ECONOMIC POLICY

NEVA MAKGETLA: Why cutting the fuel price levy is not a simple matter

The unequal impacts and high externalities associated with the petrol price hike mean it shouldn't simply be reversed

BL PREMIUM
31 July 2018 - 05:08 Neva Makgetla

Picture: ISTOCK

The petrol price hike underscores two central pressures on economic policy in SA.

On the one hand, SA's unusually deep income inequality means that while the policy demands of well-off households generally dominate the public discourse, they often do not reflect the critical concerns of the low-income majority. On the other hand, economic decisions can no longer ignore environmental costs around climate change.

In the four months to July the price of unleaded petrol spiked almost 20%. The immediate causes were a recovery in global petrol prices, which coincided with a weakening in the rand, along with most other emerging-market currencies.

The petrol price hike has a profoundly different impact on low-and high-income households. Lower-income families depend on public transport. In the two years to April 2018, fares climbed only about half as fast as the petrol price.

In rand terms, Statistics SA's Living Conditions Survey for 2015 found that households as a group spent R75bn on petrol. Half was spent by the richest 10% of households, with median income of over R40,000 a month in 2017 terms. The next richest decile accounted for a quarter of the petrol spend.

In contrast, households spent a total of R50bn on public transport, and it was far more equitably spread. The poorest decile spent R2.4bn, with the highest spending in the sixth, seventh and eighth deciles. The richest 20% of households together paid only about R7bn for public transport, far less than they spent on petrol.

Overall, the poorest 60% of households used 9% of their income for public transport and 1% for petrol. In contrast, the richest 20% spent 5% of their (higher) incomes on petrol and just 1% on public transport.

These spending patterns mean that the petrol hike most affects the sixth to ninth deciles of households by income level, with incomes ranging in 2018 from R5,600 a month to R18,700 a month. This group in effect comprises the formal working class and small business owners, who both own cars and rely heavily on public transport. The higher cost of petrol has raised their cost of living by an estimated 1.4%.

In contrast, poorer households are less affected. If public transport fares continue to rise half as fast as petrol prices, the worst-off 50% of households will see an increase of about 0.8% in their cost of living. The increase will depend on how much bus and taxi operators pass on to customers.

Petrol consumption also imposes large external costs on society, which should also be taken into account in any policy response. For one thing, petrol is a major import product, costing SA about R20bn a year. Simply cutting domestic prices while international prices increase will add to pressure on the balance of trade. Even more important, petrol is a central source of pollution. That's why public policy has long encouraged greater use of mass and non-motor transport. Finding ways to reduce the petrol price would undermine those efforts.

Finally, someone will pay for any mitigation measures, whether it is through cuts to other types of government spending, higher taxes or, if the fuel tax is reduced, users of the national roads that depend on fuel tax revenue for maintenance. Some 80% of freight uses the national roads, so their quality critically affects long-term economic growth.

In short, the unequal impacts and high externalities associated with the petrol price hike mean it shouldn't simply be reversed. Ideally, mitigation should centre on compensating households for lower overall real incomes, for instance through general tax cuts with an increase in social grants.

As a second best, the fuel levy could be moderated for minibus taxis and buses but not for private cars.

• Makgetla is a senior researcher with Trade & Industrial Policy Strategies.