

# South Africa's long-term fiscal choices

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**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# Social spending as a measure to address inequality

*“Since the eighteenth century, the rise of tax-based social spending has been at the heart of government growth.*

*It was social spending, not national defence, public transportation, or government enterprises that accounted for most of the rise in government’s taxing and spending as a share of GDP over the last two centuries.*

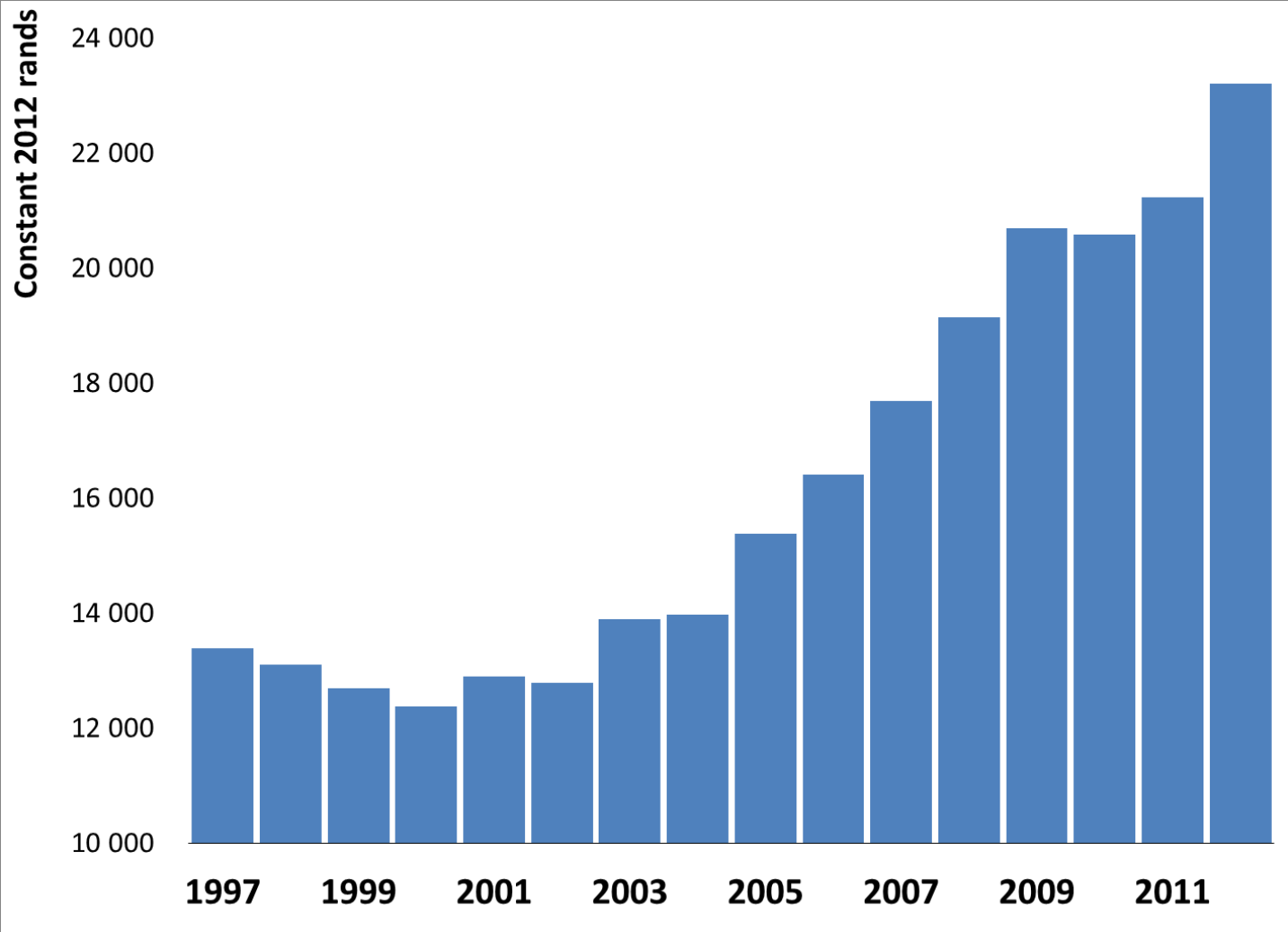
***The increasing role of social spending in our lives has been linked to three other great social transformations: the transition to fuller democracy, the demographic transition towards fewer births and longer life, and the onset of sustained economic growth.***

*Social spending’s share of national product derives its permanence from the likely permanence (we hope) of these three great transformations – that is, of democracy, of human longevity, and of prosperity.”*

Peter Lindert, *Growing Public: Social Spending and Economic Growth since the Eighteenth Century* (2004)

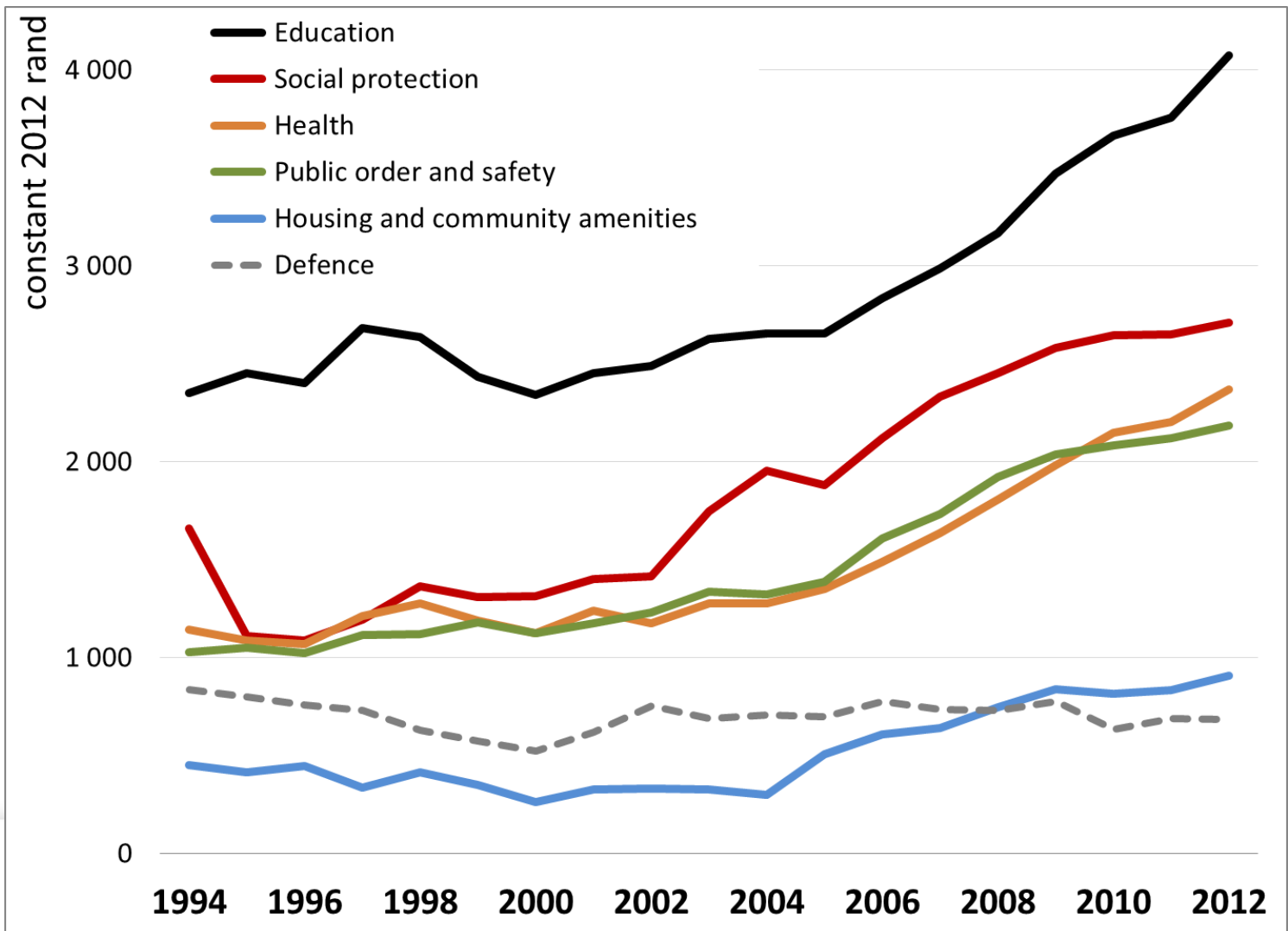
# Dramatic increasing in spending per capita since the democratic transition

Real spending per capita of general government



# Changes in the composition of expenditure

## Real spending per capita of general government



# Is it sustainable?

- It is often presumed that the democratic fiscal dividend is not sustainable. Some have gone as far to argue we face a “fiscal cliff”!
- The **long term fiscal model** is a framework for posing the question: is this level of social spending sustainable over the next several decades.
- It does so by looking at the impact of the following factors on public expenditure:
  - Economic growth and income per capita
  - Demographic trends and utilisation of public services
  - Policy scenarios that take account of NDP objectives
- It then benchmarks sustainability as follows: *assuming no change in tax policy, is the expenditure path consistent with a stable debt trajectory.*
- A debt path that is stable or declining over time is regarded as sustainable. An explosive debt path is not sustainable.

# Issues and drivers of spending projections

## ■ Key drivers of spending projections

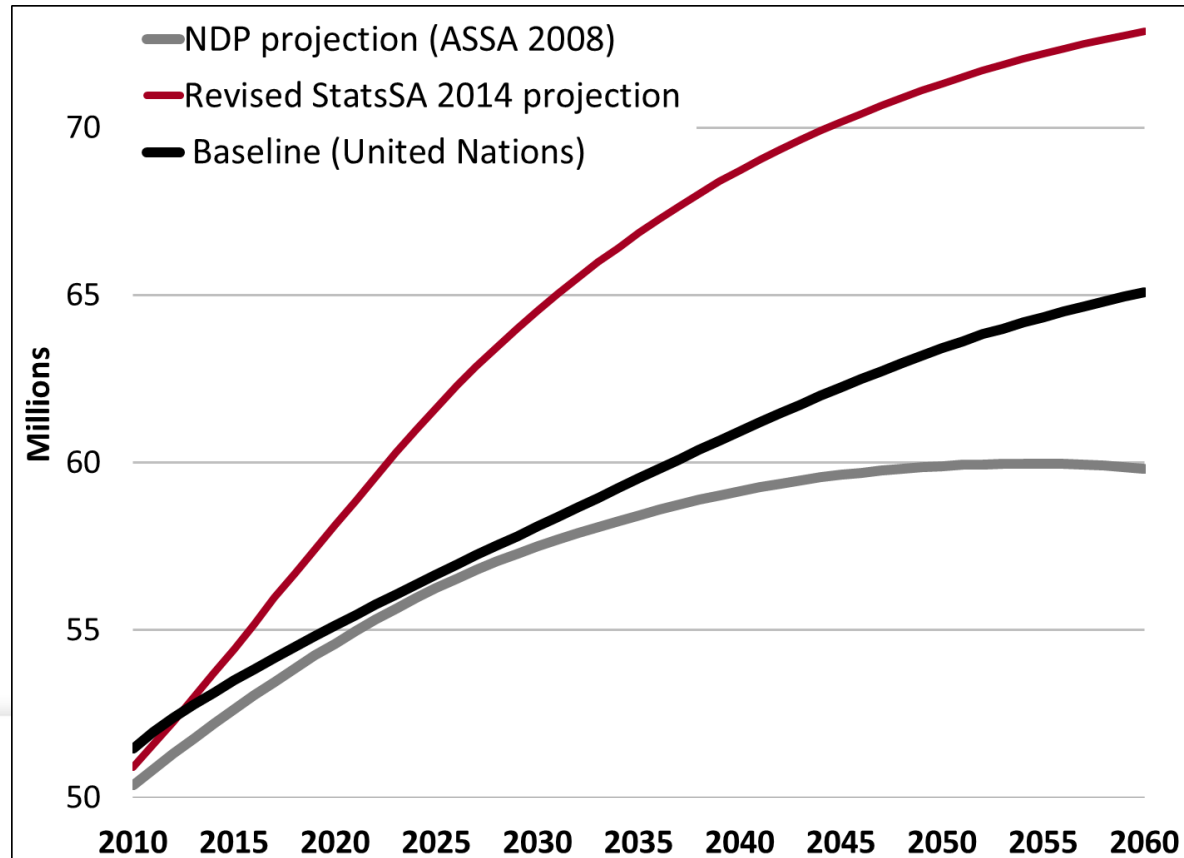
- Population growth and demographic structure (*updated to reflect a new population baseline*)
- Economic growth and per capita income (*updated to reflect lower medium term growth assumptions*)
- Take-up rates, enrolment, utilisation and access
- Wages, prices and excess cost growth: (*public sector wages are assumed to remain in line with overall wages, which growth at CPI + labour productivity*)

## ■ Difficult issues

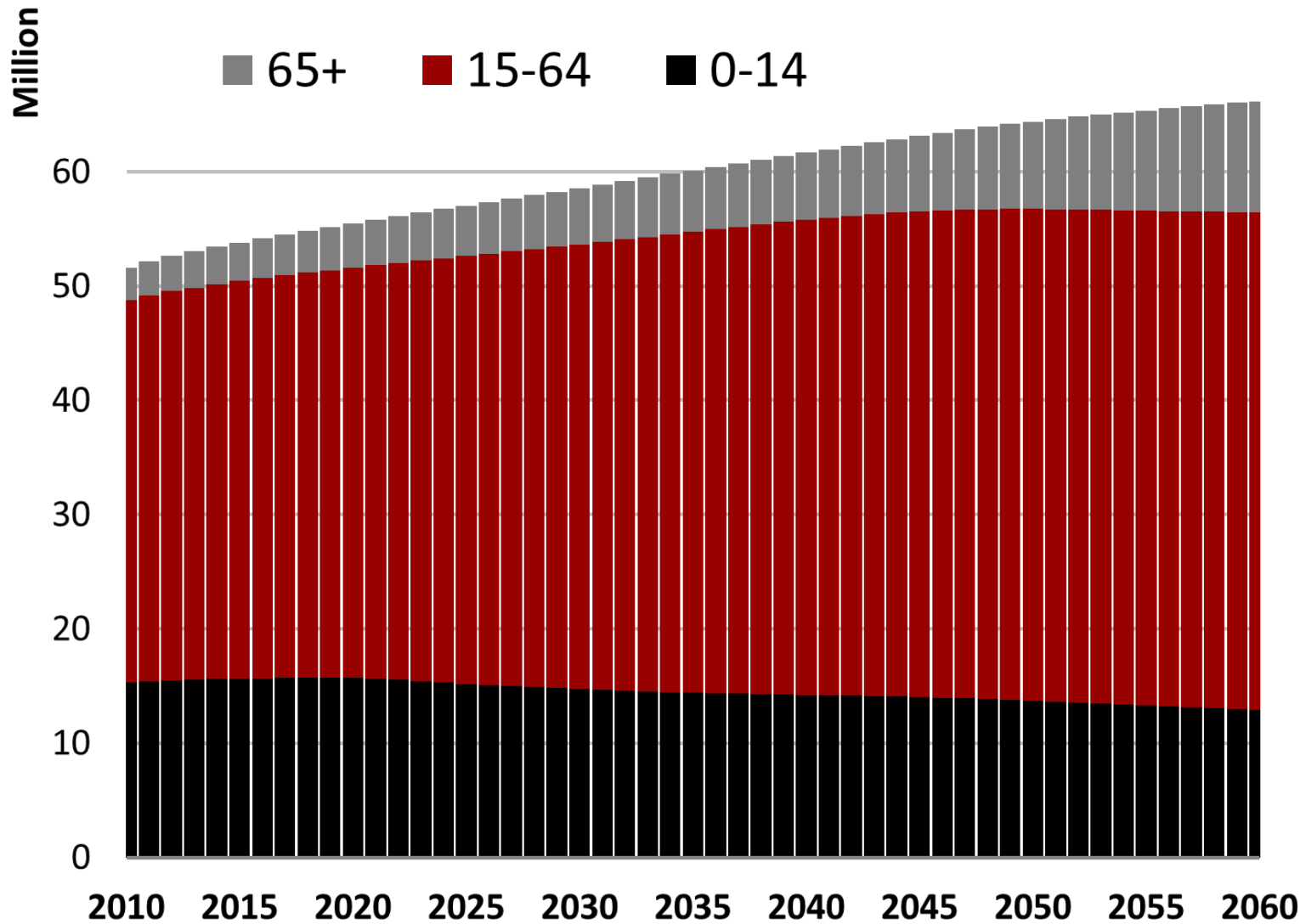
- Forecasts vs. projections
- Projecting from a time of deep structural change
- Census, 2011
- Medium-term forecasts and transition to long term projections
- Defining ‘unchanged policy’ assumption
  - Policy intent vs. policy practice
  - Recent growth rates or share of income
- Feedback effects
- Income distribution and poverty levels

# Variation in population estimates

- Population estimates were initially based on NDP projections
  - The NDP used a base population of 50.6 million as the estimated 2012 population. Census 2011 estimates the 2012 population to be 51.8 million.
  - The NDP projected the population to be between 58.2 million to 61.5 million in 2030. Census 2011 projected that in 2030 the total number of people living in South Africa will be 64.5 million persons
- There remains uncertainty about population trends (Fertility, HIV/AIDS, Migration)
- Official mid-year estimates show a dramatic acceleration of population growth
- How sustained will the Census 2011 Fertility trend be?
- We have chosen to use the revised UN projection as our baseline.



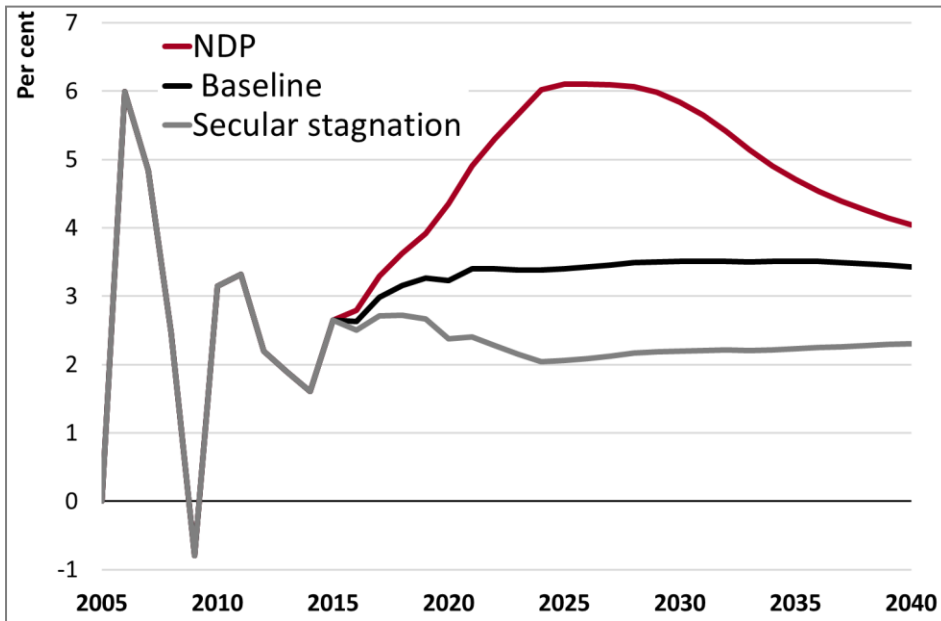
# Population trends and fiscal incidence



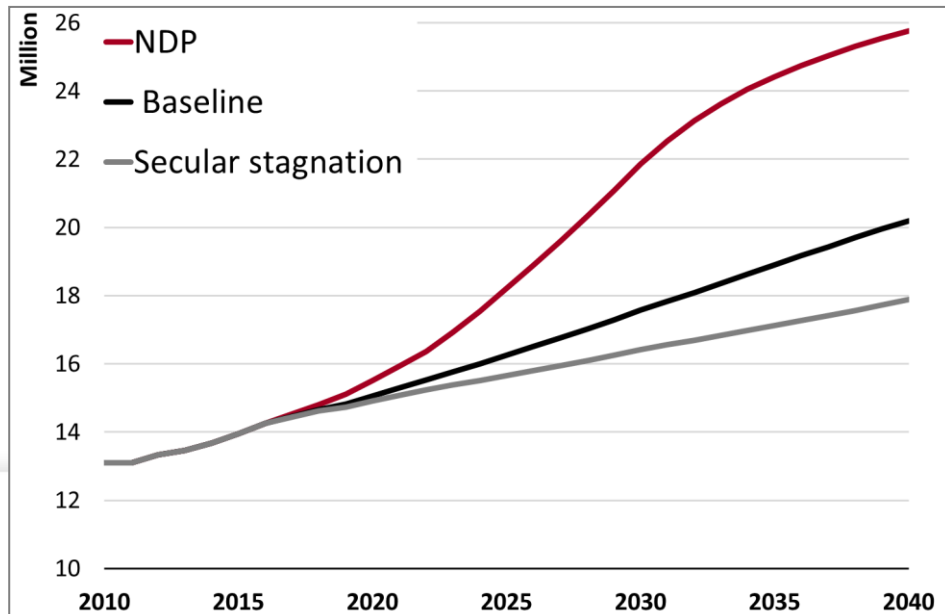


# Growth and employment prospects

## Three economic scenarios



## Formal employment in three economic scenarios

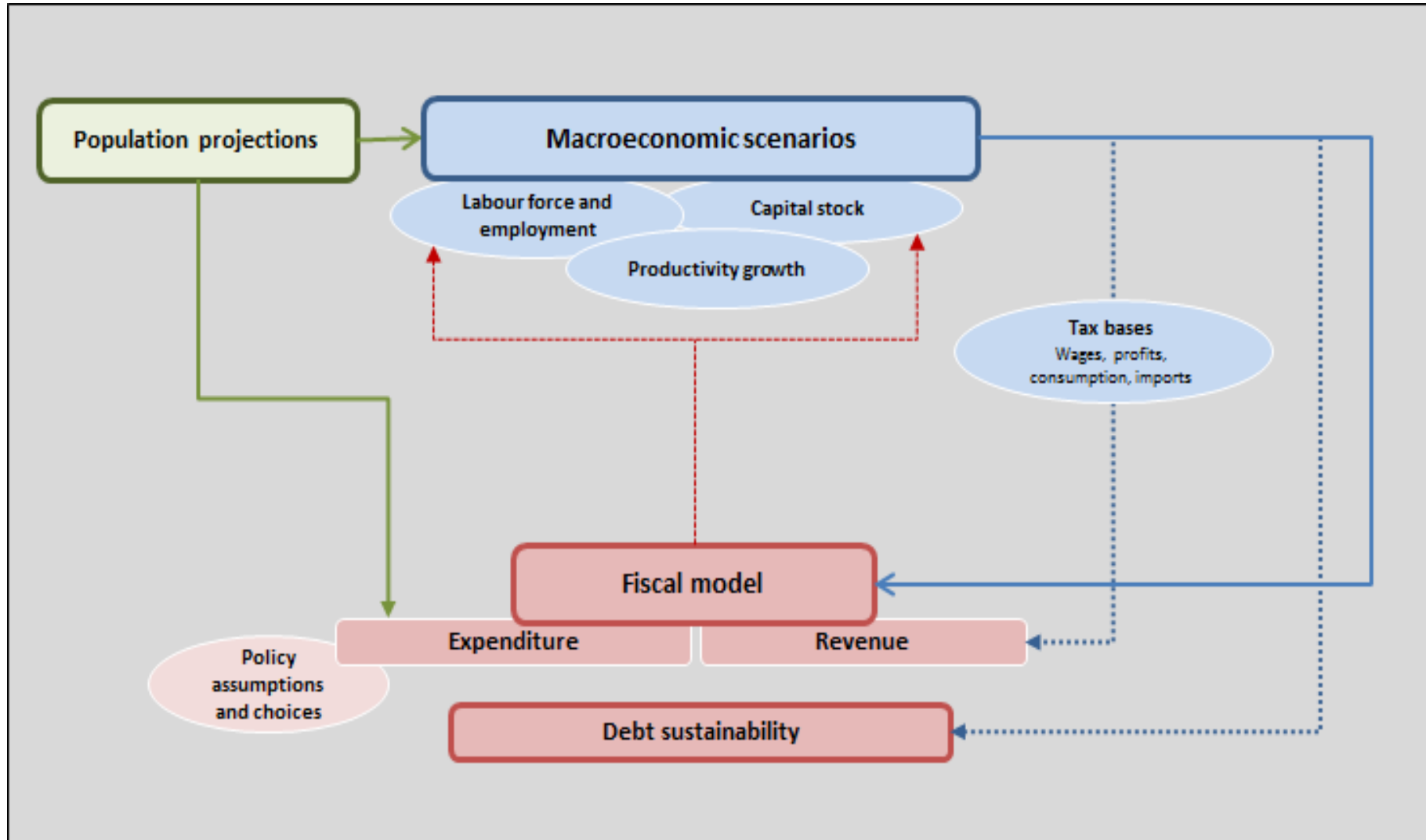


# Policy scenarios

	“No policy change” scenario	Policy change scenario
<b>Social grants</b>	<ul style="list-style-type: none"> <li>Take-up rates increase as access improves, and then stabilise</li> </ul>	<ul style="list-style-type: none"> <li>Universalisation: raising of means test to tax threshold</li> <li>Take-up rates increase further to threshold rates</li> </ul>
<b>Health</b>	<ul style="list-style-type: none"> <li>Utilisation rates per age group grow moderately</li> </ul>	<ul style="list-style-type: none"> <li>National Health Insurance: significant increases in utilisation rates financed by public contributions</li> </ul>
<b>Basic education</b>	<ul style="list-style-type: none"> <li>Learner-education ratios decline with falling number of school children</li> </ul>	<ul style="list-style-type: none"> <li>No major policy changes</li> </ul>
<b>Post school education</b>	<ul style="list-style-type: none"> <li>Enrolment ratios increase moderately in line with recent trends from 2012 to 2030</li> </ul>	<ul style="list-style-type: none"> <li>White Paper on post-school education and training; significant increase in enrolment rates</li> </ul>
<b>Expanded Public Works Programme</b>	<ul style="list-style-type: none"> <li>1 300 000 work opportunities by the year 2020, declining thereafter</li> </ul>	<ul style="list-style-type: none"> <li>2 000 000 work opportunities by the year 2020, declining thereafter</li> </ul>



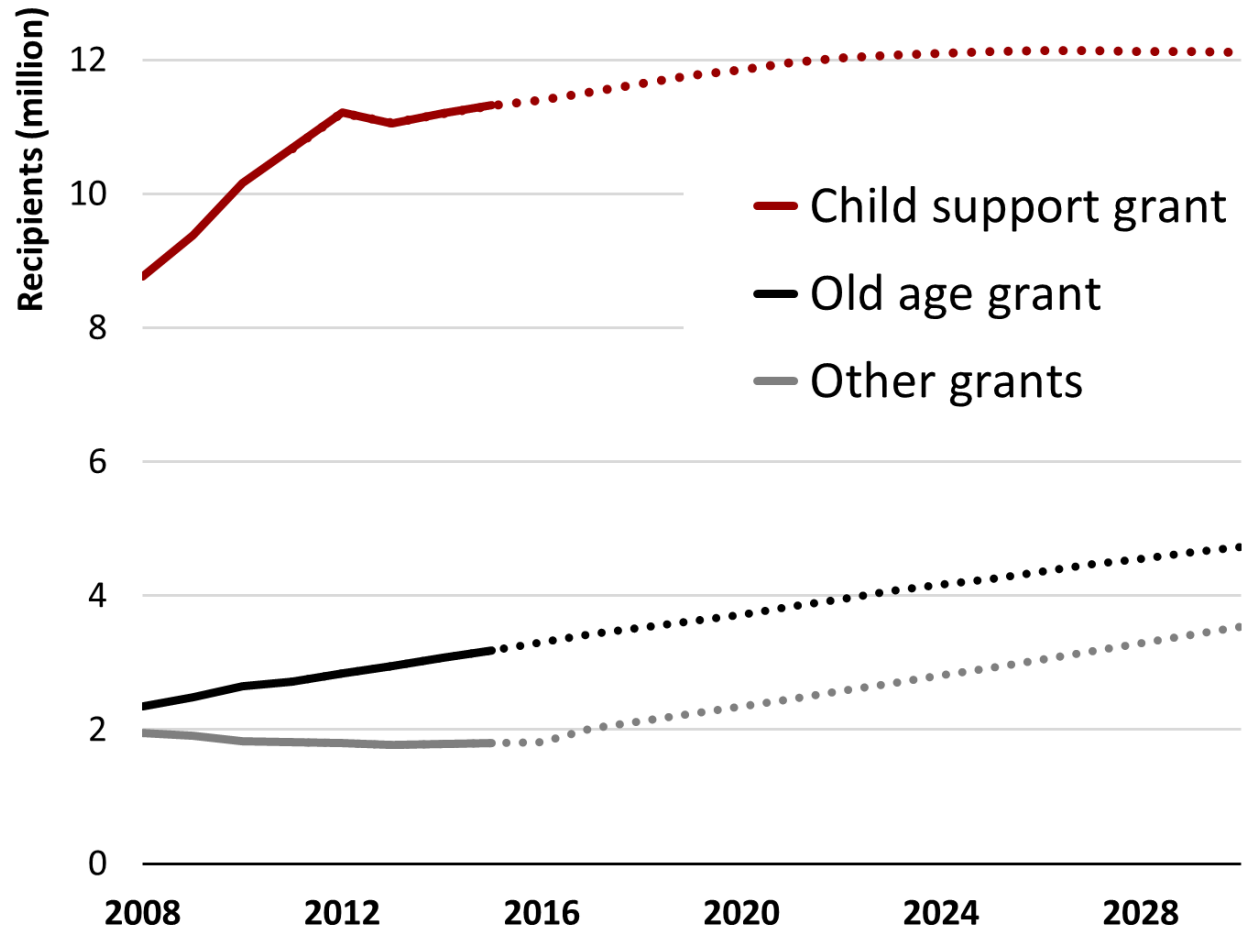
# Modelling approach



# Social grants (Assumptions)

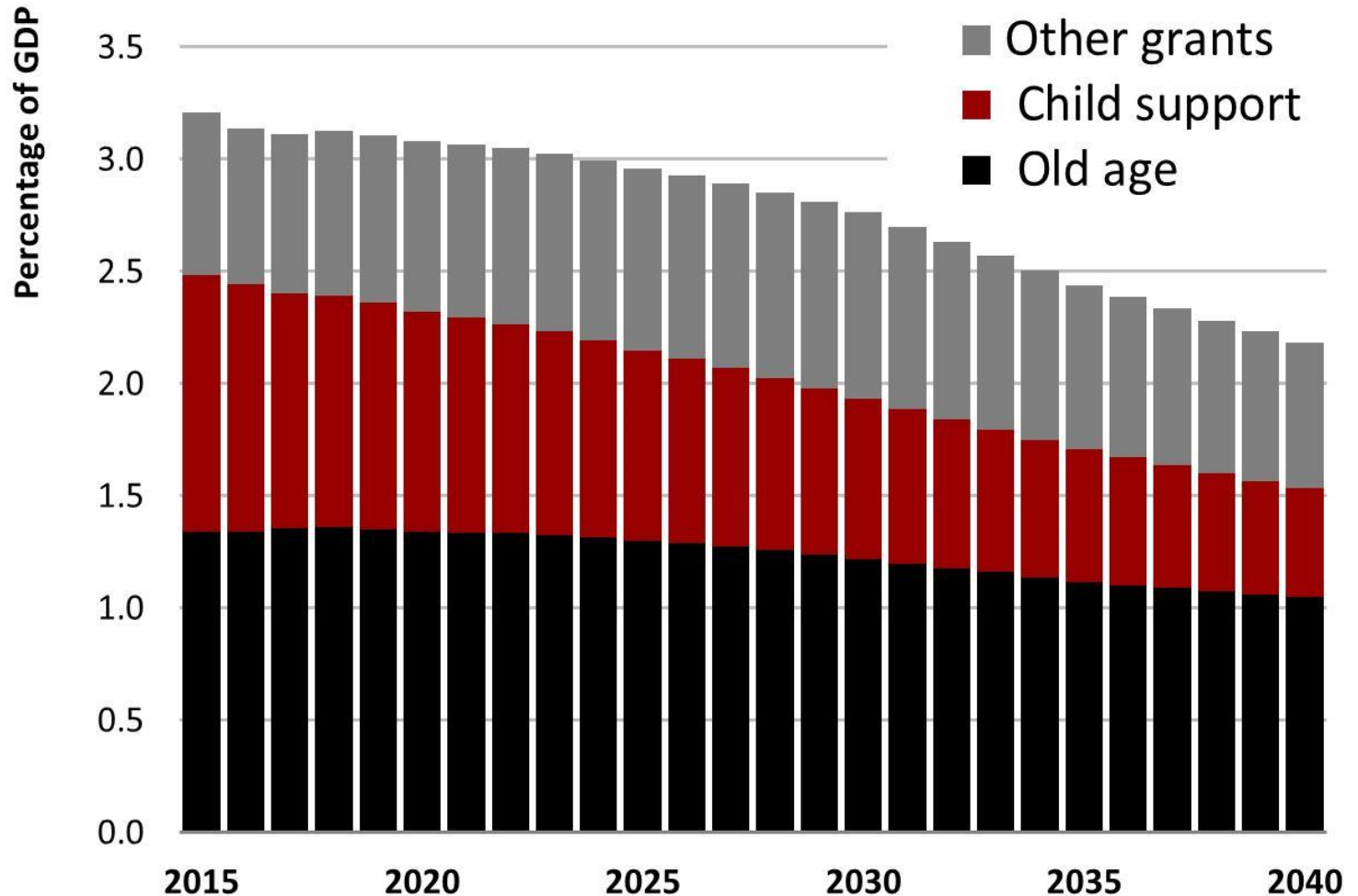
- Uptake rates have grown dramatically over the last ten years mainly as a result of changed eligibility criteria
- Assuming stable policy going forward, the model assumes a 10 percentage point increase in uptake rates for eligible cohorts over the next 15 years

## Projected recipients



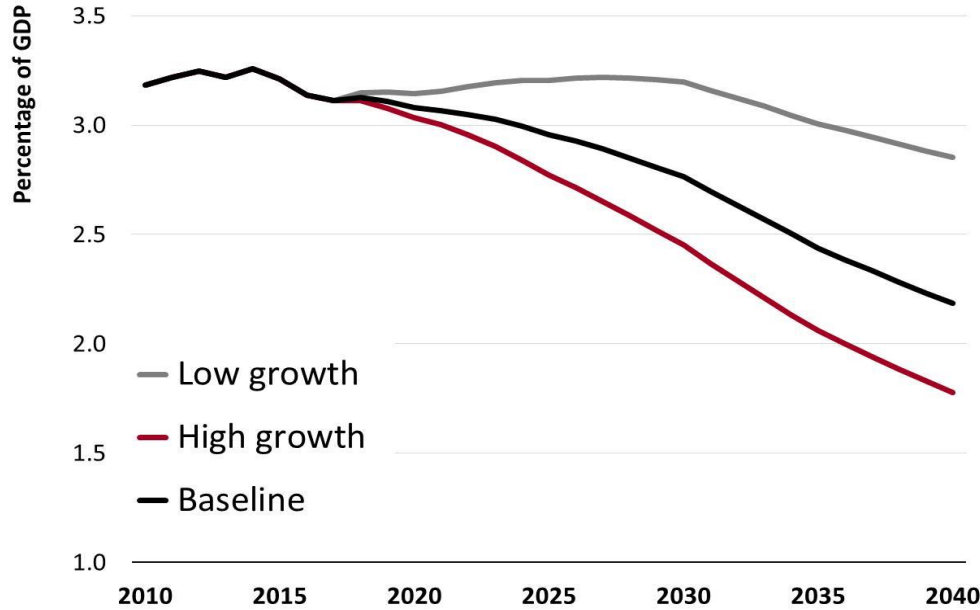
# Social grant projection

Projected grant expenditure as a percentage of GDP

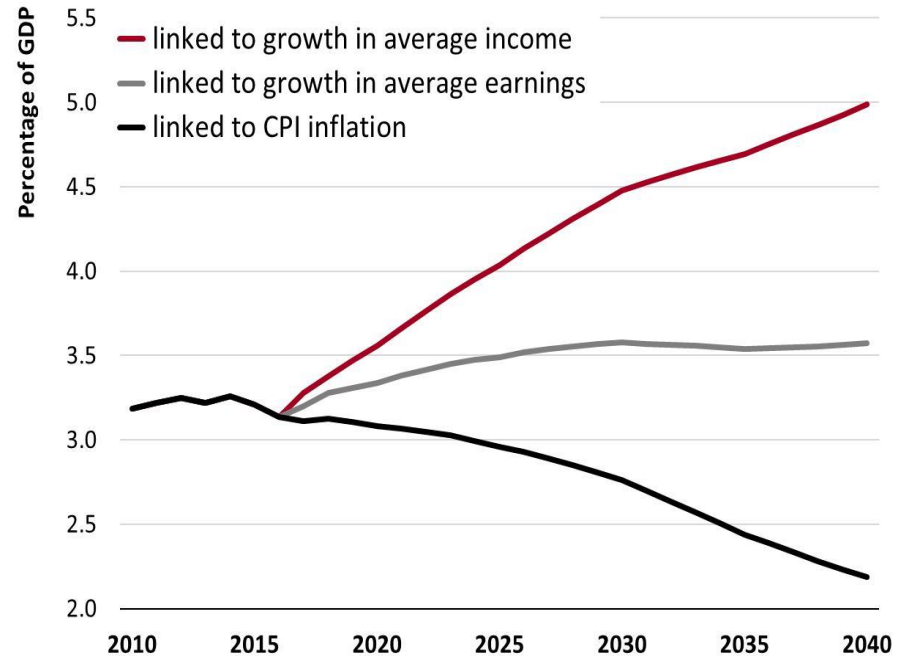


# Social grants scenarios

Spending in three economic scenarios

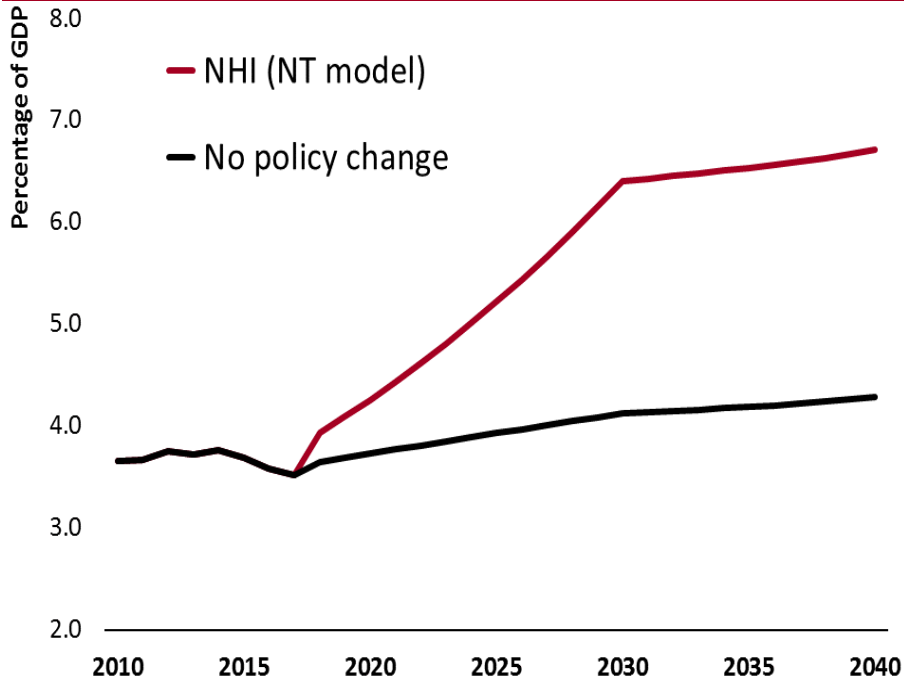


Varying policy on grant increases (in baseline scenario)

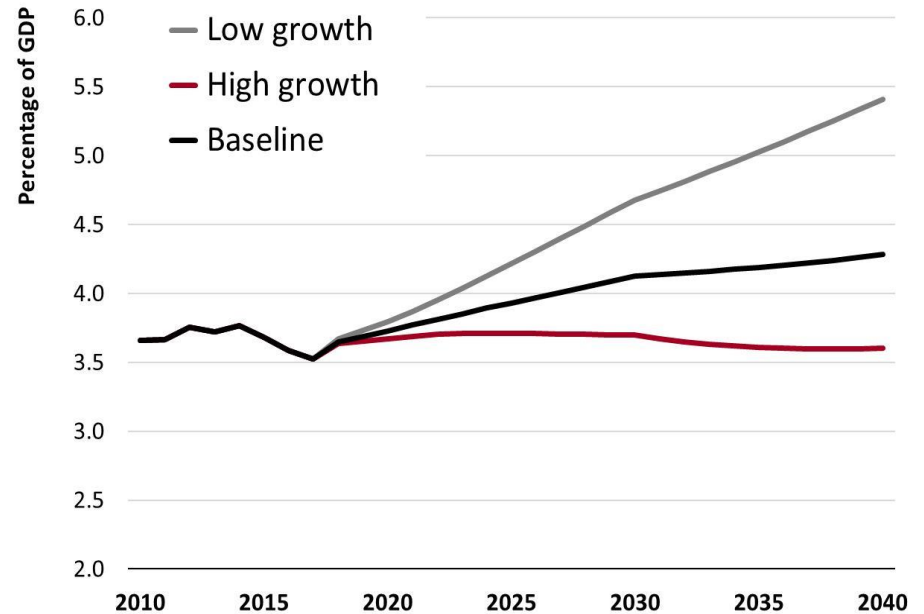


# Health care with and without NHI

Public health spending as a share of GDP

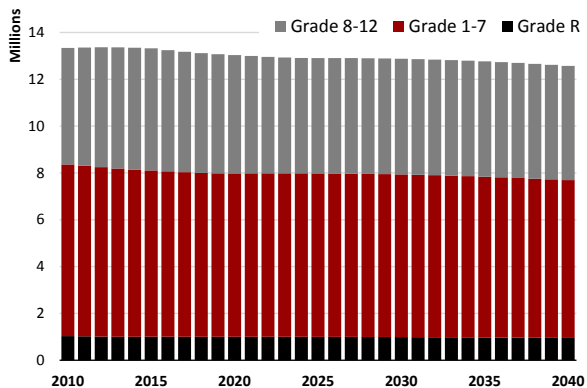


NHI under three economic scenarios

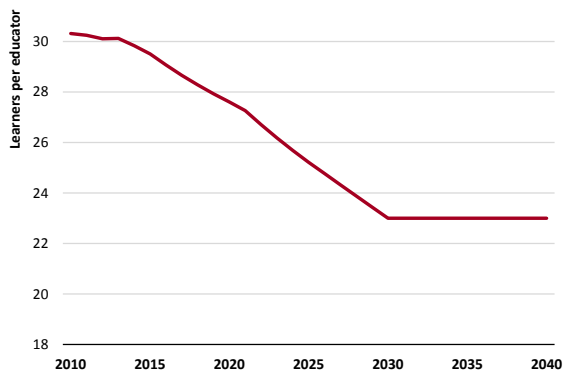


# Basic education

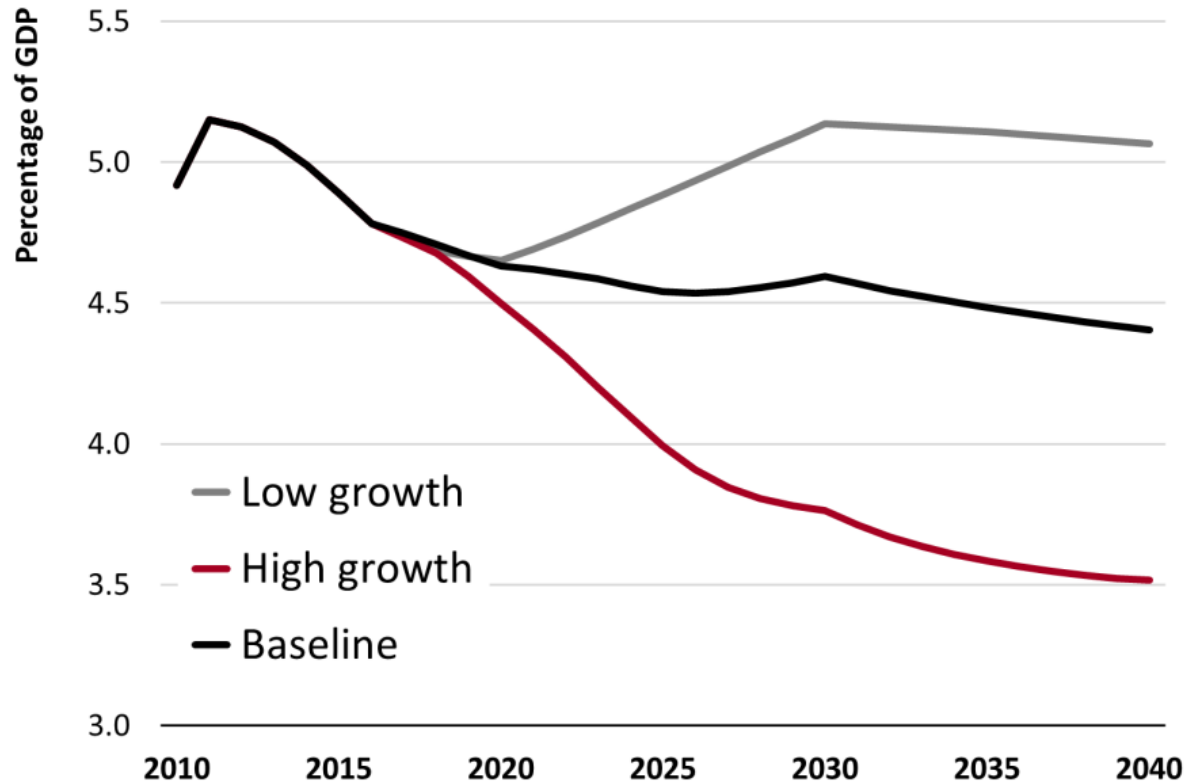
Projected school-age population, 2010 - 2040



Average learner-educator ratio, actual and projected



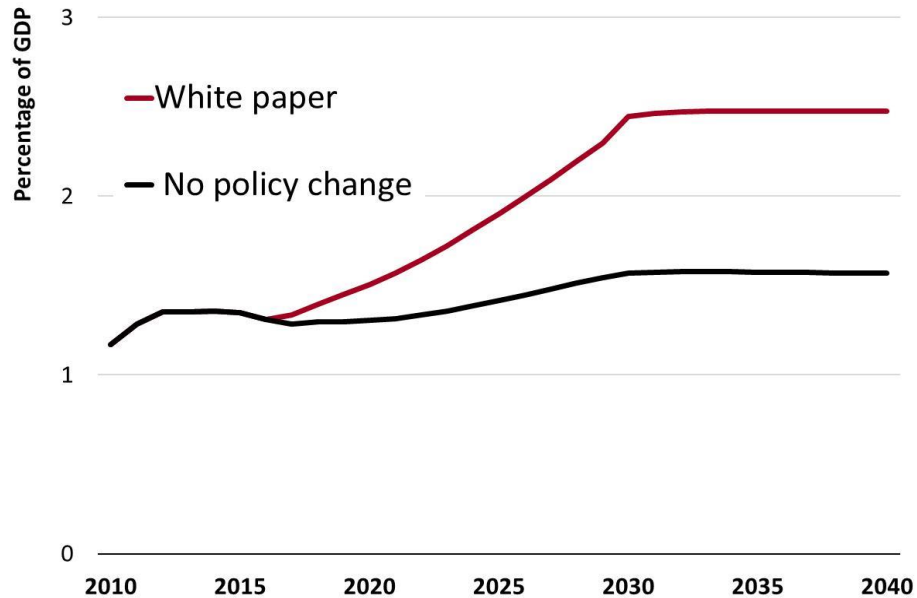
Basic education expenditure in three economic scenarios



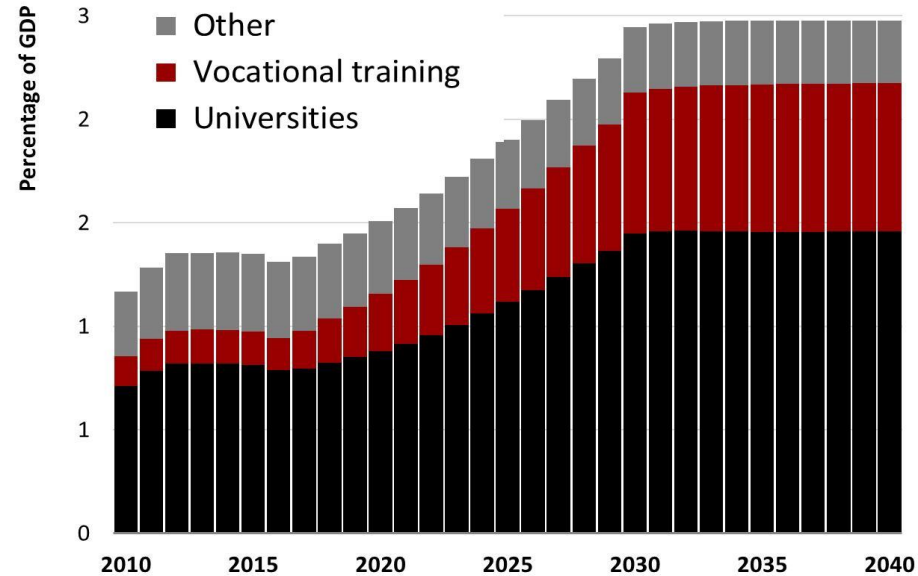


# Post-school education

Projected post-school education spending

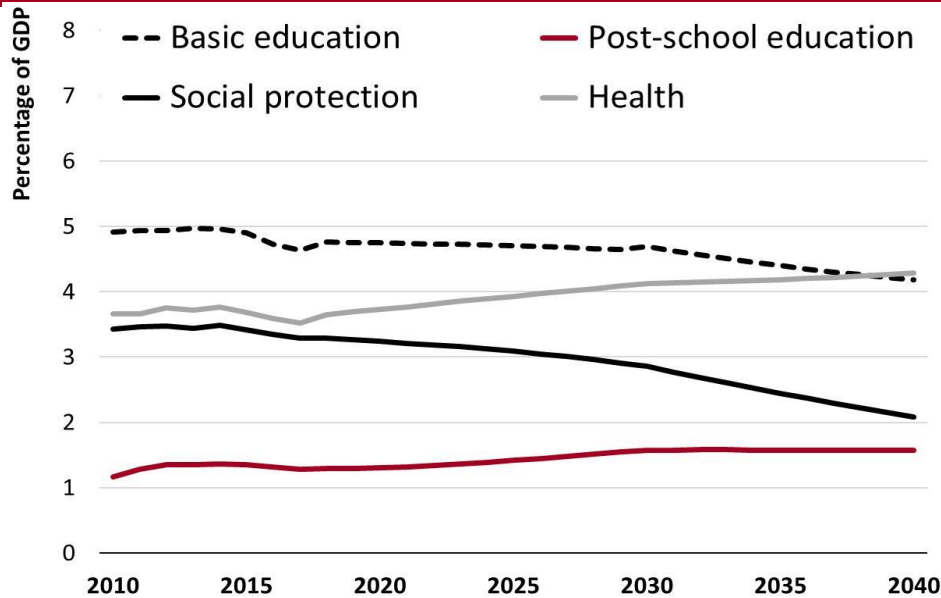


Drivers in growth in spending in the NDP scenario

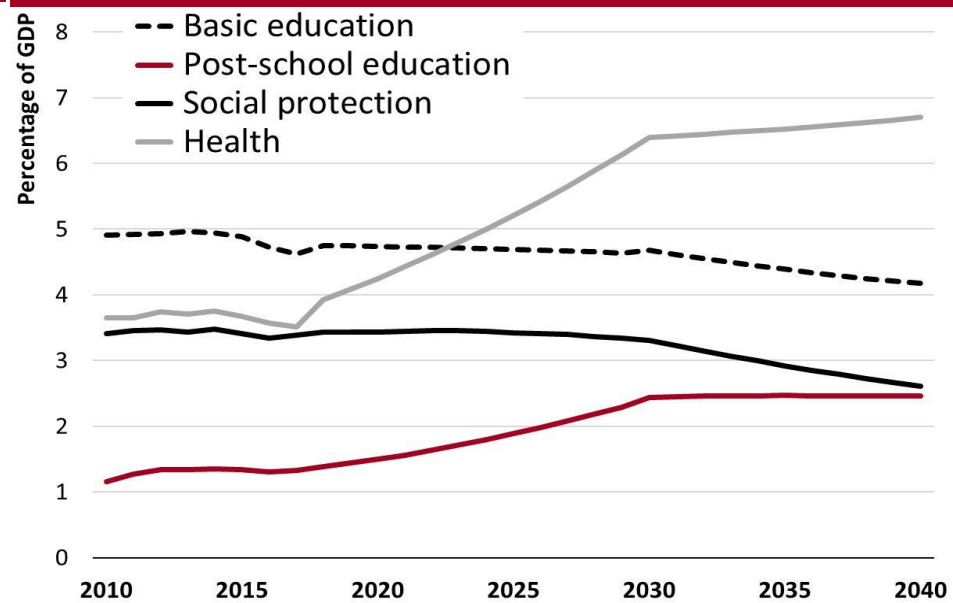


# Summary of projections

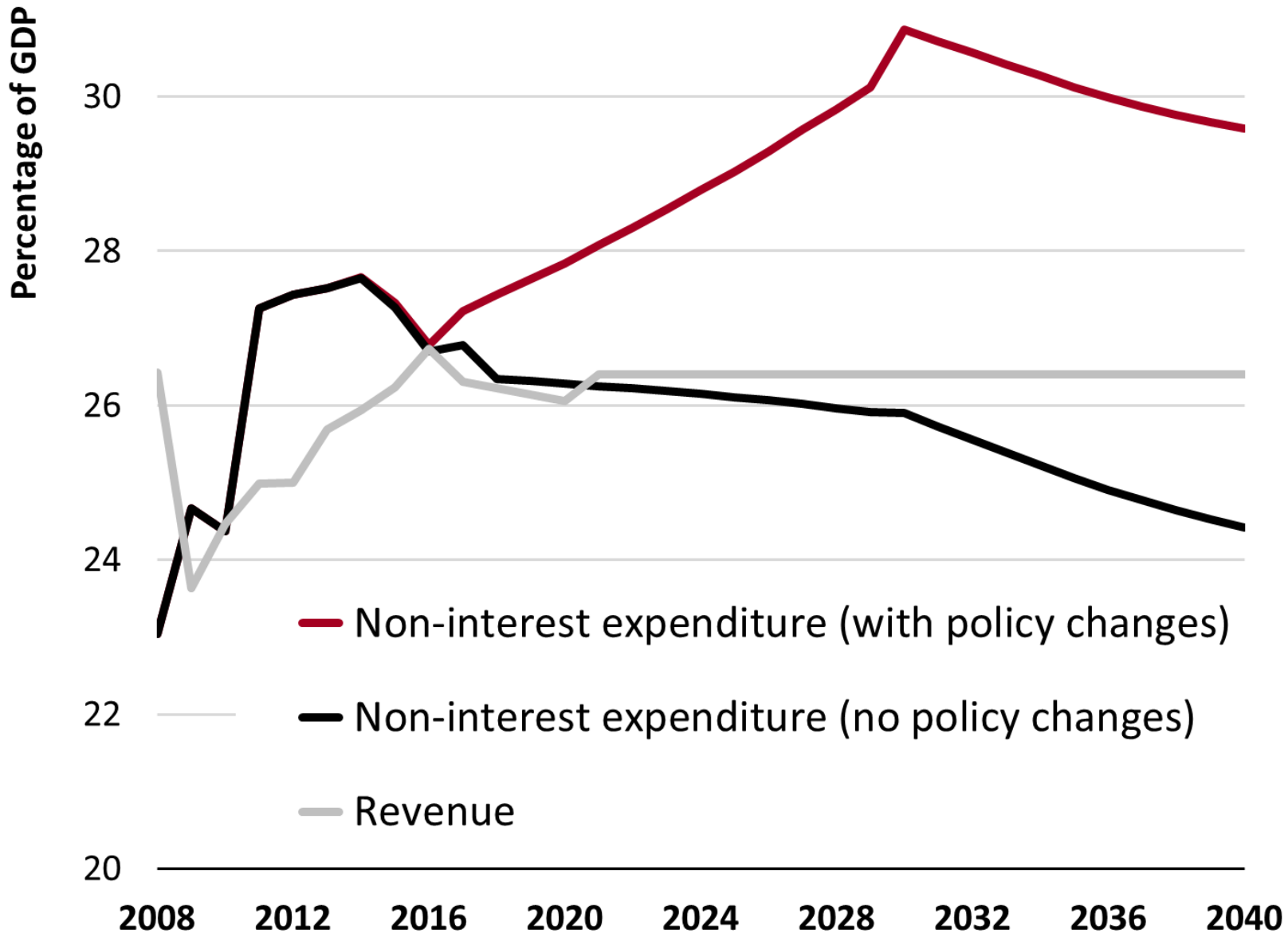
Projected spending assuming no policy change



Projected spending with new policies



# Sustainability with and without new policies



# Key conclusions

- Current levels of spending are sustainable, provided that real growth remains above 3. In a secular stagnation scenario, social spending will be increasingly difficult to sustain. Faster population growth will also put strain on the fiscus, if not accompanied by higher economic growth.
- Assuming that policy practice remains consistent with recent years:
  - Social grants will not place significant pressure on fiscal sustainability; in fact they could diminish in fiscal importance.
  - Declining school-age population implies the resources currently allocated to basic education will become increasingly sufficient.
  - Demographic pressures on health-care spending and high growth of utilisation will require greater resources to sustain the current level of service provision
- This implies that government can sustain the (current) social wage beyond the medium term projection.
- However, without faster growth, the path of debt-reduction will not be ideal and the country will remain vulnerable to shocks for years to come.

# Key conclusions

- New social policies proposed in the NDP – including NHI, the expansion of vocational training and significant growth of public works employment – will place significant pressure on the fiscus in the coming decades.
- Fiscal sustainability requires that one (or a combination) of the following factors should accommodate structural increases in spending:
  - Acceleration of economic growth
  - Increases in the structural level of taxation
  - Shifting resources from other priorities
- The age-incidence of fiscal policy combined with demographic trends suggest favourable dynamics. However, new spending pressures are most likely to emerge for the young unemployed. Adjustments currently on the public agenda include:
  - Significant expansion of public works
  - Absorbing youth into vocational training
  - Reforms to social grants to include young unemployed.