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TheInvestor

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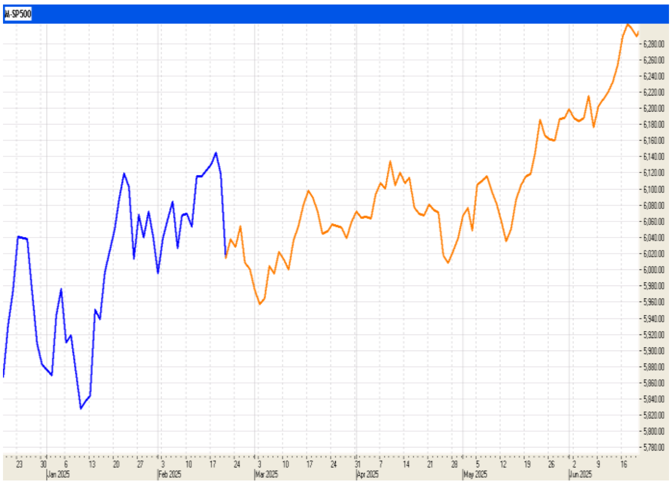
ShareFinder's prediction for Wall Street for the next 3 months (left) and the JSE (right).



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Securing your assets

By Richard Cluver

There's a new sheriff in town and many fear he is quite mad. But it could be worse than that. Could all the bluster be a smoke screen hiding a nearly fanatical belief that he is a new messiah sent to save the world from itself? Yet might he be the one who makes change possible?

After all, could so many people whose opinions we usually respect be wrong in their belief that Donald Trump is the right man to deal with the world's seemingly intractable current problems? And can the bulk of global investors who daily turn to Wall Street's S&P500 Index for guidance on the financial health of the planet also be wrong for, though economic policy uncertainty is spiking, the extraordinary truth is that investment markets are rising strongly in the face of it all!

Furthermore, though many believe Trump is tilting at windmills, the fact is that a significant percentage of respected economists believe his economic ideas could be sound! Governments everywhere are taking far too much of the economic pie and spending it wastefully, that's why growth is stuttering everywhere and why change is urgently needed….while US debt could soon engulf us all!

So, while it is probably true that the vast majority of the world's population are appalled by Donald Trump's personal image as the worst kind of playground bully, the locker-room sexual-prowess boaster whose gross egocentric personality appals even the most broad-minded of us, the same majority appears to believe he is nevertheless the right man for the moment. Furthermore, let us not forget that the formal vote in the US Electoral College gave Trump 312 votes against Kamala Harris' 226: an overwhelming majority of voters who clearly believed the US needed change and that Trump was their best hope!

Recognising that global politics and our own sense of morality – what is right and what is wrong with the way we collectively behave – adheres to an endless cycle which over time swings too far in either direction before it auto-corrects, it is thus probably true that Donald Trump has been elected by the American people because they perceive that the pendulum has swung too far towards a general philosophy which we might loosely define as Christian liberalism….others are calling it 'Woke.'

Liberalism which began with the simple idea that "All men are equal before God" has in recent years evolved in the eyes of liberal politicians into a massive system of wealth-transfer from the Haves to the Have-Nots. As a result the tax-burden on ordinary folk (caused by those who have recently led world politics) has become so severe that the great majority can no longer afford even the basic building blocks of traditional capitalism like home ownership, the provision of a retirement nest-egg and the ability to provide their children with tertiary education!

Their ballot-box-revolt is displacing governments all over the planet and in the US it has given Americans Donald Trump who has a core belief is that the wealthy are grossly and unfairly over-taxed and that the substitution of Income Tax in the place of import tariffs in 1913 was a gross mistake because it transferred the costs of government from the people as a whole to a dwindling minority.

And of course he is correct in the final result because in the US the top one percent now pay half of all federal taxes while the top 50% of filers are responsible for 98% of all income taxes.

In the Developing World the ratios are even more skewed with the South African example that only three percent pay more than three quarters of all income tax.

Replacing income tax with tariffs

Much like the controversial VAT trade-off which deadlocked the 2025 Budget, Trump's Income Tax plan would clearly spread the cost of government more evenly across all of the US, something Socialists oppose and this is the nub of their criticism of taxes like VAT since they are said to hurt the poor more severely than they do the wealthy. But how severely would such a switch hit the average American and indeed the average South African?

So let's start by considering what level of import tariffs would be required to replace income tax in the US, noting that last year the US imported goods and services worth $4.110-trillion against exports worth $3.19-trillion resulting in a trade deficit of $918.4-billion….the principal reason why Trump wants far bigger tariff barriers to protect home-grown producers.

Meanwhile, Federal Income Tax revenue in 2024 was $4.92-trillion. Thus a back of the cigarette box calculation suggests that in order to replace income tax, Trump would have to apply an average import duty of 120 percent. That would arguably shock the world into another Great Depression!

Just how seriously that might impact the average US consumer might be judged by noting that imports constitute 14 percent of US GDP while two thirds of GDP is represented by retail spending. So, on the face of it, increasing the price of imported goods by 120 percent will have a serious impact on the average American at retail level. Moreover, while the average American household spends nearly 14 percent of its budget on food and beverages, the poor on average spend 32.26 percent. So it COULD impact the poor severely…but would it really?

But before you start shouting UNFAIR, you should note that imported foodstuffs are largely represented by luxury goods in the average US shopping basket; think French wine, Dutch cheese etc, items that are very unlikely to feature very high on the shopping lists of cash-strapped families. Indeed, official US statistics reflect the imported portion of the average US grocery basket is less than 13 percent. And it is nearly zero when one examines what the poor spend!

In South Africa, the principal reason why the proposed 13.3 percent VAT increase was thrown out last week was the fact that the poor spend 50 percent of their income on food whereas wealthy families spend only 11 percent.

So how would such a tax switch work in South Africa? Well here, Income Tax produces 33 percent of Government's R2.2-trillion gross revenue - or a total of R728 billion - while our annual import bill is R153.7-billion and so our imports would have to be burdened with a 473 percent import tariff to replace Income Tax which implies it might be completely unworkable here.

But let's not be too quick to jump to conclusions. In South Africa food imports represent just 6.32 percent of all merchandise imports though that does include a fifth of our white maize consumption which is a staple of poor households. Furthermore, 63 percent of the diesel used in this country is imported and 29 percent of petrol and so, unless one excluded maize and fuel from import tariffs, increased import duties could significantly impact transport costs which could in turn severely impact the poor…..except of course that the Government does already heavily tax fuel. It takes R6 on every litre!

That aside, the problem with taxation in South Africa is that the wealthy are so heavily taxed that overwhelming numbers are leaving the country. Furthermore tax tsar Edward Kieswetter wholeheartedly agrees and constantly cautions against any taxes which target the 'Wealthy: Income Tax, Capital Gains taxes and Estate Duty because in SARS' experience such increases no longer yield increased revenue. They only encourage tax avoidance of which the most problematic is the emigration of the wealthy who take rare skills with them.

The facts here are that we have 18-million South African taxpayers but just 180 000 of them pay an average of R4.03-million each: representing 45 percent of the entire burden. If the burden were equally shared among South Africans' 18-million registered taxpayers, each would pay just R3 361 a month out of an average income of R25 304. That's an average tax rate of 13.2 percent against the 45 percent paid by our wealthy: a surely fairer approach? That's why Kieswetter is asking for a bigger budget to be able to go after those who are not paying their fair share!

Actually it is high time we started realising how vital our 'wealthy minority' are to the economy. This tiny group. Which is regularly pilloried by politicians as "still living off the benefits of apartheid" are in fact such a tiny and dwindling minority that they might all soon disappear completely. Indeed, the 'Wealthy' represent just 0.0025 percent of ALL South Africans and we desperately need them here because they are our entrepreneurs, our top professionals and our senior management whose presence on average accounts for the livelihood of 300 people each. But currently they are leaving the country in record numbers! Four hundred multi-millionaires - those with assets of more than R18-million – left last year and 500 the year before.

But it is not just the ultra-wealthy who are going, middle-income people are leaving in even greater numbers because, notwithstanding taxes which collectively strip even our middle-income people of more than half their earnings, there is the added burden of estate taxes which prevent them from guaranteeing the futures of sometimes vulnerable children. And of course there are Capital Gains Taxes which, though costlier to collect than the revenue they produce, both impede the capital-building requirements of retirement-planning and the economic growth of nations.

Yet, despite these heavy burdens, governments everywhere are still unable to balance their annual budgets. In the latter case, in countries like South Africa this lethal cocktail of estate duty and CGT, because of their toxic knock-on effects on capital creation, is a major contributory cause of our record levels of unemployment because capital shortage is the reason our borrowing costs are so high that in turn, together with our minimum wage legislation, they make it impossible for local industry to be globally competitive! Often wondered why South Africa is rapidly de-industrialising? Now you understand!

But despite these elevated levels of taxation, few governments are able to boast deficit-free budgets with the result that we are now witness to the greatest debt burden the world has ever known. In the US the national debt is so severe that in the eyes of its most respected business school, the Wharton School, it is probable that this year could see America's $34-trillion debt burden upset the world's financial markets by precipitating something worse than the 1930s Great Depression.

Indeed, developmental states like South Africa already manifest unemployment rates worse than those which marked the Great Depression. In the US unemployment peaked at 24.9 percent in 1933 compared with South Africa's current official 32.9 percent, that latter number being some 2.6 times South Africa's 12.5 percent of workers who were employed in the social 'Make-Work' programmes of the mid-1930s.

Trump believes that the American people have lost control of their economy; that it is controlled by a "Civil Service Bureaucracy" which he and his supporters believe annually squanders something close to one trillion dollars. But even if he is able to curtail that much wasted spending, it will not be enough to eliminate the deficit. Currently the US Government spends $7-trillion a year against revenue of $5.2-trillion adding $1.9-trillion annually to its current debt of $35.5-trillion.

Furthermore, Trump's campaign-promised tax cuts through the extension of his 2017 'Tax Cuts and Jobs Act' - which lowered tax rates for most Americans - will alone cost $4.6-trillion over 10 years. And he has promised a raft of others likely to cost another $half-trillion annually before one even tries to count in the consequence of economic measures like punitive tariffs.

Collectively these imply the impossibility of eliminating the US deficit. In short then, as Nobel prizewinning economist Joseph Stiglitz was quoted last week as warning that, "there is no way that the incoming administration can enact its economic agenda and keep the government running."

So the advent of Donald Trump with his seemingly extremist policies could actually be a last resort for a stuttering world economy heading to financial Armageddon. Sooner rather than later, the American people will no longer be able to service the interest burden of that debt, so let's ponder for a moment the consequence.

For the US itself, possibly the most serious result would be the collapse of the US dollar and its replacement as global trade's "unit of account." That essentially means that the US Dollar, which is the medium of some 92 percent of world trade, will no longer be able to fulfil that role. For the US, however, it means far more.

Unlike its trading rivals, no matter how much debt the US government owes foreign investors, it can currently simply print all the money it needs to pay them back. That is why the world has suffered from a severe inflation problem in recent years with knock-on effects which pose further hidden taxes on the people. Other countries must meanwhile buy either the dollar or the euro to pay their foreign debt. And the only way for them to do so is either to export more than they import or to borrow more dollars or euros on the international market.

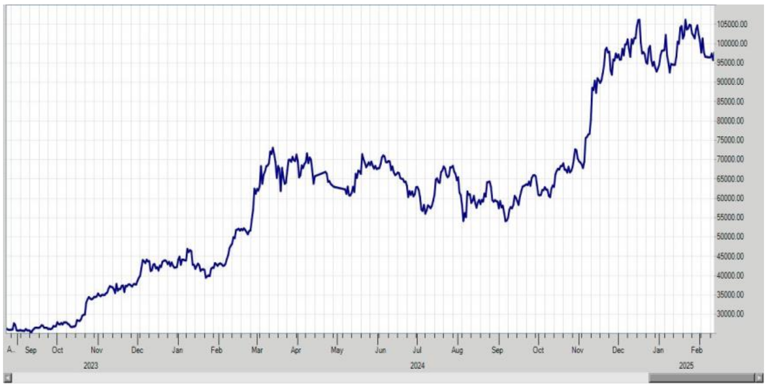
However, if the US dollar is displaced as the world's unit of account, the US will no longer have that money-printing advantage and, like the rest of nations will only be able to spend what it rightfully earns. In a flash the illusion of American wealth will be gone forever. No surprise then that Donald Trump is promising to punish any nation which backs the BRICS plan to create an alternative world currency!

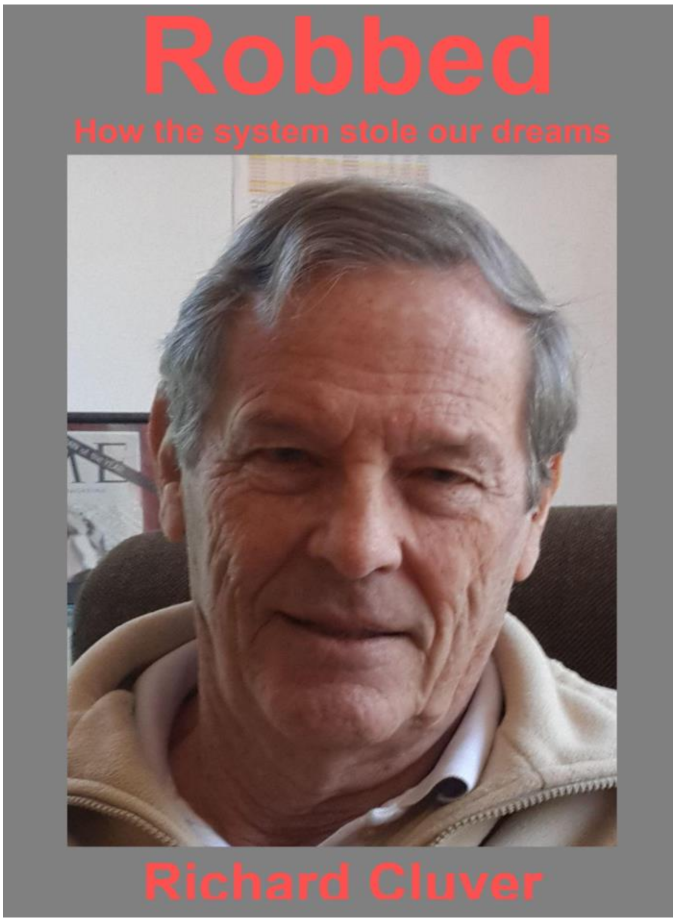
So if the dollar collapses, investment markets everywhere will not be able to continue normal operations in the face of such dramatic change. The cost of personal debt will inevitably soar to uncontrollable levels as credit dries up, commodity prices soar and the values of traditional hedge investments gyrate dramatically.

What can the ordinary person to protect his savings in the face of such threats? The easiest and most tradable means of protecting personal wealth is to invest in the shares of companies which themselves are largely free of debt and have a robust trading moat surrounding their operations….in

Blue Chip shares like those which form the bedrock of my Prospects Portfolios which is pictured below:

I cannot end, however, without observing that Wall Street, by its best measures, currently remains optimistic with its investment markets telegraphing confidence in the US economy. Even Bitcoin which offers the wealthy a means of moving their capital away from the prying eyes of governments, has recently come off the boil – see graph on the right. So perhaps the crash we fear might not be as imminent as some fear!





Because we believe the information in Richard Cluver's latest book should be essential reading for everyone who wishes to survive the monetary chaos that likely lies around the corner, we have made it available as a FREE DOWNLOAD

Click here to get your copy

Richard writes: "It is my considered belief that mankind has freely down the centuries given ourselves into successive forms of slavery because we have individually lacked the self-confidence to take leadership of our own lives into our own hands!

"This book is accordingly given free to all the people of Planet Earth in the hope it might promote a healthy discussion among all of us about the manner in which we have chosen to govern ourselves in the 21st Century.

If the thoughts I have expressed in it resonate with you, I encourage you to pass it on freely to everyone you know.

Revenue Thoughts for the USA

By John Mauldin

Real or not, the fact of Donald Trump's proposed trade affects business and consumer confidence, which in turn affects the economy in broader ways. Uncertainty surrounding growth and inflation is already high. Adding possible tariffs to the outlook is a further complication—and, in my view, an unnecessary one.

BUT… my view, like yours, is restricted. None of us outside Trump's inner circle know what the real goals are. What looks like needless chaos might lead to benefits that outweigh the costs.

One potential benefit is revenue. Could the tariffs produce significant tax revenue that would help reduce the federal debt? The president seems to think so. He's said it many times, often referring to the McKinley era when tariffs represented almost all the government's tax revenue.

In the current situation, we obviously need all the revenue we can get. But every kind of tax has side effects. The goal should be to create a fair system that produces the necessary revenue at the lowest possible cost for the economy. Could import tariffs be part of a new system that better accomplishes these goals? I would have once called this unthinkable. But we've reached a point with deficits and national debt where we must think the unthinkable. Everything has to be on the table.

But putting everything on the table doesn't mean everything stays on the table. It just means every idea should get a fair look. That's what I'll try to do today.

But before we jump into that, I need to do something that I've not done in 25 years of writing this letter. I am going to have to throw the flag on myself (or for the rest of the world either a yellow or red card). I suppose we could call it 15 yards for unnecessary data sourcing or perhaps roughing the data—data sourcing interference by the offense? I was rightly called out by multiple scores of readers for using uncorroborated data when talking about government spending.

You were right. There was enough verified data from government sources on fraud and overpayments that I didn't need to go there. It obscured the point I was trying to make and unnecessarily called the entire premise into question. I want to thank readers for their sometimes not so gentle feedback, because I deserved it. And you deserve better. I will do better.

I would actually prefer never to visit the intersection of politics and economics ever again, but I'm afraid with the current administration that won't be possible. We have to deal with what's happening in the real world. Sigh. And disagree when appropriate.

Highly Tentative Baseline Estimates

If tariffs are to be part of the revenue mix, we need to know how much they can contribute, and at what cost to the economy. Unfortunately, any answer is necessarily filled with assumptions. And you know what they say about assumptions.

The first problem is we don't know which countries and products would be tariffed, and at what rates. Even if we knew, there is no guarantee it would stay the same for long.

If the tariff plans were coming from Congress, there would be a long guessing game while they negotiated a bill. Then we would have clarity (for better or worse) once something passed. That's not how this is working. The President is using presidential authority that gives him wide latitude to do whatever he wants and to change course as events unfold. This has some advantages, but it creates even more uncertainty.

But let's assume Trump settles on a tariff scheme and then leaves it alone. Predicting its effects would still be hard because we can't know how other countries would react. Nor would we know how American companies and consumers would respond. This is Game Theory 101. The world was at an equilibrium. Whether it is a fair equilibrium is beside the point. The equilibrium exists. When one player changes the rules all the other players will adapt. The first player can try to guess what the other players will do, but he has no control over it. This makes assumptions particularly difficult.

Nonetheless, without some kind of baseline estimate, it's hard to even have a conversation. Several organizations have been trying to crunch the numbers and show what may happen. I'll review a few for you. Just recognize the limitations. As you will see, the estimates are all over the board.

The Budget Lab (TBL) at Yale issued a report last week on Trump's idea for a "reciprocal" tariff regime. This would involve raising the tariffs on a country's exports to the US to match whatever rate it charges on exports from the US. In practice, this would mean large tariff increases on most imports, since many other countries charge US exporters far more than the US charges them.

The TBL study estimates this plan would produce $3.5 trillion in tariff revenue over the next 10 years, assuming other countries didn't retaliate. In an alternate scenario assuming retaliation, it would be more like $2.7 trillion. However, those numbers are "conventionally" scored. A "dynamic" analysis that includes likely effects on GDP growth would reduce revenue by $200–400 billion over the 10 years.

Again, all this is highly tentative. If it is correct, and if that kind of scenario were to actually happen, the Treasury would get additional revenue of (worst case) roughly $227 billion to (best case) $350 billion annually, on top of income and other taxes. Those are big numbers. Not big enough to balance the budget on their own, but enough to make a difference.

Another study by the Tax Foundation looked at a "universal baseline tariff" plan—essentially a 10% or 20% across the board tax on all imports. They estimate a 10% universal tariff would raise $2 trillion over 10 years, while a 20% universal tariff would raise $3.3 trillion, when conventionally scored. Dynamically scored to consider likely economic effects, the revenue estimates are $1.7 trillion and $2.8 trillion, respectively.

As in the reciprocal tariff plan, the universal baseline idea produces significant revenue, but is not alone sufficient to balance the budget or offset the other tax cuts Congress is presently considering. It would help, though.

One more example: The nonpartisan Committee for a Responsible Federal Budget (CRFB) looked at the new 10% tariff Trump announced on China, which took effect on February 4, and the 25% tariffs on Canada and Mexico which are on hold until March.

The CRFB estimate shows the China tariff would generate a total of $200 billion in 2025–2035. The 25% rate on Canadian imports to the US (with a lower rate for certain energy products) would produce $500 billion over the 10 years, while the Mexico tariff would yield $750 billion. On a dynamic basis, the three would combine for $1.3 trillion over the 10 years. Or about $130 billion a year.

Unpredictable Things

All three of those tariff plans are quite aggressive. They would surely have serious side effects, if enacted. Global trade is an incredibly complex, interconnected web; unpredictable things can happen once you start unravelling them. Does the estimated revenue justify those risks? It's hard to say. But I personally think the unintended consequences will be significant. Like the first term, that will likely mean a lot of adjustments. Tariffs on autos are very complex and could result in much higher new car costs, which will eventually mean higher used car costs. Unless there are exemptions…

Let's also note that raising revenue isn't the only reason to consider tariffs. Remember where all this started. The US decision to normalize trade with China by allowing them into the WTO wreaked havoc on parts of the US manufacturing sector, putting many out of work and launching a variety of social consequences. Yes, we got lower consumer goods prices in return, but this was a cold comfort to many suffering Americans. And our government did little to help them.

Sidebar: Today the US manufacturers more goods than it ever has, it just does it with fewer workers. While it is convenient to blame manufacturing job losses on China or Mexico or another country with lower labour costs, productivity-enhancing technology has also been a very large factor in the loss of manufacturing jobs. With the expected growth of the robotics industry over the next decade, this is going to become even more evident, which is why some people with the economic understanding that God gave a goose suggest that we should tax the use of robots. Back to the main story…

In short, we failed to anticipate the side effects or make plans on how to handle them. That was a mistake some think we should correct. Furthermore, the COVID period demonstrated the very real risks of being dependent on foreign sources for important goods. China's geopolitical ambitions also make it unwise for the US to rely on a potential adversary.

Further, it's not as if we don't already have a lot of tariffs. According to The Economist, "America already levies taxes on a vast range of goods brought into the country. Its harmonized tariff schedule has 13,000 categories, from 'artificial flowers, foliage and proven parts thereof' to 'swords, compasses, bayonets, lances and similar arms.' If America decides that fairness means going tariff for tariff with all 180 or so trade partners, enacting that would produce around 2.3 million individual tariffs and result in outsourcing its trade policies to countries with entirely different industrial structures and interests."

As they point out, the mass confusion would border on the absurd. So any tariff would pretty much have to be across-the-board or very limited.

It's not easy. Columbia has a 70% tariff on coffee imports to protect its coffee industry. Putting a 70% tariff on coffee coming into the US wouldn't create a coffee industry in the US (with the acknowledged exceptional coffees of Hawaii and Puerto Rico).

Torsten Sløk points out that if you wanted to replace the income tax with tariffs as in the McKinley era, rates would probably need to be around 200%. On everything. He notes that would be inflationary. I would add that even a 20% tariff will be inflationary.

Share

I think it's pretty clear Trump wants the Federal Reserve to cut rates. However, even if tariffs only raised inflation by 1 or 2 tenths of a percent, it's still the wrong direction. That might be offset by the deflationary impact of fewer federal jobs. Or not. It gets murky very fast.

Let's note, though, the impact on American jobs would be important even if tariffs raised no revenue at all. In fact, "no revenue" might be the ideal outcome in the minds of many people (not mine!) if it meant Americans had stopped buying foreign goods because we had reasonably priced domestic substitutes. But as of now, our economy isn't able to deliver any such thing.

Further, it matters which particular goods we are talking about. You've heard of "comparative advantage," the Ricardian classic theory that every nation is better off if it concentrates on doing what it does best and importing the things it can't make cost-effectively at home. This idea has limitations, but it's generally right.

The US, for all our problems, still has a large, dedicated, and educated labour force. We're good at technology and sophisticated manufacturing. Others are better at labour-intensive, repetitive kinds of production—textiles and apparel, for instance. That's the basis for a win-win relationship.

If tariffs are the kick everyone needs to change direction, then I can see them as a temporary measure. But making them a permanent pillar of the tax system is risky and unnecessary. There are better ways to get the revenue our government needs.

Gargantuan Change

An old political rule sounds trite but really works:

> If you want more of something, subsidize it.
> If you want less of something, tax it.

Under our current system, we primarily tax income, thereby discouraging something we should reward. Pretty much every economist who has ever studied this says it makes more sense to tax consumption.

Import tariffs are a kind of consumption tax, but not a well-designed one. Because domestically produced goods are exempt, tariffs simply shift consumption. Indeed, that's their goal, as discussed above. But a better consumption tax would encourage people to spend less and save more.

Longtime readers know that I advocate a Value Added Tax, or VAT system. Almost every country other than the US uses the VAT. Some combine it with an income tax on higher-earning people. The particular parameters vary but it is essentially a sales tax applied at all levels of production.

I always get pushback when I talk about a VAT, for reasons we will discuss below. This time I will offer a way to fix those very real concerns and problems.

As far as I can tell, I first mentioned the VAT idea in a February 2012 letter. I cited an idea Larry Lindsey and Marc Sumerlin offered in their 2008 book, What a President Should Know. Here's how I described it.

"What they suggest is to tax consumption with a 20% Value Added Tax (VAT). There would be no taxes for incomes under $100,000. None. No Social Security. No Medicare. If you make less than $100,000 you pay nothing.

"All income over $100,000 is taxed at 20%, no matter what the source. No capital gains rate or dividend break. I assume that also means no municipal bond exemptions. No exemptions for anything. Every last tax expenditure goes away. Corporate tax rates would be 20%, and again I assume no exemptions. If you make a profit, you pay taxes.

"Although they did not say it in the book, they essentially agree with Hobbes that income measures what you contribute to society and spending measures what you take from it.

"What society wants (and needs) is more income, as that grows tax revenues and general wealth. Consumption—what you get from society—is taxed. We don't just need to tax millionaires more, we need more millionaires that we can tax. And you get that by encouraging growth in the economy.

"They also note that their proposal was revenue-neutral in 2007, and included a $2,000 per child tax credit. Every worker would get an approximate 7.5% pay raise from the removing of Social Security and Medicare taxes. While businesses would also get that same tax break, they would have to pay a VAT on salaries, which would be an increase in cost. Welfare, the social safety net, and health care would all be funded.

“As the VAT would not be paid on exports, it would put us on a more even ground with those nations that have a VAT and certainly lower business taxes, both of which would make us more competitive and increase exports and thus employment.

“One can adjust the levels of both the VAT and income taxes to match the desired level of government spending. I might prefer less, but that is not the point here. Match these taxes (along with the normal excise taxes) with entitlement reform, a properly structured health-care system, and some cuts in other areas, and you are close to a balanced budget.”

(I know you’re wondering so I’ll save you the math: $100,000 when they finished the book in 2007 is equal to about $153,000 today. And the VAT rate would have to be higher because of the increased expenditures. Income taxes might have to be adjusted as well. There are literally scores of ways you can play around with this.)

Would a 20% VAT really raise significant revenue? Roll forward to my 2023 Time to Consider a VAT? letter. I noted a 2022 CBO report analysing a possible 5% VAT, estimating it would raise $338 billion yearly. But that was for a 5% rate that excluded about 40% of household consumption. A 20% rate on a broader base would obviously raise $2 trillion+, along with a still-large amount of revenue from corporate and income taxes. And the various distortions and perverse incentives of the income tax system would be greatly reduced.

Combined with true spending reform, I think a system like this would go a long way toward solving our fiscal ills and enable more sustainable economic growth. There are two big barriers.

- First, the transition would have to be planned carefully to let everyone adjust. It would probably need to be phased in over several years.
- Second, the plan would have to address the legitimate fear that the income tax part would get expanded under later administrations, leaving people paying more than were under the old system. I would suggest that the entire scheme only pass IF a constitutional amendment passes requiring a 60% vote in both the Senate and the House to raise the income tax. No amendment, no VAT.

We don’t have to balance the budget to make the bond market go back to sleep at some future crisis. We simply have to get the deficit substantially below nominal GDP (today that would mean about a $1 trillion deficit), keep tight control over government spending, and over time we could grow our way out of the debt crisis.

You might call this a completely unrealistic pipe dream. I get it. And today, it is. But when we are faced with a debt crisis around the end of the decade, we will need solutions. Everything will be on the table. Those who oppose a VAT must offer their own alternative. It can’t simply be “cut entitlements” because that will get nowhere close to majority support, and will be overturned when the next Congress is elected. Cutting entitlements is a death sentence for re-election. Good bad or indifferent, entitlements are here to stay. (Reform them? Absolutely.)

Absent a shift, we will be forced into some kind of budget compromise in the crisis that I believe is coming. It will be a gargantuan change to the planet's largest economy, not to mention the reserve currency. It could go badly wrong if we don't get it right. As I keep saying, we are past the point of having easy choices. Anything we do is going to hurt.

I highly doubt anything like this is on Trump's radar screen, but it should be. He may actually be the only one who can do it. Just as only Nixon could go to China, maybe only Trump can fix the tax system. And tariffs are just tinkering around the edges.

One last thought. This is not doom and gloom. I think it is just realistic. It is also very possible that proper planning can keep you and your family economically viable through this crisis. The important word in that last sentence is planning. Stay tuned…

Growth is a positive sum game

By Brian Kantor

A large threat to the long-term growth prospects of the SA economy is the loss of essential skills to emigration. Such losses have been a continuous drain on the growth potential of our economy both before and after 1994.

That US President Donald Trump has seen fit to champion the cause of white South Africans who feel they have been discriminated against could be even more damaging to the country than imposing higher tariffs or denying aid. The drain of emigration could become a flood, a severe potential loss that might be avoided by seeking the friendship and support of the US rather than so gratuitously incurring its ire and enmity.

How could this be done to the benefit of SA and its growth prospects? I would suggest by doing in SA what Trump aspires to do in the US. That is, for SA to become a truly colour blind and meritocratic society and economy.

Our policies over the past 30 years have focused on restitution for black South Africans rather than on stimulating growth. Understandable, perhaps, but ultimately self-defeating.

Economic growth would be greatly enhanced by unfettered competition for jobs and contracts to supply the state and its agencies. This process would be particularly helpful to the least advantaged poor of SA in the form of well-paid jobs, and indirectly in the form of the better education and healthcare that only a prosperous and competitive economy could afford.

BEE clearly does not benefit the poor. There must come a time when the highly educated and talented black elite of SA are willing to compete on their own considerable merits for the commanding heights of the economy and its governance. The sooner that happens, the better for growth and our international standing.

Faster growth may not reduce inequality and should not be expected to do so. Those who have already may well be given more and be resented when it has a racial or ethnic basis. But envy should not be allowed to frustrate the realisation of the greater good, as it has to date. Higher incomes earned fairly by providing superior service to customers and employers should be applauded, not resented. Growth is a positive sum game.

How badly has the SA economy been doing? According to the recent, extensive Income & Expenditure Survey of 19,940 households conducted by Stats SA, it has been doing unbelievably badly. Literally unbelievable, since its estimates of household income and expenditure and their distribution by race are so widely different from the national income estimates that they should be rejected.

The survey estimated that between 2006 and 2023, inflation-adjusted household consumption expenditure of all SA households declined by a real 1.9%. Real black household expenditure, with a 62% share of all spending, is estimated to have risen by an impressive 36.2% over these years, while the household spending of increasingly poor white SA households is estimated to have declined by 21%.

Households headed by those with a tertiary qualification seemingly did even worse. They apparently saw their expenditure decline by 29.2% between 2006 and 2023. No case for envy here — if it were true.

The income story is seemingly less depressing. Black-headed households are estimated to have seen their incomes rise by 46% between 2006 and 2023, while white incomes declined by only 7.7%. All household incomes are estimated to have grown by 5% since 2006. This suggests a completely implausible and unobserved increase in real household savings — the difference between incomes and expenditure.

By contrast, the National Income Statistics record that real household disposable income rose by 42% between 2006 and 2023, while real household consumption expenditure increased in line, by 37% over that period.

Such inexplicable differences in the measures of income and expenditure need reconciliation. What does it all imply for the reconstruction of the weights in the consumer price index that depend on the survey? And for our measures of inflation

AMSA: the sound and fury of a partial closure

By JP Landman

Returning from a very relaxing holiday in Namibia, we walked into a storm around the closure of the long steel business by ArcelorMittal South Africa (AMSA). The saga concerns more than just steel – it is about public policy issues on tariffs, import protection, localisation and industrialisation. It is worth unpacking a bit.

AMSA, started life as Iscor, the South African Iron and Steel Corporation, way back in the 1920s. It was established by Hendrik van der Bijl, the pioneer who single-handedly industrialised South Africa and who also started Eskom, the Industrial Development Corporation (IDC), Safmarine and more. Over the years, Iscor played a huge role in South Africa's industrialisation, producing the steel essential for a modern industrial economy. It really consisted of 2 businesses: steelmaking with furnaces at Pretoria, Newcastle, Vanderbijlpark, Vereeniging and, later, Saldanha; and mining, producing iron ore and coal.

Very important: the company could source its own iron ore to produce steel. In 1989 Iscor was privatised and listed on the Johannesburg Stock Exchange (JSE). In 2001, the company was split into 2: Iscor (steelmaking) and Kumba Resources (mining). In 2006, Kumba Resources was split into Kumba Iron Ore and coal-mining interests, which formed the core of today's Exarro Resources.

Iscor enjoyed a preferential price for iron ore from Kumba Resources in a cost-plus arrangement. However, after Kumba Resources split up, disputes arose on the terms of the agreement and Kumba Iron Ore cancelled it in 2010. A new agreement on more market-related terms was agreed in 2013 – and this must have hit Mittal Steel's profits.

Today, AMSA manufactures long and flat steel. 'Long products' include reinforcing bars for reinforced concrete, beams, channels and angle iron for structures for industrial buildings and plants, transmission towers, rails for railways and many others. 'Flat products' refer to all forms of plate, like the sheets that become corrugated iron, the plates for the bodies of cars and trucks or for manufacturing a wide variety of secondary products for the building industry, and many others.

Long steel is more than 50% of AMSA's business – and that is what is being closed down. The flat steel business will carry on.

Global context

In the first half of the previous century a steel industry, like a national airline, was seen as part of a country's prestige. Many governments built steel plants. This led to a huge oversupply of steel internationally and many steel producers got into financial troubles. Indian entrepreneur Lakshmi Mittal saw the gap. He started buying up steel businesses, rationalised them and sweated the assets. He bought Iscor in 2004, changing the name to Mittal Steel. In 2006, he bought the French/European steel company Arcelor. As a sop to furious European opposition, he changed the name to ArcelorMittal. In this process Mittal became fabulously wealthy and helped to drive the rationalisation of the global steel industry.

His was not the only rationalisation initiative. The once mighty British Steel (itself a product of massive rationalisation) was merged with the Dutch Koninklijke Hoogovens to form Corus Steel. Tata from India bought Corus Steel, closed facilities, and now Britain produces only 25% of earlier volumes. Rationalisation is still carrying on as we see with Nippon Steel from Japan trying to buy US Steel, a transaction that President Joe Biden vetoed.

A friend of mine who spent his working life in steel construction retired and became a professor at the Stellenbosch Engineering Faculty. About 8 years ago he guided an M student to do a thesis on the development of alternative steel beams made from welded flat steel should AMSA close its long steel plant in South Africa. The closure of the long products plant has been expected for more than a decade, due to global consolidation.

The rise of the mini mills

Steel is made from iron ore, but it can also be made from scrap metal. This is done in a mini mill. By using electricity, scrap metal is melted at very high temperatures and steel comes out on the other side. It is a completely different technology from the production of steel from iron ore. Importantly, mini mills manufacture long steel products, making them direct competition for the AMSA long steel business. Today, mini mills produce 50% of South Africa's long steel demand.

Government policy actively supported mini mills with a highly controversial policy called PPS – Price Preferential System. Scrap dealers in South Africa must offer their scrap to a mini mill in South Africa at a price equal to the international price of scrap in Rotterdam minus 30%. In that way, the mini mills in South Africa can get scrap metal at a preferential price and make cheaper long steel. AMSA is naturally very upset about this arrangement and want it scrapped. The PPS is scheduled to expire on 31 July 2027 but it could be renewed. Since 2022 there has also been a ban on scrap export to reinforce the PPS. The 2 policies are complementary.

Worldwide there is a huge shortage of scrap metal. Some 30% of the 1,9 billion tonnes of steel produced worldwide comes purely from scrap, and even the steel made from iron ore has more than 20% recycled content. So, there is a huge demand for scrap globally and prices reflect that – it is very profitable to export scrap.

There is the public policy choice: let scrap be exported or keep it here to produce long steel? Is it beneficiation or just a subsidy or both?

Between the PPS, the export ban and IDC support, the mini-mill industry grew from non-existent 17 years ago to providing 50% of SA's long steel today. It is an open question whether they will survive if they lose the preferential price arrangement and export ban. A few are now in business rescue. As in all business sectors, one can assume some will survive and some not.

ArcelorMittal also uses scrap metal in its process and thus benefits from having cheap scrap available, but not nearly as much as the mini mills do. It never invested in the very different machinery and technology needed to make steel from scrap. Had AMSA done that, it could have benefited from the same arrangements as the mini-mill competitors. In fact, there is a lot of criticism of AMSA's capital allocation decisions over the years, but I will not wade into that.

It is worth noting that a big mini mill, Scaw Metals, is producing hot-rolled coil that is currently not being supplied to the market by AMSA as well as high-grade steel for safety-critical applications that they are exporting to North America, Europe, Australia and even China! The idea that all mini mills are just riff-raff operations is nonsense.

Steel market in SA

South Africa has the capacity to produce 8.8 million tonnes of steel a year. Last year, total demand was only 4.1 million tonnes. The steel sector argues that if the economy grows at a higher rate, the demand will be more than 4.1 million tonnes, which will create living space for everybody. The demand for steel is indeed very sensitive to the growth in the economy – 3% is way better than 1%.

However, of the 4.1 million tonnes South Africa consumed last year, 1.3 million tonnes were imported (32%). Why do we import 1.3 million tonnes if we have 8.8 million tonnes capacity?

It comes down to price and variety. Steel is not just steel and not all steel products are created equally. Often, products are required that are not manufactured in SA because the market is too small, or local producers do not meet the required quality, or it can be obtained cheaper elsewhere. For example, in the past South Africa imported several thousands of tonnes of railway tracks a year because it was simply too expensive to make here. Currently, some 300 000 tonnes of steel are imported annually for the motor industry as the required quality cannot be manufactured here. If demand goes up, we may find that imports go up too.

More capacity that may affect the SA market is being added. A Chinese company has established a brand-new steel plant in Zimbabwe and the first imports have already arrived in South Africa. More imports from SADC into SA is not bad, but it does pressure local producers. Chinese interests are also working to establish a steel factory in Limpopo, albeit against heavy opposition from environmental groups. If it actually happens, it may take a lot of local production out of business.

Tariffs

So what is to be done now? AMSA is asking for a higher tariff on imports and the scrapping of both the PPS and export ban on scrap. Currently, there is an import tariff of 9%, but AMSA wants 25%.

Downstream manufacturers and traders are opposed to tariffs because it makes steel more expensive for them (and the rest of society).

An acquaintance in the steel industry relates the story of South African downstream fabricators who moved to America, complete with their machinery. Once there, they discovered that steel was too expensive to make the products they made here. In his first term, President Donald Trump imposed a 25% tariff on steel. One man’s tariff is another man’s higher cost. South Africans had to put their machinery into storage.

That brings us to the heart of the matter. Must local users pay more to keep producers going? It is the oldest argument around localisation policy. There's no right or wrong answer – it comes down to a public policy choice. And it does not only apply to steel.

We can import chicken cheaper than we produce locally. Chicken is the country's biggest source of protein. People now pay more for their protein because we pay an import tariff. Cheaper chicken or a local chicken industry? Make your choice.

Nevertheless, on 29 November 2024 SARS imposed provisional duties of 52.81% on structural steel imports from China and 9.12% from Thailand. These will remain in force for 6 months until 28 May 2025 while ITAC, the International Trade Administration Commission, investigates the accusation of steel dumping and prepares its recommendations. (Note: ‘structural steel’ refers to steel already undergoing some further fabrication, like welding pieces together, drilling holes, etc.)

What now?

Interestingly, AMSA has painted quite a bullish picture of life post long steel. Their managing director, Kobus Verster, said if they stop the long steel business and redeploy the capital, they can do quite well in the remainder of the business. There is life after long steel.

However, after talking to a variety of people, the consistent feedback is that AMSA will have to improve its customer service. There is allegedly a ‘take it or leave it’ attitude, which is not going down too well with downstream customers.

For the consumers of long steel there are also life after the AMSA closure as mini mills are already producing 50% of SA’s long steel. The mini mills may well start making some of the smaller products historically made by AMSA.

In another example of life after AMSA long steel, the CEO of NAACAM, the automotive component industry body, while lamenting the closure of the plant in Newcastle, pleaded that the Newcastle closure be postponed by a year, allowing them to buy time to transition local mini mills into certified suppliers of automotive grade steel. Upgrade and stay in the game.

Of course, that does not help the workers and small businesses in Newcastle, Vereeniging and elsewhere. Like steelworkers and steel communities worldwide, they are the victims of over-capacity and too much production. It is a moral and political obligation to help them. Government may well yield to this pressure; we will see in the coming days.

Industrial policy

A constant refrain in public debate is that South Africa should have a vision and a policy for ‘re-industrialisation’ and manufacturing. I am deeply sceptical of such vague exhortations. They reflect more a passionate desire for the past than an implementable plan for the future. Japanese economist Richard Koo coined the term ‘persecuted economies’ to refer to the once strong manufacturing nations that are now struggling to keep their manufacturing bases intact. As he puts it, their ‘golden era’ of manufacturing is past them. The UK, Europe, the US and Japan are examples he quotes.

The persecuted economies and industries compete with Indo-Asia, particularly China. The latter has the critical elements for manufacturing: technology, scale and skills. How would lesser producers survive when both Tesla and German car manufacturers lose market share to Chinese car manufacturers (Tesla, particularly to BYD)?

There is, of course, a new trend all over the world to impose tariffs, and Trump will accelerate it. Whether that changes any of the underlying commercial dynamics remains to be seen.

So what?

There is huge overcapacity in the global steel industry. Steel can be sourced and imported cheaply from many sources. Despite the big over capacity locally, SA still imported 32% of the steel it consumed.

Several developments over the years pressured AMSA’s profitability: it lost the preferential price it once enjoyed in buying iron ore; the rise of the mini mills brought local competition in long steel;

customers complained about poor service; and there is criticism of poor capital allocation. It all adds up.

It remains to be seen if mini mills can operate without the preferential price arrangement and export ban on scrap metal. AMSA is closing only its long steel business. Steel plate production will continue.

With 50% of long steel provided by mini mills and about 32% of consumption imported, reports that the whole steel industry would die are simply exaggerated.

The public policy choice is the same as for chicken: put up tariffs and protect a single industry, or let the consumer pay less and have more choice. That's a tough public policy choice.

The rise and collapse of industries is part and parcel of life. When industries collapse, jobs are lost, capital is destroyed, and support industries are hit very hard.

The emphasis should, therefore, not so much be on protecting industries but rather protecting workers – helping them to retrain, relocate and restart. And industrial policy must support new industries – not protect declining ones.

For South Africa, the option is to have an industrial policy that is laser-like focused on the areas we can compete in (like green energy, tourism and conservation), develop capabilities (like hospitality and personal services) and expand from existing successes (like agriculture and maybe mining).

Note: I wish to acknowledge the generous help received from Hennie de Clercq and Charles Dednam in compiling this note. Any mistakes and all opinions are my own.