PARLIAMENT
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The PBO's written answer to the question raised by the Select and Standing Committees on Finance on austerity

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Parliamentary Budget Office

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1. Purpose of the written response

The PBO submission to the Select and Standing Committees on Finance stated that "[t]he government continues austerity with the 2023 budget, which follows the same failed fiscal consolidation path stumbled down over the past decade". This prompted a question on whether the PBO submission had a contradiction given its content on Budget's response to SONA and alignment with the MTSF. The purpose of this brief is to respond to the questions raised.

2. Defining austerity

Austerity is broadly understood as policies implemented by governments to reduce budget deficits through spending cuts, tax increases, or a combination of both.[1]

Some scholars expand this definition to include[2]:

- Government spending which is not increasing in real terms (that is, after inflation)
- Regressive tax policies
- Reassignment of funds away from investments in the public sector
- Cyclically adjusted deficit (government borrowing adjusted for cyclical variations) shrinks
- Policies which fail to close the gap between a country's actual and potential Gross Domestic Product and,
- Tight monetary policy (i.e. high interest rates), and an overvalued exchange rate.

Austerity and fiscal consolidation are often used interchangeably. Wren-Lewis[3] proposes that we consider austerity as fiscal consolidation that results in economic harm (more specifically involuntary unemployment or a noticeably more negative output gap). Wren-Lewis argues that "austerity is generally completely unnecessary". Other scholars specify that austerity is fiscal consolidation implemented during a period of economic crisis or low growth.[4]

Austerity is not purely a technical process but a political-economic choice. Austerity has served to appease financial markets by appealing to rentiers and credit rating agencies. People active in financial markets, particularly those seeking short-term high returns in secondary and derivatives markets, are generally concerned that increased government expenditure could increase inflation and so reduce the real rate of return on their financial assets.

3. Austerity in South Africa: What makes this budget an austerity budget?

The 2023 Budget maintains government's long-standing fiscal consolidation stance of reducing government consumption spending. According to the National Treasury (NT), this "critical policy stance" to stabilise debt improves market sentiment. However, the PBO argues that austerity hurts the real economy, erodes the state's capacity to deliver services and risks higher debt. It means less resources for teachers, doctors, nurses and police to serve a growing population. Austerity is

[1] Buttonwood. (2015). What is austerity? Available [online]: https://www.economist.com/buttonwoods-notebook/2015/05/20/what-is-austerity

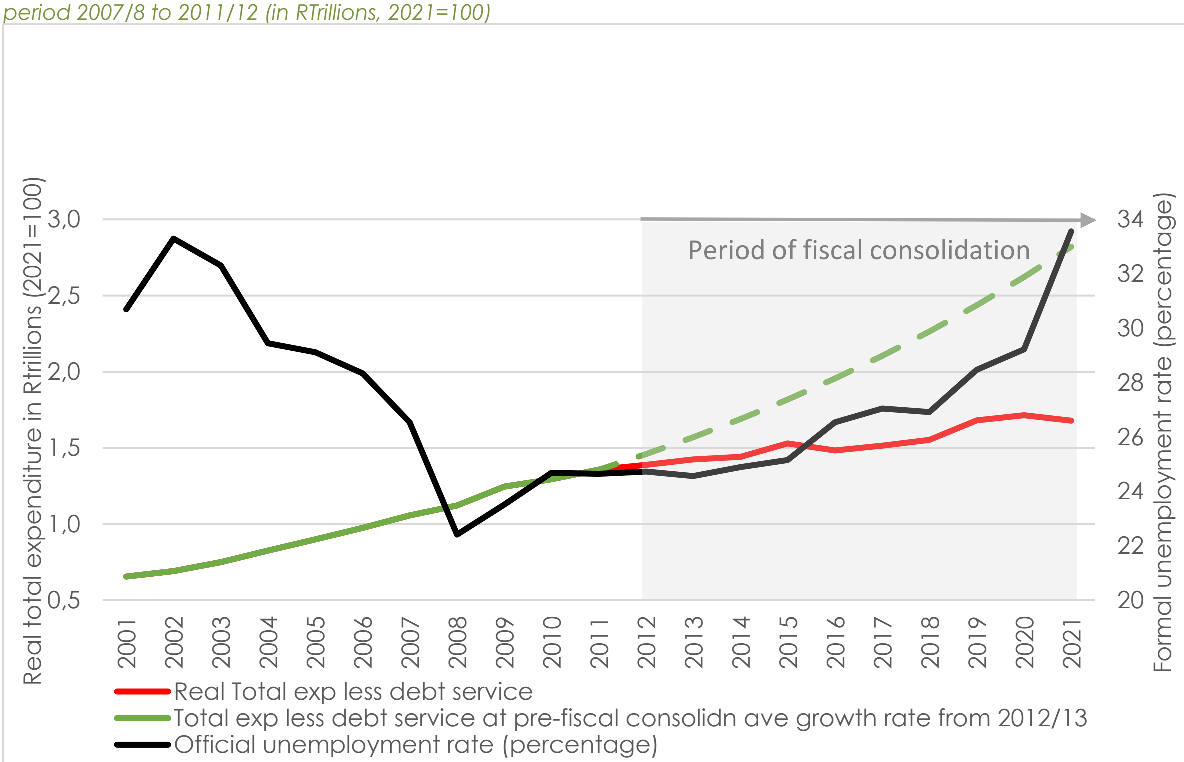
[2] Sibeko, B. (2019). The cost Austerity: Lessons for South Africa. Available [online]: https://www.iej.org.za/the-cost-of-austerity-lessons-for-south-africa/

[3] Wren-Lewis, Simon (2015). Defining austerity. "mainly macro" blog. https://mainlymacro.blogspot.com/2015/12/defining-austerity.html

[4] Potters, C. (2021). Austerity Measures, Do They Work, with Examples. Available [online]: https://www.thebalancemoney.com/austerity-measures-definition-examples-do-they-work-3306285

disastrous for developing a capable state that adequately addresses historical inequalities and meets the country's developmental objectives. The risks to the credibility of the fiscal policy framework listed by the NT are far outweighed by the socio-economic risk of not adequately investing in society. The fiscal consolidation in South Africa is causing socioeconomic harm, which classifies it as austerity.

Figure 1 Comparing Real total expenditure less debt service from 2011/12 to 2025/26 with Real total expenditure less debt service if the average annual growth rate of that amount had stayed the same as the average growth rate for the period 2007/8 to 2011/12 (in RTrillions, 2021=100)



Source: PBO calculations using data from the 2023 Budget Review

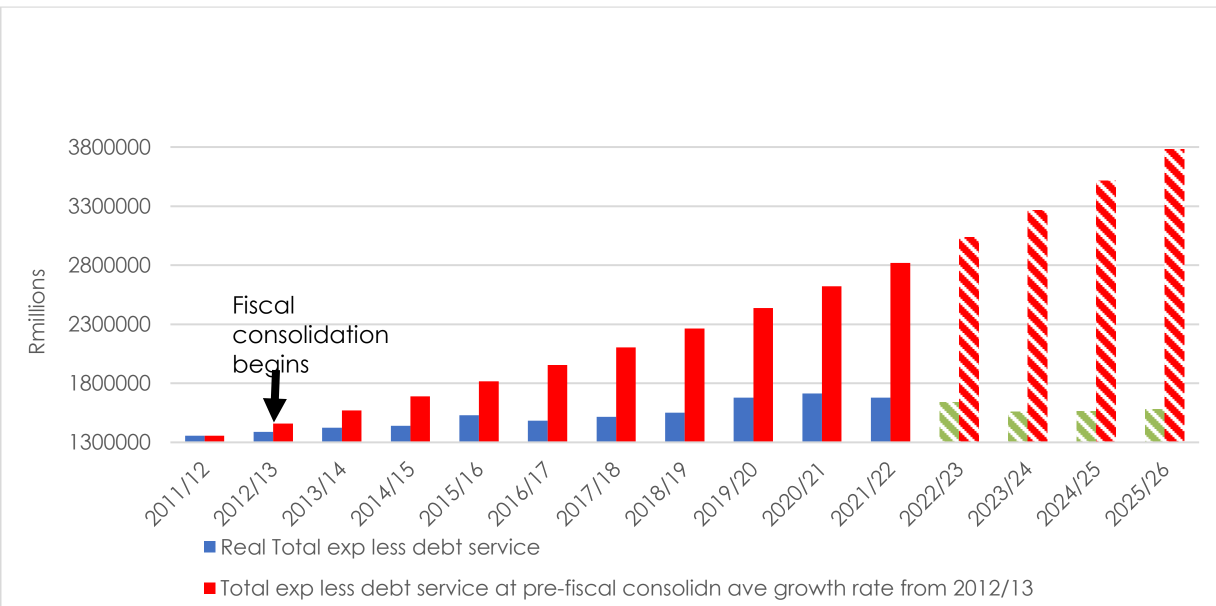
Figure 1 compares the actual real expenditure of government less debt service costs (or real non-interest expenditure) with an estimated trend for real government expenditure less debt service costs that increases this variable at its average rate of growth for the 5 years 2007/8 to 20011/12 for the period of fiscal consolidation from 2012/13 to 2021/22 (Figure 1 shows calendar rather than financial years). The difference between the actual and projected expenditure less debt service costs provides an estimate of the amount of austerity for the period since the government introduced fiscal consolidation in 2012/13 until 2021/22. The cumulative difference between the actual and projected real government expenditure less debt service costs (i.e. austerity) for this period is R6.7 trillion (real, 2021=100). The cumulative estimated austerity for the period 2012/13 to 2021/22 is 4.1 times larger than the real actual expenditure less debt service for 2021/22, which represents a relatively intense level of austerity.

The methodology used to estimate the size of austerity is based on a methodology used in the United National Conference on Trade and Development's 2017 Trade and Development Report that was titled "Beyond austerity: Towards a global new deal" (see Box 1.1, p. 3).

A major driver of fiscal consolidation has been to reign in government expenditure. Some commentators may argue that South Africa has not had austerity because real expenditure after debt service costs has increased in nominal terms over the period of fiscal consolidation. However, this is a very narrow and limited perspective that does not take into account the level of need in the economy. It also does not recognise that the economy required a substantial period of economic stimulus after the global financial crisis of 2008. Figure 1 shows the impact of the global financial crisis on unemployment during 2009 and 2010. A larger government stimulus over a longer period to the economy in the form of increased expenditure to support households and businesses could possibly have changed the trajectory of unemployment. Instead, the government introduced fiscal consolidation and exacerbated the pro-cyclical nature of its fiscal policy. From 2014, unemployment would grow and slowly worsen to its pre-Covid level of 28.5 per cent.

Policies which fail to close the gap between a country's actual and potential GDP

Figure 2 Comparing actual and forecast real total non-interest expenditure from 2011/12 to 2025/26 with estimates of real total expenditure less debt service if the average annual growth rate of that amount had stayed the same as the average growth rate for the period 2007/2011/12



Source: PBO calculations using data from 2023 Budget Review

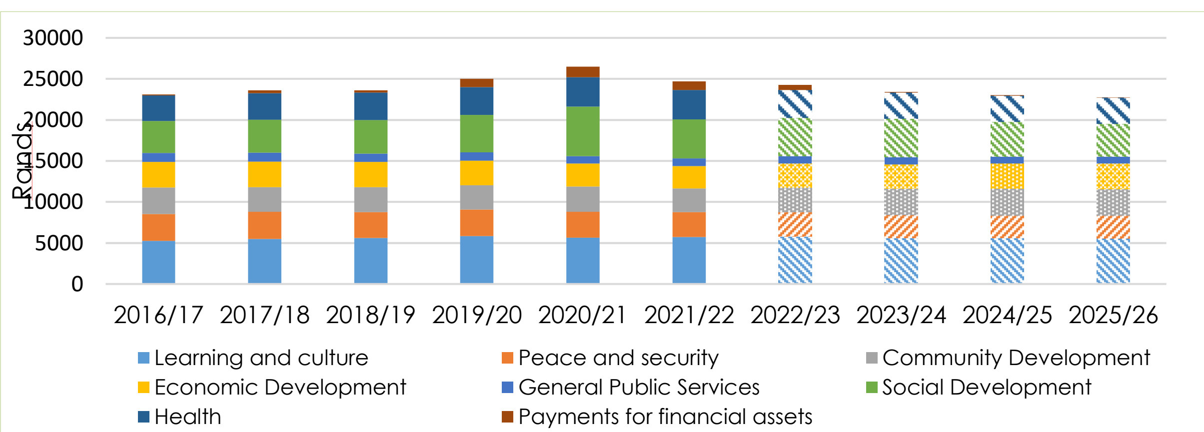
In considering the MTEF, government should take into account the cumulative direct and indirect impacts of government's austerity on the economy over the last decade. Sustained real growth in government expenditure after debt service costs could have substantially altered economic dynamics and provided the spending into the economy that could have spurred increased private household and business spending. The likelihood that a government stimulus could have spurred better economic growth would have meant that South Africa's debt-to-GDP ratio and debt service costs as a percentage of GDP would have been lower. Debt service costs could actually have increased in this scenario but the debt service cost as a percentage of government spending could probably have been much lower. Instead, continued fiscal consolidation over the MTEF is likely to constrain growth, investment and employment. The NT projections in the 2023 Budget Review of the expenditure components of GDP over the MTEF explain how fiscal consolidation is expected to hinder GDP growth. They project that government consumption expenditure will decline by an average of 0.6 per cent annually over the current MTEF.

Both private and public sector investments have declined since the global financial crisis of 2008. The 2023 Budget's growth forecasts over the MTEF depend largely on projected investment growth. The NT projects investment to grow at an average of nearly 3 per cent over the MTEF mainly driven by private sector energy projects which NT hopes will ease the energy constraint, improve overall business sentiment and stimulate fixed investment. However, SA's track record with regard to fixed investment has been poor, particularly during the fiscal consolidation period. The structural reforms proposed by the NT do not fundamentally address the deeper structural challenges that hamper investment and growth in the economy. The structural problems have been worsened by the negative impact of austerity and the pandemic. A decade of austerity interacting with extraordinarily high levels of unemployment, poverty and inequality, market concentration, financialisation and misallocation of capital, and inadequate state capacity to deliver infrastructure projects all point toward continued poor investment and economic growth performance.

Government spending which is not increasing in real terms

As shown in Figure 1, total real per capita expenditure declines in the medium term. Only expenditure on economic development and community development increase marginally in real terms. In 2016/17 total real expenditure per capita was R23 116, by 2025/26 this will decline to R22 747.

Figure 3: Real per capita expenditure (2016=100)



Source: PBO calculations using Budget 2023 data

The austerity approach should not be solely isolated to Budget 2023. In their document, A framework for achieving spending efficiency in a fiscally constrained environment, National Treasury acknowledges that:

> Government has been reducing the growth of spending by focusing on underspending programmes and those which are growing much faster than consumer price inflation. The recent round of across-the-board decrease approach in allocation for all programmes was implemented. The most significant disadvantage of this approach is the fact that some programmes become inefficient as a result of large reductions.

This admission by the NT suggests that some of the problems that programmes and departments have been experiencing may have been caused by fiscal consolidation. This negative impact on efficiency in turn leads to budget cuts for the affected programmes. A vicious circle of cuts and inefficiency is perpetuated within the public sector.

Real per capita trends in the health function decline over the medium term. These real declines are likely to be higher given that medical price inflation is higher than consumer price inflation (CPI). Disinvestments in health have long-term socio-economic and fiscal implications for the state and society.

In the 2021 budget, National Treasury acknowledged that the low growth in compensation along with early retirements "will reduce the number of available teachers". They added that this reduction in the number of teachers "coupled with a rising number of learners, implies larger class sizes, especially in no-fee schools, which is expected to negatively affect learning outcomes."[5] This example demonstrates how macroeconomic decisions have disproportionate distributive impacts on particular groups.

Social grants are another area of great concern. In some years, grants have increased below inflation. The Children's Institute argues that in 2011/12, the Child Social Grant (CSG) would have covered 79 per cent of the cost of basic foodstuffs necessary to avoid hunger. By 2018/19 it covered only 71 per cent of the cost of these goods, a decline of 8 per cent. These reductions occurred despite evidence that shows the significance of grants for human development. Low investments in the short run, lead to greater costs in the future. The reductions in child support grants before the pandemic could very well have reduced household resilience to the health and economic impacts of the pandemic.

[5] Budget 2021

4. Conclusion

There is a large body of international evidence that shows how austerity leads to rising unemployment, falling incomes and increased inequality.[6] Evidence also shows that austerity exacerbates existing structural inequalities within countries. The President has stated that "African women are the face of poverty" in South Africa. Austerity is likely to deepen the plight of these women as well as the majority in South Africa who have been suffering through a protracted cost of living crisis.

Fiscal consolidation has negatively impacted government's role in supporting aggregate economic demand and constrained growth, investment and employment. Lower growth over the decade has caused higher debt-to-GDP ratios. Fiscal consolidation efforts continued at the height of the Covid-19 pandemic. Even with relief measures, actual on-budget expenditure was insufficient. The austerity mindset with regard to fiscal policy within the government caused the economic stimulus package to be inadequate and led to premature budget tightening. The consequences of an austerity mindset are that households have faced higher levels of unemployment, poverty and inequality and become less resilient. Households have become more vulnerable to serious, interrelated global and domestic risks that can cause sudden large-scale damage and long-term pain. The July 2021 social unrest was a symptom of the extent to which the economic strain of the pandemic added to the existing suffering of households. While the July 2021 unrest spurred the government to reintroduce the SRD grant, an austerity mindset within government has meant that the grant has not been adjusted for inflation, which has eroded the buying power of the grant.

The National Development Plan: Vision for 2030 sets the ambitious goal of eliminating poverty and reducing inequality. Continued austerity means that government will very likely not be able to reduce unemployment, poverty and inequality.

[6] Ortiz. I, et al. (2015). The Decade of Adjustment:
A Review of Austerity Trends 2010-2020 in 187 Countries Available [Online]: https://www.social-protection.org/gimi/gess/RessourcePDF.action?ressource.ressourceId=53192; Sibeko, B. (2019). The cost Austerity: Lessons for South Africa