

A fiscal anchor for South Africa

Avoiding the mistakes of the past

This presentation provides a short summary of a detailed BER Research Note, also available on the BER's website.

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INTRODUCTION

- South Africa's sovereign debt-to-GDP ratio has more than tripled since 2008, and along with this rapid increase, so have debt-servicing costs.
- Fiscal credibility has been eroded, in part because National Treasury (NT) has not met its own forecasts, in part due to an underperforming economy.
- The International Monetary Fund (IMF) has recommended that South Africa adopt fiscal rules.
"A fiscal rule anchored in a prudent debt ceiling can help underpin the consolidation and support policy credibility."
- NT has also committed to a process of consultations on fiscal rules/anchors. As noted in MTBPS 2024, a discussion document will be released by the end of March 2025.
- Markets are also starting to call for fiscal rules - as an example:

Godongwana needs to show the nation is on a "corrective fiscal path,"....."The easiest way to do that might be the adoption of a fiscal rule." -Razia Khan, Standard Chartered Bank

WHAT ARE FISCAL RULES?

- Fiscal rules are defined as constraints on fiscal policy, typically defined in terms of an indicator of overall fiscal performance or numerical limits on budgetary aggregates.
- Fiscal rules can be based on a political commitment, coalition agreement, statutory status, international treaties and could even have a constitutional basis.

There are four general types of rules:

- 1) **debt rules**, which set limits on debt-to-GDP ratios,
- 2) **budget balance rules**, which set targets for budget balances, normally expressed as a percentage of GDP,
- 3) **expenditure rules**, which set limits to public expenditure growth and
- 4) **revenue rules** which set targets for revenue collection, or limit tax burden. Most of these categories have different variations, most notably to adjust targets for economic cycles.

PREVALENCE OF FISCAL RULES

Table 1: Adopted Fiscal Rules across the world as at 2021

Rule or combination of rules	Number of Countries
Expenditure rule	2
Debt rule	5
Budget balance rule	8
Subtotal	15
Revenue rule + Expenditure rule + Debt rule	1
Revenue rule + Debt rule	2
Expenditure rule + Debt rule	2
Revenue rule + Expenditure rule + Budget balance rule + Debt rule	5
Revenue rule + Budget balance rule + Debt rule	9
Expenditure rule + Budget balance rule	10
Budget balance rule + Debt rule	26
Expenditure rule + Budget balance rule + Debt rule	35
Subtotal	90
Total	105

Source: Siebrits & Calitz (2023)

PROS AND CONS OF DIFFERENT RULES

Type of rule	Pros	Cons
Debt rule	<ul style="list-style-type: none"> - Direct link to debt sustainability. - Easy to communicate and monitor. 	<ul style="list-style-type: none"> - No clear operational guidance - No economic stabilization feature (can be pro-cyclical). - Debt could be affected by developments outside the control of the government.
Balance rule	<ul style="list-style-type: none"> - Easy to communicate and monitor. - Provides a form of operational guidance to governments. - Close link to debt sustainability. 	<ul style="list-style-type: none"> - No economic stabilization feature (can be pro-cyclical) - Significantly affected by developments outside the control of the government. - Often associated with negative effects to budget composition.
Cyclically adjusted budget balance	<ul style="list-style-type: none"> - Relatively clear operational guidance - Close link to debt sustainability - Economic stabilization function (i.e., accounts for economic shocks) 	<ul style="list-style-type: none"> - Correction for cycle can be imprecise and complicated. - Complexity makes it more difficult to communicate and monitor
Expenditure rules	<ul style="list-style-type: none"> - Clear operational guidance - Allows for economic stabilization - Relatively easy to communicate and monitor. - Generally better at containing fiscal policy during economic upswings 	<ul style="list-style-type: none"> - Not necessarily have a direct link to debt stabilisation. - Often associated with negative effects to budget composition.
Revenue rules	<ul style="list-style-type: none"> - Can be used to contain the size of governments and improve revenue policies and administration 	<ul style="list-style-type: none"> - No direct link to debt stabilisation. - Could be prone to procyclical fiscal policy

Source: Adapted from: Schaechter, A. (2012).

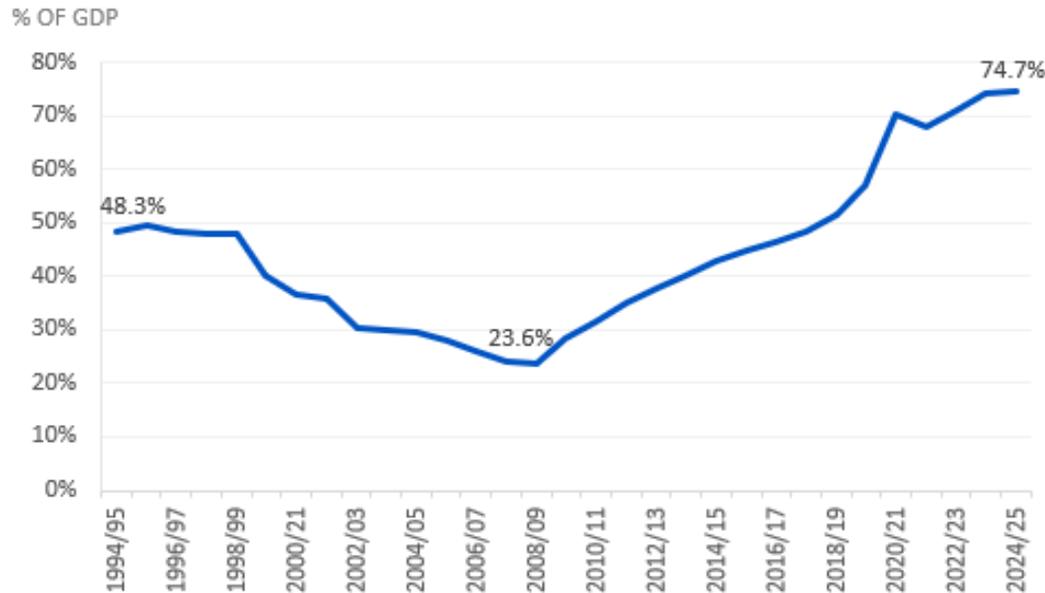
Policy Problem

- Fiscal Deterioration and Sustainability
- Fiscal Credibility

FISCAL DETERIORATION AND SUSTAINABILITY

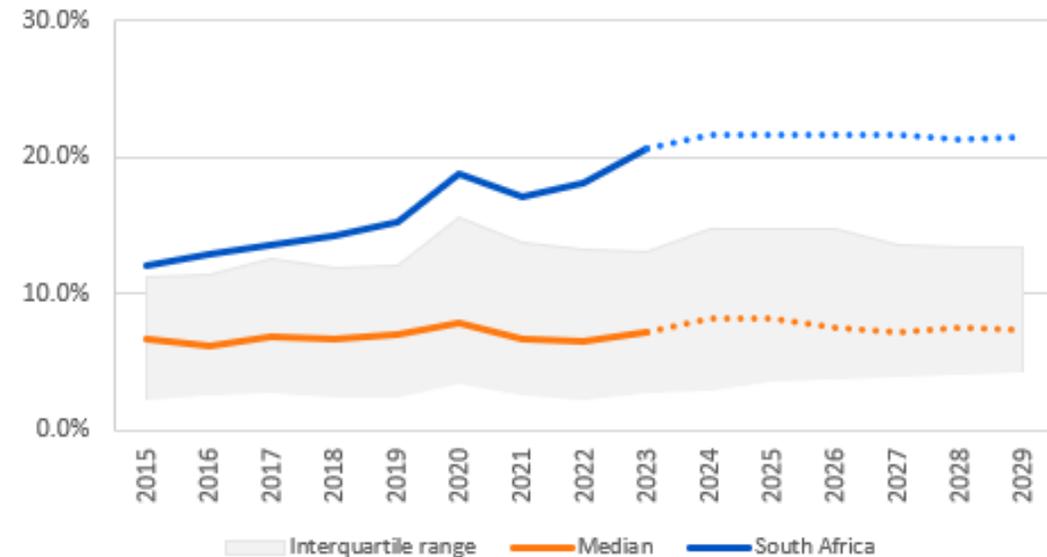
- Since the 2008/09 financial year South Africa’s debt-to-GDP ratio, and debt-servicing costs have increased dramatically. Debt-servicing costs have been the fastest-growing expenditure item in the South African national budget for several years, with clear crowding out effects. (Increased from 8.8% of revenue in 2008/09 to 21.6% in 2024/25).
- While running a deficit, the fact that average interest rates on net government debt exceeds the long-term nominal economic growth rate renders South Africa’s fiscal position unsustainable ($r > g$)

Figure 1: Gross Loan Debt-to-GDP Ratio from FY1994/95 to FY2024/25



Source: IMF World Economic Outlook Database and National Treasury Data

Figure 3: South Africa’s debt-service costs compared with peers



Source: MTBPS 2024

FISCAL CREDIBILITY

- Fiscal credibility - whether markets and economic agents believe what treasuries announce will happen with a reasonable margin of error.
- **There seems to be a consensus that South Africa's fiscal credibility has eroded significantly over the last decade.**
- Sources of credibility erosion are as follows:
 - **Time-inconsistency and (non) credible commitment to debt stabilisation.**
 - Since 2010/11 the debt stabilisation year has been changed 10 times from 2015/16 to 2025/26
 - Since 2010/11 the debt stabilisation level has been changed 13 times from 40% to 75.5%
 - **Over-optimism in forecasting**
 - On average over the last 10 years, GDP growth forecasts by the NT were 2.3 percentage points higher in the third year of the MTEF.
 - **Increasing expenditure pressures**
 - Concerns over overall policy credibility across the South African Government for several years.
 - **Questionable nominal non-interest expenditure ceiling**
 - Exceptions, objective not always clear, not anchored to a debt level

Effectiveness of Fiscal Rules

- Can fiscal rules restore credibility, and improve sustainability ?
- Fiscal rules, inflation and the repo rate

EFFECTIVENESS OF FISCAL RULES

- **Empirically the track record of fiscal rules is mixed**, and functions in the broader institutional context of a country.
- The complication from an empirical basis is to establish whether there is a causal relationship between fiscal rules and fiscal performance, however, there is at least a correlation. **(Pre-existing culture influence fiscal performance- however, culture is also formed and influenced by institutions.)**
- **Low compliance.** From 2004 to 2021, compliance with budget balance rules and debt rules was 42 and 50 per cent respectively.
- Despite erratic compliance, various authors argue that numerical rules are still effective despite challenges.
- **Some studies suggest that only “strong rules” are effective** and “weak” fiscal rules sometimes render poorer results than under circumstances without fiscal rules (Ardanaz et al. 2023).
- **Rule strength is determined by** coverage of the rule, legal basis, supporting monitoring arrangements, enforcement procedures, flexibility mechanisms to respond to shocks, and ex-post and ex-ante application.

EFFECTIVENESS OF FISCAL RULES

- Institutions such as fiscal rules, independent watchdogs, and fiscal transparency contribute to the build-up of fiscal credibility.
- Fiscal rules are often associated with reducing the gap between market and official forecasts and are often used as a mechanism to restore fiscal credibility.
- In the correct setting fiscal rules can be **effective signalling tools, credibility enhancing** and a measure to **bolster fiscal policy continuity**.
- **Caution: If designed poorly, or reneged on soon after its adoption, fiscal rules could erode fiscal credibility even further.**

FISCAL ANCHOR, INFLATION AND THE REPO RATE

- It is argued that a credible fiscal anchor can reduce inflation and the repo rate.
- By considering fiscal and monetary policy as a game whereby there are objectives that are in tension - misaligned decisions can lead to undesirable economic consequences, such as high inflation or excessive debt.
- The economic outcomes are improved when the two players coordinate. This can be done with clear rules for each player.
- **In South Africa, there is rule-based monetary policy; but no rule-based fiscal policy. This leads to a suboptimal outcome – arguably where the central bank keeps interest rates too high not because it thinks the Treasury’s policy is inflationary, but because it cannot predict the Treasury’s actions.**

Fiscal Rule Design

- Objectives
- Guiding principles for design

OBJECTIVES

- **It is critical that the objective of fiscal rules is clear to the public and markets**, and the key objectives are arguably to ensure fiscal sustainability and fiscal credibility.
- **The objective of the existing nominal non-interest expenditure ceiling is not always clear**, and it has arguably lost credibility.
- Debt stabilisation should be the initial objective, but this is likely not sufficient, and debt reduction should follow the stabilisation phase.
- The objective of fiscal rules can also be considered as achieving fiscal sustainability as a **prerequisite for growth in the South African context**. (Theory of change approach)
- **NB! Fiscal rules should assist South Africa in constraining fiscal policy in periods of economic upswings.**

“[The] true test of rules occurs in good times when economic plenitude spurs voters and interest groups to demand more of government and politicians respond with tax cuts or spending increases. The seeds of most fiscal collapses are sown during good times”. -Allen Schick (2003)

GUIDING PRINCIPLES FOR DESIGN

- **Sustainability:** In the past there did not seem to be a link between debt sustainability and the existing non-interest expenditure ceiling.
- **Stabilisation qualities:** The rule should not increase economic volatility.
- **Simplicity:** It should be easy to understand, communicate and monitor fiscal rules, and compliance (Consider independent monitoring of compliance).
- **Operational Guidance:** The rule design should provide operational guidance for fiscal policy.
- **Legal Basis:** Prominent feature of measuring fiscal rule strength.

An Anchor for South Africa ?

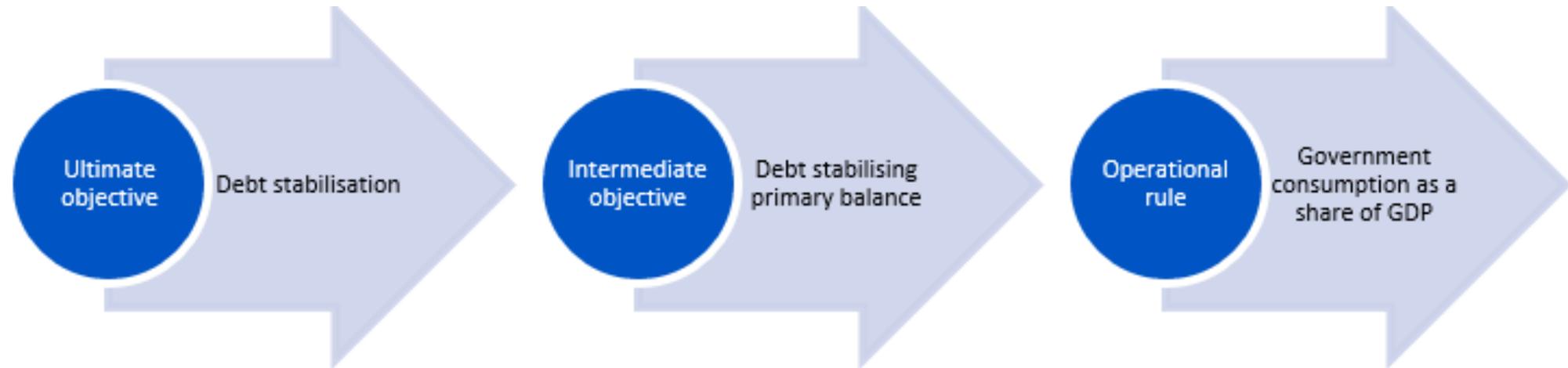
- What should guide the setting of the anchor?
- Possible rule design
- Conclusion

WHAT SHOULD GUIDE THE SETTING OF THE ANCHOR?

- **Drawing from the literature, we identify the following considerations for a fiscal anchor:**
 - Consideration 1: Political buy-in.
 - Consideration 2: Independent monitoring.
 - Consideration 3: Clear differentiation between operational objectives and the ultimate objective.
 - Consideration 4: Balance fiscal consolidation with economic growth.
 - Consideration 5: Have a statutory basis.
 - Consideration 6: The rule must be binding and difficult to break.
 - Consideration 7: More than one rule is possible, but this could add complexity.

POSSIBLE RULE DESIGN?

- A possible design is to create an **initial integrated fiscal rule** that differentiates between an **operational short-term rule** (i.e., one that can guide the budget process), **with an intermediate objective**, which supports the **initial ultimate objective** which is fiscal sustainability.



- **Once debt has definitively stabilised, the next phase would be to reduce debt, and to introduce a suitable debt anchor.** This should be achieved by targeting a debt-reducing primary balance as the intermediate objective and operationalised through a government expenditure rule.

LEGISLATING FISCAL RULES IN SOUTH AFRICA

- Based on previous attempts to introduce legislated fiscal rules, which had to be certified by the Chief Parliamentary Legal Adviser or a parliamentary legal adviser, proposed legislation on fiscal rules would likely be classified under Section 76 bills.
- Section 76 bills are ordinary bills that affect provinces, and any member of cabinet, deputy ministers, individual members of parliament, and committees could introduce a bill to propose fiscal rules for South Africa.
- Section 76 bills may be introduced in either the National Assembly (NA) or the National Council of Provinces (NCOP) but must be considered in both Houses. Furthermore, members of the NCOP do not vote as individuals on Section 76 Bills but rather as provincial delegations.
- The specific mechanics of fiscal rules would depend on the particulars of how the legislation is drafted. It could either prohibit the National Treasury from tabling a fiscal framework and budget that does not comply with the fiscal rules, unless an escape clause has been triggered by Parliament ahead of tabling the budget.
- Alternately it could dictate the procedure that needs to be followed if the fiscal rules are breached, for example tabling a report along with the budget, setting out the reasons for not complying with the rules, and a detailed recovery plan.

CONCLUSION

- Fiscal rules are not a silver bullet, and do not work in isolation from the wider (institutional) context.
- Without the discipline to enforce rules, they would not address South Africa's fiscal sustainability or credibility issues.
- With sufficient political buy-in, an appropriate design and a supportive institutional organisation, it could provide positive signaling value and assist in improving fiscal sustainability and credibility.
- The true value of fiscal rules is to contain fiscal policy during economic upswings (periods of “economic plentitude”).
- NT is essentially already targeting a primary surplus that is consistent with debt-stabilisation - keeping on that path is the challenge.
- A possible design for fiscal rules is to create an initial integrated fiscal rule that differentiates between an operational short-term rule, with an intermediate objective, which supports the initial ultimate objective which is fiscal sustainability
- The next phase would be to move from debt-stabilisation to debt reduction, by introducing a suitable debt anchor, achieved by targeting a debt-reducing primary balance as the intermediate objective and operationalised through a government expenditure rule.

THANK YOU.

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