Comments on the proposed Fiscal Responsibility Bill, 2021

Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

The Parliamentary Budget Office

- The Parliamentary Budget Office (PBO) was established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act no. 9 of 2009)
- The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills
- The PBO supports the implementation of the Act by undertaking research and analysis for the finance and appropriations committees
- This presentation focuses on analysis and comments on: The Fiscal Responsibility Bill, 2020

Outline

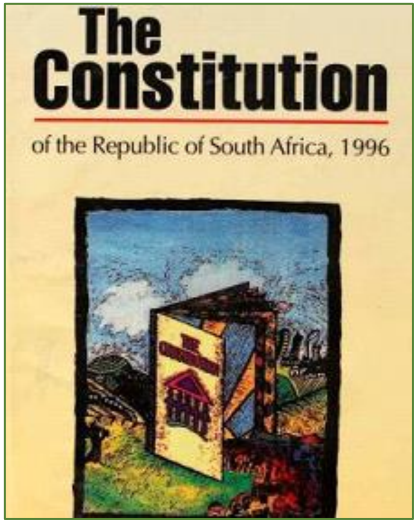
- The stated objectives of the bill
- Current legislation on fiscal, debt and guarantee management
- Parliament's role in fiscal management and fiscal policy since 1994
- Recommendations of the Fiscal Responsibility Bill, 2020
- PBO estimates of debt to GDP trajectory implied by the bill
- The main budget framework, net loan debt, provisions and contingent liabilities, including government guarantees
- PBO estimates of expenditure adjustments and changes to budget balances implied by the bill
- Concerns about the proposed Bill
- The macroeconomics of government expenditure
- Concern with top-down fiscal rules
- Conclusion

The stated objectives of the Fiscal Responsibility Bill, 2020 (the bill)

- To promote fiscal responsibility by obligating the Republic of South Africa to reduce its debt levels and its exposure to debt
- To introduce fiscal rules for the management of debt and government guarantees
- To provide for reporting requirements
- To provide for the review of the fiscal rules; to provide for certain exemptions from the fiscal rules; to increase transparency and fiscal responsibility
- To provide for matters connected therewith

Current legislation on fiscal, debt and guarantee management (1/2)

The Constitution:



- 215 (1) requires that budgets and budgetary processes of all spheres of government “promote transparency, accountability and the effective financial management of the economy, debt and the public sector”
- 215 (3) requires budgetary transparency regarding the anticipated deficits and the attendant borrowing requirements
- 218 States that government may only guarantee a loan after considering the recommendations of the Finance and Fiscal Commission

The Money Bills Act:
Requires that the Minister of Finance, in submitting the Medium Term Budget Policy Statement (Sec 6), as well as the annual budget (sec 7) provide:

- An explanation of the fiscal policy position of government
- The assumptions and cyclical factors underpinning government’s fiscal policy position
- Key fiscal ratios over the MTEF, the primary and overall balance and outstanding
- Estimates of general government and public sector debt at the end of the financial year and over the medium and long term

Public Financial Management Act (PFMA) and Budget Control

Chapter 2, 3, 4 and 5

- Developing macroeconomic and fiscal budget frameworks
- Introducing financial processes and procedures and ensuring cash management controls
- Quarterly reporting on the expenditure and revenue collected during a financial year
- Exercise control over revenue, expenditure, assets and liabilities
- Unauthorized expenditure becomes a charge against the following year's budget of a department if not approved by the Parliament/Legislature
- Strategic plans must be developed in line with MTEF budgets;
  - Measurable objectives tabled on the same day as the budget proposals
- Introduction of strict budget management aspects such as:
  - Cash flow spending for the year to be submitted to Treasury by February ;
  - Virements (Shifting of funds) limited to 8% of voted amounts of a programme;
  - Monthly reports on expenditure and revenue submitted within 15 days after the end of every month to Treasury;
  - Budget shifts to be reported within 7 days.

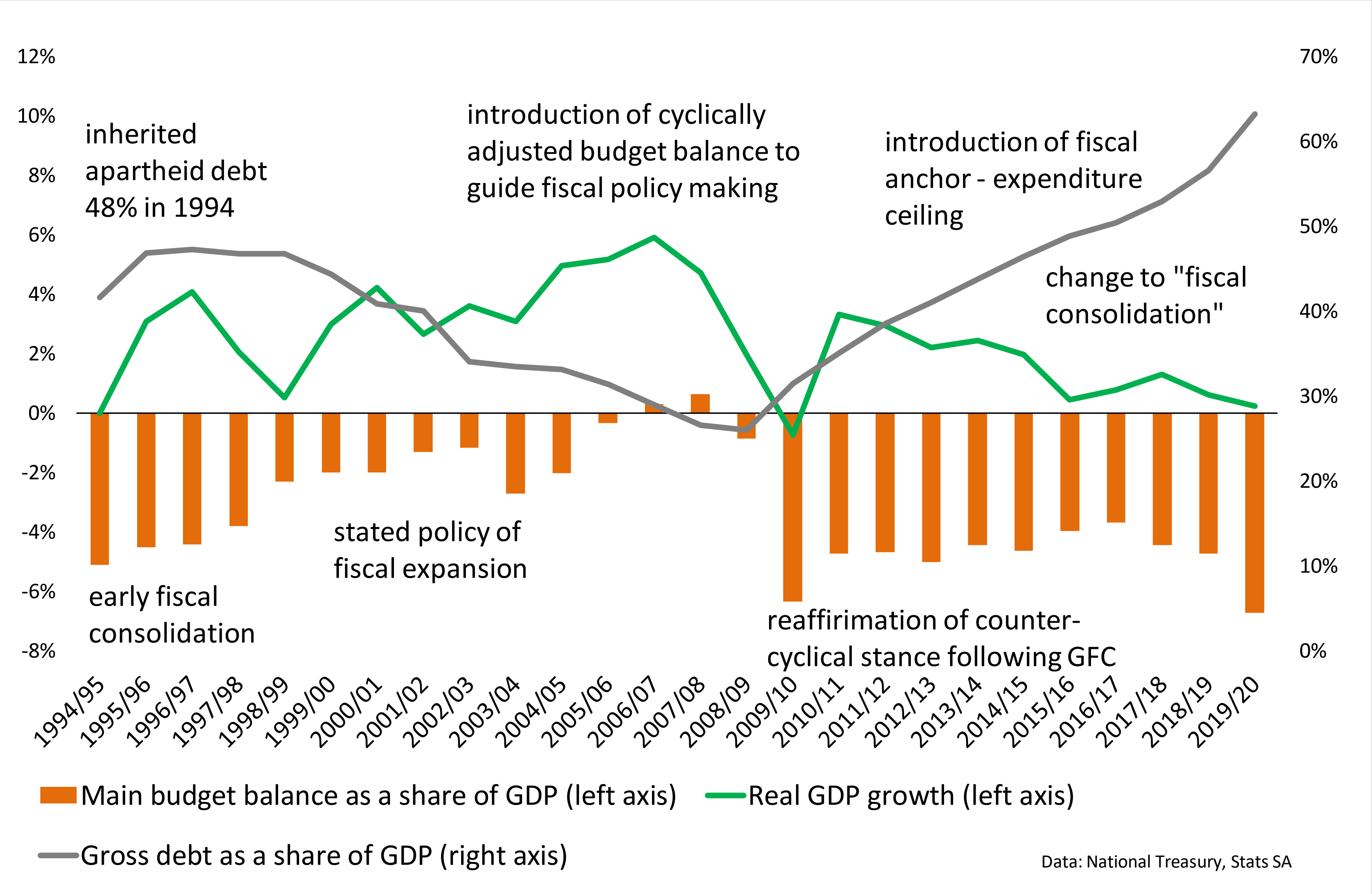
Parliament's role in fiscal management

In considering the fiscal framework and other money bills, the Money Bills Act 8(5) requires the legislature to:

- Ensure that there is an appropriate balance between revenue, expenditure and borrowing
- Ensure that debt levels and debt interest cost are reasonable
- Ensure that the cost of recurrent spending is not deferred to future generations
- Ensure that there is adequate provision for spending on infrastructure development, overall capital spending and maintenance;
- Consider the short, medium and long term implications of the fiscal framework, division of revenue and national budget on the long-term growth potential of the economy and the development of the country;
- Take into account cyclical factors that may impact on the prevailing fiscal position
- Take into account all public revenue and expenditure, including extra-budgetary funds, and contingent liabilities

The Act requires Parliamentary Budget Office to support Parliament in implementing the Act

Fiscal policy in South Africa since 1994



Data: National Treasury, Stats SA

Net loan debt over the 2021 MTEF

End of period	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**
R billion	**Outcome**	**Estimate**	**Medium-term estimates**		
Domestic loans[2]	**2 874.1**	**3 529.1**	**3 916.7**	**4 322.3**	**4 707.8**
Short-term	360.7	457.9	466.9	518.9	574.9
Long-term	2 513.4	3 071.2	3 449.8	3 803.4	4 132.9
Fixed-rate	*1 863.2*	*2 287.6*	*2 615.0*	*2 845.1*	*3 161.5*
Inflation-linked	*650.2*	*783.6*	*834.8*	*958.3*	*971.4*
Foreign loans2	**387.2**	**420.6**	**466.1**	**497.6**	**526.7**
Gross loan debt	**3 261.3**	**3 949.7**	**4 382.8**	**4 819.9**	**5 234.5**
Less: National Revenue Fund bank balances[2]	-263.6	-292.0	-180.3	-162.1	-142.9
Net loan debt	**2 997.7**	**3 657.7**	**4 202.5**	**4 657.8**	**5 091.6**
Gross loan debt % of GDP	*63.3*	*80.3*	*81.9*	*85.1*	*87.3*
Net loan debt % of GDP	***58.2***	***74.3***	***78.5***	***82.2***	***84.9***

2. Estimates include revaluation based on National Treasury's projections of inflation and exchange rates

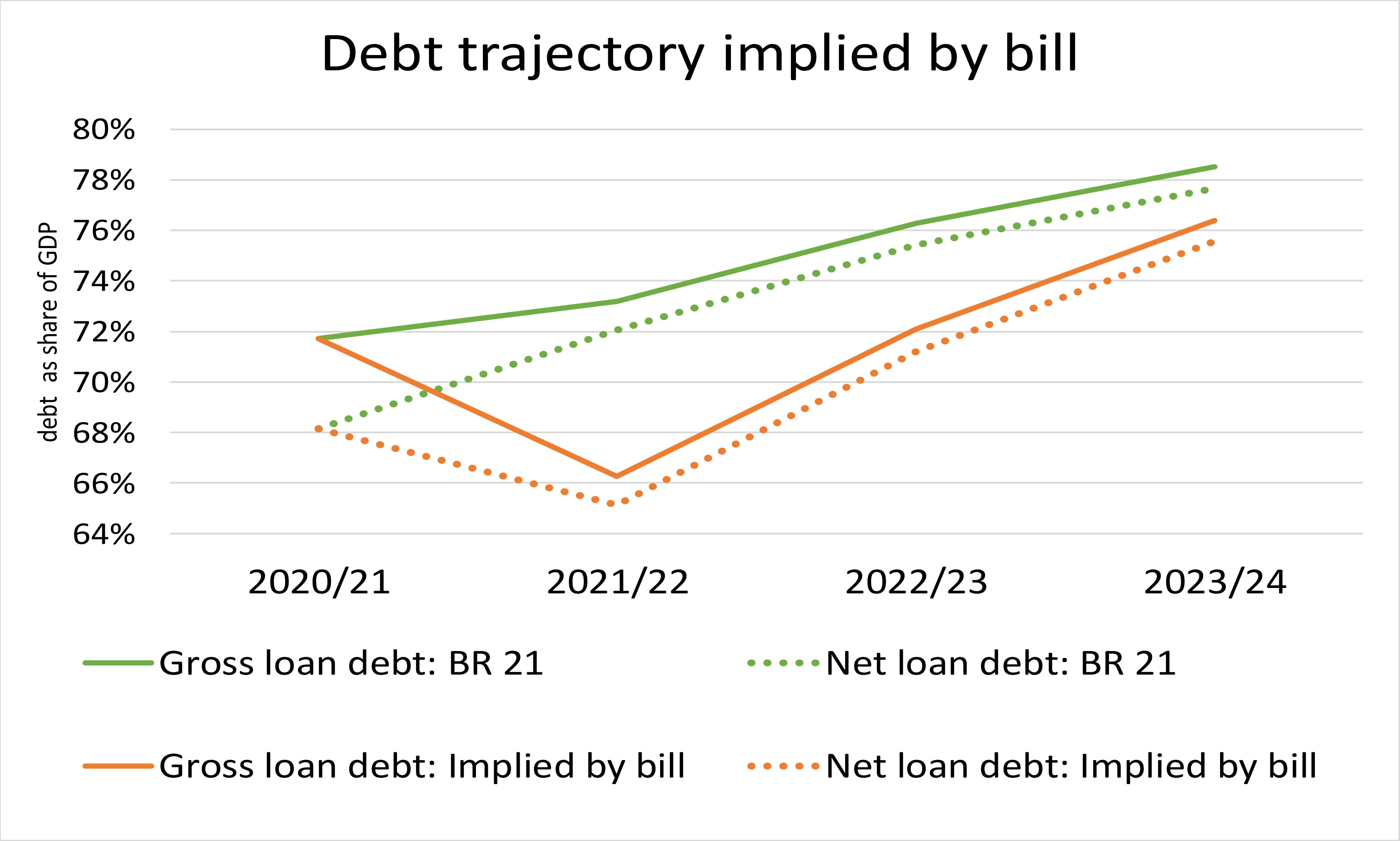
Source: National Treasury

Recommendations of the Fiscal Responsibility Bill, 2020

Fiscal responsibility Bill, 2020	Recommendations
(b) where the net loan debt is between 55 per cent and 60 per cent of the gross domestic product	(i) the primary balance on the main budget is in surplus, and that the surplus is greater than in the previous financial year; the expenditure ceiling; and
	(ii) the surplus contemplated in subparagraph (i) is achieved by adjusting
	(iii) compensation of employees is **decreased** by **five per cent** per year, from the financial year 2021/2022;
(c) where the net loan debt is greater than 60 per cent of the gross domestic product	(i) the primary balance on the main budget is in surplus, and that the surplus is greater than in the previous financial year
	(ii) the surplus contemplated in subparagraph (i) is achieved by adjusting the expenditure ceiling; and
	(iii) compensation of employees is **decreased** by **10 per cent per year**, from the financial year 2021/22

- To break even on the primary balance, the non-interest expenditure on the main budget must reduce by:
  - 13.6 per cent in 2021/22
  - 7.0 per cent in 2022/23
  - 3.2 per cent in 2023/24
- The above reduction must include a reduction of 10 per cent on compensation of employees

PBO estimates of the debt-to-GDP ratio trajectory implied by the bill



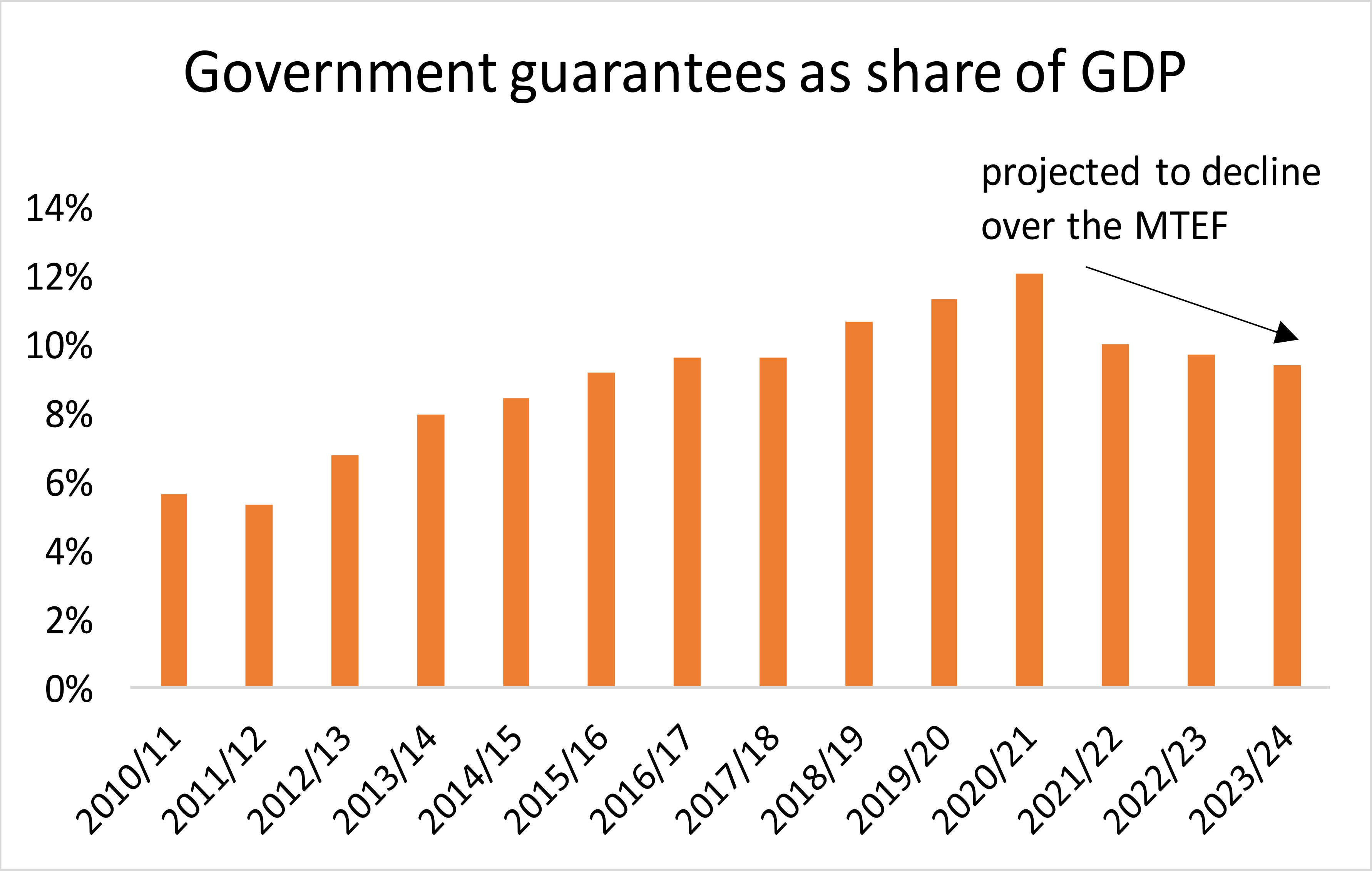
Net loan debt, provisions and contingent liabilities

The Fiscal Responsibility Bill, 2020 recommends that:

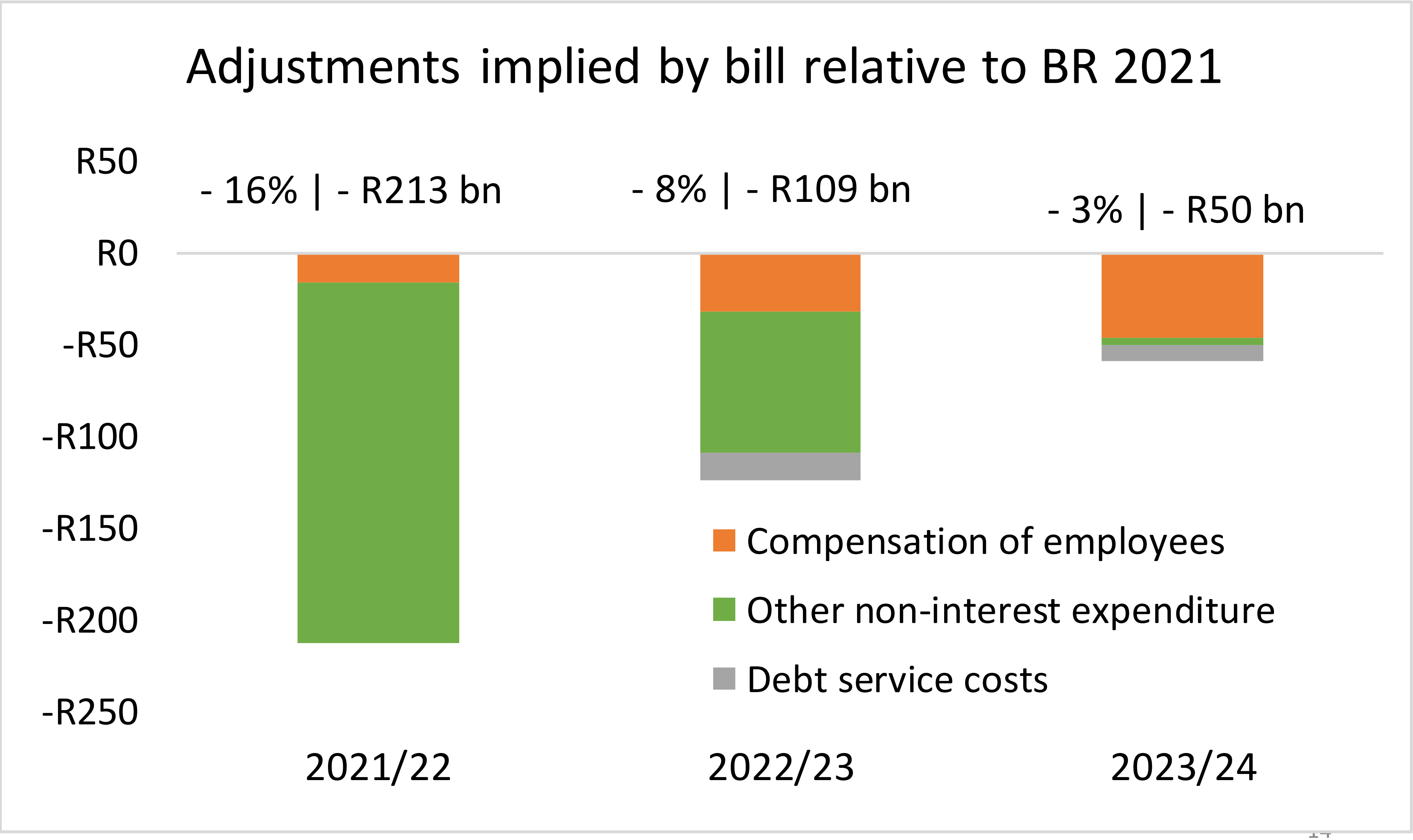
- Government guarantees may not, as a percentage of gross domestic product, be more than the total of government guarantees for the previous financial year.

R million	2019/20	2020/21	2021/22	2022/23	2023/24
Net loan debt	**2 997 770**	**3 657 717**	**4 202 494**	**4 657 886**	**5 091 603**
Provisions	**341 883**	**381 585**	**406 128**	**406 610**	**411 676**
African Development Bank	66 509	56 840	57 324	57 398	58 179
Development Bank of Southern Africa	20 000	20 000	20 000	20 000	20 000
Government employee leave credits	14 137	14 137	14 137	14 137	14 137
International Bank for Reconstruction and Development	36 169	30 127	30 383	30 423	30 836
International Monetary Fund	111 774	159 344	160 699	160 907	163 096
New Development Bank	93 033	100 914	123 360	123 520	125 200
Contingent liabilities	**1 056 174**	**1 105 299**	**1 094 649**	**1 155 956**	**1 234 209**
Guarantees	583 808	595 030	535 820	551 728	565 725
Denel	4 430	3 430	3 430	3 430	3 430
Development Bank of Southern Africa	4 653	4 688	4 738	4 803	4 863
Eskom	326 868	316 871	312 100	300 103	321 130
Independent power producers	161 427	176 684	165 695	151 034	137 462
Public-private partnerships	8 654	8 001	8 089	7 495	5 152
South African Airways	17 867	6 180	2 380	880	880
South African National Roads Agency Limited	38 998	45 268	46 788	53 406	59 135
Trans-Caledon Tunnel Authority	13 558	13 356	20 763	23 370	26 477
Other contingent liabilities	**472 366**	**510 269**	**558 829**	**604 228**	**668 484**
Road Accident Fund	332 242	374 951	425 348	469 984	530 092
Total	1 870 423	1 997 153	2 059 606	2 166 794	2 314 369
Total % of GDP	36.3%	40.6%	38.5%	38.2%	38.6%

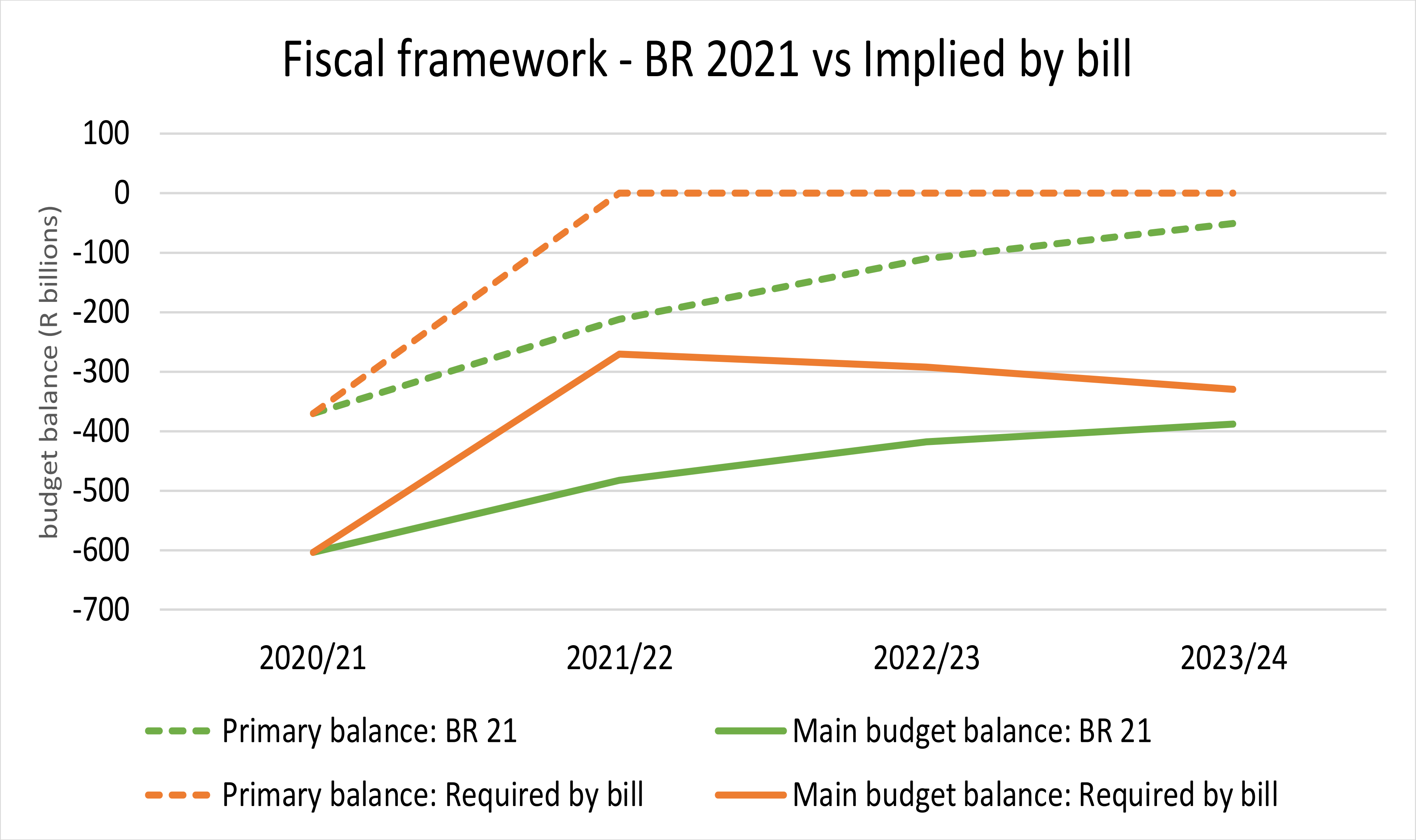
Government guarantees



PBO estimates of expenditure adjustments implied by the bill

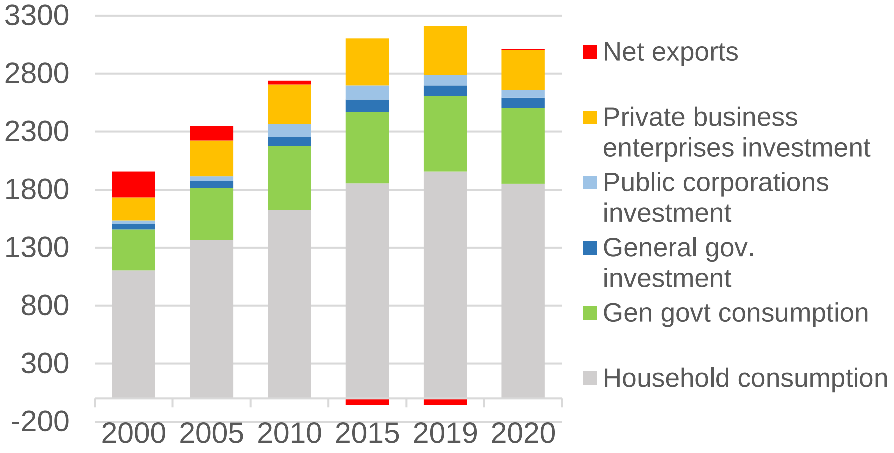


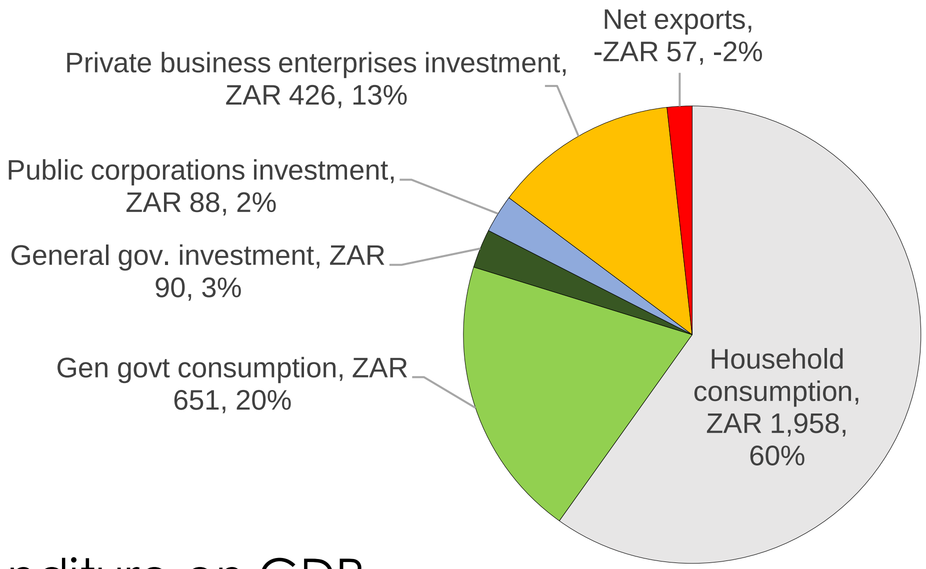
PBO estimates of primary and budget balance changes implied by the bill



The macroeconomics of gvt expenditure

Components of GDP, Rbillions (2010 = 100)





2019

- Macroeconomic perspective on expenditure on GDP
  - Y = C + G + I + (X-M), where:

Y	**Gross national income**
C	Household Consumption
G	Government consumption
I	Total investment (both public and private gross fixed capital formation)
X	Exports
M	Imports

- After household consumption, general government consumption has been the most important contributor to GDP
- General government consumption and public sector investment are important components of annual GDP

The macroeconomics of gvt expenditure

- Arguments against government expansionary fiscal policy:
  - The view that counter-cyclical expansionary fiscal policy was ineffective and would cause negative outcomes, such as crowding out private investment is no longer mainstream
  - Concerns that government debt will cycle out of control causing credit ratings to deteriorate and business confidence to drop should be viewed with caution and be backed by empirical evidence or relevant research
- Empirical evidence and global experience shows that fiscal contraction has been harmful to growth and increased unemployment and poverty
- Global experience shows that fiscal expansion has not led to higher interest rates and lower levels of investment
- Countries can face high debt repayment and cash flow constraints that raise the risk of default
  - However, exchange rate risks are the most important aspect of this risk and apply more to countries with high levels of foreign debt
- Many developed and developing countries have realized the importance of fiscal expansion during downturns, particularly crises
  - Many increased borrowing from Central Banks and utilized the extent of government balance sheets to finance expenditure and lower cost of debt

The macroeconomics of gvt expenditure

- Government expenditure and fiscal stimulus supports GDP growth:
  - Directly through injection of money into the economy
  - Indirectly through increasing the social wage through grants and provision of services
  - Households are left with more aggregate disposable income to spend and invest thus supporting GDP growth
  - Government investment in infrastructure and expenditure that increases household consumption can “crowd-in” investment
  - Increased government expenditure on poverty reduction and expansion of services can pay for themselves because they can increase GDP growth and tax revenues
  - Sustained government investment that is well targeted can support the supply side of the economy and curtail inflation and increase localisation
  - Constraints on government spending may have a negative multiplier effect

Weakness of top down fiscal rules

- Orszag, Stiglitz and Rubin (2021) succinctly summarise the problem with top down fiscal rules:
  - "We have grown skeptical about the usefulness of basing fiscal policy on any top-down anchor. Such anchors are supposed to promote fiscal sustainability, but it is hard to know where any such sustainability threshold is. Even if we knew the critical threshold value, budget outcomes are subject to very wide confidence intervals even over a window as short as a few years. Even if we knew that there would be deep concerns if debt or deficits exceeded a given top-down anchor, that knowledge by itself would not provide much guidance about what we should do today."
- They propose a new approach that combines automatic adjustment to economic condition supported by fiscal discretion:
  - "… fiscal discretion is retained but exercised after making the budget adjust more automatically and rapidly in areas where there is broad consensus that doing so is consistent with achieving broader societal goals."

Matters for Committee to Consider with top-down fiscal rules

- The experience of poor economic recovery after the 2008 global financial crisis and current experience during the economic crisis caused by the Covid-19 pandemic raises critical questions about the use of top down fiscal rules:
  - Fiscal rules may constrain or place unnecessary delays on action to respond to economic crises
  - The increasing risk of future crises and contagion related to the possibility of future pandemics, climate change related events, financial instability and political turmoil reinforces the case for fiscal flexibility
  - Government requires flexibility to act not only to respond to crises when they happen but also to mitigate risks and their socio-economic costs
  - Government expenditure can promote stability in a world prone to instability (and not the assumed stable equilibria)
  - Fiscal expansion can lead to GDP growth and so lower debt to GDP levels while fiscal constraints can cause GDP growth to decline and in this way cause debt to GDP levels to increase
    - Particularly in recessions and crises where private sector household consumption and business investment is likely to remain low

Matters for Committee to consider in processing the proposed Bill

- According to the Memorandum on the Objects of the Fiscal Responsibility Bill, 2020:
  - "Until steps are taken to bring South Africa's debt levels under control in relation to our GDP, South Africa will never be able to allocate funding to areas most in need of support, including basic and higher education, social grants and health care. South Africa must commit itself to sustainable control over the fiscus."
- There is a view that South Africa must commit itself to sustainable control over the fiscus but fiscal sustainability is not defined
- Instead, the Bill includes rules to follow when the net debt to GDP level is 50 per cent or higher
- The Bill fails to provide evidence that the proposed rules will ensure that government is "fiscally responsible"
- Unlike an expenditure ceiling, where the fiscal anchor is known and within the control of government, the proposed fiscal rule depends on two variables largely outside of government's control
  - Nominal GDP and
  - The exchange rate that influences the rand value of issued debt

Matters for Committee to consider in processing the proposed Bill

- The proposed fiscal rules will make government’s policy-making and budgetary decisions arbitrary and susceptible to exogenous factors:
  - Financial, economic, political and health problems in other countries and regions that affect global and South Africa’s economic performance
  - Exuberance or negative sentiment in global financial markets that increase exchange rate volatility
  - Regulatory & policy change in other countries affecting global financial liquidity
  - Bank and financial crises and contagion
- Perpetual revisions to the fiscal framework forced by an arbitrary metric would force repeated revisions to expenditure, adversely affecting the efficacy of government programmes and ability to plan
- The Bill fails to provide evidence that large revisions to government spending plans will not increase attendant pressures to (amongst others):
  - Increase taxation,
  - Further cut government spending, and
  - Reduce public sector COE
- The Bill fails to provide evidence that these measures and possible perpetual revisions of budgets are not going to face significant public opposition and increase economic uncertainty and prove to be not socially or politically feasible, thereby further damaging fiscal credibility

Matters for Committee to consider in processing the proposed Bill

- Lacks consideration of the likelihood that SA's GDP performance after the pandemic will be similar to the period before the pandemic means that debt to GDP levels may remain above the 50 per cent threshold, as proposed in the Bill, for a long time
- The rules proposed will require substantial across the board reductions in expenditure over the MTEF and possibly well beyond the medium term
- The rules suggested in the Bill will very likely continue the 2021 Budget's lowering of expenditure to "areas most in need of support" beyond the medium term
- The rules suggested in the Bill will very probably curtail GDP growth and could lead to worsening of debt to GDP levels even when government achieves a surplus
- A rule that legislates foreseeable real cuts to COE will very likely worsen labour relations in the public sector and country as a whole and may lead to worse outcomes and constraints on increasing productivity
- The Bill fails to provide evidence for service delivery improvement and economic performance to be brought about implementing the rules

Conclusion

- The stated aim of the proposed Fiscal Responsibility Bill, 2021 is to introduce binding fiscal rules for the management of debt and government guarantees
- The thinking behind the Bill is that unless South Africa's debt levels are brought under control in relation to GDP, South Africa will never be able to allocate funding to areas most in need of support
- However, there are serious concerns about the potential implications of the fiscal rules set out in the Bill:
  - The fiscal rule would make expenditure subject to unknown variables outside of government's control, including the size of GDP and size of government debt in rands
  - The proposed fiscal rule could cause government expenditure to be uncertain and possibly volatile and negatively affect its planning
  - The rule may potentially require perpetual and large revisions to government expenditure that could affect programmes and planning
  - This possible uncertainty could negatively impact fiscal credibility and undermine economic and investor confidence
  - The rules could lead to expenditure cuts that negatively impact economic growth and cause debt to GDP levels to increase
- There is skepticism about the efficacy of top down fiscal rules with influential mainstream macroeconomists supporting built-in automatic adjustments to economic conditions supported by fiscal discretion
- The Bills fails to show that there were considerations regarding potential service delivery and economic development implications of implementing the rules

ADDITIONAL SLIDES

Current legislation on fiscal, debt and guarantee management (2/3)

The Money Bills Act

The Money Bills Act requires that **the Minister of Finance**, in submitting the Medium Term Budget Policy Statement (Sec 6), as well as the annual budget (sec 7) to provide:

- An explanation of the fiscal policy position of government
- The assumptions and cyclical factors underpinning government's fiscal policy position
- Key fiscal ratios over the MTEF, the primary and overall balance and outstanding
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The main budget framework

	2019/20	2020/21	2021/22	2022/23	2023/24
		Revised	Medium-term estimates		
R billion/percentage of GDP		estimate			
Revenue					
Gross tax revenue after proposals	1 355.8	1 212.2	1 365.1	1 457.7	1 548.5
Main budget revenue	**1 345.9**	**1 200.8**	**1 351.7**	**1 453.7**	**1 522.0**
	26.1%	*24.4%*	*25.3%*	*25.7%*	*25.4%*
Expenditure		1 432.8	**1402.77**	**1379.63**	**1385.81**
National departments	749.7	804.5	763.3	736.3	739.0
Provinces	613.5	628.3	639.5	643.3	646.8
Local government	123.0	138.5	138.1	146.1	148.4
Contingency reserve	–	–	12.0	5.0	5.0
Provisional allocation not assigned to votes	–	–	11.6	32.1	33.2
Non-interest expenditure	**1 486.2**	**1 571.3**	**1 564.5**	**1 562.8**	**1 572.5**
Debt-service costs	204.8	232.9	269.7	308.0	338.6
Main budget expenditure	**1 690.9**	**1 804.2**	**1 834.3**	**1 870.8**	**1 911.0**
	32.8%	*36.7%*	*34.3%*	*33.0%*	*31.9%*
Main budget balance	**-345.1**	**-603.4**	**-482.6**	**-417.2**	**-389.0**
	-6.7%	*-12.3%*	*-9.0%*	*-7.4%*	*-6.5%*
Primary balance	**-140.3**	**-370.5**	**-212.8**	**-109.2**	**-50.4**
	-2.7%	*-7.5%*	*-4.0%*	*-1.9%*	*-0.8%*
Primary balance as a % of non-interest expenditure		-23.6%	-13.6%	-7.0%	-3.2%

Source: National Treasury