**Budget 2021 Should Reduce the Deficit, Not Consume More Resources**

**By Arthur Kamp | 23 February 2021**

Revenue collection should be far better than previously expected in the current fiscal year to end March 2021, and the National Treasury had an unexpectedly large cash pile of R378 billion at end January 2021. But, this does not mean South Africa has any fiscal space. The country's debt is rated sub-investment grade, reflecting the failure of its former fiscal consolidation efforts.

**SA's Budget Deficit Is Likely to Be Double Digits**

Even if the decline in revenue for the current fiscal year, relative to the initial February 2020 projection, is R212.8 billion rather than R312.8 billion as budgeted for in the October 2020 Medium Term Budget Policy Statement (MTBPS), the main budget deficit for the year would still be in double-digit territory at around -12.4% of GDP.

Of course, this in part reflects the impact of the pandemic. However, South Africa's fiscal problems are deep-rooted, reflecting three trends:

- A persistently high level of government consumption spending relative to GDP
- A long-term decline in the country's potential growth rate
- A deterioration of the state's balance sheet

**Government Is Consuming Too Much of Available Resources**

The National Treasury has no alternative but to focus on curtailing the government wage bill (the largest government consumption item). And, more broadly, it has no choice other than to pursue fiscal consolidation. The primary budget balance (revenue less non-interest spending) must return to positive territory from an estimated -7.6% of GDP in 2020/21 (assuming the revenue outcome above) if we are to stabilise the government's debt ratio.

The counterargument to fiscal consolidation is that we are in the midst of a pandemic, which requires additional spending. The problem is that the fiscal multiplier is no longer positive. The Reserve Bank has calculated that the multiplier decreased from 1.6 in 2009 to less than zero in 2019. A high level of government spending and the accompanying deterioration in the fiscal numbers is crowding out private sector activity. The government is absorbing a high share of available resources, the tax burden is increasing and persistent sovereign debt rating downgrades have been accompanied by upward pressure on borrowing costs.

**Unlike the US, Our Real Interest Rates on Debt Are Worryingly High**

It is valid to argue that direct COVID-19 related support is necessary, but as far as possible, this should reflect reprioritisation and not a permanent addition to recurrent expenditure. Better-than-expected revenue outcomes should not be spent. It should be allowed to reflect as lower-than-expected budget deficits. True, the US, for example, is about to implement another extraordinarily large fiscal stimulus package. However, the real interest rate on US government debt is far lower than in South Africa. It is the high real interest rate we pay on our debt relative to our low-trend real GDP growth rate that requires a sharp improvement in the primary balance to stabilise the situation.

**Ultimately, SA's Balance Sheet Needs to Be Rebuilt**

A shift towards lower budget deficits to stabilise the government's debt ratio is necessary but still not sufficient. Lower budget deficits in the absence of an improvement in the state's balance sheet would not be a true fiscal consolidation. It is not straightforward to measure the state's balance sheet. But, clearly,

there is deterioration reflected in the build-up in government's liabilities relative to fixed assets over many years. These liabilities include the contingent liabilities inherent in government's guarantees on state-owned companies' debt.

To extricate ourselves from this predicament requires the government to stick with its planned expenditure restraint while taking steps to stabilise state-owned companies' finances and implementing economic reforms to lift the potential growth rate. The end goal of these interventions would be to lower risk and decrease the real interest rate paid on government debt relative to the real GDP growth rate – a necessary outcome to return fiscal policy to sustainability.