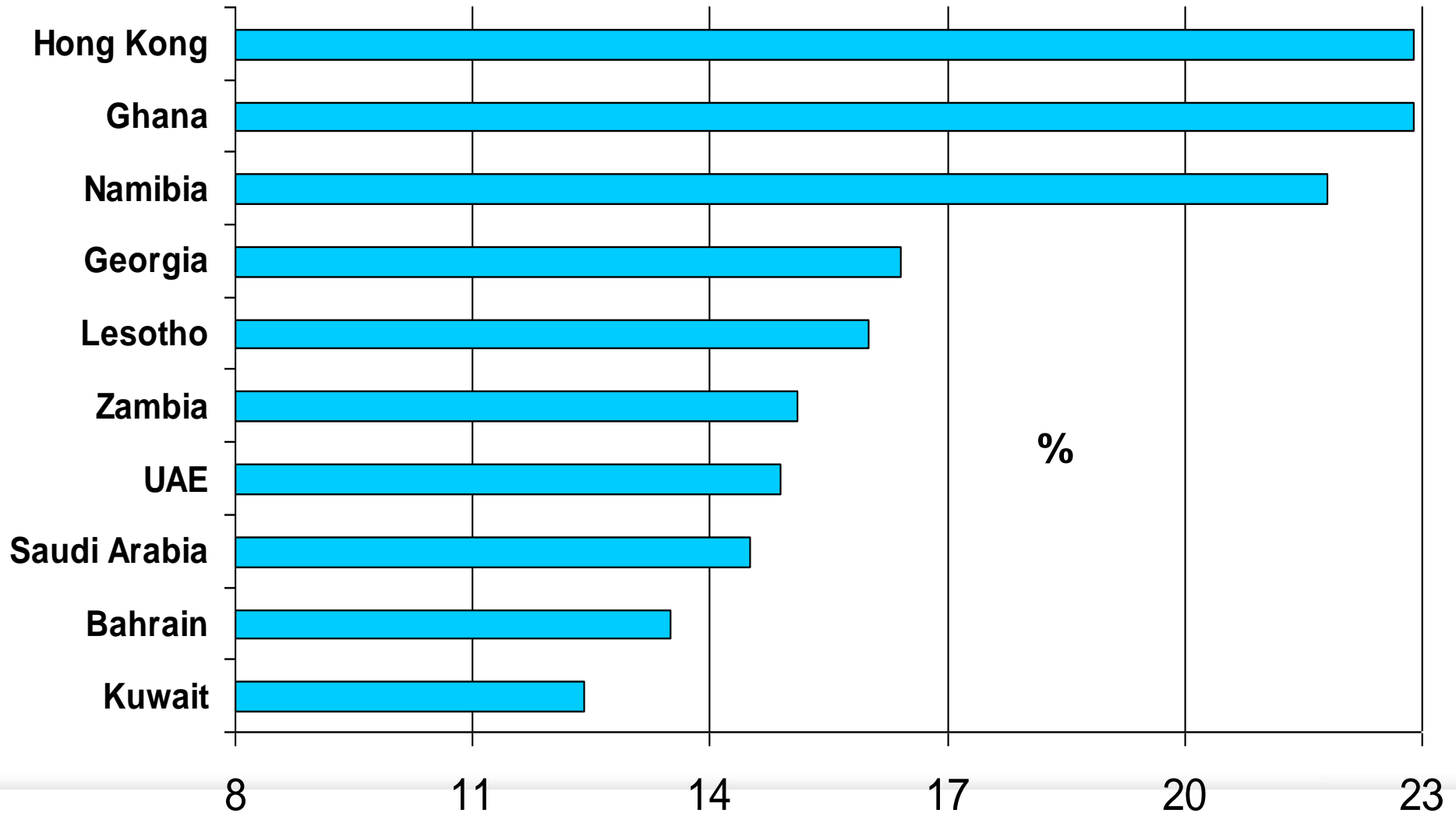


# Reversal of convergence of the big 3 tax revenue sources

– burden returns to individuals

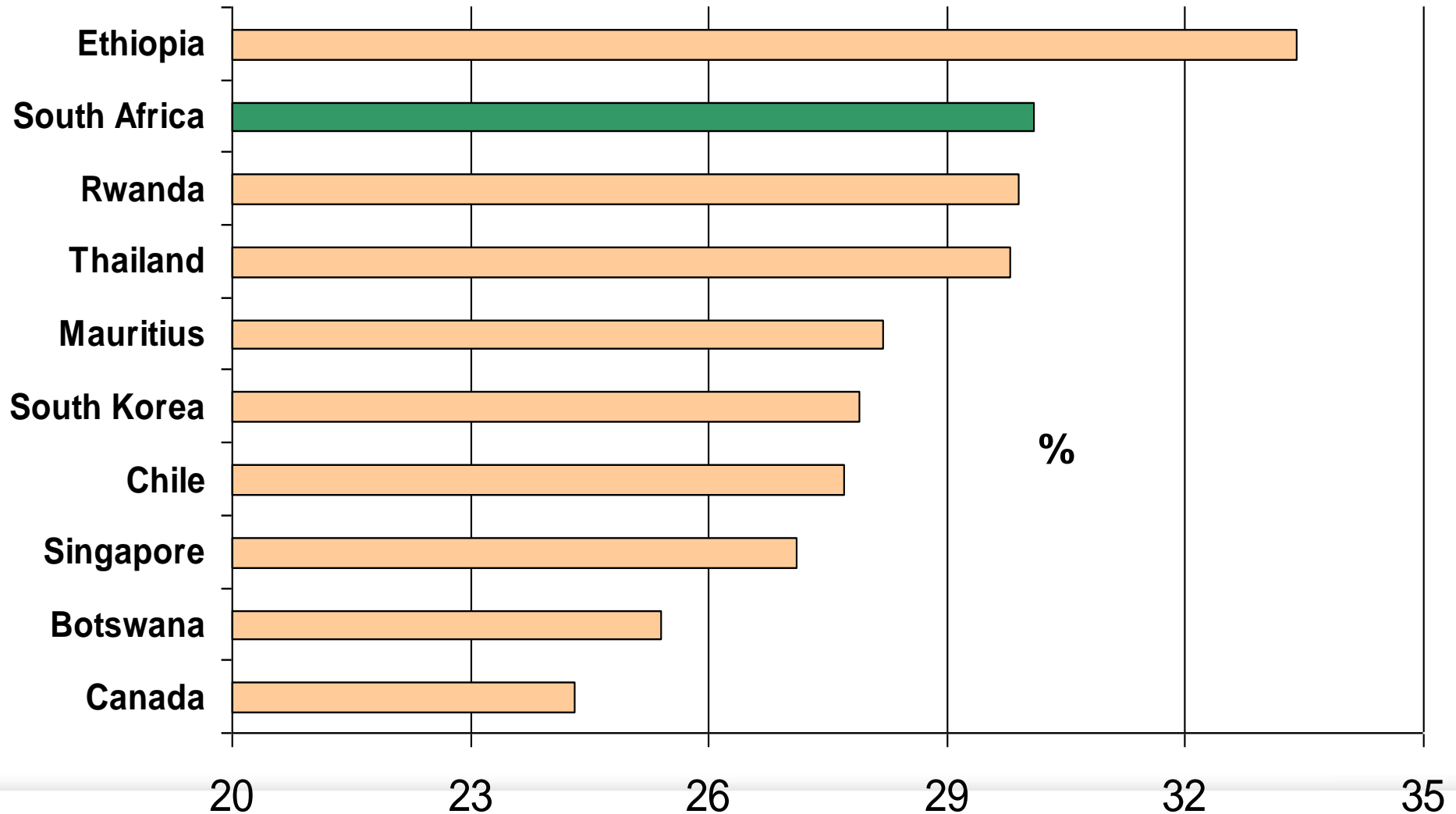


# Total tax rates for companies – selected countries (lowest)



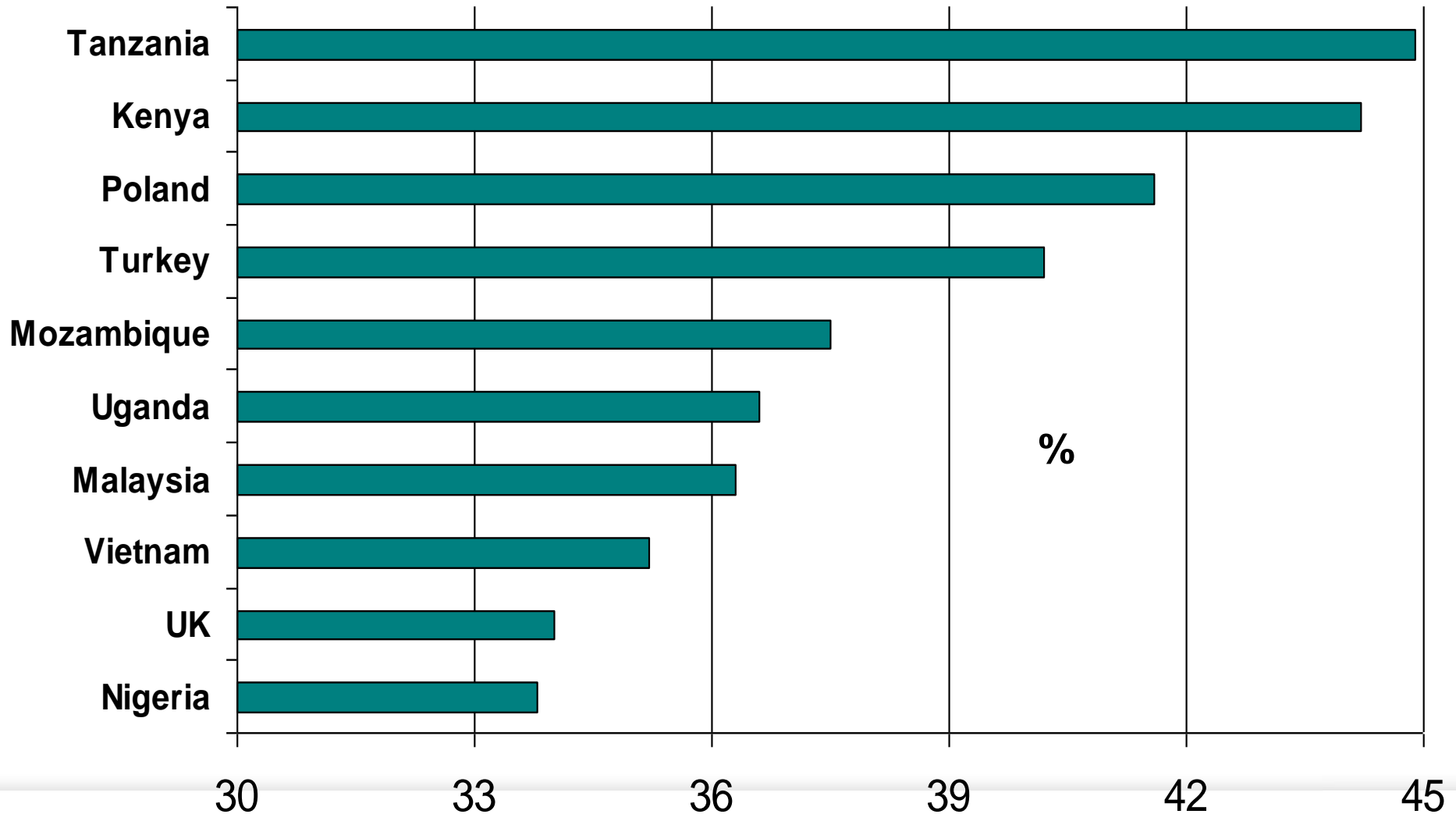
# Total tax rates for companies – selected countries

(2<sup>nd</sup> lowest)



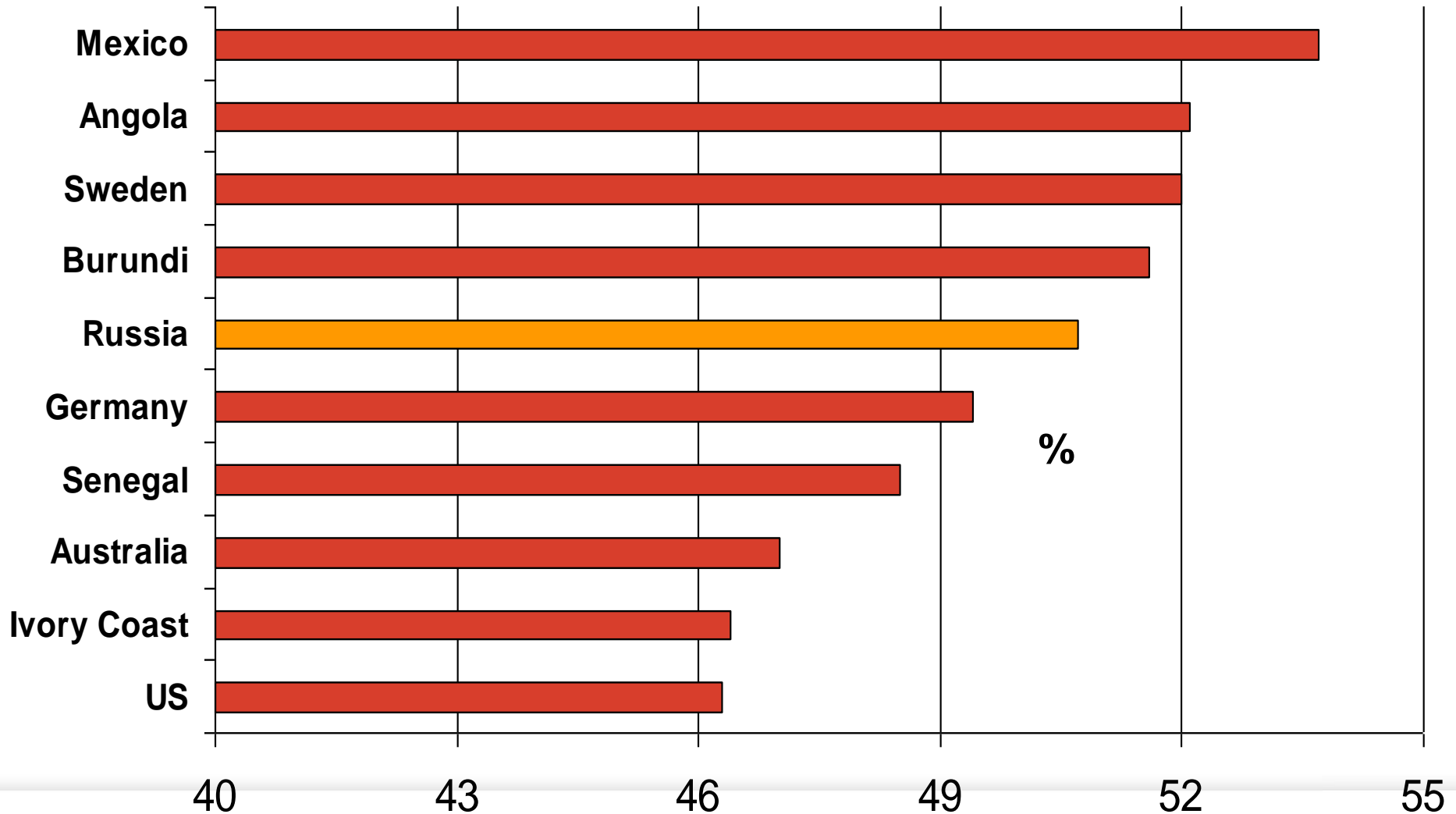
# Total tax rates for companies – selected countries

(middle group)



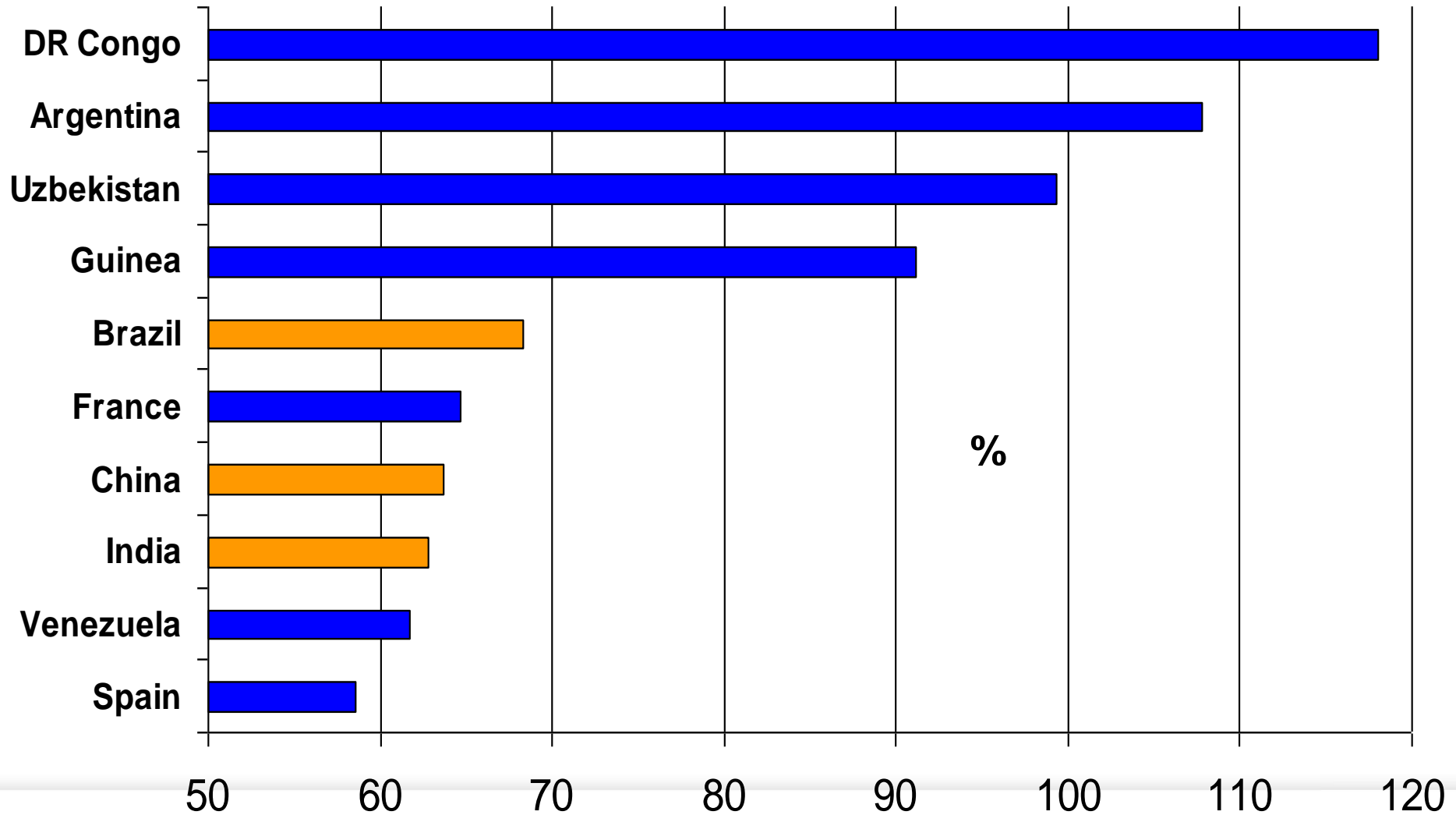
# Total tax rates for companies – selected countries

(2<sup>nd</sup> highest)



# Total tax rates for companies – selected countries

(highest)



# Economic characteristics of high deficit countries

- Significant & permanent exchange rate depreciation
- Low savings/GDP ratios
- Deficit on the financial account of the BoP
- Relatively high inflation
- Relatively low real GDP growth
- Increasing fiscal deficit
- Declining international competitiveness

# Economic characteristics of low deficit countries

- Relatively stable exchange rates (PPP trend)
- Adequate savings/GDP ratios
- Surplus on financial account of the BoP
- Relatively low cost of capital
- Relatively low & declining inflation
- GDP growth of more than 5%
- Declining fiscal deficit
- Increased international competitiveness

# The power of the tax equation

$$T = t \times (\text{Economic Activity})$$

*An increase in the level & extent of economic activity, including GDP growth, capital formation & employment creation, obviates the need to consider any increases in tax rates & reduces any undue pressure on the public finances*



# Socio-political transformation since 1994

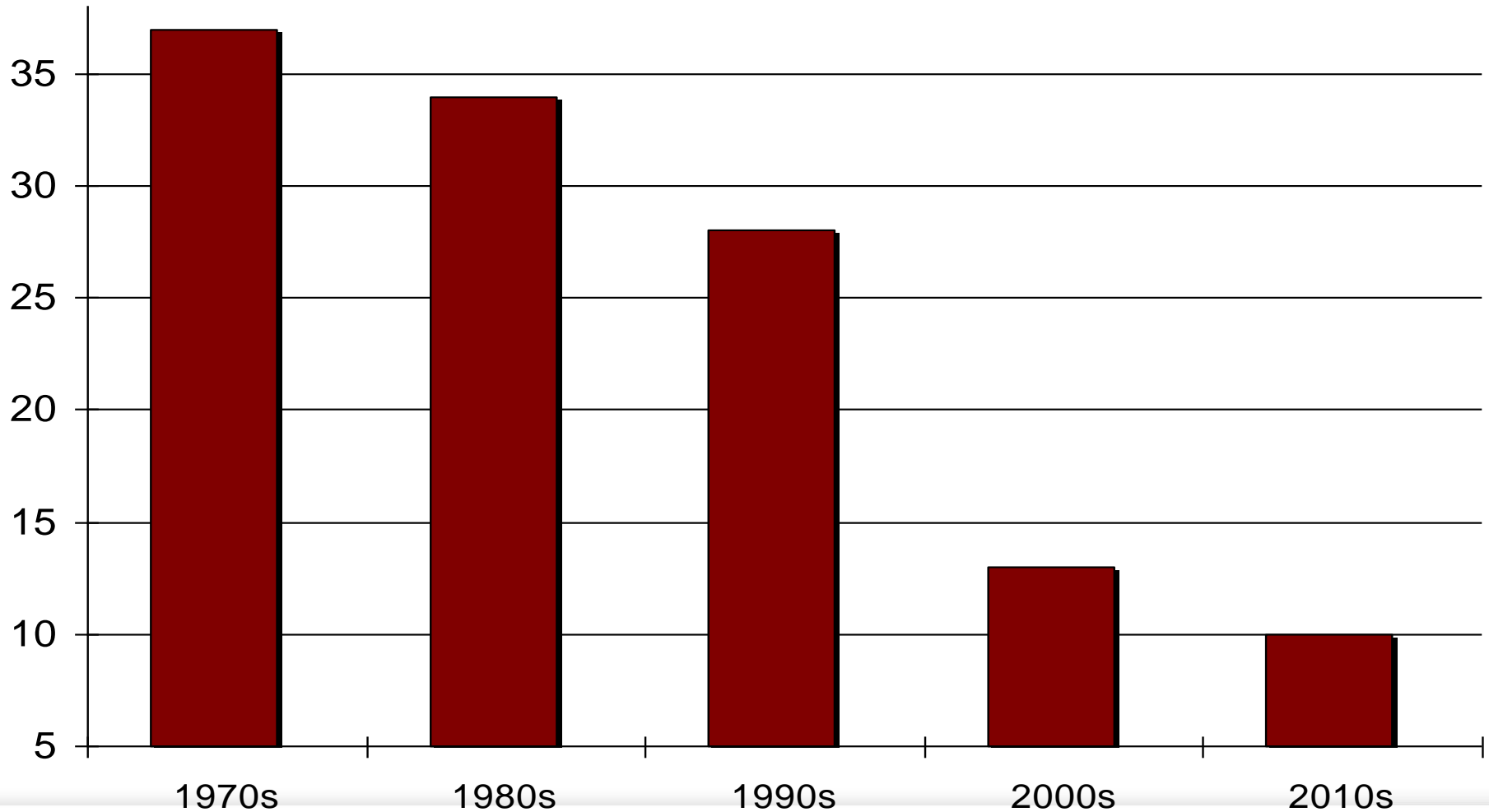
- World's most progressive constitution
- Institutionalised protection of human rights
- 5<sup>th</sup> democratic elections took place in 2014 (declared free, fair & peaceful)
- 29 different parties contested the elections
- 13 different parties represented in Parliament
- Collectively, the ANC & DA have 84% of the seats, with both parties committed to pragmatic economic policy
- Enhanced competition in politics, with Western Cape becoming the benchmark province



# South Africa's Lowest-ranked Competitiveness Indicators

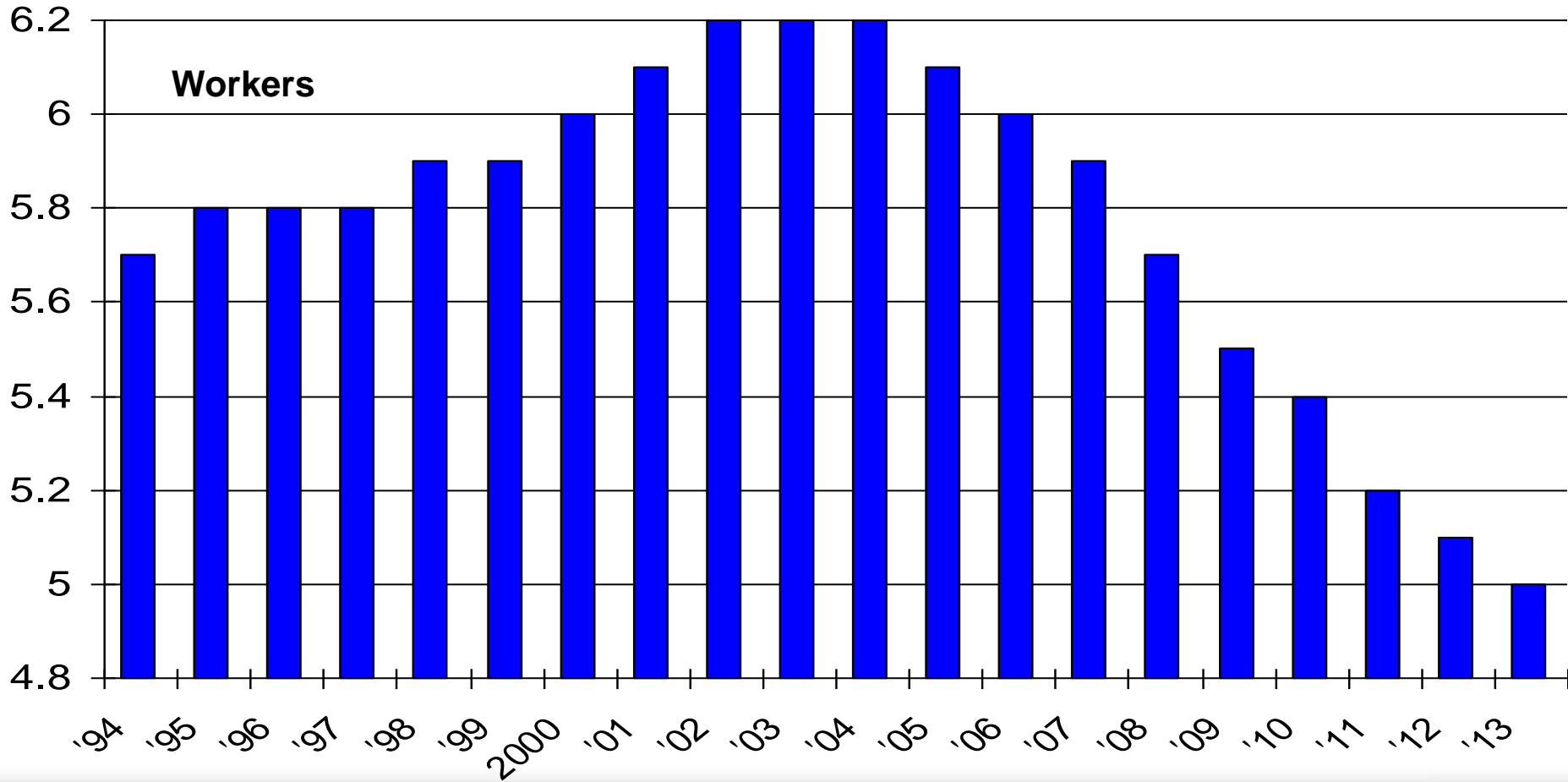
Cooperation in labour-employer relations	148
Hiring & firing practices	147
HIV prevalence	144
Quality of the educational system	146
Flexibility of wage determination	144
Pay & productivity	142
Business costs of crime & violence	141
Life expectancy	136
Business impact of tuberculosis	142
Burden of government regulation	116

# Average number of employees per business



# Ratio of labour per R1m capital employed in the economy –

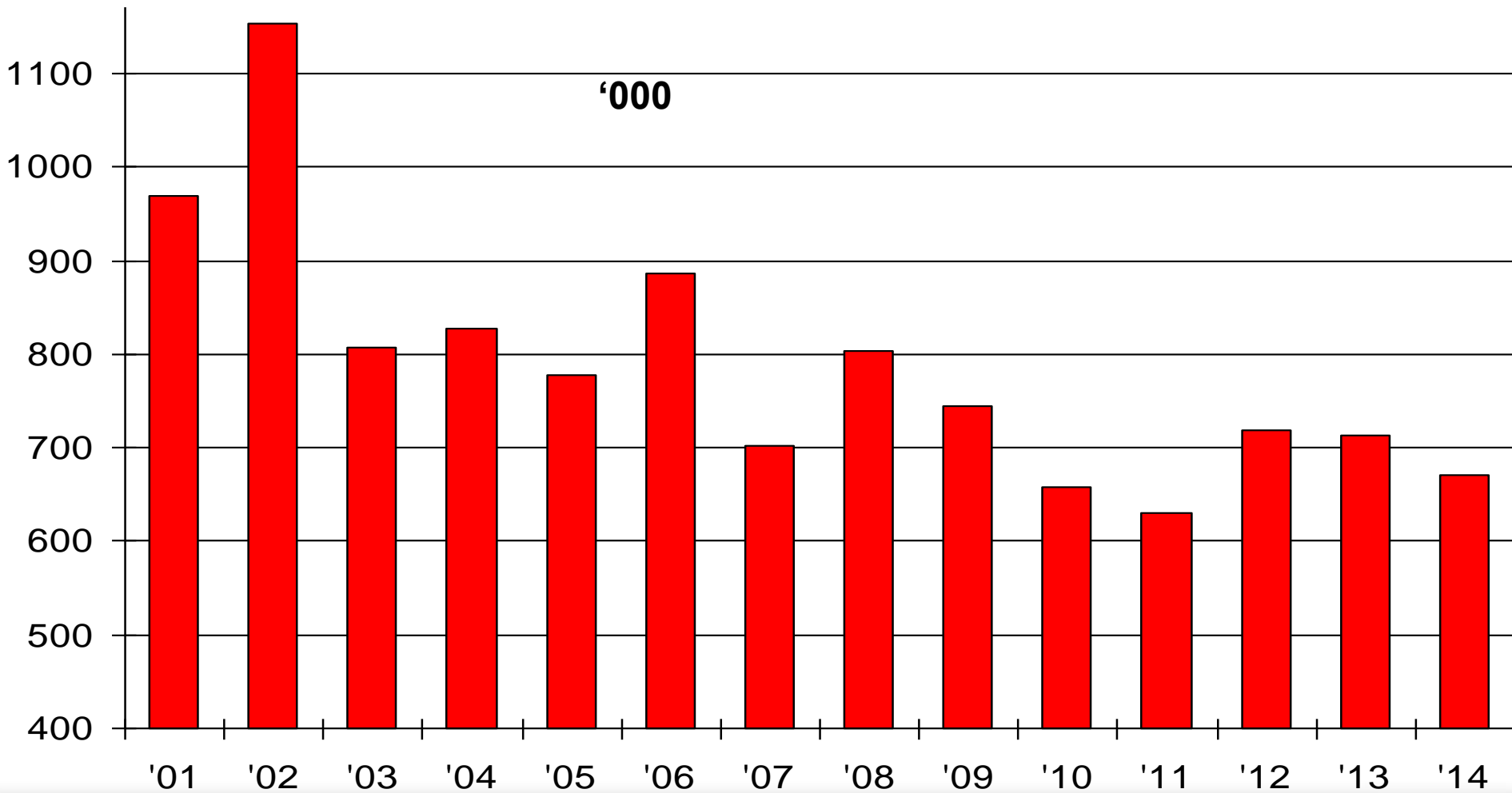
constant '05p *(Sources: SARB; own calculations)*



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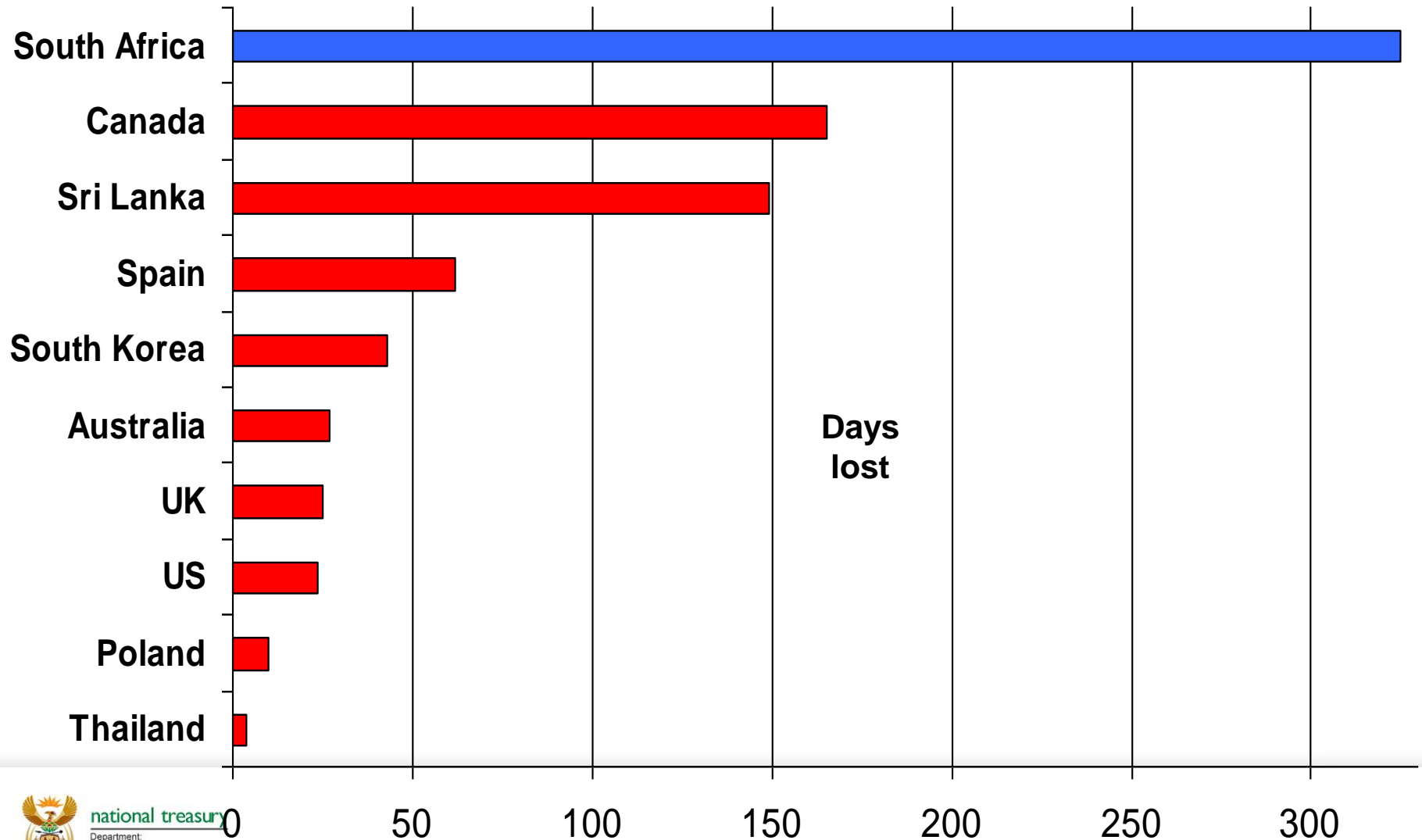
# Employment in agriculture in South Africa



# Work days lost per 1,000 workers – latest available

4-year average

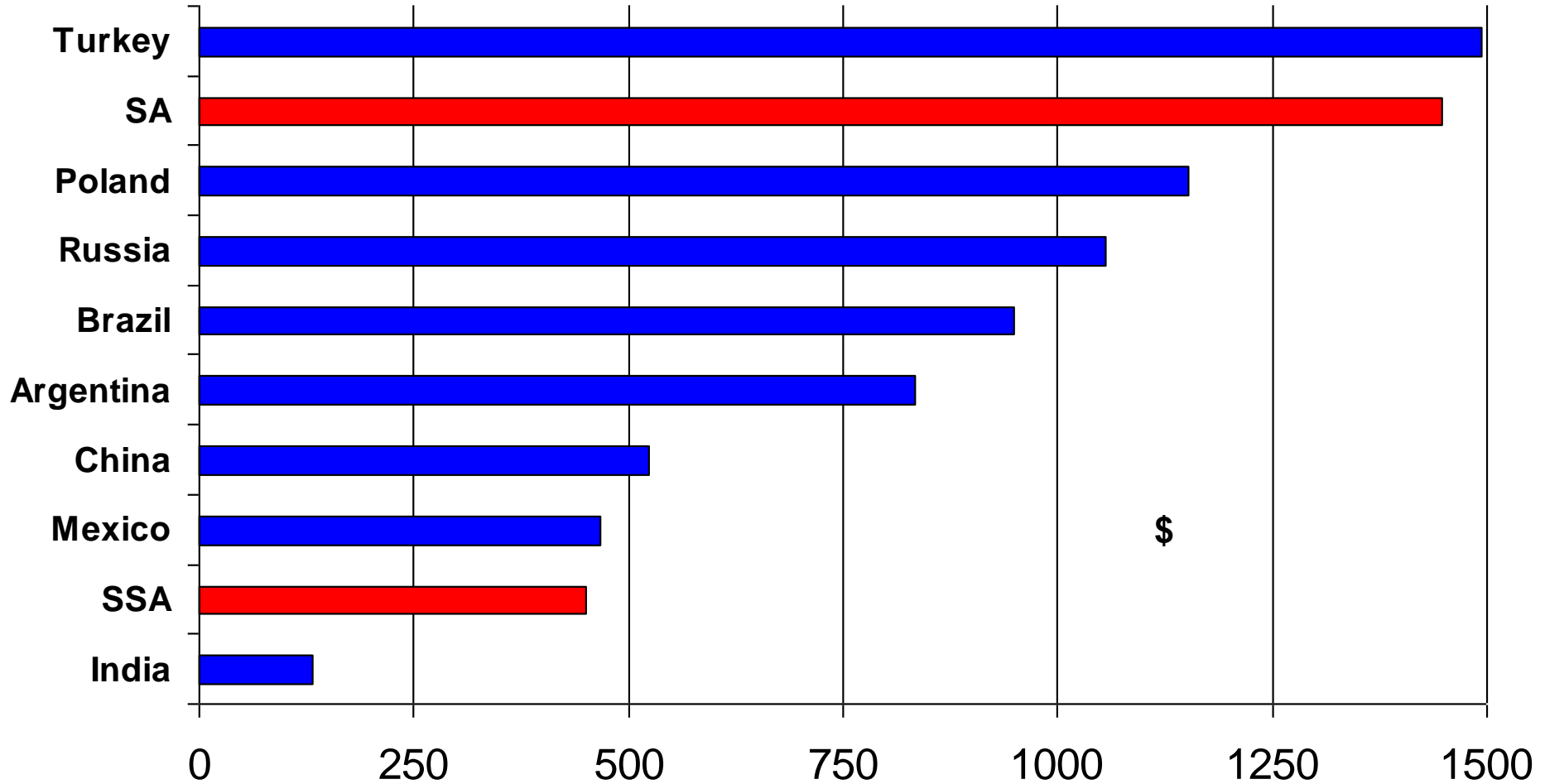
(Sources: EU; ILO; Economists.co.za)



# Average monthly wage in 2011 – selected emerging markets

(US\$)

(Sources: PwC; Ekonostrat)



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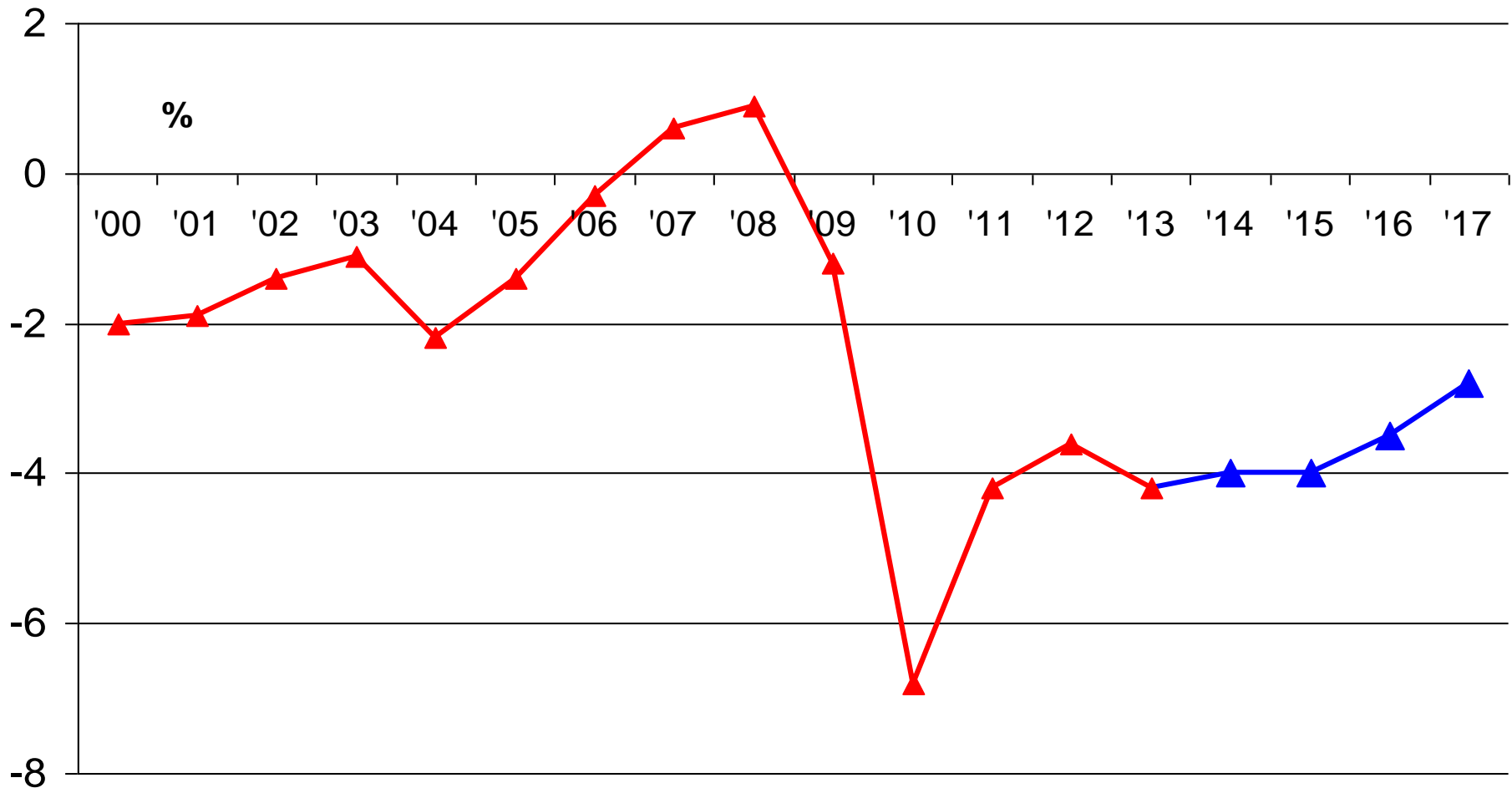
# South Africa's highest-ranked competitiveness indicators

Regulation of securities exchange	1
Auditing & reporting standards	1
Efficacy of corporate boards	1
Soundness of banks	3
Availability of financial services	2
Effectiveness of anti-monopoly policy	6
Reliance on professional management	13
Quality of air transport infrastructure	15
Quality of management schools	15
Efficiency of legal framework	16

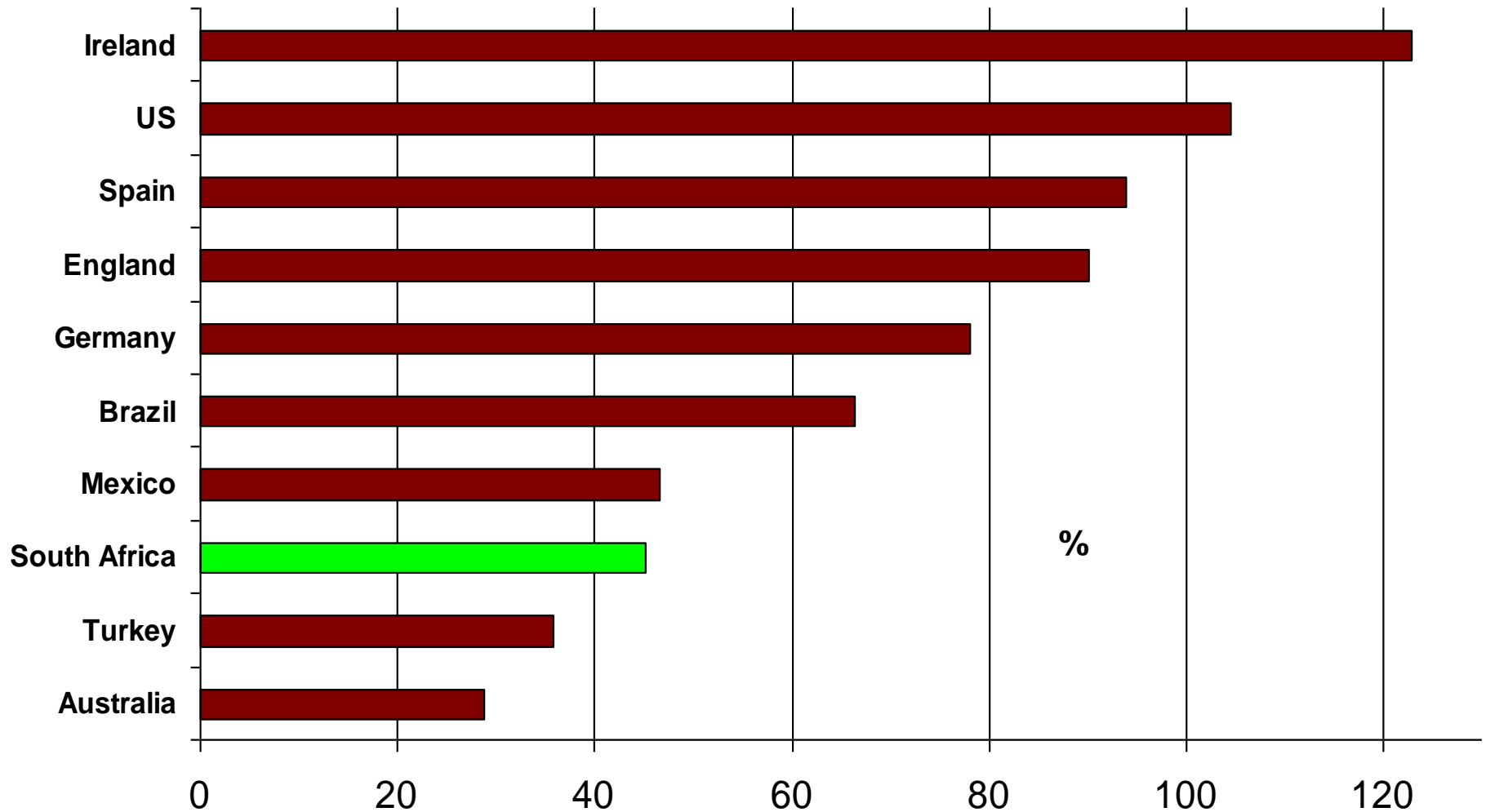
# Note #1 to Fitch & Moody's: SA budget deficit/GDP ratio &

forecasts – fiscal years ended 31 March

(Source: National Treasury)

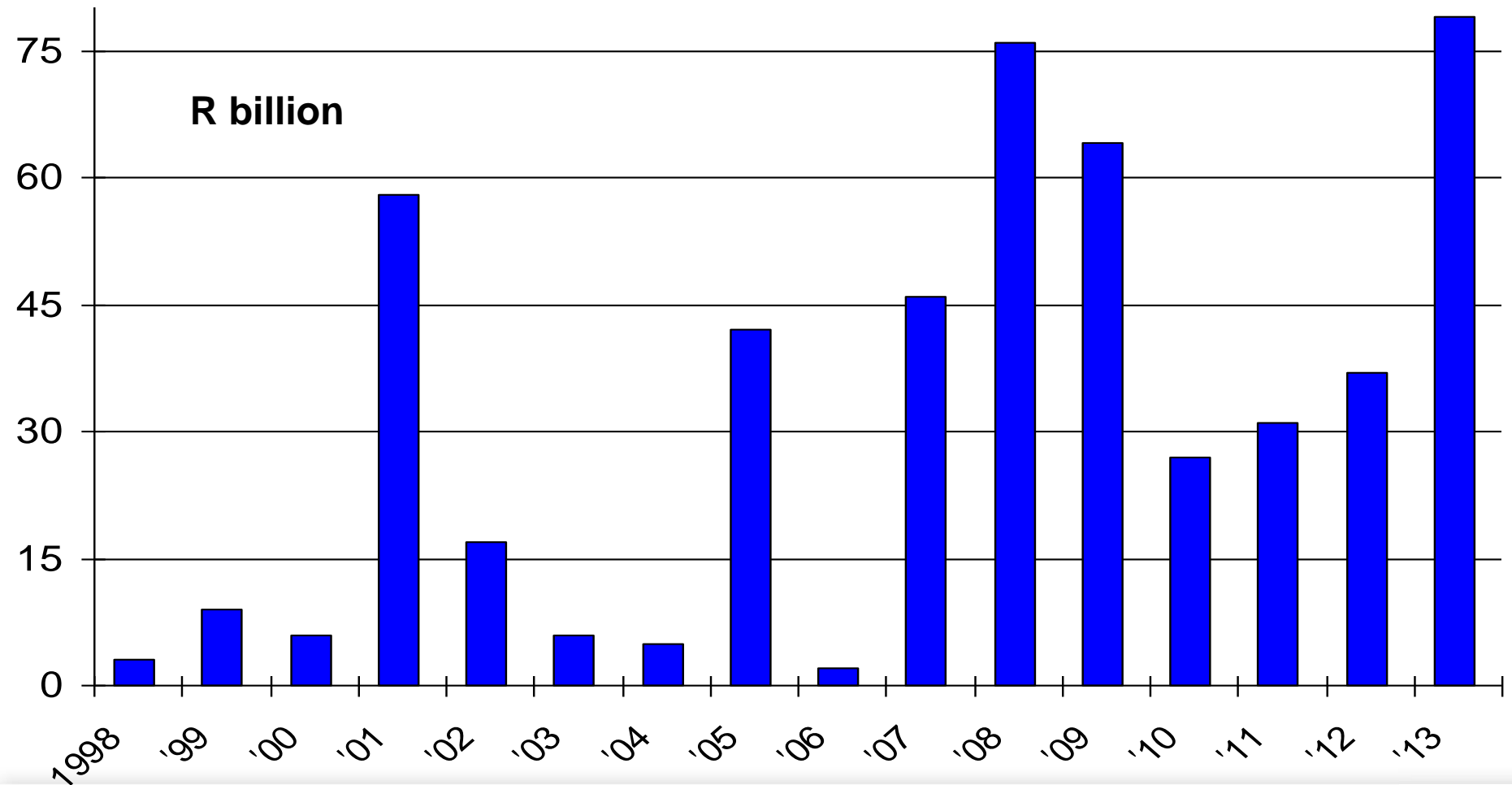


# Note # 2 to Fitch & Moody's: Gross public debt/GDP ratios – selected countries *(SA below average)*

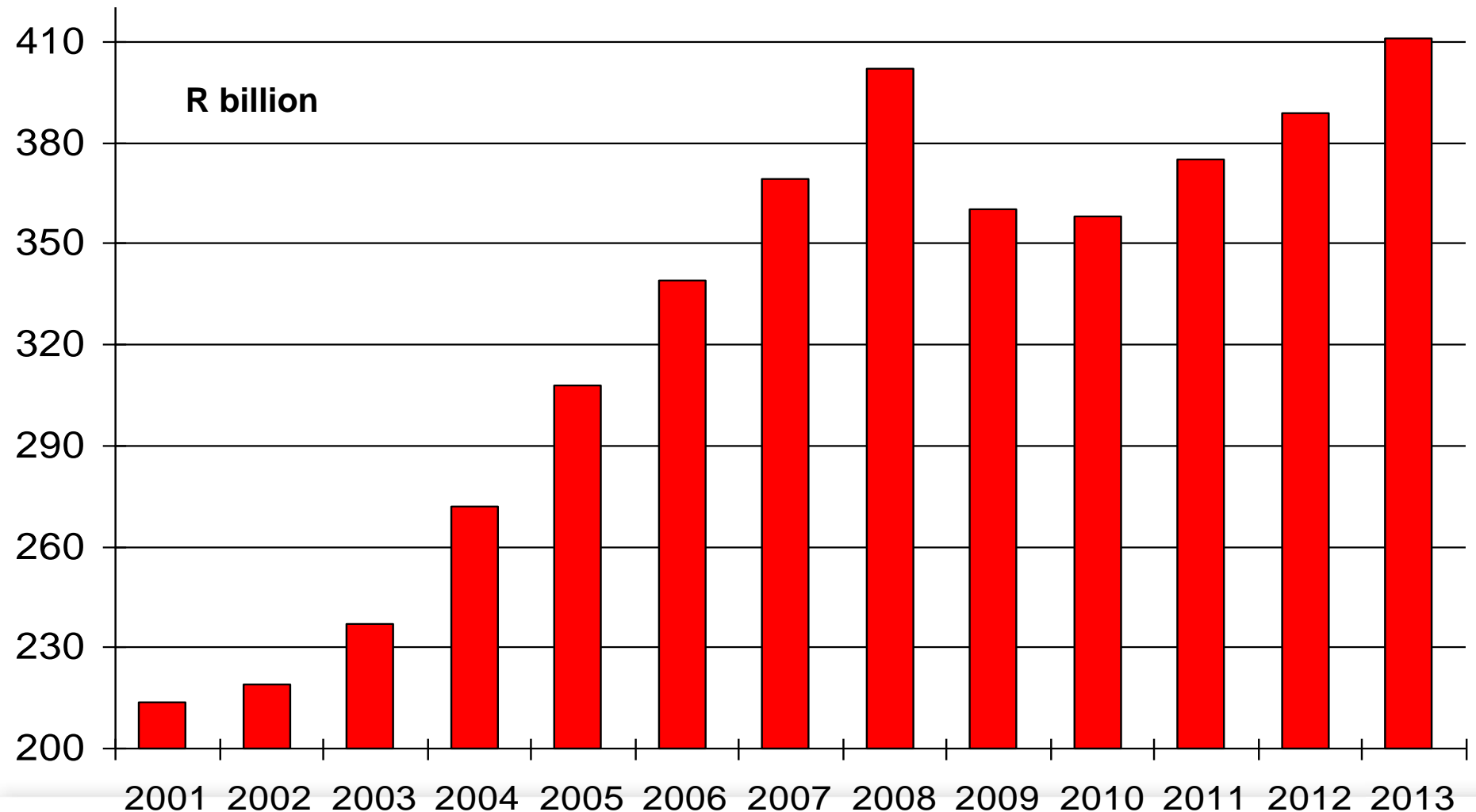


# Note # 3 to Fitch & Moody's: Gross inward foreign direct investment to South Africa

(Source: SARB)

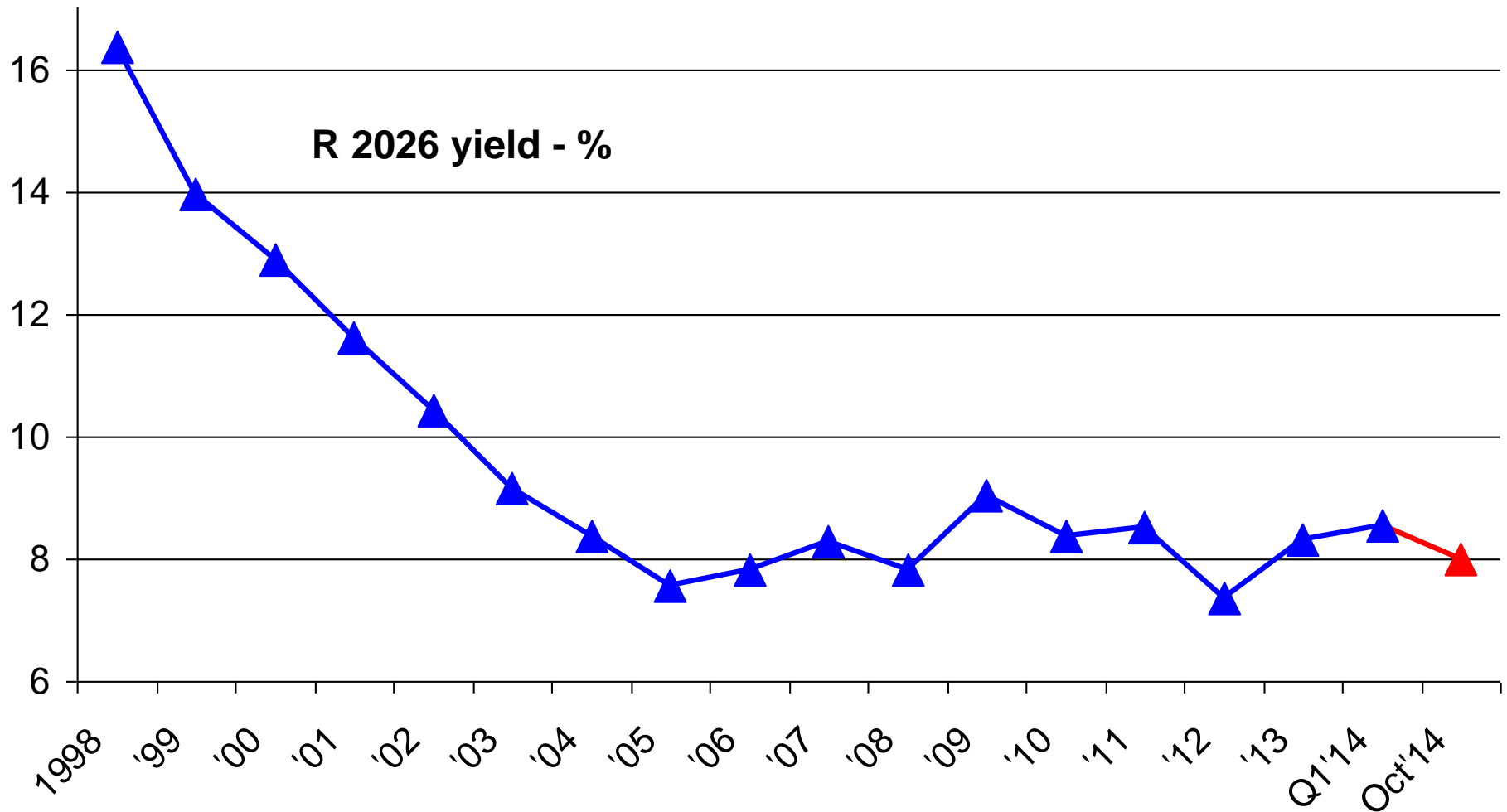


# Note # 4 to Fitch & Moody's: Real investment in new production capacity by the private sector - 2013 p *(Source: SARB)*

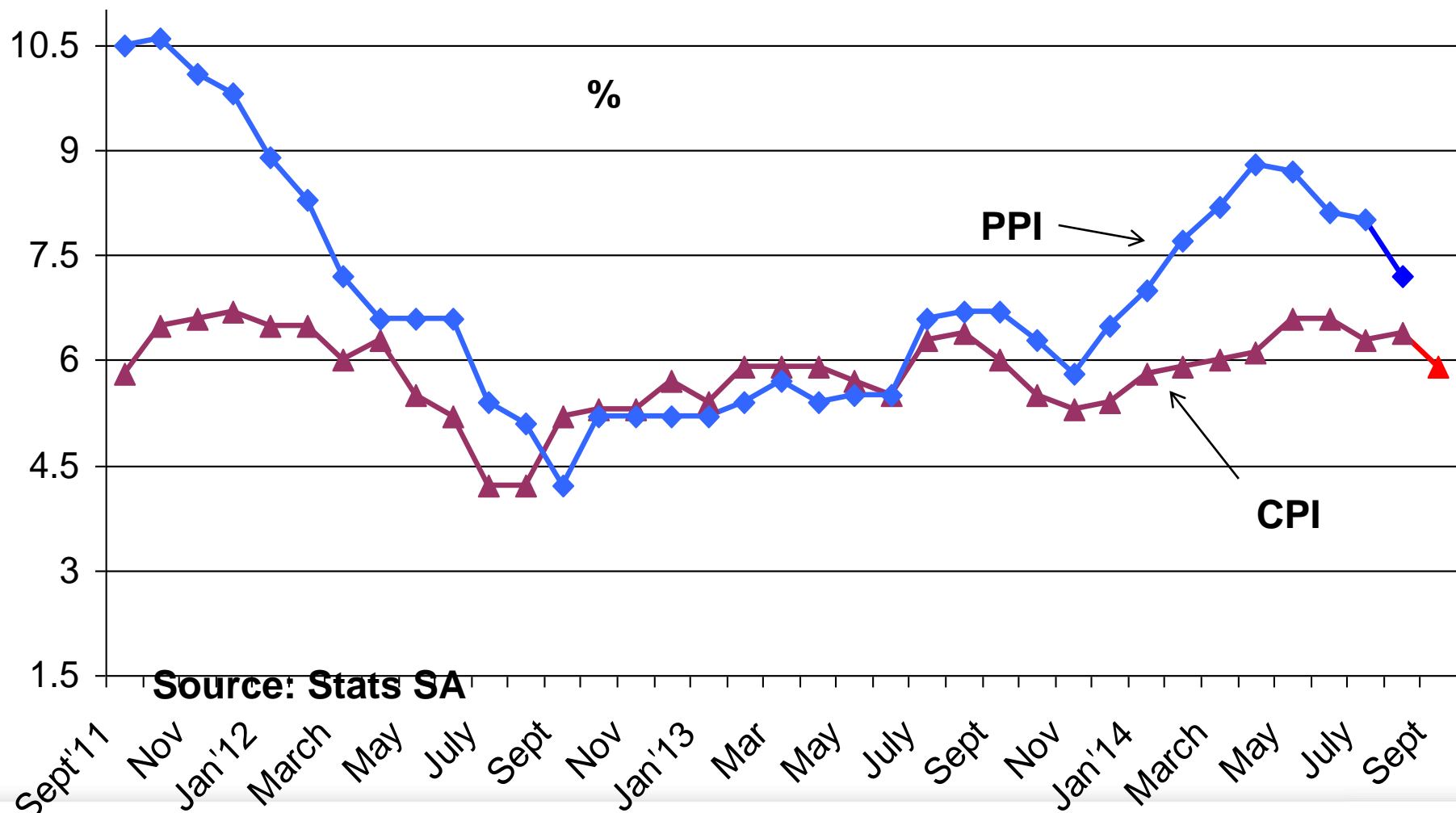


# Note # 5 to Fitch & Moody's: You fail the acid test of inverse causality with bond yield

(Sources: SARB; Thebe Securities)

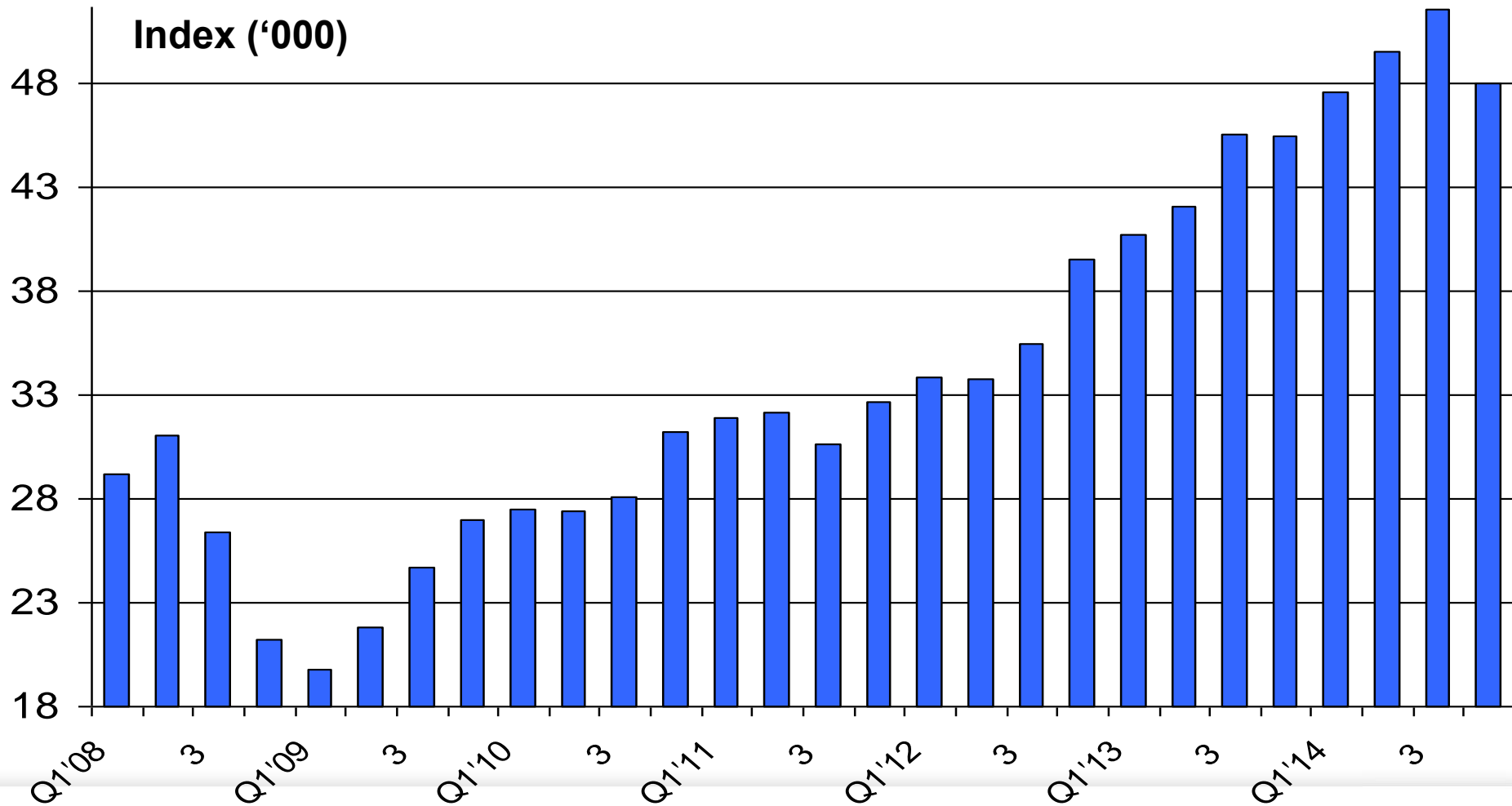


# Consumer & producer inflation should converge again soon, with CPI likely to drop to below 6% in Q3



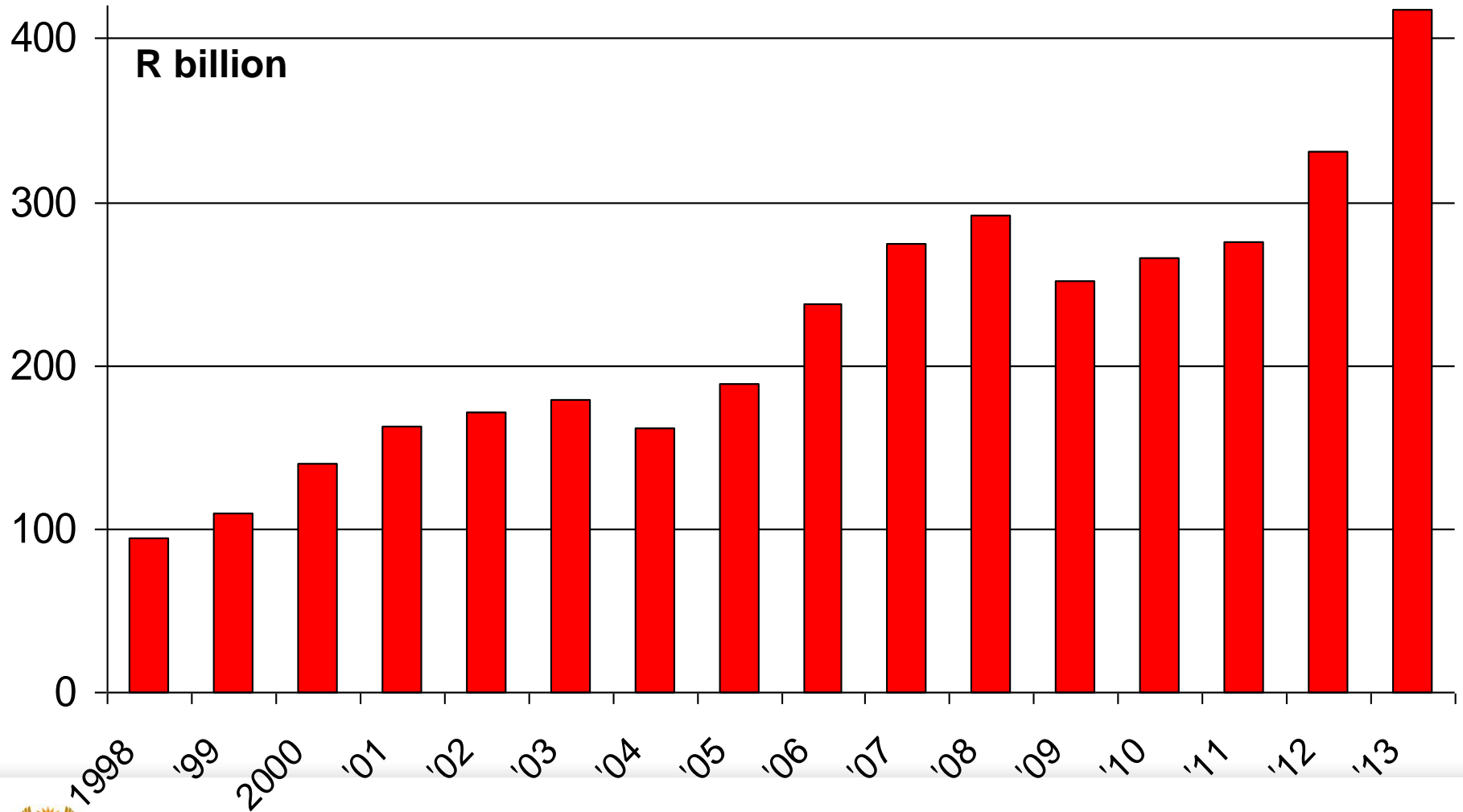
Source: Stats SA

# A new record high for JSE all share index (Alsi)



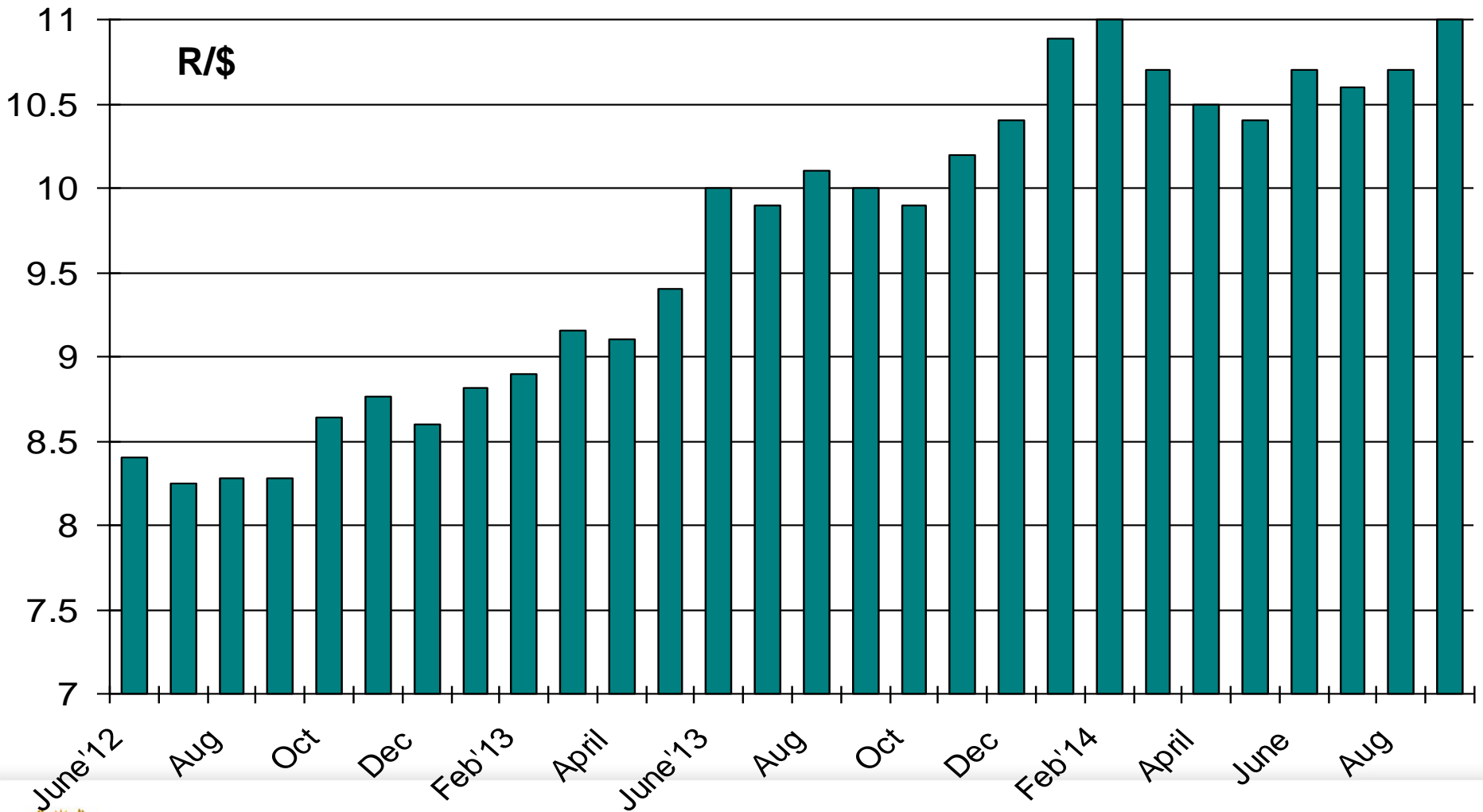
# Premium income of long-term insurers reaches a new record high

(Source: SARB)

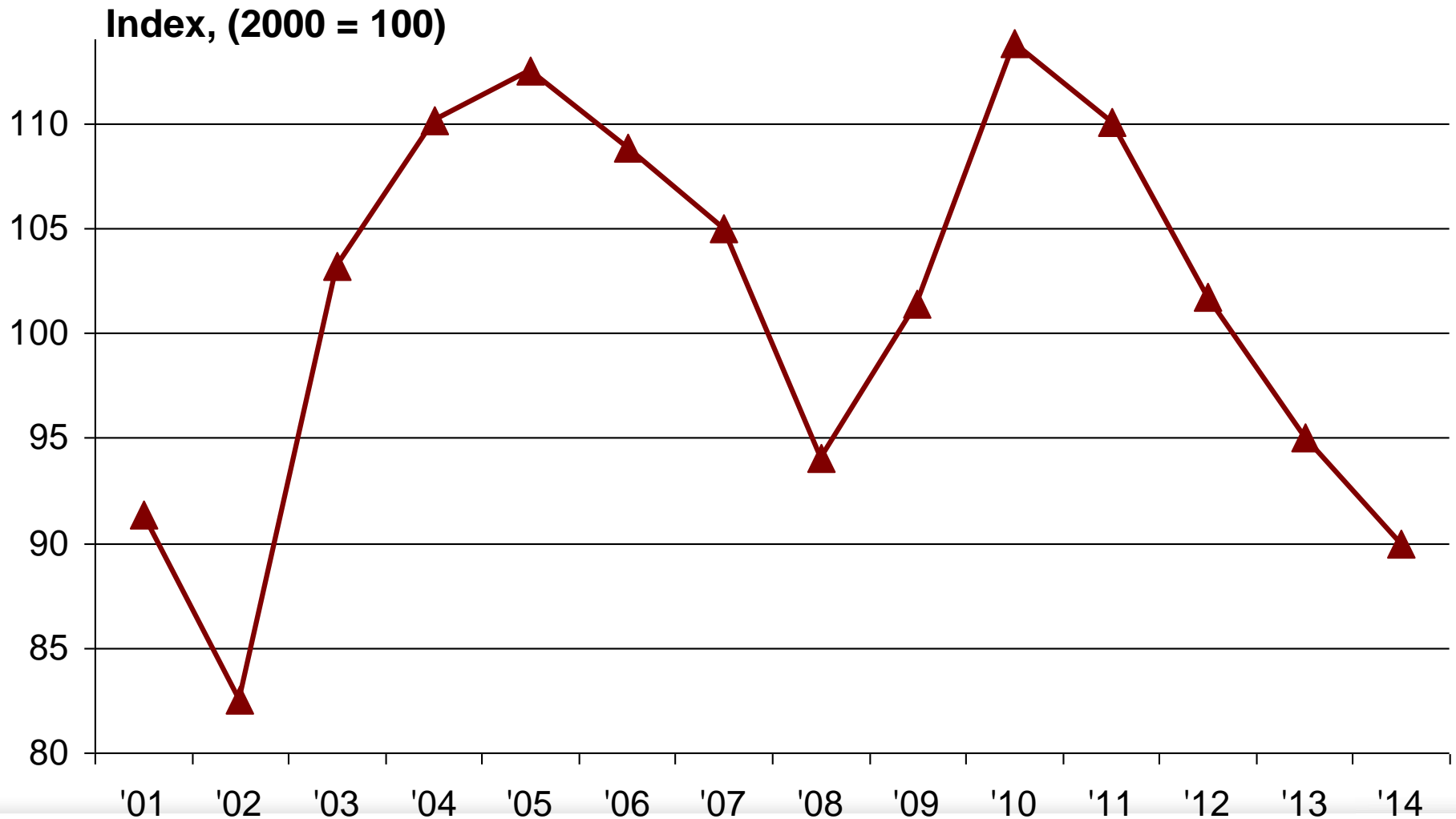


# Rand/US dollar exchange rate (monthly averages)

(Sources: SARB; Thebe Securities)

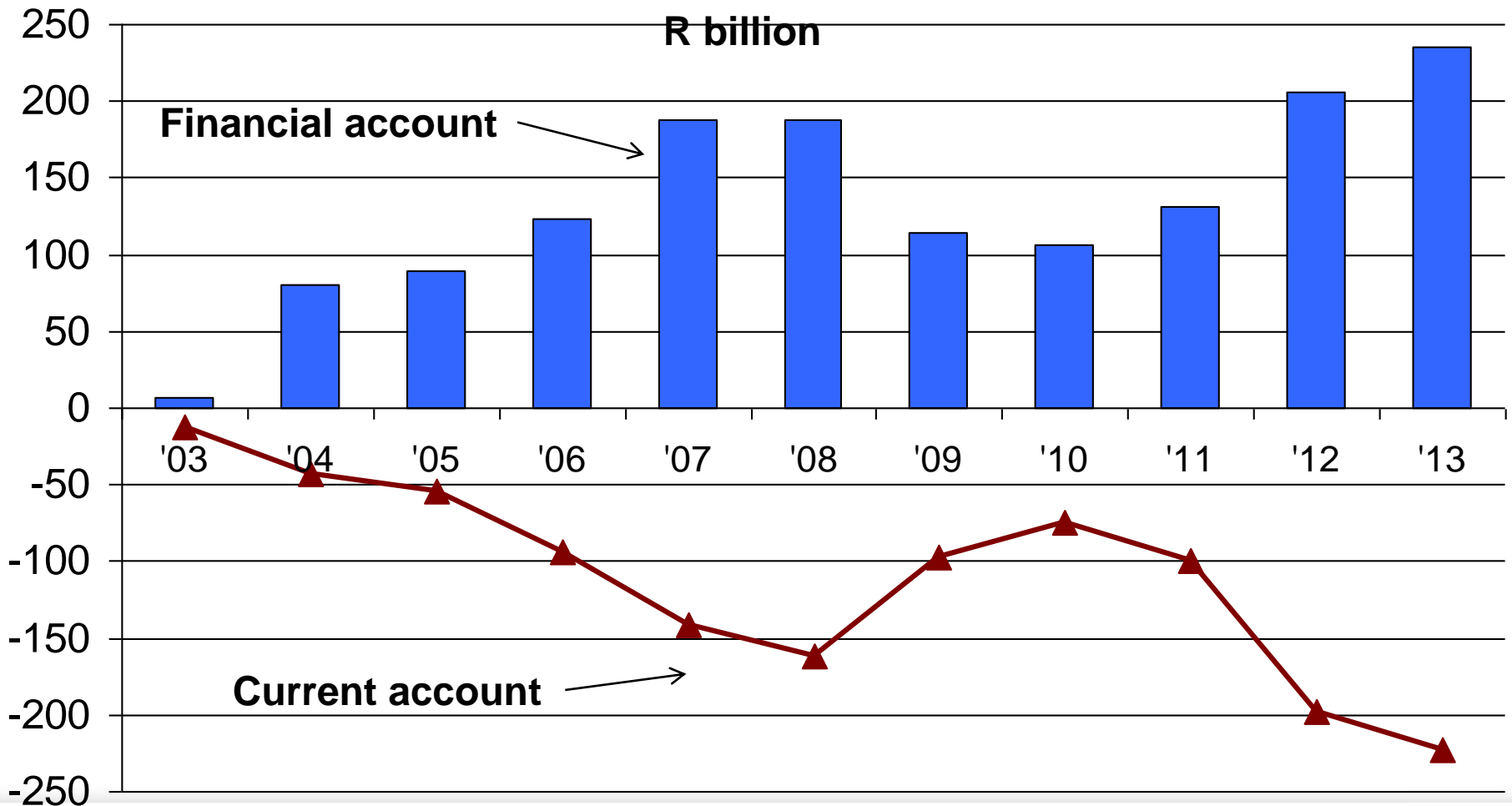


# Real effective exchange rate of the rand



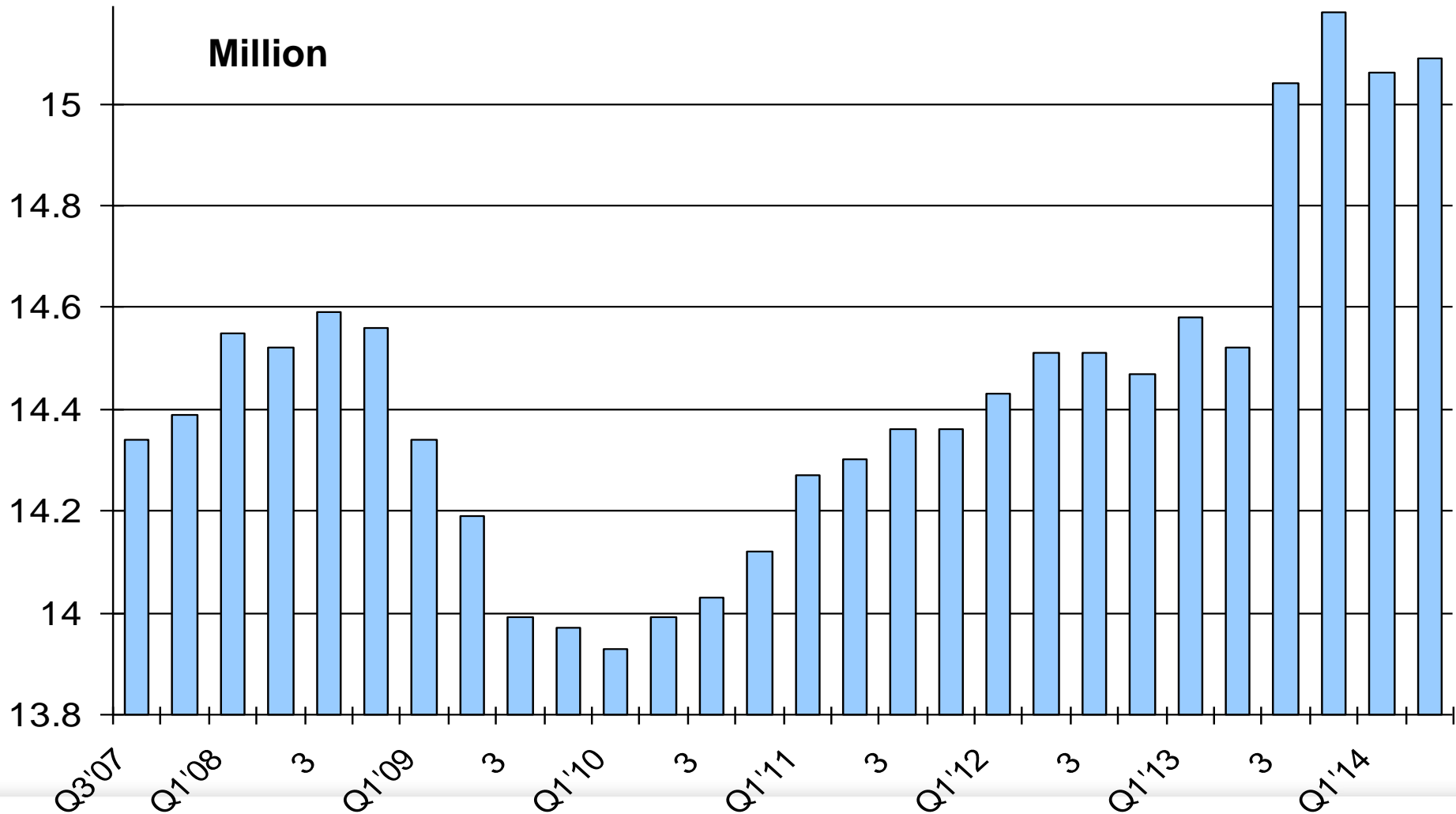
# Balance of payments – current & financial account (including unrecorded transactions)

(Source: SARB)



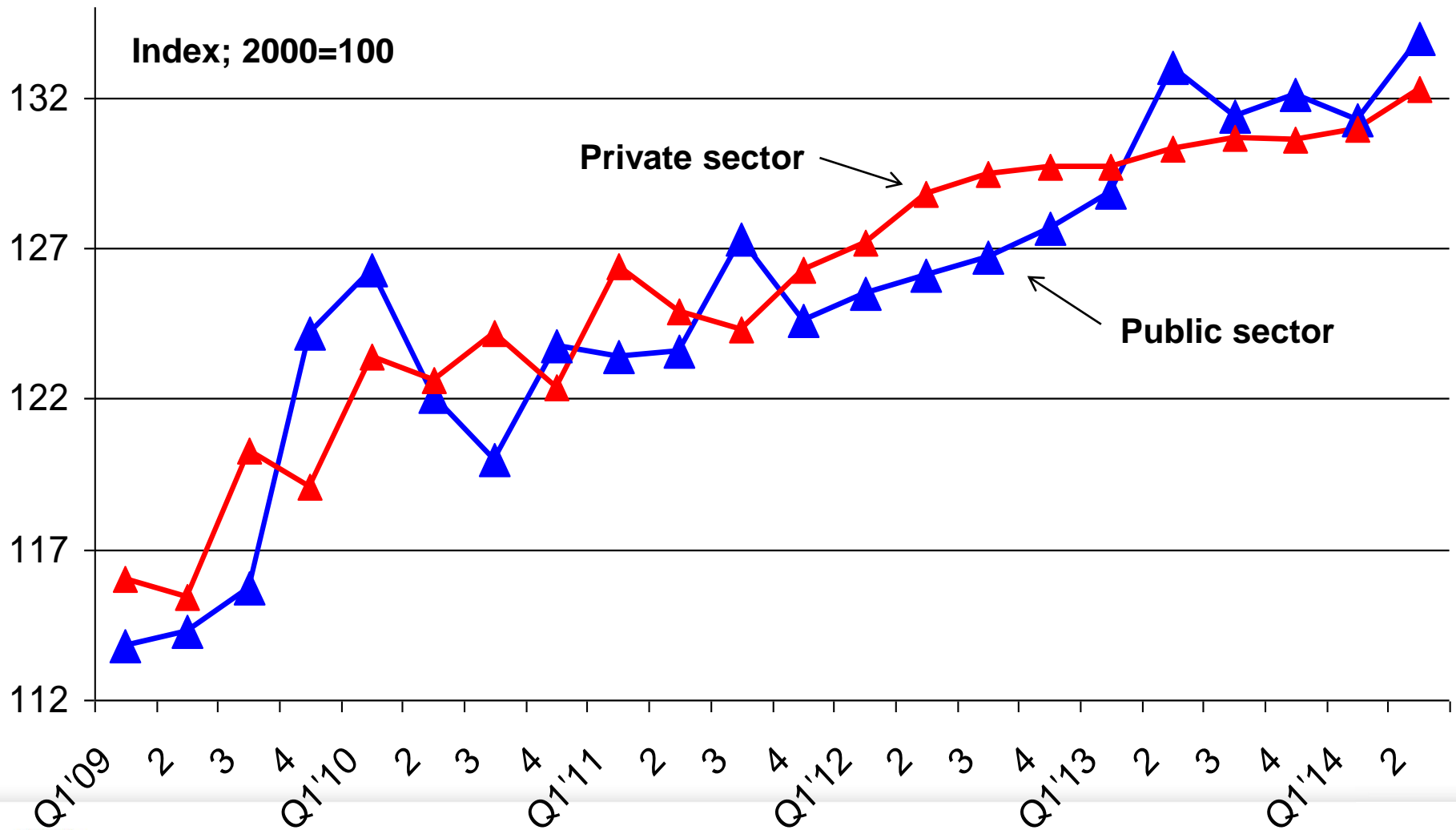
# Total employment in South Africa – continued progress after recession

(Source: Stats SA)

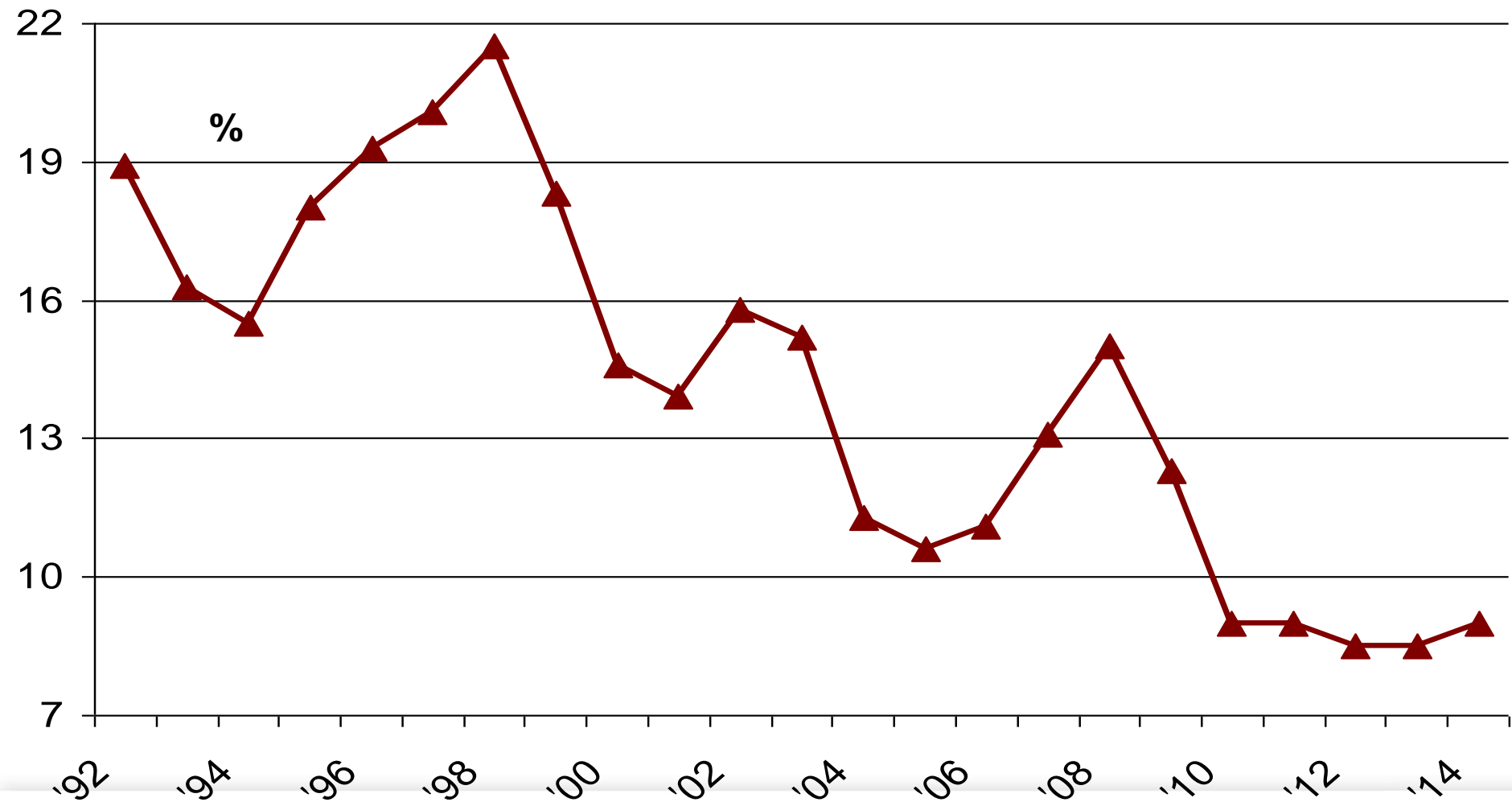


# Post-recession trends for real salaries per worker in the

private & public sectors *(Sources: Stats SA; SARB; own calculations)*

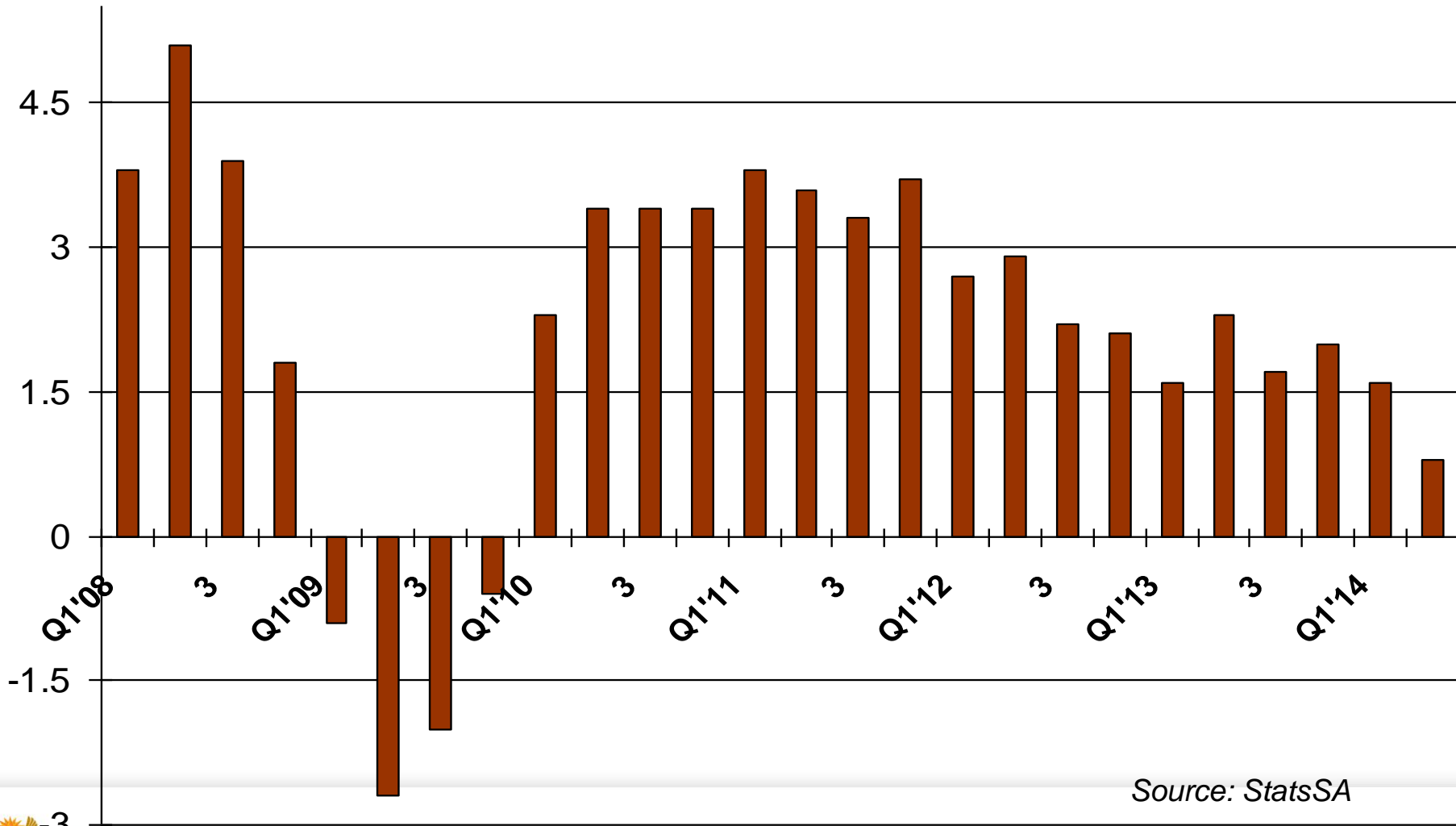


# Lowest prime rate in 40 years enhances household spending power



# Economy has expanded for 17 successive quarters

(y-on-y basis, annualised %), but trend is flat



Source: StatsSA

# New record high for gross national income *per capita* –

constant 2013p

(Sources: SARB; own calculations)

