FINANCIAL AND FISCAL COMMISSION

For an Equitable Sharing of National Revenue

POLICY BRIEF

Towards a Growth and Reconstruction Plan for South Africa

The Financial and Fiscal Commission

The Commission is a body that makes recommendations and gives advice to Organs of State on financial and fiscal matters. As an institution created in the Constitution, it is an independent, juristic person subject only to the Constitution itself, the Financial and Fiscal Commission Act, 1997 (Act No 99 of 1997) (as amended) and relevant legislative prescripts and may perform its functions on its own initiative or on request of an Organ of State.

The vision of the Commission is to provide influential advice for equitable, efficient and sustainable intergovernmental fiscal relations between the national, provincial and local spheres of government. This relates to the equitable division of government revenue among the three spheres of government and to the related service delivery of public services to South Africans.

Through focused research, the Commission aims to provide proactive, expert and independent advice on promoting the intergovernmental fiscal relations system, using evidence-based policy analysis to ensure the realisation of constitutional values. The Commission reports directly both to Parliament and the Provincial Legislatures, who hold government institutions to account. Government must respond to the Commission's recommendations and the extent to which they will be implemented at the tabling of the annual national budget in February.

The Commission consists of women and men appointed by the President: the Chairperson and Deputy Chairperson; three representatives of provinces; two representatives of organised local government: and two other persons. The Commission pledges its commitment to the betterment of South Africa and South African's in the execution of its duties.

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Policy Brief

Towards a Growth and Reconstruction Plan for South Africa

02 February 2021

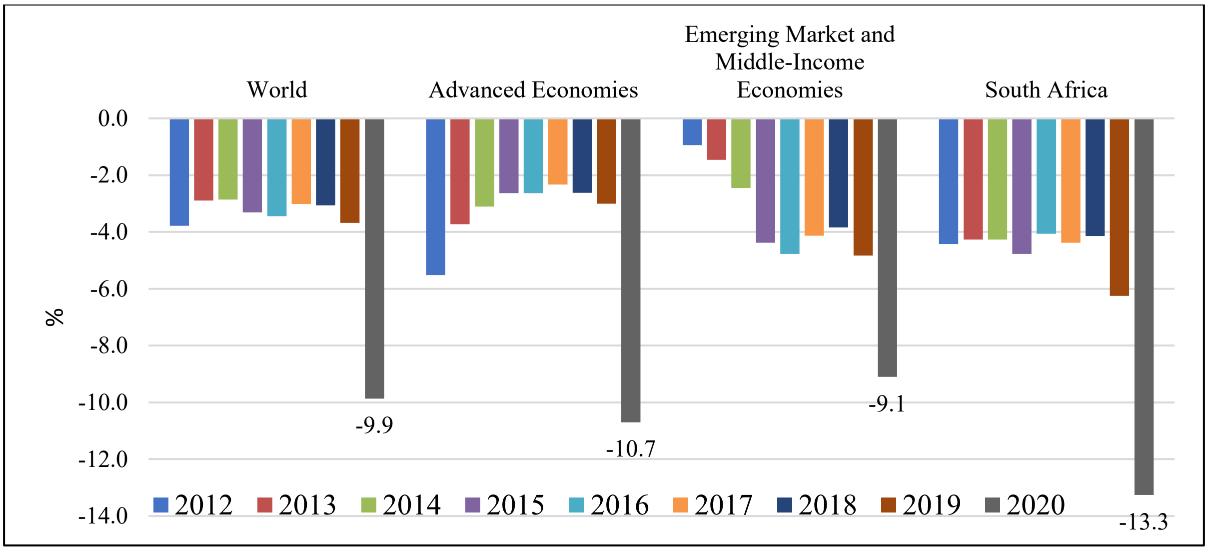
Executive Summary

At the time of the Covid-19 outbreak, South Africa was grappling with a looming recession; rising debt; and the socio-economic challenges of high levels of economic inequality, unemployment and poverty. As the virus spread through the country, South Africa was downgraded to a sub-investment grade, which compounded the situation, making it more difficult to improve socio-economic development. Like many other countries, South Africa's fiscal deficit and government debt will rise, as a result of fiscal measures taken in response to Covid-19. This will have implications for the economy and society, especially in South Africa where the cost of servicing its debt may crowd out spending on social relief and growth-inducing interventions. South Africa will need innovative thinking to overcome the likely impact of the pandemic. To kick-start sustainable recovery, the Commission recommends that government develop and execute a clear, coherent and comprehensive macroeconomic framework, while addressing challenges that may hinder recovery efforts. This will require a structural transformation of the economy, the reprioritisation of public spending and strategic reforms, such as allocating more funding to local government.

Background

The Covid-19 pandemic has caused an unprecedented health crisis in both advanced and developing economies. At the time of the outbreak, South Africa was already grappling with a long-term economic deceleration, a looming recession, a soaring debt level and the persistent socio-economic challenges of poverty, inequality and unemployment. Compounding the situation, the country's sovereign credit rating was also downgraded to sub-investment grade. The combination of Covid-19 and the sub-investment grade makes improving South Africa's socio-economic development very difficult. The International Monetary Fund (IMF) projects that, as a result of fiscal measures in response to Covid-19, the global fiscal deficit will rise to 9.9% of gross domestic product (GDP) in 2020. Between 2019 and 2020, South Africa's fiscal deficit is projected to rise from 6.3% to 13.3% of GDP (Figure 1).

Figure 1: General government fiscal balance as percentage of GDP (2012–2020)



Source: IMF, World Economic Outlook, April 2020.

The world is already functioning with negative fiscal balances, and government debts will further increase to support fiscal measures in response to Covid-19. In 2020, world government debt is projected to be 96.4% of GDP. The IMF projects that South Africa's government debt will reach 77.4% of GDP in 2020, compared to 62.2% in 2019. An increase in government debt has major implications for the economy and society. Higher government debt and a significant fiscal deficit require significant borrowing, which comes at a high cost for an economy with a sub-investment grade such as South Africa. The concern is that the cost of servicing this borrowing will crowd out much-needed spending on social relief and growth-inducing interventions.

As South Africa struggles to pivot towards recovery, innovative thinking will be needed to overcome several hurdles. A coherent and comprehensive macroeconomic framework is needed, accompanied by a structural transformation of the economy, as well as strategic reforms, such as greater funding to municipalities, to accompany the reprioritisation of the division of revenue and budget at large.

Research Findings

1. **Devising a coherent and comprehensive macroeconomic framework.** A clear economic path, endorsed by all South Africans, is long overdue. Government needs to take the lead in devising such a framework and partner with the private sector and organised labour. A good basis for a comprehensive macroeconomic framework is National Treasury's discussion document, *Towards an Economic Strategy for South Africa*, which provides a relatively comprehensive analysis of the South African economy. Where the document falls short is that it does not identify a clear economic policy for the country and does not take into account the character of the South African economy. Nevertheless, a positive development in that all role players in the South African economy have come together at the National Economic Development and Labour Council (Nedlac) to work on an economic recovery plan.

2. **Transforming the structure of the economy.** South Africa has seen a decline in real sectors in favour of financial services, which is a sector that remains largely untransformed with very little being invested back into the growth and development of the economy. Between 1995 and 2019, the manufacturing sector's share of GDP declined from 21.4% to 13.2%, while the finance sector increased from 15.3% to 19.7% (Table 1). During the last quarter of 2019, all sectors of the economy, except for financial and personal services, declined. In the first quarter of 2020, almost all sectors showed further deterioration, with only personal services, transport and construction, government activity and financial services making positive contributions to GDP. The Covid-19 pandemic is affecting each sector differently, and this will have major implications on structural changes in the country. Therefore, all relevant parties, particularly the government, organised labour and the private sector, need to have a proper discussion about the structure of the South African economy. While the need for structural changes is obvious in Table 1, other issues for discussion include technological intensity (i.e., labour or capital) in the inputs for production and ownership (i.e., the distribution of ownership of the means and industry), as well as the character of the economy (i.e., mineral energy complex) and the historical profile of the economy (i.e., labour reserves).

Table 1: Sectoral share in GDP at current prices (1995-2019)

Sectors	1995	2005	2015	2019
Agriculture, forestry and fishing	3.9%	2.7%	2.3%	2.1%
Mining and quarrying	6.8%	7.3%	8.0%	8.3%
Manufacturing	21.4%	18.1%	13.0%	13.2%
Electricity, gas and water	3.3%	1.9%	3.6%	3.8%
Construction	3.4%	2.9%	4.0%	3.8%
Wholesale, retail, motor trade and accommodation	14.4%	14.2%	15.0%	15.1%
Transport, storage and communication	9.3%	10.9%	10.0%	9.8%
Finance, real estate and business services	15.3%	20.8%	20.9%	19.7%
General government services	16.6%	14.8%	17.4%	18.2%
Personal services	5.6%	6.4%	5.7%	5.9%

Source: Calculations based on Statistics South Africa.

3. **Reprioritising within the division of revenue, accompanied by strategic reforms.** In the 2020 budget tabled in February, medium-term estimates indicated that 47.9% of resources would be allocated to national government, 43% to provinces and 9.1% to local government. The division of revenue, proposed in the 24 June 2020 Supplementary Budget, showed the national share for 2020/21 increasing from R758-billion to R790-billion, the provincial share decreasing from R649-billion to R645-billion and the local government share increasing from R133-billion to R140-billion. In addition, local government will receive further allocations, of R11-billion through the equitable share and R9-billion through the reprioritisation of allocated conditional grants to fund additional water and sanitation provision and the sanitisation of public transport.

   Arguably, the 2020 Supplementary Budget presents a step in the right direction. More funds should be going to local government, as municipalities play a pivotal role in the delivery of essential basic services such as water and sanitation. However, many issues need to be taken into account in developing the 2020 Medium-Term Budget Policy Statement (MTBPS). Government needs a robust response to Covid-19, so that the economy can improve. The economic and budget framework for 2020/21–2023/24 should take into account the significant decline in economic performance, decline in tax revenue and the general fragile state of the society, which suggests that more expenditures should go to the social sector. This has implications for State capacity and organisation, as more implementation would be happening at local government level. This could mean trimming the sizes of provinces to allow for more allocations to local governments, or reducing the size of the national government – here reforms in respect of the national macro organisation of government come to mind. Non-core and inefficient spending of departments can be reduced and some departments can be merged. It is a given that more expenditure would go to the health care sector (nationally, provincially and locally) and to economic sector departments, as well as infrastructure-related portfolios in an effort to spur economic activity.

Conclusion and Recommendations

Fundamentally, South Africa needs a growth and reconstruction programme that can guide a macroeconomic framework. The programme should be centred on clear economic and social policies. Importantly, a robust social policy is needed in order to better deal with the socio-economic challenges that have been exacerbated by Covid-19, as social policy also has a role in economic development. Other important aspects are infrastructural development, which can assist with job creation while boosting economic growth, and state-owned entities that need to contribute to growing the economy and reducing social distress. After reviewing the economic situation leading up to the Covid-19 crisis, the Commission is convinced that a fundamental structural transformation of the economy is inevitable.

The Commission recommends that:

1. The Minister of Finance develop (and execute) a clear, coherent and comprehensive macroeconomic framework that is in line with the president's economic and social support response package to Covid-19. The Minister should consider the position taken in the government document, *Towards an Economic Strategy for South Africa*, to strengthen the continuity, consistency and credibility of the economic and fiscal stance. These policy positions should be clearly represented in monetary figures, in the 2021/22 Appropriation Bill and Division of Revenue Bill for implementation in the forthcoming Money Bills as per section 77 of the Constitution
2. The ministers of finance, of economic development and trade and industry, and of labour jointly address the economic barriers, social inequality, and societal polarisation by adopting a localised product value chain approach. The expression of this approach should be found in the incentive grants frameworks of both provincial and local conditional grants, as hard conditions to permit procurement of goods only if they are made or assembled locally within the South African borders, to stimulate the domestic economy and encourage job growth while taking international trade agreements into account.

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