IS SOUTH AFRICA HEADING TOWARDS A ‘FISCAL CRISIS’?

Zimbali Mncube & Liso Mdutyana

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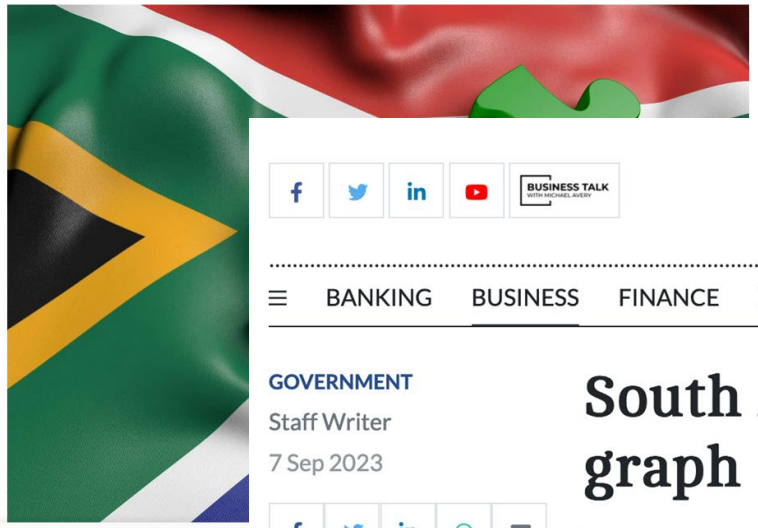
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SA has two choices: cut back spending or face financial crisis

The medium-term budget policy speech will show how dire the situation has become.





By Ina Opperman
Business Journalist

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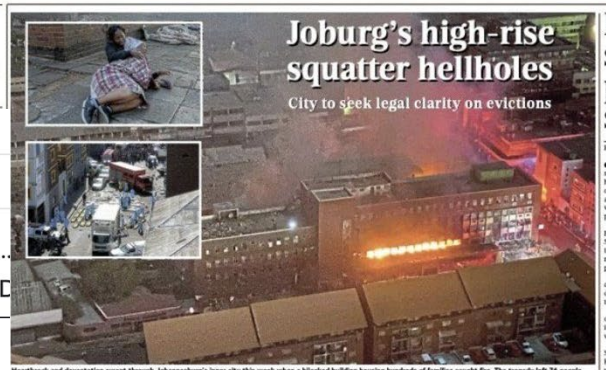
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STATE RUNS OUT OF MONEY

Treasury outlines drastic measures to curb spending, freeze new jobs and projects as tax revenue dives



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KEY ARGUMENTS

1. The budget mismatch is meaningful and should be taken seriously.
2. National Treasury has played an important role in precipitating the budget mismatch.
3. The budget mismatch does not immediately bring South Africa near a ‘fiscal crisis’ or ’fiscal cliff’.
4. South Africa does not have a debt problem, it has a growth problem.
5. National Treasury’s proposed cuts are ill advised.
6. Policies that close the mismatch, preserve and advance access to services, and are fiscally responsible exist.

1. THE BUDGET MISMATCH

REVENUE SHORTFALL

April - August 2023

R19.6 billion less than budgeted

By the end of 2023/24

R54 - R67.2 billion less than budgeted

EXPENDITURE OVERSPEND

By the end of 2023/24

Between R67.9 – R105.8 billion more to be spent than budgeted

2. NATIONAL TREASURY'S COMPLICITY

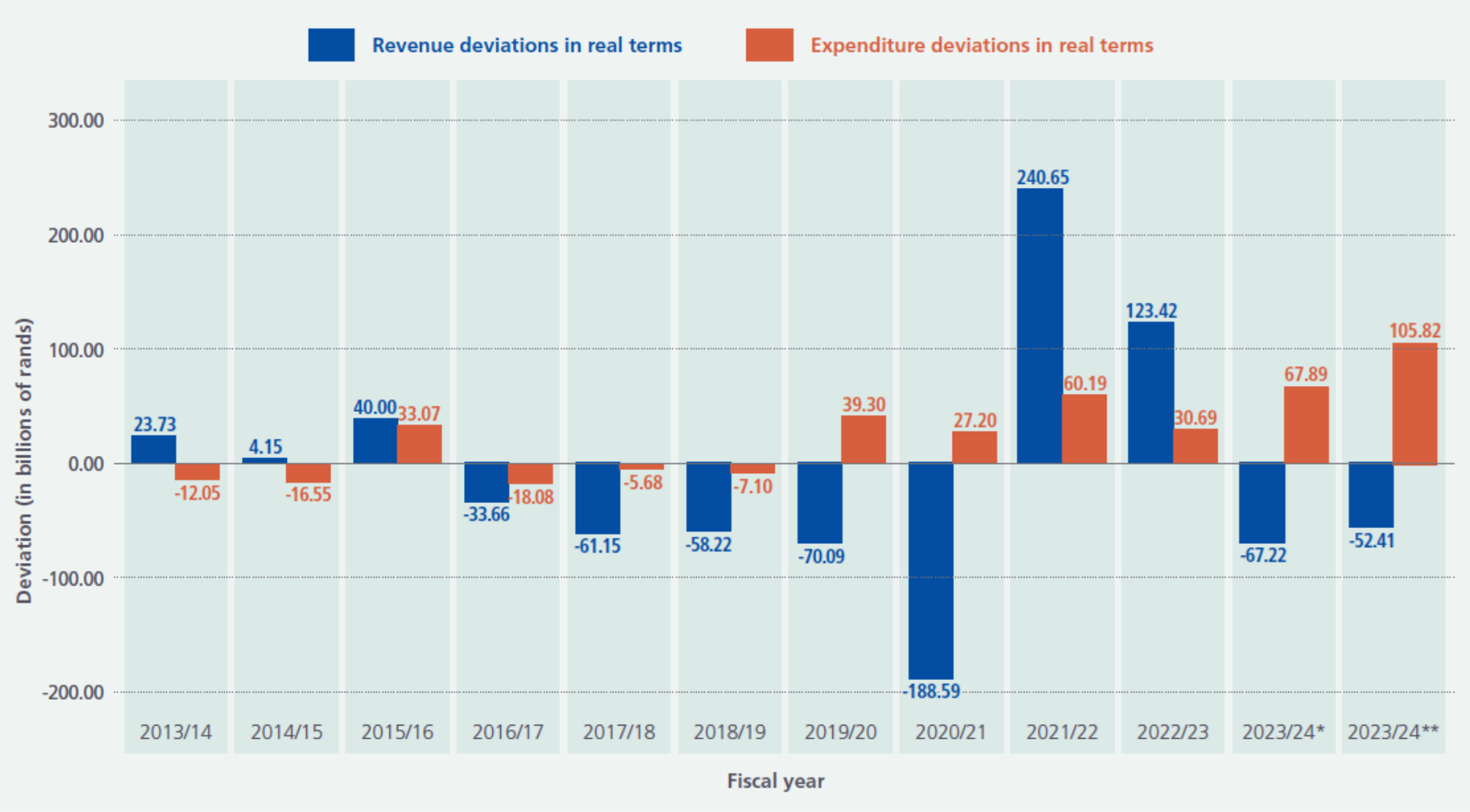
- What is driving overspend:
  - National Treasury has said that the "unforeseen" public sector wage increases have led to higher expenditure than budgeted
  - Over-optimistic growth projections under extreme austerity
  - Deliberate non-planning for foreseeable expenditure items
  - Repo rate increases by the South African Reserve Bank
  - Exchange rate loss on debt
  - If overspend is a 'crisis' then largely of Treasury's own making
- Growth in budgeted spending the lowest in the past six years
- Previous failed fiscal consolidation likely to have contributed to economic contraction and thus revenue shortfall.

3. NOT AN ACUTE FISCAL ‘CRISIS’

1. Budget mismatches and deficits are within historic norms and deficits comparable to peers.

3. NOT AN ACUTE FISCAL ‘CRISIS’

Figure 1: Revenue and expenditure deviations in real terms (April 2023 rands) (2013/14 – 2023/24)

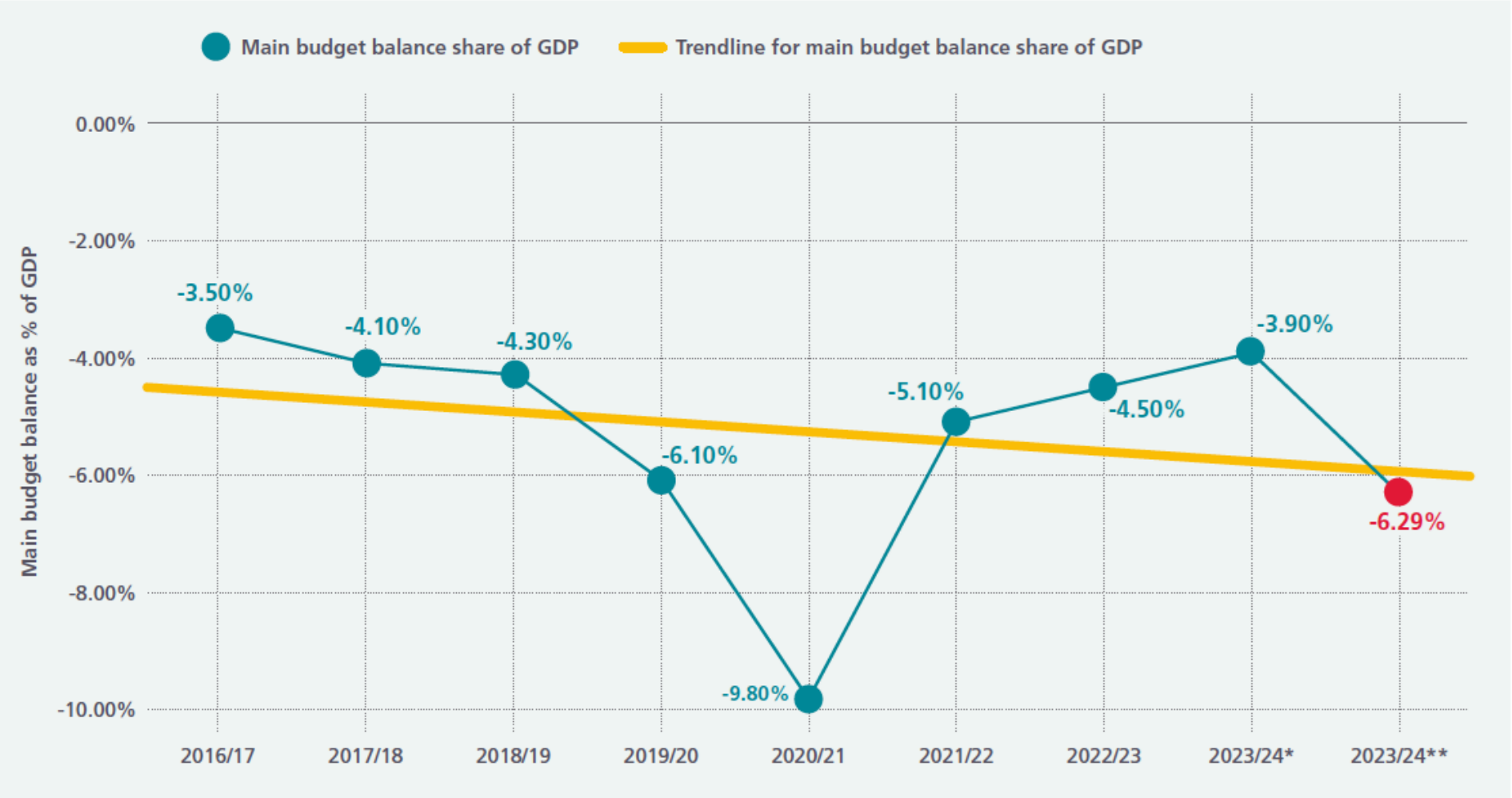


Source: National Treasury, various Budget Reviews, Annexure Table 2, own calculations[4]. Note: 2023/24 refers to original calculations using April – July 2023 data; 2023/24** refers to updated calculations using April – August 2023 data.*

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3. NOT AN ACUTE FISCAL ‘CRISIS’

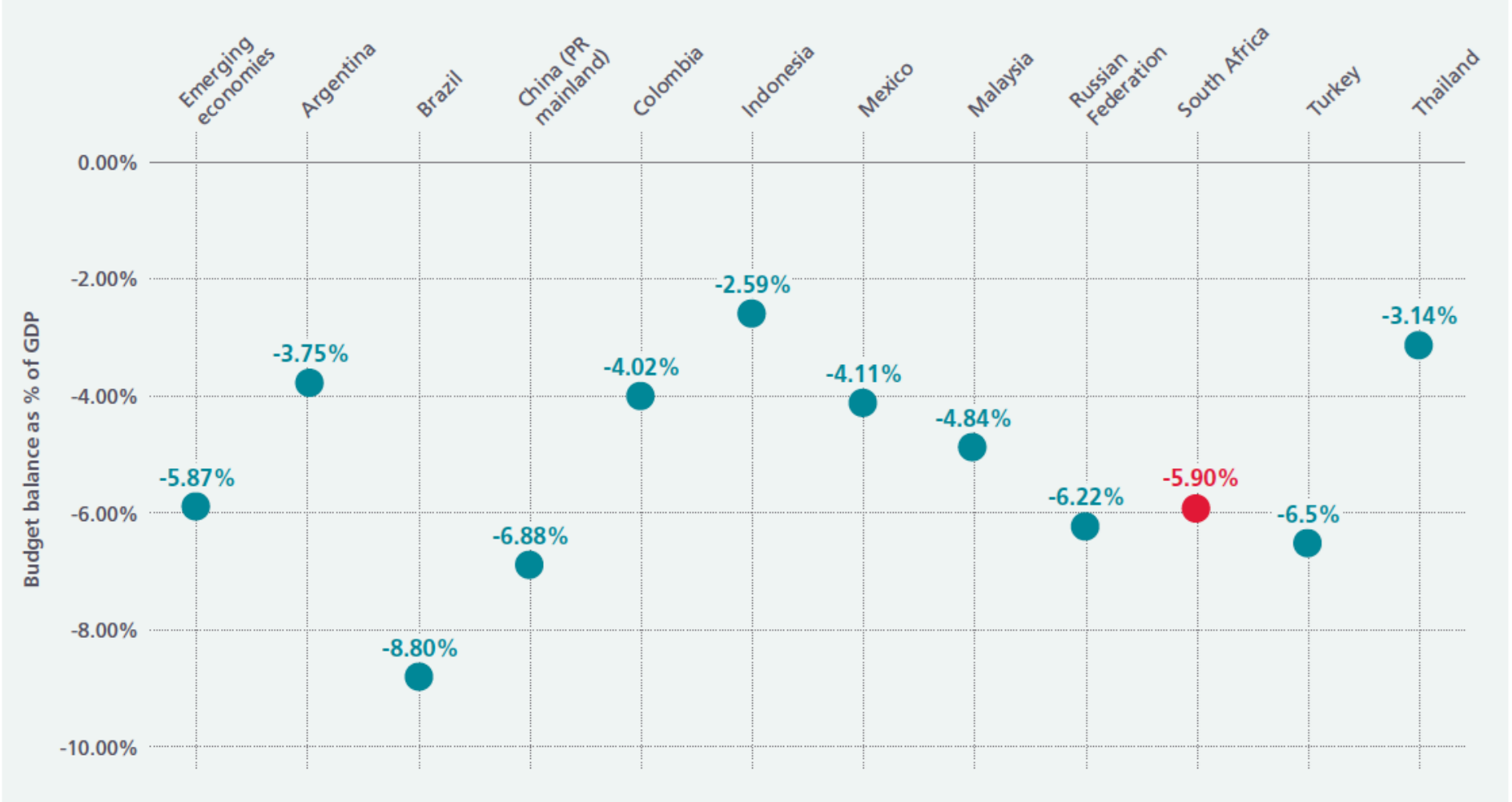
Figure 6: Government budget deficits, 2016/17 - 2023/24



Source: National Treasury, Budget Review 2023, Annexure Table 1.[23] Note: 2023/24 National Budget expected deficit, 2023/24** IEJ estimated deficit*

3. A FISCAL ‘CRISIS’?

Figure 7: Government deficit in major emerging economies, 2023



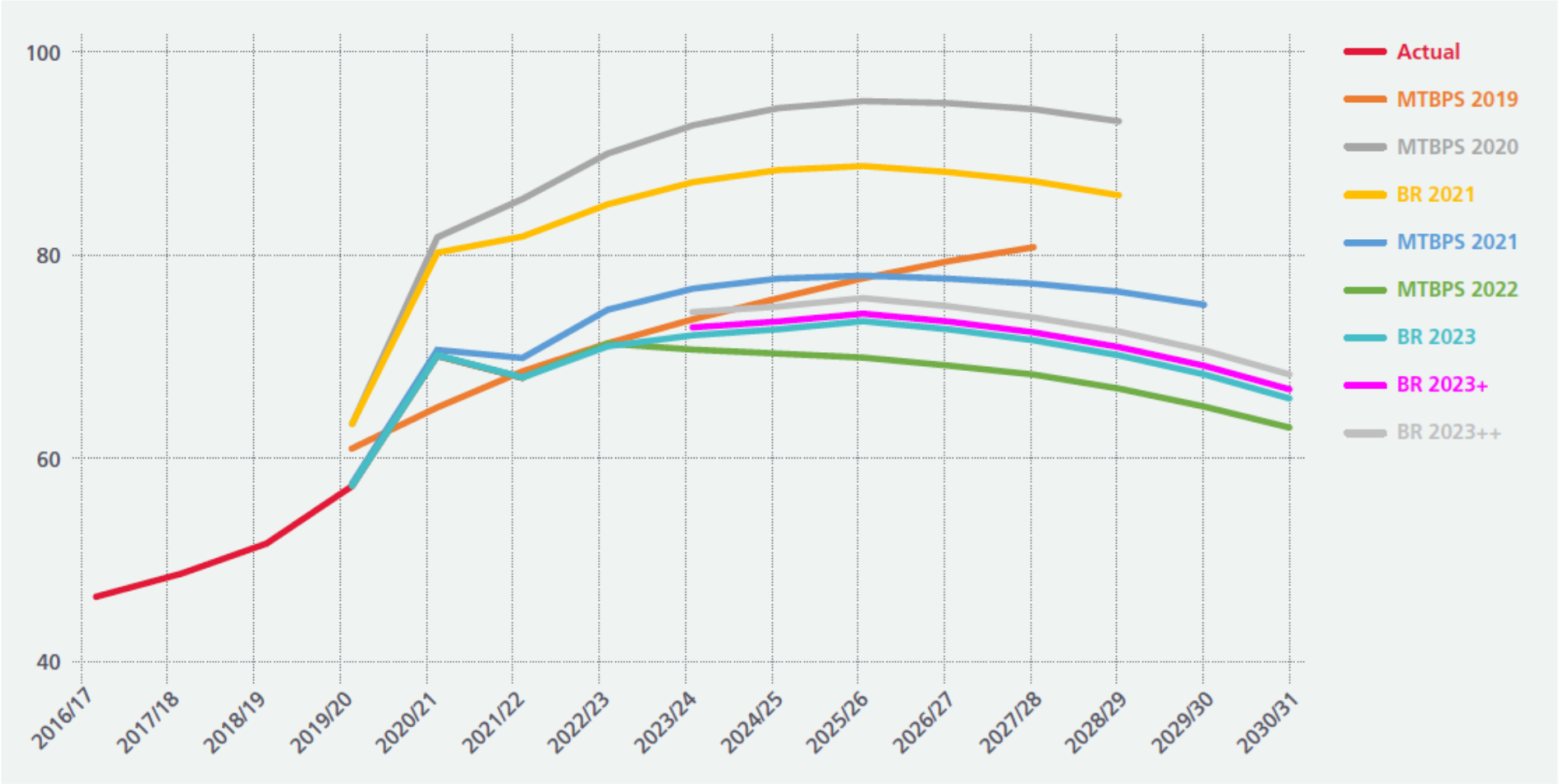
Source: IMF Fiscal Monitor, 2023[25], own calculations

3. NOT AN ACUTE FISCAL ‘CRISIS’

1. Budget mismatches and deficits are within historic norms and deficits comparable to peers.
2. South Africa has a number of pools of idle resources to close the gap and retains strong access to bond markets.
3. Even if the entire mismatch was closed by borrowing this would only raise debt modestly and remain below recent projections.

3. NOT AN ACUTE FISCAL ‘CRISIS’

Figure 10: Debt-to-GDP growth projections in different MTBPSs and National Budgets

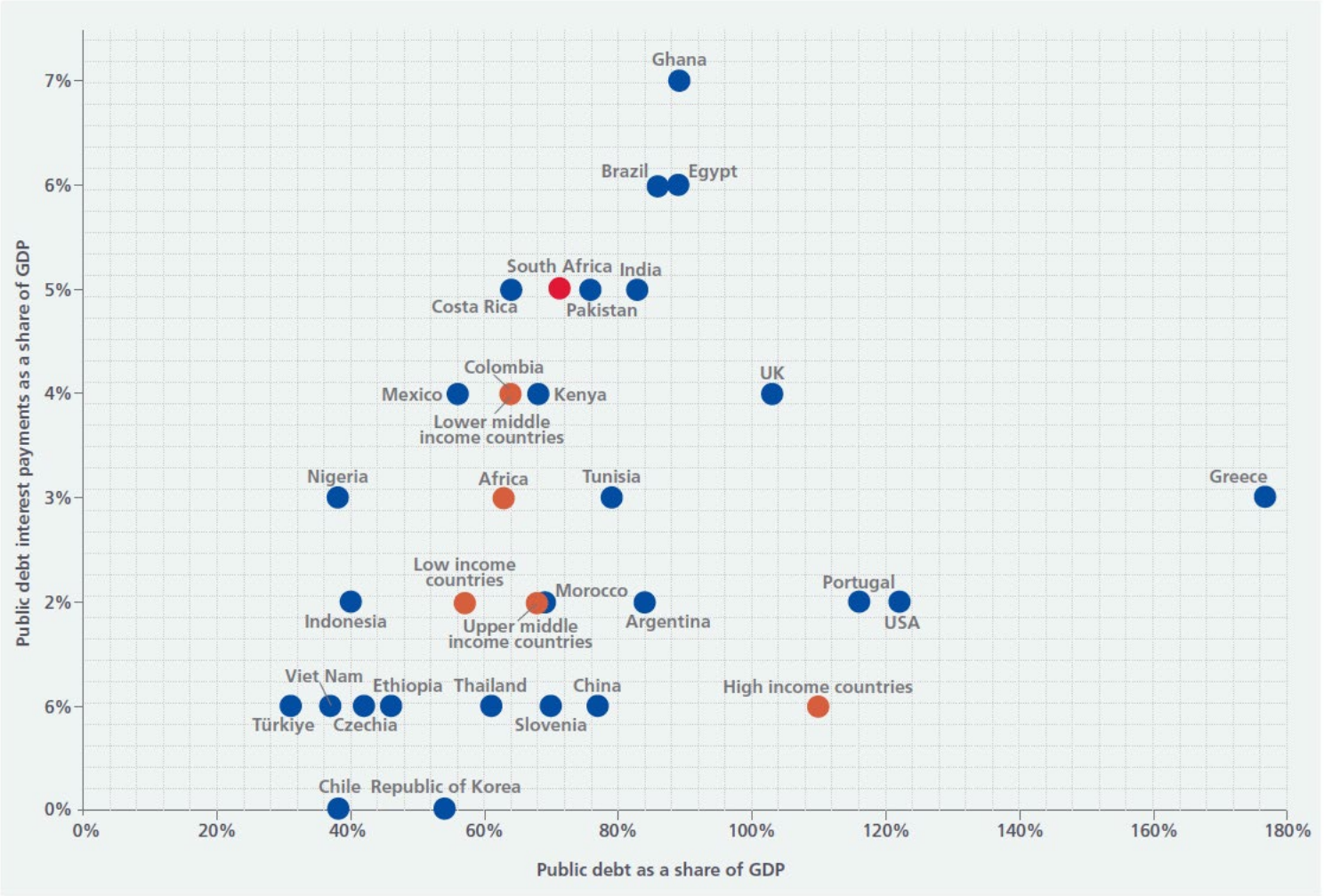


Source: National Treasury, various Budget Reviews[38] and MTBPSs[39], own calculations

4. GROWTH NOT DEBT PROBLEM

- SA 2022/23: 71.4%
- Emerging market and middle-income country average: 69%
- 88.3% borrowed in rands.

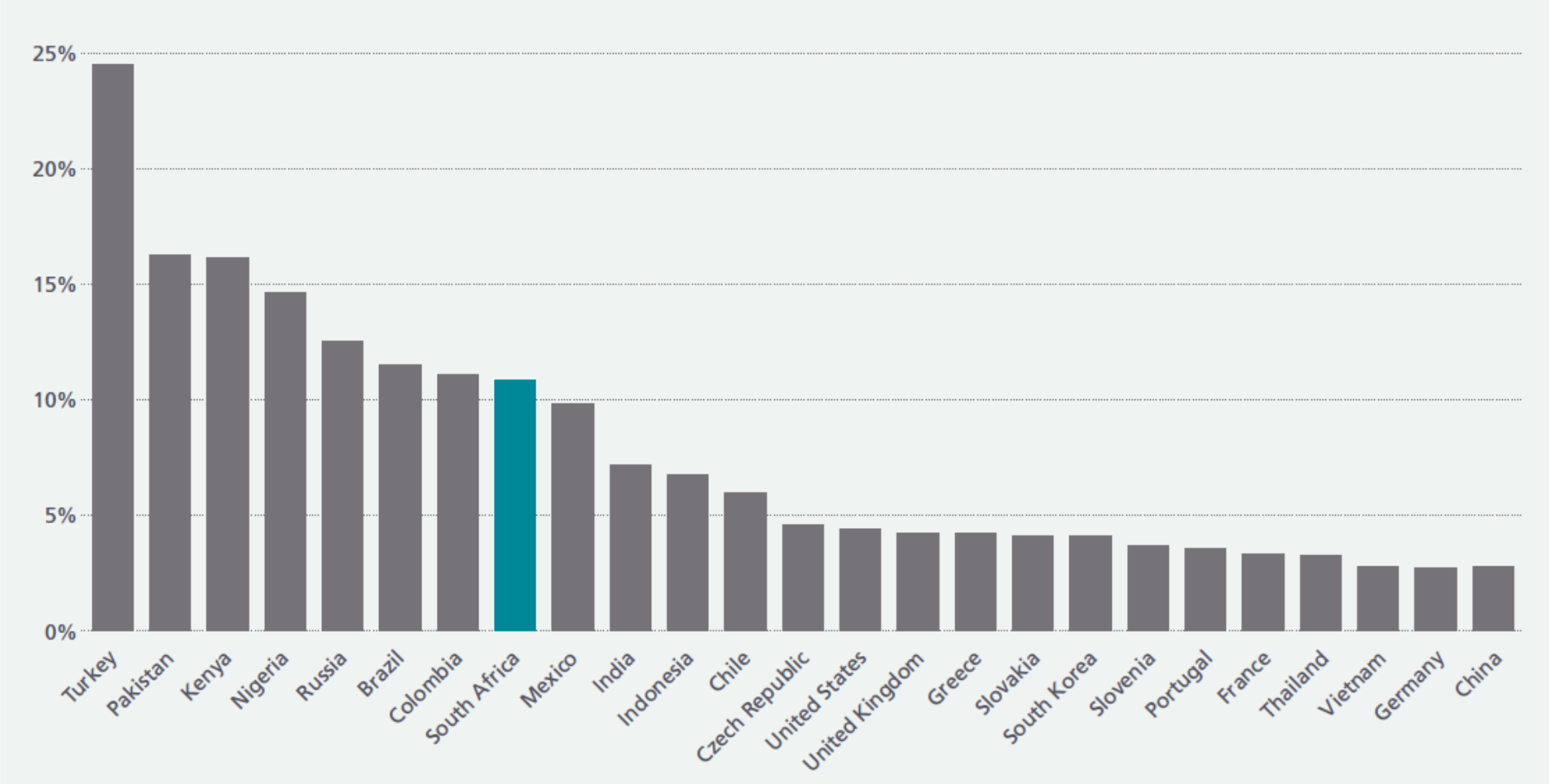
Figure 4: Public debt and interest payments as a share of GDP for select countries, 2022



Source: UNCTAD, 2023[17]

4. GROWTH NOT DEBT PROBLEM

Figure 9: International Comparison of South African 10-year Bond Yield



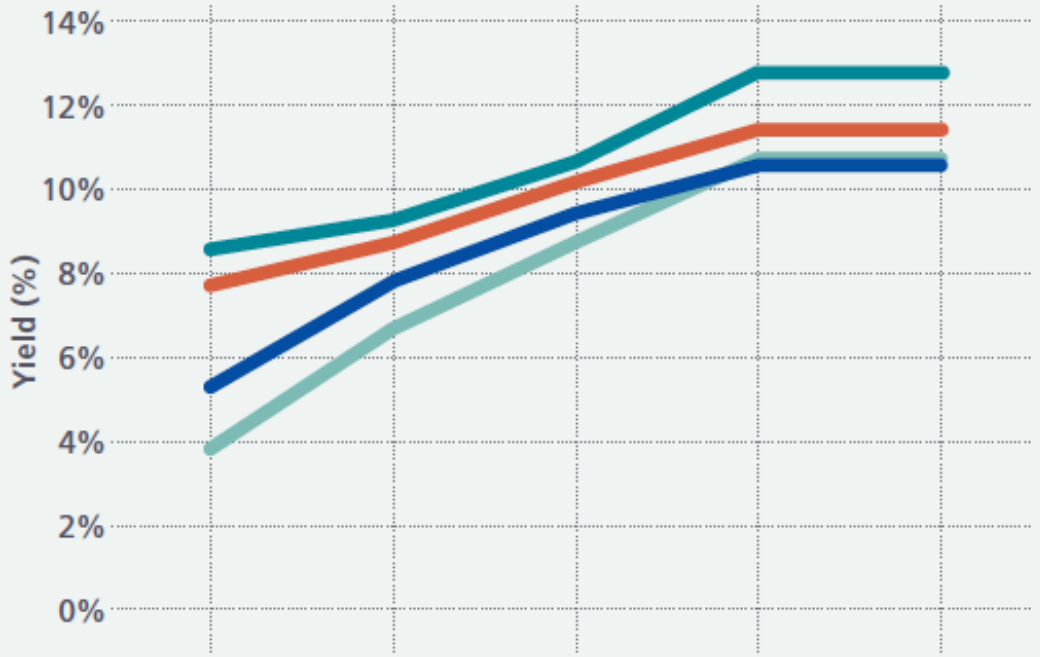
Source: World Government Bonds[34]

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4. GROWTH NOT DEBT PROBLEM

- South Africa borrows predominately in rands.
- The average maturity on South Africa's outstanding debt was 14.8 years, compared to the emerging market average of eight years.

Figure 8: South African Yield Curve



	3-month	5-year	10-year	20-year	30-year
2023	8.7%	9.3%	10.7%	12.8%	12.8%
2022	7.7%	8.8%	10.2%	11.6%	11.4%
2021	5.3%	7.9%	9.4%	10.6%	10.6%
2020	3.8%	6.7%	8.7%	10.8%	10.8%

Source: World Government Bonds[33]

5. CUTS ARE ILL ADVISED

- The reality is that budget cuts run the risk of causing economic contraction.
- Recent research shows that fiscal contraction larger than 1.5% of GDP generates a negative effect of more than 3% on GDP even after 15 years. The drop in GDP reaches 5.5% for fiscal contractions larger than 3%.
- Recent research by the IMF also highlights that, “[o]n average, fiscal consolidations do not reduce debt-to-GDP ratios”.
- Despite this, National Treasury maintains a dogmatic and ideological commitment to austerity, with achieving primary budget surpluses through expenditure cuts as the overriding objective of fiscal policy.

6. POLICY OPTIONS EXIST

1. Solve the immediate budget mismatch:

- Use some of the R459 billion owed to the South African government in the Reserve Bank's somewhat obscure **Gold and Foreign Exchange Contingency Reserve Account**. This is in keeping with other major central banks remitting profits to their respective Treasuries.
- **Increase short-term borrowing**. Even if the entire mismatch was closed in this way it would increase the gross debt-to-GDP ratio by approximately two percentage points only. In this scenario the debt trajectory would still be considerably lower than Treasury's own debt-to-GDP forecasts from 2019, 2020, and 2021.

6. POLICY OPTIONS EXIST

2. Raise additional revenue:
   - **In the short-term raise revenue** through: the removal of tax breaks for high-income earners; the removal of selected tax breaks for corporates; and restoring the corporate income tax rate to 28%. Removing tax breaks for those earning above R750 000 (around 2.9% of the working population) would alone raise an estimated R83 billion.
   - **Explore raising additional taxes through**: increased taxation on wealth and income from financial assets; tackling illicit financial flows; and capturing rents and windfalls.
   - **Do not increase increase the VAT** rate which would make the tax mix more regressive, fail to raise the sums needed, and disproportionately burden poor and low-income earners. The only VAT increase that would be defensible would be the introduction of a higher VAT rate on luxuries.

6. POLICY OPTIONS EXIST

Table 1: Tax breaks (R 000s thousands)

	2021 TAX YEAR	2023 EQUIVALENT ESTIMATE	2023 EQUIVALENT ESTIMATE > R500,000	2023 EQUIVALENT ESTIMATE > R750,000
Donations	1,356	1,534		
Travel expenses – fixed cost – business cost claimed against allowance	18,753	21,216	14,462	8,592
Travel expenses – actual business cost	1,164	1,317	524	329
Other	2,540	2,874	1,807	1,336
Subsistence allowance – local	41	46		
Depreciation	137	155		
Home office expense	869	983		
Retirement fund contributions	205,698	232,713	113,620	65,859
Employer provided vehicle expenses	3,888	4,399	2,480	1,431
Employer provided vehicle expenses (operating lease)	179	203		
Other	6,980	7,897		
Medical Tax Credits Rebate	20,633	23,343	8,104	3,927
Medical Tax Credits Rebate – additional expense	7,521	8,509	3,159	1,596
	269,759	**305,188**	**144,155**	**83,072**

Source: SARS 2022 Tax Tables[44], own calculations

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6. POLICY OPTIONS EXIST

Table 2: Proposed tax changes to income from, and trading of, financial assets

TAX	POLICY MEASURE	REVENUE POTENTIAL FOR 2023/24 (R BILLIONS)
Estate duty	· Estates valued between R3.5 million and R30 million are taxed at a rate of 36%, · Estates valued between R30 million and R146.8937 million are taxed at a rate of 41%, and · Estates above R146.89 million are taxed at a rate of 45%.	R1.87
Securities Transaction Tax	· Increasing the STT from 0.25% on all security transfers to 0.3%.	R1.41
Financial Transaction Tax	· Lower the STT rate to 0.1% but broaden the base to include the equity, interest rate, interest rate derivatives, and commodity derivatives markets	R41.00
Currency Transaction Tax	· CTT of 0.005% on all domestic over-the-counter foreign exchange rate instruments.	R3.75

Source: DNA Economics, 2021[55]

6. POLICY OPTIONS EXIST

3. Reduce the cost of borrowing:
   - **Shift some borrowing** from expensive ultra-long-term debt to cheaper medium-term debt.
   - Engage in **targeted debt renegotiation**, particularly for Eskom debt restructuring.
   - Apply **preferential or prescribed lending** to secure cost-effective domestic debt.
   - **Reduce interest rates** through targeted capital management techniques.
4. Institute a considered, transparent, consultative, and evidence based expenditure review process.

CONCLUSION

- The facts:
  - the shortfall is real but isn't that big in relative terms and doesn't amount to an acute crisis;
  - it is being overstated for political reasons;
  - we can not continue to have shortfalls indefinitely;
  - we can not continue to accumulate debt indefinitely without commensurate growth; and
  - these haphazard rushed across the board cuts are economic suicide.
- So:
  - close the gap with existing reserve funds or a little more borrowing now;
  - raise more revenue next year onwards;
  - do a spending review and carefully close what doesn't work and scale up what does;
  - in that context we can borrow what we need; and
  - intervene to lower borrowing costs.

CONCLUSION

1. ’Crisis’ is being overstated for political purposes to lock us into a technocratic process;
2. The technocratic conversations then gets caught in what to cut and where;
3. Critical to push back against this underpinning narrative in the first instance:
    1. We have a growth and social crisis;
    2. The acute shortfall can be handled; and
    3. We need a proper plan for fiscal renewal.
4. Utilise this moment to demand a fiscal policy paradigm that centres poor and working class communities and developmental priorities.