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An alternative perspective on SA debt and the sustainability of the fiscal framework

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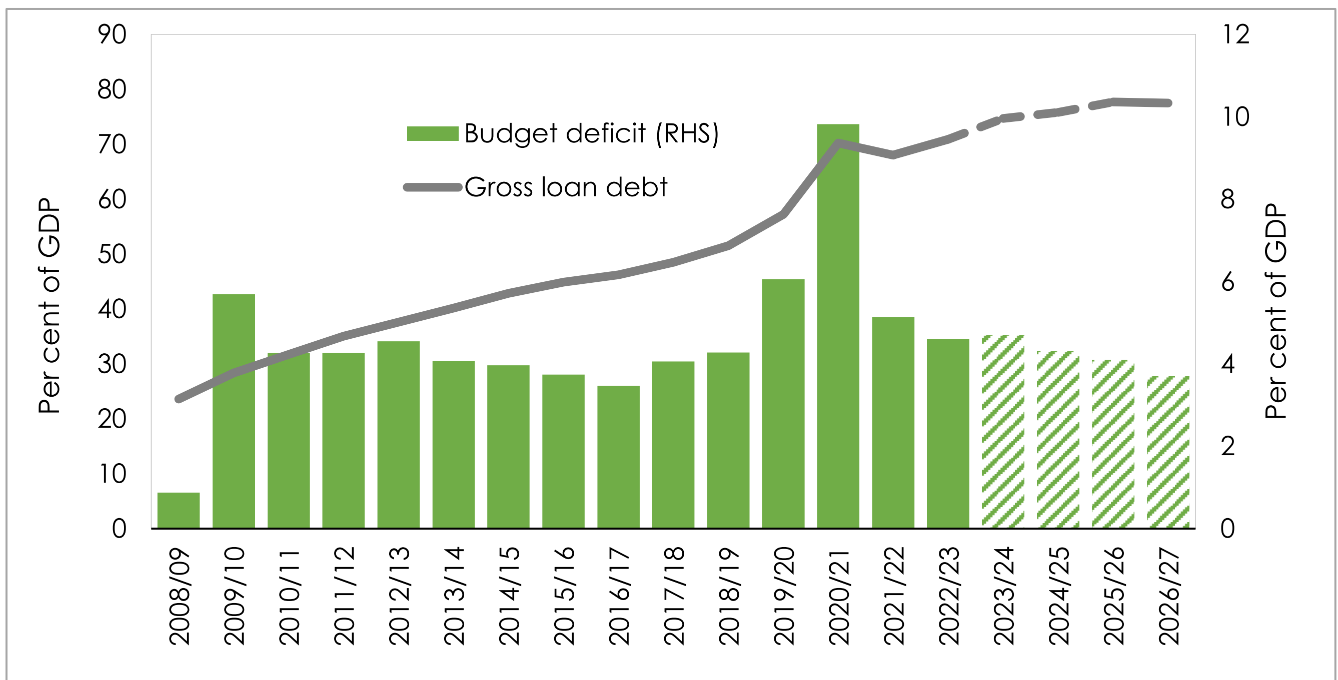
Introduction

In the 2023 Medium Term Budget Policy Statement (MTBPS), the National Treasury indicated that its fiscal strategy aims to achieve fiscal sustainability by cutting government spending to reduce the budget deficit and stabilise the debt-to-GDP ratio. However, despite implementing fiscal consolidation measures for over a decade, both the debt-to-GDP ratio and the budget deficit have worsened (see Figure 1). The PBO has cautioned on several occasions about the disproportionate impacts of austerity on vulnerable populations (women and children in particular), exacerbating income inequality and social disparities, with potentially negative long-term consequences for the economy. Moreover, the PBO has argued that austerity measures have forced the government into short-term economic planning and have resulted in a status quo where budgets are seen merely as an accounting exercise solely focused on reducing the deficit and debt levels rather than a tool for fostering development and the attainment of socioeconomic rights as enshrined in the constitution. This is not to say that the PBO suggests that the government should disregard fiscal indicators like the budget deficit and debt levels. Rather, the PBO is concerned about the "debt fear-mongering" approach undertaken by the National Treasury to advance a narrative that South Africa is facing a fiscal crisis and that there are no alternative economic policies to grow the economy and reduce debt without implementing austerity.

Figure 1: Budget deficit and total gross debt as percentages of GDP (2008-2026)



Source: National Treasury

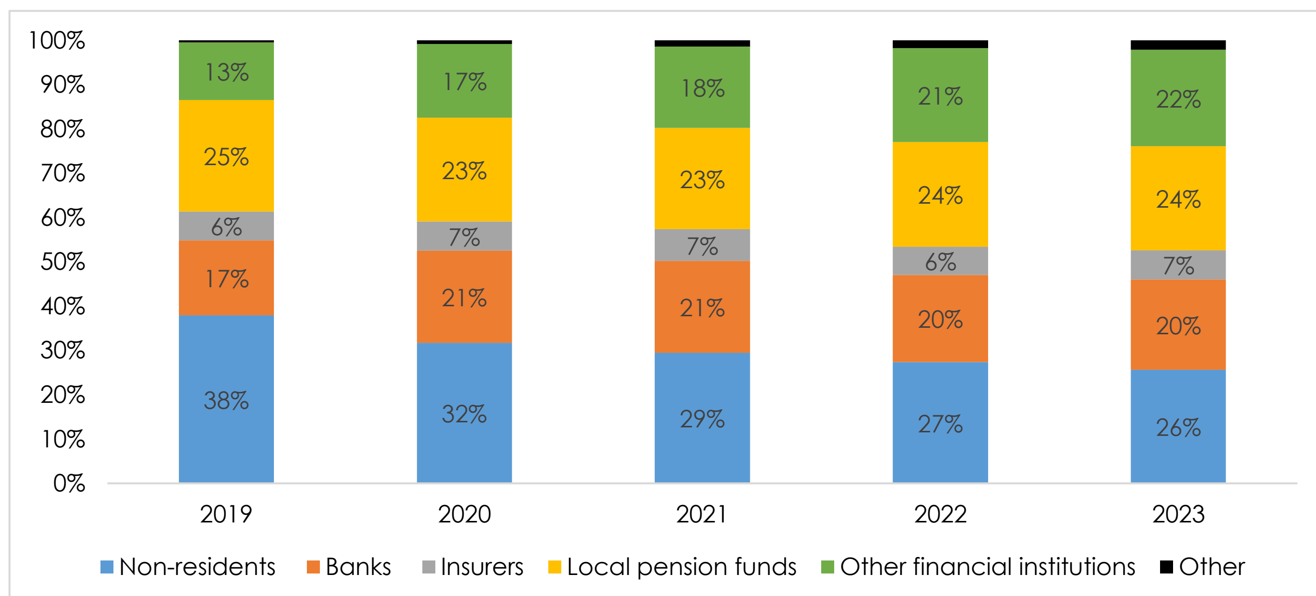
Factors mitigating against SA experiencing a debt crisis or possible default on its debt

The empirical evidence does not support the assertion that South Africa is teetering on the edge of a debt crisis. Compared to its peers, several unique factors mitigate against South Africa experiencing a debt crisis or possible default on its debt. For instance, one of the predictive factors for a default cited in mainstream literature is to consider whether a specific country has a history of defaulting on debt repayments. Argentina, for example, with a history of nine defaults (the latest in 2020), is expected to carry a much higher risk of a future default than a country without such a precarious history. Since becoming a Union in 1910, South Africa has never defaulted on its sovereign domestic or foreign

currency-denominated debt. On the other hand, domestic private sector debt required restructuring at the height of international resistance against apartheid. In 1985, the government had to negotiate the rescheduling and orderly repayment of the foreign debt obligations of SA private sector banks to manage their foreign exchange commitments. This followed a refusal by international banks to renew short-term credit lines to the local banking sector.

Historically, sovereign debt defaults have been a result of either severe domestic fiscal (or broader macroeconomic) mismanagement, i.e. poor policies, or due to external shocks. These can include a recession in a key trading partner or a plunge in a country's key export prices that are beyond the control of domestic policymakers. Given that external shocks are often the reason why countries default on their debt, the composition of total government debt is an important factor to consider. As such, it is not so much the debt-to-GDP ratio that indicates the default risk, but rather the debt composition and the access to financing. The South Africa experience is instructive. In the late 1980s, SA's external debt was not higher than it is currently. Rather, trade and financial sanctions at the peak of apartheid led to massive foreign capital withdrawals and disinvestment. This massive outflow meant that even a relatively manageable foreign debt exposure during normal times quickly became unsustainable.

Figure 2: Ownership of SA government bonds (2019-2023)



Source: National Treasury

Several countries that have defaulted on debt repayments had a relatively large share of foreign currency-denominated debt. Historically, countries have been more prone to default on foreign currency as opposed to local currency debt. A significant portion of South Africa's debt is owed to the domestic financial sector (in local currency). The National Treasury often cites how South Africa's domestic capital markets are deep and liquid enough to absorb the government's financing requirements. This financial depth puts South Africa in a better position than many other countries, which may be more reliant on capital inflows to finance their budget deficits. However, a sizeable share of South Africa's domestic currency debt is held by foreigners (see Figure 2). Therefore, South Africa remains vulnerable to a shift in risk perceptions, speculation and surges in financial outflows. In response to these embedded and often unjustified risk perceptions, the National Treasury chooses to increase offered interest rates on newly issued bonds to ensure that all auctioned bonds are sold. At the same

time, higher interest rates disproportionately benefit the profits of the financial sector while adversely impacting the working class.

Another mitigating factor is that South Africa's debt maturity profile relative to other emerging economies safeguards the country from sovereign debt defaults in the near future. For instance, the average maturity of government securities is fifteen years compared to the emerging market average of eight years, meaning that debt obligations may be fulfilled diligently across the belly of the yield curve. Also, South Africa's budget, or resource allocation framework, protects investors. This is because debt service costs receive priority over any other expenditure item. The National Treasury subtracts debt service costs from the total consolidated budget before undertaking the division of revenue. As such, even in a worst-case scenario where tight financial conditions undermine the government's ability to issue more debt, history shows that South Africa is likely to first experience protracted periods of fiscal consolidation before the country defaults on interest payments.

Alternative policy choices for economic development and fiscal sustainability

Beyond the factors mitigating against a potential debt crisis, the government also has viable alternative policy and budget options at its disposal to steer the current fiscal and economic growth trajectory of South Africa in a more economic developmental direction. For instance, the budget could contribute towards achieving lasting fiscal sustainability by directing more resources towards social welfare, public services, and infrastructure development in pursuit of a new demand-led growth trajectory. Given the reality that the government's supply-side structural reforms are unsuitable for stimulating investment and economic growth in a nation with serious demand-side constraints due to structural inequality, poverty, and unemployment. The South African economy also remains extremely concentrated (both in terms of market share and wealth) with a high level of financialisation. Economic policy, particularly macroeconomic policy, has to take into account this economic context. Structural economic transformation rather than a narrow view of structural reform is required to tackle the high levels of structural unemployment, poverty, and inequality, which are constraining aggregate demand in the economy.

The government can also leverage its full public sector balance sheet, including the Unemployment Insurance Fund (UIF) reserves and the Government Employees Pension Fund (GEPF), to fund a fiscal stimulus for the economy. A well-spent fiscal stimulus can reduce the debt-to-GDP ratio through spurring economic growth and building state capacity. In addition, the government can use some of its R459 billion residing in the South African Reserve Bank's (SARB) Gold and Foreign Exchange Contingency Reserve Account to improve its liquidity position and fund industrialisation. Prudential limits on domestic pension funds can also be further amended to restrict the amount of domestic funds that can exit the country.

The 2023 MTBPS highlighted that South Africa's high cost of borrowing is what makes its debt unsustainable, with debt-service costs as a share of revenue expected to increase from 20.7 per cent in 2023/24 to 22.1 per cent in 2026/27. In addition, the National Treasury argued that rising debt services costs are crowding out important social spending. Inherent in the National Treasury's approach to debt sustainability, is the assumption that government debt is solely a fiscal policy phenomenon caused by the government and can only be addressed through excessive expenditure cuts. Monetary policy is seen as neutral and ineffective in addressing South Africa's escalating debt stock and debt service costs. The South African Reserve Bank's Monetary Policy Committee often alludes to how the government's debt level impedes the effectiveness of monetary policy. Meanwhile, in the 2023 Budget Review, the National Treasury published a sensitivity analysis illustrating the responsiveness of debt and

debt-service costs to changes in macroeconomic variables such as interest rates, inflation, and exchange rates. The analysis showed that a 1 percentage point increase in inflation and interest rates, together with a R1 depreciation of the rand against the dollar, results in a R54.9 billion increase in gross loan debt and a R6.2 billion increase in debt-service costs.

Both monetary and fiscal policy have a strong role to play in managing interest rates on government bonds. This could be achieved in several ways, including yield curve management (through more medium-term borrowing), targeted debt renegotiation, preferential or prescribed lending, and accessing capital on more favourable terms, including via the SARB. The South African Reserve Bank Act 1989 (Act nr. 90 of 1989) allows the SARB to purchase government bonds within a legislated limit. During the COVID-19 pandemic, the SARB bought approximately R34 billion worth of government bonds in the secondary market. The SARB also has the option to offer credit at reduced rates to specific sectors or entities, such as Development Finance Institutions or state-owned enterprises. However, because the government seems to have chosen an ideological approach that sees its role as enabling market-friendly policies, these initiatives have received insufficient consideration and even been ignored.

Domestic resource mobilisation

The National Treasury suggests that the economy is not able to generate enough revenue, even though South Africa has a relatively broad tax base compared to most middle-income countries. There is certainly scope to improve domestic resource mobilisation and redistribution through progressive tax reforms, leveraging development finance, and monetary policy reforms (beyond interest rates), amongst others, to diversify and build resilience in public financing. Improved revenue generation results in a reduced budget deficit ensuring that the government relies less on debt to finance its developmental priorities. Moreover, taxes serve a dual purpose from a developmental perspective. They can be harnessed as a strategic instrument to redirect production and resources, while simultaneously shaping the desired distribution of income. Some of the potential areas in tax for increasing domestic revenue include:

- Implementing progressive measures to tax wealth and income from financial assets;
- Expanding the Illicit financial flow (IFF) frameworks in addition to the Base Erosion and Profit Shifting (BEPS) framework to curb IFFs;
- Introducing windfall taxes for sectors that benefit from the commodity price boom;
- Implementing excess profits tax on companies that have used the inflation upsurge to boost profit and make up for COVID-19 losses, as well as excess profits from interest rate hikes;
- A systematic review of tax incentives and removal of ineffective incentives;
- Given the poor empirical evidence that the reduction in corporate income tax leads to higher investment, the government should consider restoring or increasing the corporate income tax. The Institute for Economic Justice estimates that the revenue fund forgoes about R12 billion in revenue due to the reduction in corporate income tax from 28 per cent to 27 per cent.

Conclusion

The prevailing fiscal situation in South Africa reflects the cumulative impact of past decisions in economic policymaking. UNCTAD notes that “fiscal space cannot be identified as a predetermined level of resources in any economy. Rather, it depends on past and current fiscal policy choices, such as the extent of the government’s spending, its savings, and the level of its debt relative to GDP. What

matters most is the flow of revenue that accrues to the government over a period of time as a result of tax and expenditure changes and their subsequent impact on GDP through the fiscal multipliers". The choice to mainly manage debt by cutting expenditure has not taken into account the regenerative interaction between public investment, labour productivity, social and economic development, rights, and equity.

The PBO concludes that austerity measures such as fiscal consolidation and the introduction of fiscal rules that are not supported by any empirical evidence will not achieve fiscal sustainability and grow the economy. In the long run, debt stabilisation or fiscal sustainability may be achieved only through pro-growth demand and supply measures that build resilience and productivity in households and businesses, particularly small and medium businesses.