INSTITUTE FOR ECONOMIC JUSTICE RESEARCH POLICY ADVOCACY

STATEMENT

Claims that South Africa is heading towards a 'fiscal crisis' are overstated

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Today the Institute for Economic Justice (IEJ) publishes research that shows reports of an immediate and acute 'fiscal crisis' in South Africa are being exaggerated for political purposes.

IEJ Executive Director, Dr Gilad Isaacs, explains : "Our analysis shows that the much-discussed revenue shortfall is within historical norms and well within the government's ability to close. The data does not support claims that we are standing on the edge of a so-called 'fiscal cliff' or 'financial crisis'. National Treasury is likely stoking panic to push through unnecessary and unpopular budget cuts."

The true state of the nation's finances

The IEJ's estimates a revenue shortfall of R67.2 billion if no changes are made for the rest of 2023/24. This is within historical norms. In 2017/18, 2018/19, and 2019/20 revenue shortfalls ranged from R58.2 to R70.1 billion.

A R67.9 billion expenditure overspend is projected for 2023/24 based on current trends. The largest share of this is R37.5 billion from the predictable but unbudgeted public sector wage bill increase. The overspend is also comparable to other years, but the revenue shortfall and expenditure overspend compound one another.

National Treasury should have budgeted for items included in the overspend and if this overspend is a 'crisis' then it is one entirely of National Treasury's own making.

South Africa's current debt levels should not be characterised as being at 'crisis' proportions. The country's debt-to-GDP ratio (at 71.4% in 2022/23) is in line with the emerging market and middle-income country average (of 69% in 2022/23). However, the debt trajectory is of concern

if there is no credible growth strategy. The critical issue facing South Africa's borrowing is the cost of debt - that is high interest rates - combined with a lack of effective growth strategy.

While the acute budget mismatches can be relatively easily managed, repeated revenue shortfalls and expenditure overruns would be unsustainable over the medium term. The only credible strategy to tackle debt levels is through economic expansion.

Considered and viable alternatives to Treasury's frantic cuts

The rushed and indiscriminate budget cuts currently being rammed through by National Treasury will cause economic contraction. Recent research shows that fiscal contraction larger than 1.5% of GDP generates a negative effect of more than 3% on GDP even after 15 years. The drop in GDP reaches 5.5% for fiscal contractions larger than 3%.

The IEJ's research suggests that these budget mismatches and the further pressures on the horizon provide an opportunity for the fundamental reform of South Africa's fiscal framework in order to centre the role and potential of the budget in advancing developmental priorities. Such a strategy should:

1. **Solve the immediate budget mismatch**:
    - Use some of the R459 billion owed to the South African government in the Reserve Bank's somewhat obscure Gold and Foreign Exchange Contingency Reserve Account. This is in keeping with other major central banks remitting profits to their respective Treasuries.
    - Increase short-term borrowing. Even if the entire mismatch was closed in this way it would increase the gross debt-to-GDP ratio by approximately two percentage points only. In this scenario the debt trajectory would still be considerably lower than Treasury's own debt-to-GDP forecasts from 2019, 2020, and 2021.
2. **Raise additional revenue:**
    - In the short-term raise revenue through: the removal of tax breaks for high-income earners; the removal of selected tax breaks for corporates; and restoring the corporate income tax rate to 28%. Removing tax breaks for those earning above R750 000 (around 2.9% of the working population) would alone raise an estimated R83 billion.
    - Explore raising additional taxes through: increased taxation on wealth and income from financial assets; tackling illicit financial flows; and capturing rents and windfalls.
    - A general increase in the VAT rate would make the tax mix more regressive, fail to raise the sums needed, and disproportionately burden poor and low-income earners. The only VAT increase that would be defensible would be the introduction of a higher VAT rate on luxuries.
3. **Reduce the cost of borrowing:**
    - Shift some borrowing from expensive ultra-long-term debt to cheaper medium-term debt.
    - Engage in targeted debt renegotiation, particularly for Eskom debt restructuring.
    - Apply preferential or prescribed lending to secure cost-effective domestic debt.
    - Reduce interest rates through targeted capital management techniques.

4. **Institute a considered, transparent, consultative, and evidence based expenditure review process**.

National Treasury's political campaign

While South Africa does face fiscal challenges, National Treasury seems determined to force through spending cuts and to terminate or limit programmes it is opposed to - including the highly-successful Social Relief of Distress (SRD) grant and the Presidential Employment Initiative.

Zimbali Mncube, IEJ Tax and Budget Policy Researcher and co-author of the IEJ Policy Brief, frames the politics currently at play as follows: "In exaggerating a 'crisis' National Treasury is able to force through chaotic, dire, and ultimately deadly austerity measures across the board. This will undermine progress made towards realising socio-economic rights by other government departments, stifle economic growth and job creation, and exacerbate the extreme hardship experienced by millions of people for years to come. IEJ research takes the fiscal challenges seriously, but shows how they can be handled in the short term to avoid a social crisis, while putting in place the necessary plans to leverage the budget to achieve sustainable growth."

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