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BRENTHURST
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MEDIUM-TERM BUDGET POLICY STATEMENT - IT'S ALL ABOUT WAGES

IT ALL COMES DOWN TO THE WAGE BILL. That was our main conclusion after wading through the latest Medium-Term Budget Policy Statement (MTBPS). South Africa has been spending beyond its means for several years. Going into COVID-19, there was a general awareness that expenditure needed to be cut, and growth boosted.

Four months into the COVID-19 crisis, in June 2020, Finance Minister Tito Mboweni announced very ambitious spending cuts of R230bn in the two years starting 1 April 2021. This was in addition to the R160bn in cuts to the projected wage bill that had already been announced in February 2020. If these cuts were implemented, the Supplementary Budget projected that South African government debt-to-GDP would stabilise at 87.4% of GDP in 2023/24.

At first glance, it appeared that there was a fair bit of backtracking in the MTBPS plans to cut spending. The peak in the debt-to-GDP ratio has been pushed out to 95.3% of GDP in 2025/26. Overall spending is forecast to be cut by around R100bn less than was announced in June. Of this, the National Treasury is forecasting interest costs to rise by R25bn – partly due to the higher bond issuance that will be required to fund the larger deficits.

The "capitulation" in non-interest spending was R77bn over two years. Given the sheer size of the funding requirement South Africa faces in the current and forthcoming years, any slippage on expenditure plans is not ideal. However, the planned cut in non-wage spending envisaged in June was likely to lead to a significant erosion in already weak service delivery.

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The better plan is to reprioritise spending in the budget to improve service delivery and increase the social wage. By social wage, we mean the services and amenities provided in South Africa from public funds. The Presidential Economic Advisory Council's recently released document clearly noted that "where tough decisions need to be made is wages" and that "it will not be possible to shrink the deficit with our current wage bill".

The MTBPS added R160bn back to non-wage spending and compensated by planning even deeper cuts in the wage bill. Essentially, the MTBPS plans a flat government wage bill over the next three years. Given the pressure on private sector wages through the COVID-19 crisis, this step is exactly what is needed.

In the current fiscal year, public sector wages will account for 60% of all taxes collected. Therefore 2.5% of the population will consume 60% of all taxes collected. In 2006, average public sector remuneration was just under 3 times per capita GDP. By 2020, this has grown to 4.7 times per capita GDP. As the latest MTBPS notes, this divergence in growth is not sustainable.

> **IDEALLY, THE PRESIDENT WOULD LOOK TO CONSOLIDATE GOVERNMENT DEPARTMENTS, THEREBY REDUCING THE NUMBER OF MINISTERS AND SENIOR BUREAUCRATS.**

The trillion-rand question is whether there is the political appetite to hold this very unpopular line with public sector unions.

The Finance Minister adopted a conciliatory tone in his approach to the wage negotiations: "We cannot expect our civil service to carry the burden of nation building alone. Consideration should be given to the proposal for across-the-board compensation pay reductions to management-level positions, across national, provincial and municipal governments, state-owned entities [and] all other senior public representatives."

Ideally, the President would look to consolidate government departments, thereby reducing the number of ministers and senior bureaucrats. That would go a long way to appease union concerns about fat-cat politicians and senior managers. However, firing the politically connected may be even less palatable for the ANC than holding the line on wages.

The MTBPS attempts to be realistic about the spending cuts that can be achieved while holding a tough line on wages. With that combination, the MTBPS is solid – aside from the allocation of R10bn to SAA.

If the tough line on wages collapses, it becomes impossible for South Africa to avoid the passive path outlined in the June Supplementary Budget. Quite quickly, that path leads to failed auctions. To avoid that, the spectres of prescribed assets, capital controls, debt monetization and eventual default loom.

There is a high road to be found in these numbers. Completely flat wages for four years are unlikely, but an agreement with limited slippage is likely to boost market confidence and lead to lower borrowing costs.

Going into the MTBPS, there was some hope that the National Treasury would be able to reduce issuance in the coming weeks. It is running ahead of issuance year to date. However, the expenditure changes mean that issuance cannot fall.

The implementation of some of the key reforms listed in the economic recovery plan – starting with the acceleration of the renewable energy transition and easing the cost of doing business – will boost confidence, investment and growth, while lowering borrowing costs. Higher growth rates will broaden the tax base and ease the debt ratios. Revenues could surprise on the upside due to higher mining sector profits this year. This combination could allow for lower issuance post the February 2020 Budget – which would further lower bond yields.

The risk is that the capitulation on SAA signals an inability of the government to take the difficult stance on wages. If that were to occur, the reverse of a virtuous circle will happen rather quickly.

> **THE IMPLEMENTATION OF SOME OF THE KEY REFORMS LISTED IN THE ECONOMIC RECOVERY PLAN WILL BOOST CONFIDENCE, INVESTMENT AND GROWTH, WHILE LOWERING BORROWING COSTS.**

Source: Ninety One Asset Management

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