A Budgetary Policy Strategy for South Africa

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Introduction

Purpose

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• To provide input and recommendations around a sustainable budgetary policy strategy for South Africa in response to the MTBPS 2018

Outline

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• Context –> Fiscal Policy rule–> Taxation levels & revenue –> Expenditure reduction strategy –> Recommendations –> Concluding remarks

Problematic context

- Eroded social contract between taxpayers & government;
- Trust deficit -> budgetary deficit; reprioritisation is imperative
- All consumers are taxpayers; unbearable burden –> “new fiscal anchors needed in addition to expenditure ceiling” Minister of Finance
- Exponential increase in cost of living; fuel, VAT, electricity, currency depreciation etc. etc.
- Much lower economic growth than was projected, according to first quarter performance
- Revised Debt:GDP ratio: approx. 60% forecast for 2023 –> compounded burden due to ever increasing debt servicing costs & unrealistic expenditure programmes

The Fiscal policy rule

Fiscal policy rule

- The customary measures of the government deficit to GDP ratio and total borrowings to GDP ratio have very little information content

- There are three technical measures that are commonly used to assess the viability of a funding scheme. These are:

  1. The solvency ratio.
  2. The loan to value ratio
  3. The capital charge to capital cost ratio

- What constitutes a safe solvency ratio depends on 1) the variability and predictability of tax revenues, and; 2) the scope which a government has to increase rates of taxation or reduce discretionary expenditures, as and when necessary.

Fiscal policy rule cont.

- The key solvency parameters, together with the deficit and debt to GDP ratios (as a matter of interest), that would result from the application of this rule are given below:

Item	Ratio
Solvency ratio	0.658
Loan to value ratio	0.710
Capital charge to capital cost	0.902
Deficit to GDP	0.036
Debt to GDP	0.463

- There is thus a close correspondence between the results produced by this fiscal policy rule and the projected state of Government finances for the next fiscal year (see full Fiscal Strategy submission, pages 4-9)

- This makes it possible to easily adopt such a rule without encountering a difficult series of adjustments.

Fiscal policy rule cont.

The basis of current concern of the credit rating agencies with respect to Government finances is not the absolute level of accumulated debt (although this is some R275 billion in excess of an ideal level*). Rather, it is the limited scope that is available for raising further revenues in the form of taxes, excise duties and user charges.

* The difference between the projected amount in outstanding debt (R2768 billion) and the net loan debt that would have resulted from following the rule (R2494 billion)

What about?

Taxation levels & Revenue

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Taxation levels & revenue

- A theoretical, non-linear, relationship in the shape of an inverted U exists between rates of taxation and amounts in government revenues that can be extracted from an economy.
- This is graphically represented as the so called “Laffer curve” (See the full ‘Taxation ceiling for South Africa and the implications of the Laffer curve’ submission).
- Practical applications of this theory are complicated by the fact that tax rates are only one of the factors that influence government revenues.
- However, it is possible to make econometric calculations that relate government revenue from all sources to the average tax burden on the economy. This was done using data covering the period 1969/1970 through to the 2017/2018 fiscal year (Source: SARB).

Taxation levels & revenue cont.

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- Analysis of results obtained showed that we have already reached the point where further increases in taxation would be counterproductive in terms of actual revenue collection
- At tax levels prevailing between 2014 and 2017, a one percent increase in taxation produced only 0.05% in additional real tax revenue
- Also, the data shows that each percentile of increases in taxation historically correlates to an average decline in GDP of about 0.3%
- According to calculations, the optimal level of taxation for South Africa should lie somewhere between 20% and 24% of economic output
- This is at least 5% (and up to 9%) below the 28.9% level of the 2017/2018 fiscal year.

Expenditure reduction strategy

Expenditure reduction strategy

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- *Since revenue collection is critically constrained, a significant reduction in State expenditure is necessary.*

- According to our data, the reduction required in recurring current Government expenditures lie between R270 billion as a minimum and, ideally, R485 billion per annum.

- If drastic measures are not taken, government runs the risk of losing control over its finances in the next decade

- This sentiment is evident in the Minister of Finance's recent decision to let National and Provincial departments absorb the extra-budgetary expense (R30 Billion) of the Wage Bill

Expenditure reduction strategy cont.

- All cost reduction strategies are based on two main principles:
  1. Allocative efficiency (elimination of activities that are unnecessary)
  2. Productive efficiency (reduction in the resources needed to achieve essential outputs)

- In terms of allocative efficiency, the main recommendations made below speak to potential activities and/or entities that can be eliminated entirely, sold to the private sector, or operationally restructured.

- In terms of productive efficiency, this time of financial strain in the public sector should be used to deal with serious governance issues in all organs of state.

  - Examples range from procurement fraud and financial incompetence of municipal managers to poor service delivery resulting from an mismanaged or undermanaged (and thus underperforming) workforce.
  - We strongly support the revitalized power and responsibility of AGSA to tackle fruitless, wasteful and irregular expenditure

Here Is What We Suggest

Recommendations

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Recommendations

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1. **Remove** deeply insolvent state-owned enterprises from Government ownership and/or the consolidate entities / departments with overlapping functions

2. **Phase out** all Government agencies (central, regional and local) that do not confer a useful, direct and immediate benefit on the public at large

3. **Wind-up** Government departments (and activities within Government departments) that provide little or no benefit to the public at large (or, in fact, constitute obstacles to economic growth)

4. Further **strengthen accountability** mechanisms and enforce sound management practices & human resource efficiency in all organs of state

5. **Eliminate** residual corrupt networks in the public service that threaten the economic sovereignty of South Africa

Conclusions

Conclusions

- Financial mismanagement, corruption & general maladministration has exacerbated the scarcity of funds available to government for the performance of its essential functions

- The social contract between taxpayers and government has been eroded – self-correction in the public sector is needed to remedy this

- Increasing taxation will not yield adequate increases in revenue or improved economic growth; so, wasteful and superfluous expenditure must be eradicated immediately

- South Africa is on a precipice, and now is the time to take difficult decisions that will preserve our economic sovereignty and sustainability

Thank You.

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