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News Article : Is a fiscal policy council the answer?

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The sharp increase in the government's wage and salary bill could perhaps have been avoided

There is no denying that, rightly or wrongly, in the opinion of some people the credibility of South Africa's fiscal policy has been impaired.

The most recent downgrading of South Africa by all three leading rating agencies is the most visible evidence thereof, but various analysts, including myself, have previously expressed the view that the National Treasury's grip on government finance is slipping.

Recent events have shown that concern about SA's public finances is not without grounds.

Three matters stand out: the e-tolling saga, confirmation that the current wage negotiations in the public sector implies exceeding the budget, and government's plans to go on an infrastructure drive after the fiscal space has been used up by an increase in current expenditure.

The implementation of a set of fiscal rules with which the state budget must comply is one way of promoting credibility, as is the creation of a statutory fiscal institution that plays an independent evaluative and directional role in fiscal policy.

The most transparent and comprehensible form of fiscal rules is the imposing of restrictions on the annual budget deficit and government debt.

In fact, in the 2011 Budget Review the National Treasury proposed that the government should accept such rules, the difference being that the structural budget balance (the headline balance adjusted for the impact of the business cycle on government revenue) should be used instead of the headline balance.

However, the level of the restrictions was not specified, apparently because it is deemed to be a political decision.

However, nothing has come of this, which indicates a lack of political support for the idea.

Instead, the Treasury has announced a set of fiscal guidelines and committed itself to the publication of a long-term fiscal review within the next 12 months, in which the long-term implications of the current fiscal policy will be set out.

Perhaps the review will also sketch different scenarios, showing what will happen in the event of a deviation from the proposed plans.

The Treasury's proposals are based on the following principles:

- Contra-cyclical fiscal policy, which in a South African context is interpreted as allowing the structural budget deficit to increase in an economic downturn and decrease during an upswing. Ideally, however, contra-cyclical policy requires the budget to balance over the course of the economic cycle, in other words budget surpluses should be pursued during upswings with a concomitant decrease in government debt.

- Sustainability of government debt, in other words that government spending should increase at most at the same pace as economic growth over the long term; a faster and permanent increase in government spending will have to be accompanied by higher taxes. It also requires dissaving by the government, i.e. the financing of current expenditure by means of loans, having to be avoided.
- Intergenerational equity, which implies that the extent of government debt should not just be kept in check so as not to place too big a burden on future generations, but that loans should also only be used to finance capital expenditure to boost economic growth. The tax base that has to carry the cost of higher government debt will then also grow and prevent an increase in tax rates for future generations.

Opponents of fiscal rules often argue that such rules impede the flexibility of fiscal policy and could in fact contribute to pro-cyclical fiscal policy.

However, the value of such rules during times of upward pressure on government spending is acknowledged.

The European debt crisis shows clearly that the success of fiscal rules depends largely on the institutional framework within which they are applied.

For fiscal rules to carry any weight, they must be monitored by competent institutions with the necessary political influence.

In 2010 Parliament requested the Financial and Fiscal Commission to investigate the merits of fiscal rules, which resulted in a brief report released in October 2011.

In this report the Commission expressed its reservations about the desirability of fiscal rules, but then put forward the interesting proposal that the establishment of a South African Fiscal Policy Council could be considered.

Such a fiscal council would comprise independent experts, with a small technical support team to supplement the one that already exists in the National Treasury.

The credibility of the council would depend on the political cost associated with disregarding its recommendations.

The responsibilities of the fiscal policy council could include the following:

- determining the assumptions on which budget projections are based
- forecasting the budget
- estimating the cost implications of policy initiatives
- assessing the budget on the basis of fiscal rules, inter alia with a view to sustainability and optimality
- evaluating fiscal transparency
- evaluating fiscal policy, ex-ante (whether it is likely to achieve its objectives), as well as ex-poste (whether it achieved its set objectives in the past).

Several developed and developing countries have institutions that can be regarded as fiscal policy councils.

The oldest of these is probably the Central Planning Bureau in the Netherlands (since 1947). Others include Denmark, Germany, Austria, Belgium, Sweden, Canada, Japan, the UK and the US.

Emerging-market countries that have already taken this route are Hungary, Slovenia, Chile, Indonesia, Jordan, Korea and Mexico.

This raises the question of whether the National Planning Commission (NPC) could not play the role of a fiscal council in South Africa, which would obviate the creation of a new institution.

The implementation of the National Development Plan obviously has far-reaching fiscal implications and it would therefore be fitting for the NPC to consider these.

In fact, the National Treasury's planned long-term fiscal review would make sense only if it is done within the context of the development plan.

Although the NPC only acts in an advisory capacity, it could put subtle pressure on the political leadership to bring fiscal policy in line with the development plan by pointing out the implications of any deviation from optimal policy.

For example, the sharp increase in the government's wage and salary bill could perhaps have been avoided by highlighting the trade-off with infrastructure financing.

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