A framework to achieve better fiscal outcomes for South Africa

National Treasury

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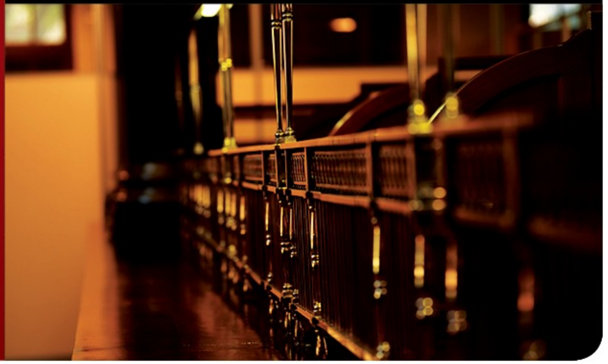

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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- INTRODUCTION
- FRAMING THE PROBLEM: SOUTH AFRICA'S FISCAL LANDSCAPE
- THE ROLE OF FISCAL ANCHORS IN PUBLIC FINANCIAL MANAGEMENT
- DESIGNING A FISCAL ANCHOR
- FISCAL REFORM IN SOUTH AFRICA
- DESIGNING A FORMAL FISCAL ANCHOR

Fiscal anchors are part of an attempt to build an institutional framework to achieve better fiscal outcomes

Actively Stabilising Debt

Achieving a debt-reducing primary surplus is the core fiscal priority since the end of the pandemic

- Government is pursuing a growing primary surplus strategy to slow debt accumulation
- The fiscal strategy is on track for debt-to-GDP ratio to peak in 2025/26 before declining.
- The long-term goal is to reduce the debt ratio towards a more sustainable range

Embedding fiscal discipline

A fiscal anchor is being considered to ensure long-term fiscal discipline.

- The anchor will strengthen our existing framework making sustainability a requirement.
- There are a range of choices available using international best practices
- The design will balance the need for discipline with flexibility, supported by strengthened independent oversight.

Improving spending quality

The budget process is being reformed to improve the efficiency and impact of every rand spent.

- A comprehensive review of the MTEF is underway to strengthen budget structures
- Govt is applying insights from spending reviews to realise savings from low-impact programmes
- We are tightening procurement rules and increasing financial oversight of SOCs to ensure value for money.

Lowering borrowing costs

Fiscal discipline is the key tool to restore confidence and reduce the high cost of debt and strengthen the social wage.

- NT actively manages the debt portfolio through a mix of instruments to manage refinancing risk and borrowing costs.
- Developing innovative instruments to mobilise private capital, including a new vehicle to de-risk infrastructure projects.
- Developing a sustainable finance framework for green bonds and enhancing our debt sustainability forecasting models.

Strengthening the capacity of fiscal institutions

The National Treasury and SARS are building the capacity required to execute these reforms effectively.

- Completed a comprehensive review of our internal budget processes to improve fiscal oversight.
- A medium term budget commitment in the fiscal framework to strengthen the South African Revenue Services
- An on-budget allocation for early retirement in order to rejuvenate the public service system

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Our problem is the lack of a framework that ensures a credible commitment to a sustainable fiscal path

The Commitment Problem

How do we bind the state to a fiscal plan that is executed over the term of an administration, ensuring policy predictability?

The Correction Problem

How do we ensure that when fiscal slippage occurs, there is a mechanism that is credible and predictable for fiscal correction over the medium term that prevents prolonged periods of debt accumulation and which all stakeholders in the fiscal system believe?

How do we enhance the Medium-Term Budget Policy Framework to answer these questions?

Source: Luc Eyraud et al., 'How to Calibrate Fiscal Rules A Primer' (Washington, D.C.: IMF, 2018);
Luc Eyraud et al., Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability (International Monetary Fund, 2018); IMF, 'Staff Report for the 2024 Article IV Consultation'.
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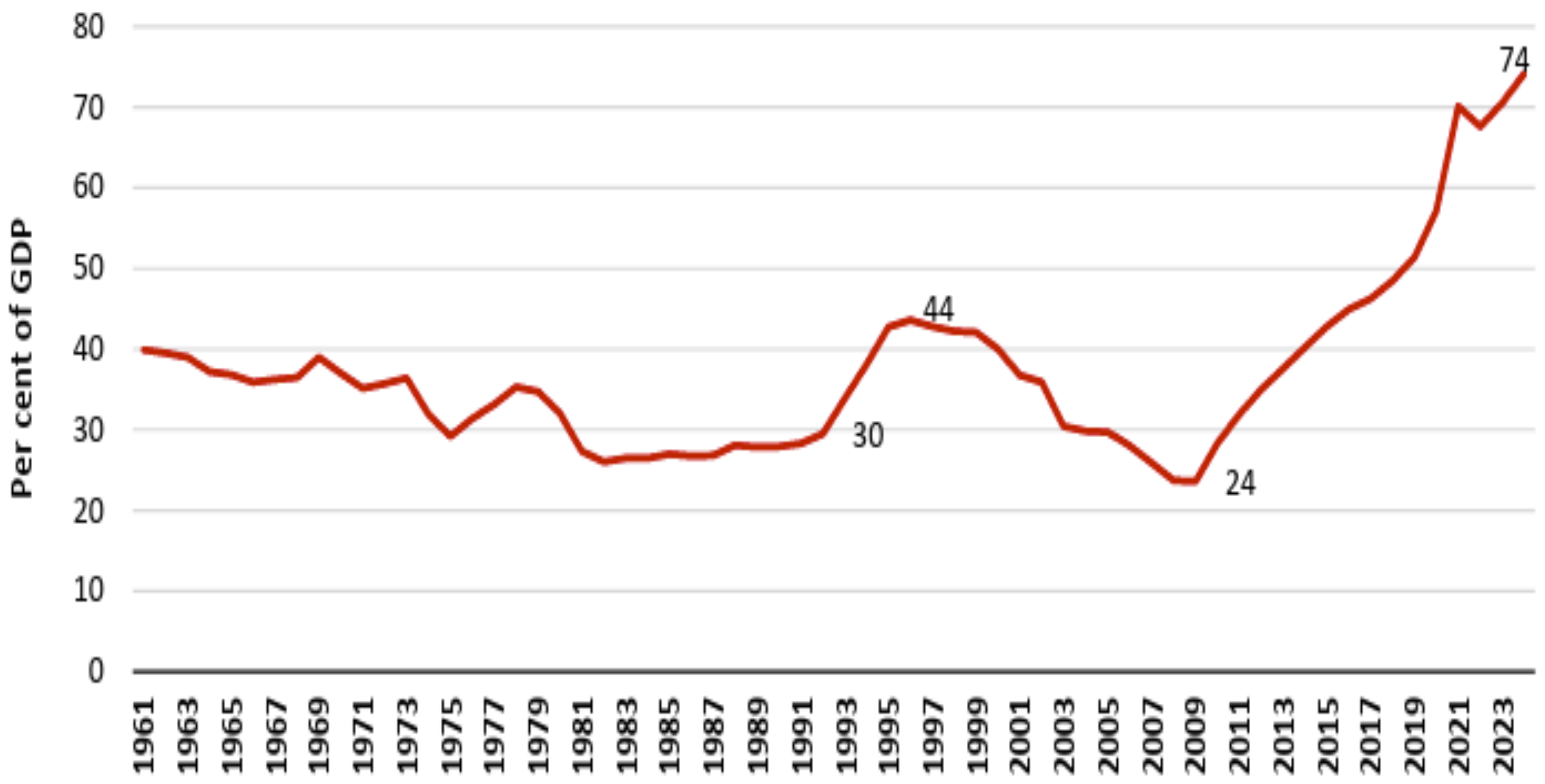
The last 15 years represent an unprecedented debt accumulation

Gross debt-to-GDP, fiscal years, 1960/61 to 2023/24

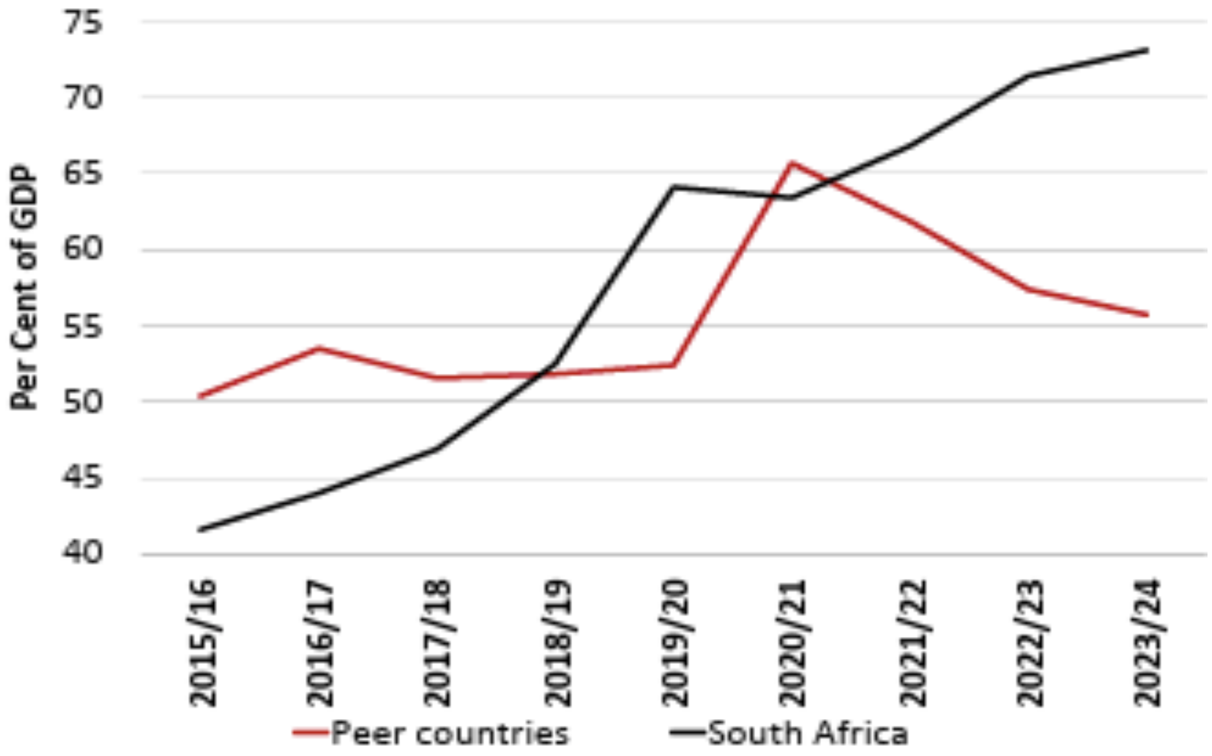


- Between 2008/09 and 2023/24, South Africa's debt-to-GDP ratio increased from 23.6 per cent to 74.1 per cent
- Debt-service costs have gone from consuming 9 per cent of revenue to 21 per cent.

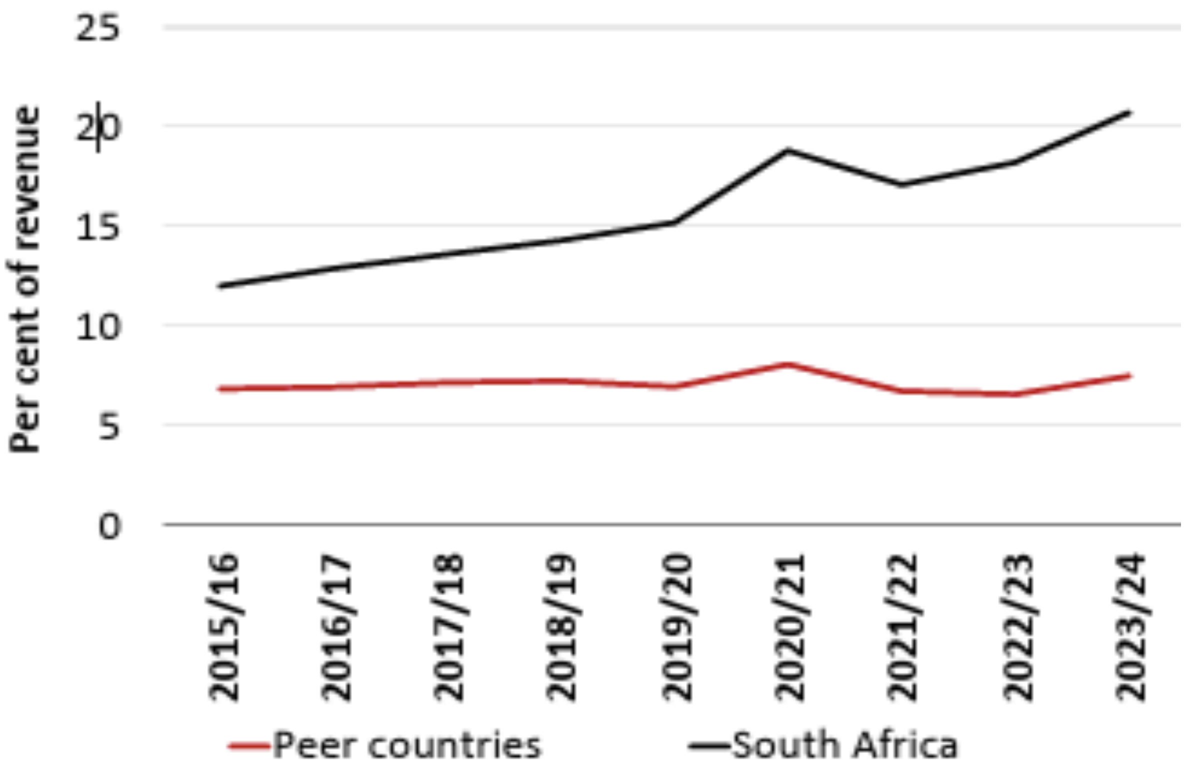
Source: NT

South Africa’s debt liabilities exceed those of peer countries

South Africa’s debt trajectory compared with peers



South Africa’s debt service costs compared to peers



- Countries with deep, persistent macroeconomic imbalances face rising risks of crisis.
- Even in the absence of a costly and disruptive crisis materialising, deep macroeconomic imbalances translate to slower economic growth as interest rates climb and investment levels fall.

Source: Carmen M Reinhart, Vincent Reinhart, and Kenneth Rogoff, ‘Dealing with Debt’, Journal of International Economics 96 (2015): S43–55; Carmen M. Reinhart, Kenneth S. Rogoff, and Miguel Savastano, Debt Intolerance (National Bureau of Economic Research Cambridge, Mass., USA, 2003).
National Treasury, ‘Macroeconomic Policy: A Review of Trends and Choices’ (Pretoria: Government of South Africa, 2024); Ricardo Hausmann et al., ‘Macroeconomic Risks after a Decade of Microeconomic Turbulence’, CID Faculty Working Paper Series, 2022.
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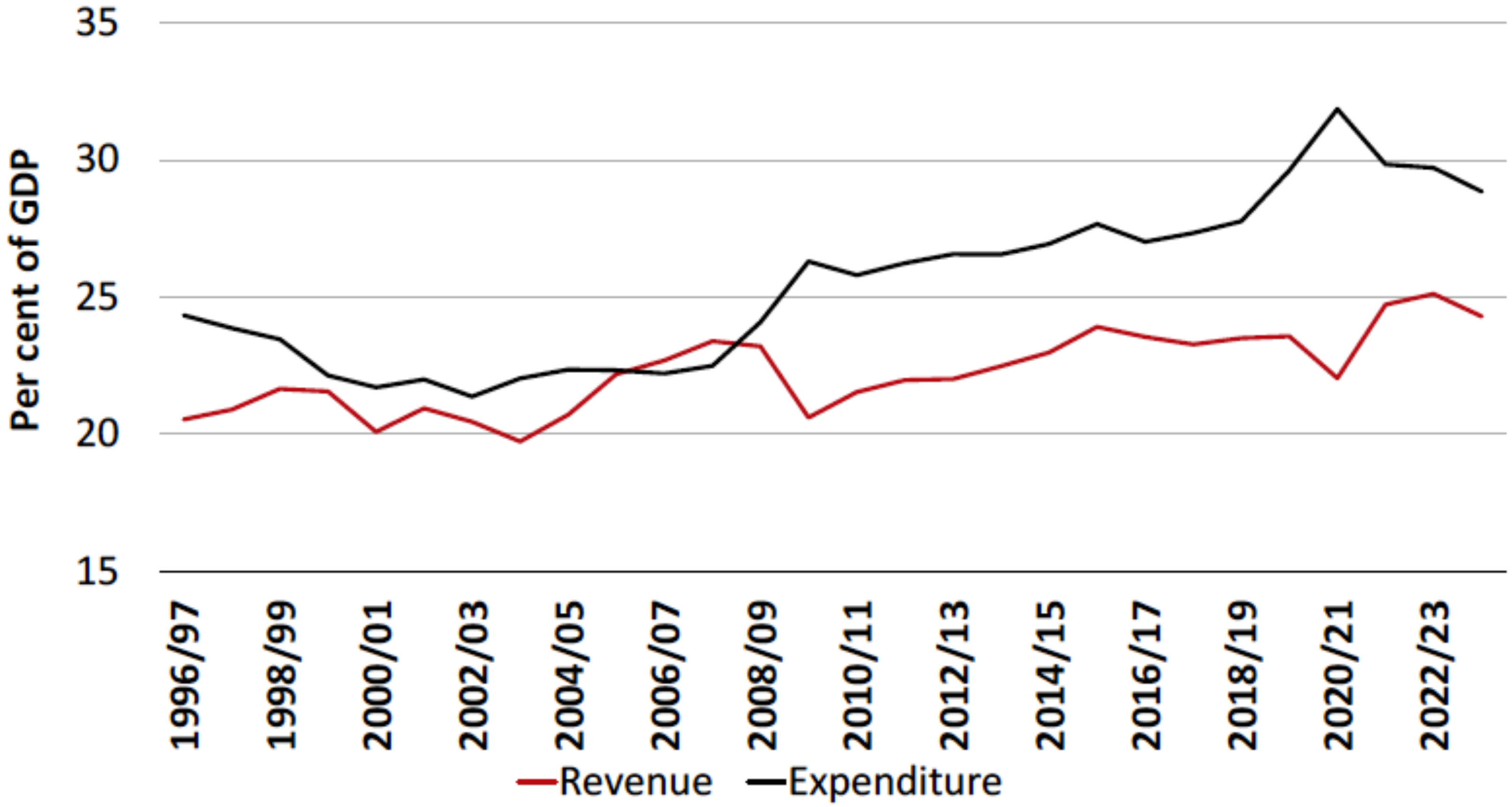
A large structural deficit opened up following the global financial crisis

Figure 4: Main budget revenue and expenditure, 1994/95 to 2023/24

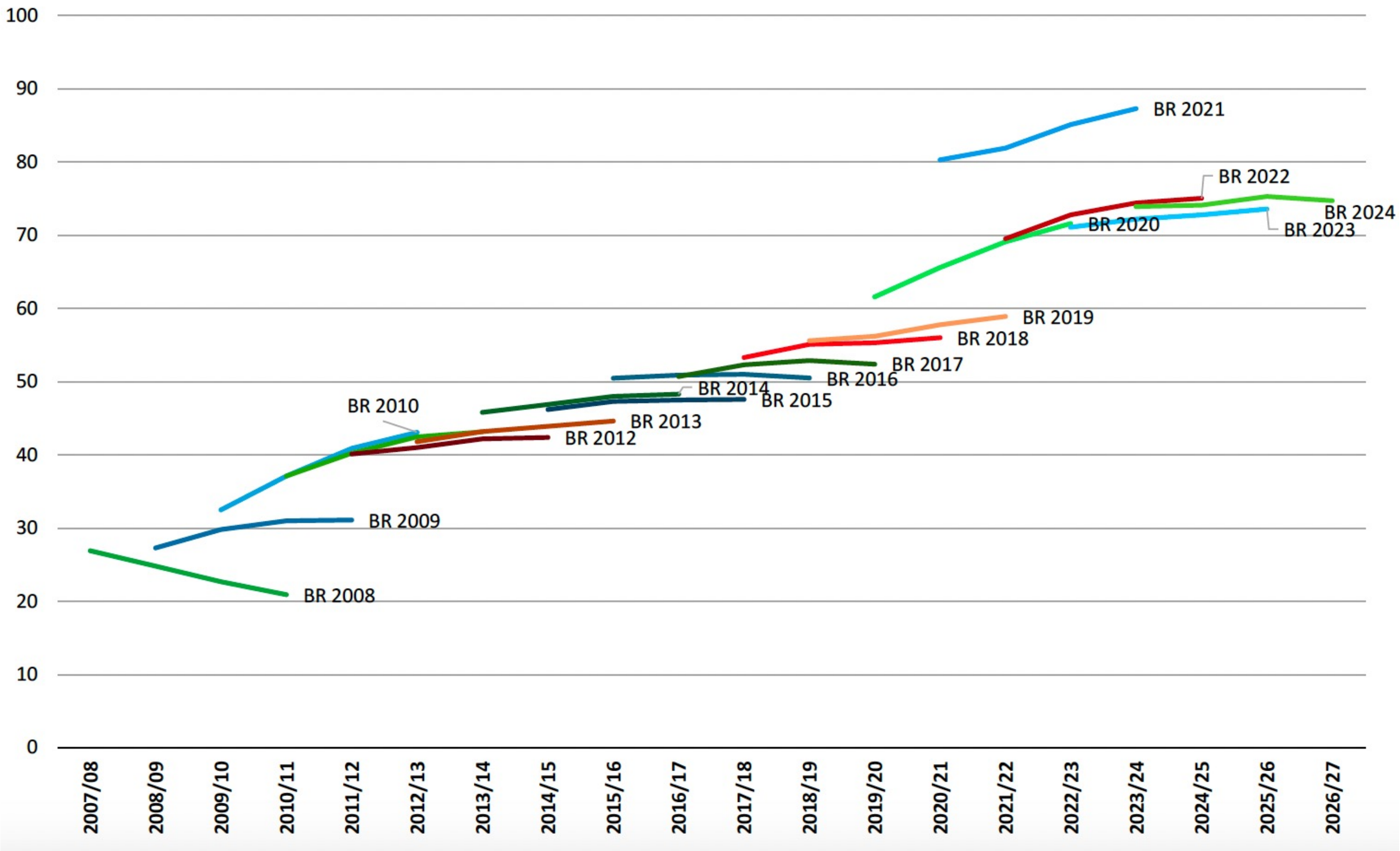


- Persistent gaps between revenue and expenditure causing sustained deficits
- Low economic growth limiting revenue growth and increasing fiscal pressures
- Unanticipated economic shocks (e.g., global financial crisis, COVID-19 pandemic)
- Rising public wage bills and failures in state-owned enterprises (SOEs)
- Increased borrowing costs due to credit rating

Source: NT

Fiscal policy has deferred debt stabilisation for over a decade…

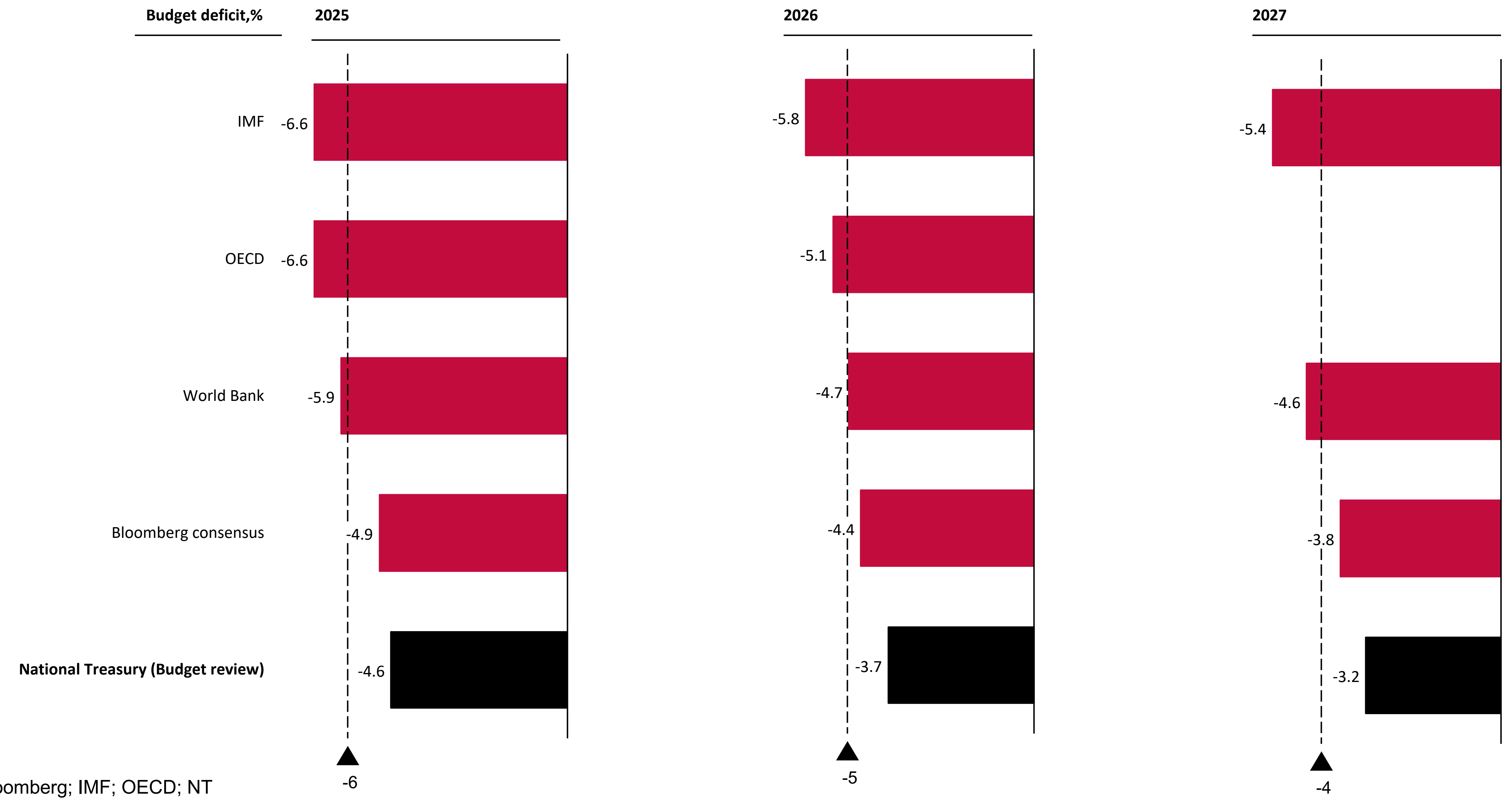
Gross debt to GDP, fiscal years, 2007/08 to 2026/27



Source: NT

- Since 2009, nearly every budget has projected debt would stabilise in the near future.
- In practice, the stabilisation target has been repeatedly postponed and revised upwards as we failed to achieve the necessary fiscal adjustments.
- Each postponement, while often seeming legitimate at the time, has had a cumulative effect, adding to the total debt burden and creating a self-reinforcing cycle of higher interest costs.
- This history reveals a systemic "deficit bias." It is the strongest evidence for why a more formal, credible fiscal anchor is now necessary to bind policy to a sustainable path.

…Has this created a consensus for a much higher budget deficit than the Treasury



Source: Bloomberg; IMF; OECD; NT

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The role of fiscal anchors in most modern public finance management systems

Fiscal Responsibility	Promotes responsible macroeconomic management and serves as a clear, public measure of debt sustainability
Transparency	Enhances transparency in the budget process, avoids budgetary gimmicks, and ensures fiscal plans are predictable and reflect the country's affordability constraint
Sustainability	Ensures the social wage is built on a durable foundation by keeping debt-service costs manageable, thereby safeguarding resources for long-term service delivery
Credibility	Reinforces the credibility of the Medium-Term Expenditure Framework (MTEF) as a planning framework and ensures citizens, taxpayers and other economic agents trust that fiscal slippage will be corrected
Flexibility	Includes well-defined escape clauses for major shocks and disasters, while ensuring the process of setting fiscal policy does not create political brinksmanship

Source: Fiscal anchors discussion document

Fiscal sustainability can be understood at three formal levels, moving from solvency to a forward-looking commitment to future generations

Solvency	The ability of a government to maintain its spending without defaulting on its financial obligations, primarily by ensuring existing debt can be refinanced.	Ensures the state can continue to finance its basic day-to-day operations.
Refinancing	The ability to repay debt *without* resorting to significant and disruptive fiscal adjustments, such as major increases in taxes or large, reactive reductions in operational spending.	Avoids triggering disruptive economic crises and the need for painful, emergency austerity measures.
Growth of the debt stock	The state where public debt is not growing faster than the economy's capacity to service it indefinitely, requiring a credible plan to stabilise the debt-to-GDP ratio.	Prevents imposing an impossible burden of debt and painful choices on future generations, making it a commitment to intergenerational equity.

Sources: Reinhart, Rogoff, and Savastano, Debt Intolerance; Armando Barrientos, 'Participation and Earnings of Older People in Argentina: Nice Work If You Can Get It?', The Journal of Development Studies 47, no. 7 (2011):
John H Cochrane, 'The Fiscal Theory of the Price Level: An Introduction and Overview', Journal of Economic Perspectives, 2021;
Serkan Arslanalp and Barry Eichengreen, 'Living with High Public Debt', in Global Financial Flows, 2023.
Olivier Blanchard, 'Public Debt and Low Interest Rates', American Economic Review 109, no. 4 (2019): 1197–1229;
Burger and Calitz, 'Sustainable Fiscal Policy and Economic Growth in South Africa'.
International Monetary Fund, 'Review of the Debt Sustainability Framework for Market Access Countries', Policy Paper (Washington, DC: IMF, February 2021).

Fiscal sustainability is the foundation for safeguarding the social wage, enabling growth, and protecting the vulnerable

Safeguards the social wage

- Prudent fiscal management is the only way to guarantee the long-term viability of critical social programs like grants, healthcare, and education.
- An unsustainable path forces a trade-off between servicing debt and funding public services, directly threatening the social wage.

Enables inclusive growth

- An unsustainable path creates a vicious cycle of low confidence and high interest rates, acting as a permanent "brake on growth" and deterring job-creating investment.
- A sustainable framework enhances creditworthiness and lowers borrowing costs for the entire economy, creating the conditions for sustained economic expansion.

Protects the most vulnerable

- The consequences of a fiscal crisis—high inflation and deep spending cuts—are not borne equally and inflict "deep and regressive hardship" on those least able to protect themselves.
- A stable fiscal position is the state's first line of defence against macroeconomic shocks that disproportionately harm the poor.

Sources: Reinhart, Rogoff, and Savastano, Debt Intolerance; Armando Barrientos, 'Participation and Earnings of Older People in Argentina: Nice Work If You Can Get It?', The Journal of Development Studies 47, no. 7 (2011):
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Fiscal Anchors Creates a Virtuous Cycle of Discipline and Credibility

Fiscal anchors are formal benchmarks or constraints, typically established in a Fiscal Responsibility Law (FRL), that institutionalise a long-term commitment to sound financial practices.

Purpose: To enhance fiscal discipline, transparency, and accountability by committing government to clear, monitorable fiscal policy objectives and strategies.

How do they work: functions as a public commitment and communication device, creating a predictable framework that guides budget decisions and fosters informed political and public engagement.

Importance: prevent unsustainable imbalances, mitigate financial risks, and reinforce investor confidence, which helps to lower borrowing costs for the entire economy.

A resilient economy and a stronger social compact, built on a foundation of public trust in the management of the nation's finances.

Source: Holger Van Eden, Pokar Khemani, and RPJ Emery, 'Developing Legal Frameworks to Promote Fiscal Responsibility: Design Matters', Public Financial Management and Its Emerging Architecture, 2013, 79–105.

Fiscal sustainability is the foundation for safeguarding the social wage, enabling growth, and protecting the vulnerable

Principle-based frameworks (Type I)

- **What it is:** Emphasises broad principles like transparency, accountability, and sustainability without mandating specific numerical targets.
- **How it works:** Governments are required to explain and justify how their policies comply with the agreed-upon standards.
- **Key Trade-off:** High flexibility, but effectiveness depends heavily on institutional strength and political consensus.
- **Example Countries:** New Zealand, Australia

Procedural frameworks (Type II)

- **What it is:** Introduces requirements for mandatory fiscal reports, policy statements, and medium-term budget frameworks to guide the planning process.
- **How it works:** Emphasises transparency and structured fiscal management through the provision of high-quality information and detailed plans.
- **Key Trade-off:** Enhances transparency, but may not be sufficient to enforce discipline on its own.
- **Example Countries:** South Africa (currently), Brazil, India

Numerical Rule-Based frameworks

- **What it is:** Imposes legally binding, strict numerical targets or ceilings on fiscal aggregates like debt, deficits, or expenditure growth.
- **How it works:** Sets a hard limit on what government can borrow or spend, often with "escape clauses" for major shocks.
- **Key Trade-off:** High credibility and predictability, but can be rigid and counterproductive in a crisis.
- **Example Countries:** Many European Union members, Germany, Chile

Sources: Reinhart, Rogoff, and Savastano, Debt Intolerance; Armando Barrientos, 'Participation and Earnings of Older People in Argentina: Nice Work If You Can Get It?', The Journal of Development Studies 47, no. 7 (2011):
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An independent fiscal council assists with oversight, enhancing accountability, and building trust

In a Principle-Based Framework (Type I)	Reinforces transparency and accountability by providing an independent, objective assessment of whether government policies are complying with the stated fiscal principles, fostering a better-informed public debate.
In a Procedural Framework (Type II)	Enhances procedural integrity by providing an independent view on the accuracy of fiscal data and the realism of budget assumptions, and monitoring if medium-term plans adhere to stated goals.
In a Numerical Rule-Based Framework (Type	Upholds credibility by monitoring compliance with hard numerical targets, assessing the sustainability of those targets, and discouraging "creative accounting" practices to bypass the rules.

Source: Luc Eyraud et al., ‘How to Calibrate Fiscal Rules A Primer’ (Washington, D.C.: IMF, 2018);
Luc Eyraud et al., Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability (International Monetary Fund, 2018); IMF, ‘Staff Report for the 2024 Article IV Consultation’.
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South Africa has proposed a range of fiscal rules in the past

Structural budget balance rule

- In 2007, South Africa introduced the concept of a structural budget balance, also known as the cyclically adjusted budget balance, to guide fiscal policy
- This approach adjusts for temporary fiscal developments that don't represent lasting changes in either expenditure or revenue
- The structural budget balance represents the budget balance after adjusting for cyclical influences on revenue and spending
- To determine this balance, they adjust the main budget balance for cyclical fluctuations in revenue and spending
- This process includes accounting for unusually high tax collections from profits during times of significantly high commodity prices
- The structural budget balance acts as an indicator of fiscal policy sustainability
- Although South Africa set it as a fiscal target, they did not legislate it as a fiscal rule
- South Africa reports on the structural budget balance to prevent the development of a structural deficit from increasing expenditure commitments based on cyclically high tax revenues

Expenditure ceiling

- South Africa introduced the expenditure ceiling in 2012 to enhance transparency and forward-guidance on fiscal policy
- Not legislated but built upon the well-established MTEF
- Aimed to contain non-interest expenditure growth while balancing social commitments with competitiveness, investment, and infrastructure maintenance
- Rule: No upward adjustment in spending projections during the first two years of the MTEF period
- Marked departure from regular additional spending allocations common in the early 2000s
- Bolstered fiscal policy certainty and defined the expenditure trajectory
- Clear, easily communicable, and didn't depend on complex calculations or unobservable variables
- Targeted non-interest spending from the National Revenue Fund directly
- Offered departments a clear resource path, enhancing MTEF planning
- Set in nominal terms, meaning inflationary changes influenced real growth rates
- Government didn't specify the ceiling-setting criteria for the outer year of each framework or its alignment with broader objectives
- Coincided with substantial public-sector wage agreements and deteriorating expenditure composition

Fiscal rule of thumb

- The 2015 MTBPS introduced the "guideline for debt sustainability," commonly referred to as the "fiscal rule of thumb"
- The rule built on the notion of the expenditure ceiling in that NT proposed that guideline determine the expenditure ceiling in the outer year of every fiscal framework
- Guideline sought to aimed to tie the spending ceiling to South Africa's long-term economic growth projections
- The rule was initially based on South Africa's average growth rate between 1995 and 2015 of 3%
- The long-term guideline embodied the fiscal principles of countercyclicality and debt sustainability
- The key escape clause was that during economic booms, spending would grow slower than the economy; in downturns, spending would grow faster than GDP
- The guideline intended to maintain expenditure as a steady fraction of national income
- A secondary escape was for capital projects

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We are mindful of the range of pushback that we have received related to this reform noting that is not a substitute for fiscal consolidation

An Anchor is a not a Magic Wand

- An anchor is not a substitute for fiscal consolidation
- A fiscal rule is an accounting identity; it has no economic content on its own. It cannot magically create fiscal space. May work if the shocks are the same as what they always were in previous business cycles.

South Africa already has a Strong Procedural System

Well-developed institutional framework for fiscal prudence, including:

- The PFMA, which provides for transparency and accountability.
- The MBARM Act, which establishes clear procedural guidelines for the budget process.

No Formal Commitment for the Tabled Budget

- No statutory requirement for the initial budget tabled by the Minister of Finance to explicitly meet a defined sustainability test
- The existing rules apply mainly to amendments made by Parliament, not the budget itself.

Source: Luc Eyraud et al., 'How to Calibrate Fiscal Rules A Primer' (Washington, D.C.: IMF, 2018);
Luc Eyraud et al., Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability (International Monetary Fund, 2018); IMF, 'Staff Report for the 2024 Article IV Consultation'.
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A Type I fiscal rule roots the fiscal anchor in parliamentary process

- A fiscal anchor that legislates a set of clear principles for sustainability, not a hard numerical target.
- May not necessarily buy the fiscal-authorities market credibility but is more democratic in that it empowers the legislature to correct fiscal slippage
- Type I institutionalises the process of linking policy to these standards by requiring each new administration to table a comprehensive, multi-year Fiscal Plan in Parliament and publicly demonstrate its sustainability
- This approach offers greater flexibility to respond to changing economic conditions, but its credibility depends heavily on the strength of our institutions and a shared political consensus on sustainability.

Defining Sustainability Metrics	• Legislation would formally define the standards for fiscal sustainability (e.g., building on the principles already in the MBARM Act) against which all fiscal plans would be assessed
Tabling a Fiscal Plan	• The PFMA would be amended to require each new administration to table a detailed fiscal plan, outlining its revenue, expenditure, and borrowing projections.
Mandating Parliamentary Oversight and Approval	• Parliament would be empowered and required to publicly debate, scrutinize, and ultimately approve this plan, holding the executive to account for its long-term commitments.
Enhancing Transparency through Hearings	• Parliamentary committee processes would be strengthened through public hearings, incorporating expert testimony and civil society participation to inform the debate.
Institutionalising Independent Fiscal Oversight	• The roles of independent bodies like the Parliamentary Budget Office (PBO) and the Financial and Fiscal Commission (FFC) would be expanded to provide non-partisan analysis and advice to Parliament.

A well-designed Type III numerical fiscal rule can buy the fiscal authorities credibility

- The most stringent approach, which imposes a legally binding, numerical target or ceiling on a key fiscal variable (e.g., the debt-to-GDP ratio or the budget deficit).
- A rule removes discretion by legally obligating the government to table budgets that comply with the hard limit, enhancing policy predictability and credibility
- This approach offers maximum certainty and discipline and can buy the fiscal authority's credibility which in turn can create fiscal space if market participants believe the fiscal plans of the authorities
- This approach offers certainty and discipline. It can enhance the credibility of fiscal authorities, which in turn can create fiscal space if market participants trust the government's plans.

Defining the Rule

- Make the crucial decisions on *what* to target (debt vs. deficit), the specific *level* (e.g., 60% of GDP), and the *timeframe* for compliance.

Amending Legislation

- Revise foundational laws like the PFMA and MBARMA to make the numerical rule legally binding on the budget as tabled by the Minister.

Designing for Transparency

- Create comprehensive definitions to prevent evasion, ensuring all liabilities (e.g., from SOCs) are transparently and consistently accounted for.

Establishing Enforcement

- Institute strong compliance mechanisms, potentially monitored by an independent fiscal institution, to assess adherence and recommend corrective action

Incorporating Flexibility

- Design clear, objective, and transparent "escape clauses" for severe economic shocks, with a defined path for returning to compliance to maintain the rule's integrity.