Key messages

South Africa has entered a much more challenging economic period, wherein priority expenditures for children are at risk. Even priority spending areas that have shown positive growth are now likely to face spending cuts, at least over the medium-term. The severity of the austerity measures in Budget 2021 means that this is almost certain, especially since spending on education, health, and social development will grow at rates below expected inflation.

The government of the Republic of South Africa has indicated that it wants to change the composition of spending. In this regard, while total government will decline, proposed spending on infrastructure will increase at a rapid rate. It is important, therefore, that the health and education sectors are prioritised in this regard.

During the last decade (FY2011 to FY2019), priority expenditures for children were largely protected and there were positive gains for most services utilised by children. Gains were recorded for Early Childhood Development (ECD) programmes, larger investments in Primary Health Care (PHC), social grants were pegged to the prevailing consumer price inflation, and frontline professionals and workers received above-inflation salary increases.

Spending on basic education, in spite of the windfalls for other areas of social sector spending during the last decade, fell behind, and given the latest austerity measures, fiscal space will remain challenged in this critical human development sector. However, the severity of the proposed cuts means that other social sector functions that did well during the last decade will now also be subjected to stringent cost-cutting measures.

In terms of the various scenarios modelled in this report, protecting priority expenditures for children will require a heroic effort by the government of South Africa. To enable this to be achieved requires a large reduction in non-priority expenditures. However, child spending is likely to be badly affected in plans to shift the composition of expenditure from current (consumption) to infrastructure spending, due to the labour-intensive nature of the children’s sector. This suggests that budgetary reprioritisation is a far more difficult option to preserve and expand fiscal space for children’s programmes.

Debt financing provides another useful option to improve the fiscal space for child-centred services. However, government intent is clear via its fiscal consolidation programme, and the social service sectors are required to make large sacrifices. Debt financing appears to be planned to be used to finance capital investments. This might be good for financing and expanding school and health infrastructure but will not touch those parts of the budgets that children desperately need: school nutrition, books and learner support materials, quality and qualified schoolteachers and healthcare workers, and social grants that do not lose their purchasing power.

Increased government revenue was also considered in the modelled scenarios. Given that Personal Income Tax (PIT) has been the dominant form of tax collection for government and if one factors in the negative impact of COVID-19 on employment, it is debatable whether an aggressive expansion in PIT is possible. Corporate Income Tax (CIT) has lagged behind PIT in its overall shares and contributions to government revenue and might be compromised in its ability to fuel further spending increases for the government. Government’s own projections of the buoyancy of its various tax instruments appear to be overstated in the MTBPS 2020, which reduces the overall usefulness of additional government-mobilised revenue, as an avenue to pursue fiscal space for child spending.

There is clearly no simple answer to the fiscal space challenge. While no single option considered in this report provides a viable way forward, employing several options in combination might spread the burden across the mechanisms and, thereby, minimise the impact on South Africa’s financial position and its economy.
In the short-to medium-term, improvements of the efficiency and cost-effectiveness of public sector service delivery become vital. While this is endorsing a long view of how fiscal policy can best support child spending, concerns about the impact of expenditure cuts on incentives for departments to continue to provide quality-based services are real. Shortage of cash may further worsen the accumulating expenditure arrears situation in health, and an intensification of cuts may even generate new-found concerns for other sectors less hitherto affected by expenditure arrears.

Key recommendations

The space to make radical and long-lasting changes to the country’s overall fiscal position is limited. The present situation requires a series of difficult and complicated trade-offs that will not be easily accepted or implemented. In view of these challenges, the government of South Africa is encouraged to:

• Utilise provincial reserves to buffer child spending, especially in provinces that are rural in nature and have large numbers of poor children.

• Ensure that the decision to de-couple social grant allocations from consumer price inflation is reversed.

• Implement the findings of the planned Public Expenditure Reviews to ensure that departments are held accountable for the quality and quantity of spending under their control.

• Commit to a spending floor for child spending in public schools and primary healthcare and measure the extent to which departments complies with this proposed spending floor.

• Use a reasonable portion of the country’s debt financing to buffer child-focused services and programmes, while investing more in social infrastructure in basic education and primary healthcare.

• Use savings from reduced investments in State Owned Enterprises (SOEs) to boost child spending in critical areas like rural social infrastructure and experimentation in school education, to improve the quality of teaching.
Introduction

South Africa has entered a challenging period in the management of the country’s public finances. Slow economic growth, prior to the emergence of COVID-19, and the cumulative economic impact of the health pandemic have resulted in the national economy shrinking by more than seven per cent in 2020.

Under these circumstances, it is desirable and necessary to probe the extent to which such changes have affected and will likely affect the resources available to finance children’s programmes.

This Policy Brief is devoted to an analysis of the fiscal space available to finance child-focused programmes and services. The International Monetary Fund (IMF) defines fiscal space as:

“Room in a government’s budget that allows it to provide resources for a desired purpose without jeopardising the sustainability of its financial position or the stability of the economy.”

The Policy Brief interprets “desired purpose” as spending that is important to children. These important requirements include:

• Combined national and provincial spending on basic education and health.
• National spending on social grants for children, which include the foster care, child support, and care dependency grants.
• Combined provincial social development spending on social welfare services, which includes expenditure in the Children and Families programme.
• National spending on social welfare service via the Welfare Services Policy Development and Implementation Support programme.
• Higher education expenditure on teacher education.

The “room in a government’s budget” does not have a universally agreed definition and depends very much on the country context. Some countries use broader fiscal aggregates such as the primary balance to define fiscal space, while others focus on “allocative efficiency” criteria, irrespective of broader fiscal metrics. This Policy Brief takes a pragmatic view and views priority expenditure for children as a percentage of the country’s Gross Domestic product (GDP) and tracks such patterns over time.

Consistent with UNICEF South Africa’s public finance work in 2021, the period FY2010 to FY2019 is the main focus of this Policy Brief. However, given the current interest in fiscal space for children, the Policy Brief puts forward speculative analyses about the extent to which the present budget framework impacts the fiscal space available for children’s programmes.

In its simplest form, this Policy Brief defines fiscal space for children’s priority expenditures as the difference between available revenue, debt financing and all other non-priority expenditures and interest paid on government’s debt.

Section 2 examines fiscal space for children’s programmes for the period FY2011 to FY2019. Section 3 looks at potential scenarios and projects future fiscal space for children’s programmes, based on a range of assumptions and economic variables. Section 4 considers the various options for improving fiscal space in view of the latest public finance and economic data.

FISCAL SPACE FOR CHILDREN’S PRIORITY EXPENDITURES, FY2011 TO FY2019

Priority expenditures for children constituted between 10 and 11% of the country’s Gross Domestic Product (GDP) between FY2011 and FY2019. Between FY2013 and FY2019, those shares rose gradually, and given the slow growth of GDP over this period, this probably indicates real growth in priority expenditures for children. Education expenditures for children hovered around the 5% mark, while health expenditures stayed close to the 4% mark. Social welfare for children consumed the smallest shares (0.2% on average), while expenditures on children’s social grants hovered around 1.3% and 1.4% during this period.

It is important to understand the key expenditure drivers that impacted priority expenditures for children during the last decade. Mapping such trends, would allow one to predict how the various social sector budgets would react if consistent changes (increases or decreases) are introduced into these budgets.

i. UNICEF South Africa commissioned DNA Economics to develop a fiscal space model for children’s priority expenditures. The period covered included FY2011 to FY2019 (retrospective analysis) and FY2020-FY2022 (prospective analysis). The work commenced in 2020 and was concluded at the end of February 2021. New developments will have rendered some projections obsolete, but the main results remain valid.

ii. The primary balance is the difference between revenue and non-interest expenditure. It measures the extent to which a country can afford its chosen policy agenda. It differs from the conventional balance in that the latter measures the difference between revenue and all other expenditures (including debt servicing costs).

iii. “Allocative efficiency” refers to the ability of a government to deploy resources to where they are most needed or where the country’s policymakers deem it most desirable to spend scarce government resources.
FIGURE 1: Priority expenditure for children as a % of GDP, FY2011 to FY2019
Sources: Provincial Estimates of Revenue and Expenditure 2019 and Medium-Term Budget Policy Statement 2019 (own calculations)

TABLE 1: Composition of provincial health expenditure, by programme and economic classification. (Darker colour indicates higher priority over time), FY2011 – FY2019

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<thead>
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<tbody>
<tr>
<td>District Health Services</td>
<td>42.1%</td>
<td>45.8%</td>
<td>46.9%</td>
<td>3.6%</td>
<td>1.1%</td>
<td>13.7%</td>
</tr>
<tr>
<td>Central Hospital Services</td>
<td>19.0%</td>
<td>19.2%</td>
<td>20.6%</td>
<td>-1.1%</td>
<td>-1.4%</td>
<td>13.0%</td>
</tr>
<tr>
<td>Pro vincial Hospital Services</td>
<td>20.0%</td>
<td>19.0%</td>
<td>17.6%</td>
<td>-9.1%</td>
<td>-0.9%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Other</td>
<td>11.5%</td>
<td>10.6%</td>
<td>10.3%</td>
<td>0.1%</td>
<td>0.9%</td>
<td>8.6%</td>
</tr>
<tr>
<td>Economic Classification</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>60.9%</td>
<td>62.8%</td>
<td>63.3%</td>
<td>1.1%</td>
<td>0.5%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Goods and services</td>
<td>28.5%</td>
<td>28.6%</td>
<td>29.4%</td>
<td>0.1%</td>
<td>0.8%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Payments for capital assets</td>
<td>7.4%</td>
<td>5.0%</td>
<td>4.7%</td>
<td>-2.5%</td>
<td>-0.3%</td>
<td>2.6%</td>
</tr>
<tr>
<td>Transfers and subsidies</td>
<td>3.1%</td>
<td>3.5%</td>
<td>2.5%</td>
<td>0.4%</td>
<td>-1.0%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Payments for financial assets</td>
<td>6.0%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>-0.1%</td>
<td>-12.5%</td>
</tr>
</tbody>
</table>

TABLE 2: Composition of provincial education expenditure, by programme and economic classification (Darker colour indicates higher priority over time), FY2011 – FY2019

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Public Ordinary School Education</td>
<td>80.1%</td>
<td>77.4%</td>
<td>79.8%</td>
<td>2.7%</td>
<td>2.3%</td>
<td>8.8%</td>
</tr>
<tr>
<td>Administration</td>
<td>6.6%</td>
<td>6.9%</td>
<td>6.5%</td>
<td>0.3%</td>
<td>2.2%</td>
<td>8.5%</td>
</tr>
<tr>
<td>Infrastructure Development</td>
<td>5.7%</td>
<td>7.0%</td>
<td>4.8%</td>
<td>1.2%</td>
<td>0.2%</td>
<td>5.2%</td>
</tr>
<tr>
<td>Public Special School Education</td>
<td>2.9%</td>
<td>3.4%</td>
<td>3.6%</td>
<td>0.5%</td>
<td>0.2%</td>
<td>14.3%</td>
</tr>
<tr>
<td>Examination and Education Related Services</td>
<td>2.7%</td>
<td>2.9%</td>
<td>2.7%</td>
<td>0.2%</td>
<td>-0.2%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Early Childhood Development</td>
<td>1.4%</td>
<td>1.8%</td>
<td>2.0%</td>
<td>0.4%</td>
<td>0.2%</td>
<td>18.5%</td>
</tr>
<tr>
<td>Other</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.0%</td>
<td>0.1%</td>
<td>11.9%</td>
</tr>
<tr>
<td>Economic Classification</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>77.9%</td>
<td>76.1%</td>
<td>77.2%</td>
<td>1.8%</td>
<td>1.0%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Goods and services</td>
<td>9.3%</td>
<td>9.7%</td>
<td>9.7%</td>
<td>0.4%</td>
<td>10.0%</td>
<td>9.9%</td>
</tr>
<tr>
<td>Payments for financial assets</td>
<td>7.3%</td>
<td>8.2%</td>
<td>7.9%</td>
<td>0.9%</td>
<td>-0.2%</td>
<td>-7.8%</td>
</tr>
<tr>
<td>Payments for capital assets</td>
<td>5.5%</td>
<td>6.0%</td>
<td>4.7%</td>
<td>0.5%</td>
<td>-3.3%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Transfers and subsidies</td>
<td>0.0%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>-0.1%</td>
<td>11.6%</td>
</tr>
</tbody>
</table>

TABLE 3: Composition of Children and Families programme by subprogramme (Darker colour indicates higher priority over time), FY2011 – FY2019

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Administration</td>
<td>11.1%</td>
<td>5.6%</td>
<td>7.5%</td>
<td>-5.5%</td>
<td>1.9%</td>
<td>-2.9%</td>
</tr>
<tr>
<td>Care And Services To Families</td>
<td>5.5%</td>
<td>5.9%</td>
<td>6.6%</td>
<td>0.4%</td>
<td>0.7%</td>
<td>24.0%</td>
</tr>
<tr>
<td>Child And Youth Care Centres</td>
<td>16.4%</td>
<td>16.4%</td>
<td>17.5%</td>
<td>0.0%</td>
<td>1.1%</td>
<td>20.0%</td>
</tr>
<tr>
<td>Child Care And Protection</td>
<td>22.6%</td>
<td>26.1%</td>
<td>25.8%</td>
<td>3.5%</td>
<td>-0.3%</td>
<td>22.2%</td>
</tr>
<tr>
<td>Community-Based Care Services For Children</td>
<td>4.6%</td>
<td>11.3%</td>
<td>9.1%</td>
<td>-6.7%</td>
<td>-2.2%</td>
<td>47.1%</td>
</tr>
<tr>
<td>ECD And Partial Care</td>
<td>39.9%</td>
<td>34.8%</td>
<td>37.5%</td>
<td>-4.4%</td>
<td>2.8%</td>
<td>16.0%</td>
</tr>
</tbody>
</table>
Provincial spending on health has been driven by significant growth and prioritisation of the provincial District Health Services (DHS) and Central Hospital Services (CHS) budget programmes and spending on compensation and goods and services. However, this prioritisation has come at the expense of capital spending - see below-inflation growth rates in spending in the Health Facilities Management programme and the Payments for capital assets economic item.

The budgetary allocation shifts in provincial health spending indicate de-prioritisation of mid-levels of care toward primary care and more specialised health services. This is shown by a decreasing share of Provincial Hospital Services (PHS) (mid-level) and an increasing share given to DHS (primary) and CHS (specialised).

Priority expenditures on basic education (exclusive of Higher Education spending) for children have lost substantial ground, especially when considering the drop in FY2019. The positive trend in the budgetary priority between FY2015 and FY2018 should also not be confused with a positive spending trend. Indeed, rather than being driven by increasing priority spending, this trend is driven by a slow-down in total spending (denominator). Although this points to a measure of fiscal protection, the trend in spending per child reveals a budget under pressure.

Nevertheless, for the same reason that PHC is important in health, ECD is important in education, and its increased priority, as observed in Table 2, is an important observation. Although still a small spending item compared to the rest of basic education spending, ECD’s proportion is growing. A similar trend is observed in “per learner” terms, implying that spending growth exceeds inflation and ECD enrolment growth.

Examining child welfare through the lens of the provincial Children and Families programme, total spending in this area grew at an average annual rate of 11.6%, thus increasing its share of total government spending. This rate of growth more than compensated for inflation and the growth in the child population, leading to a 3.4-fold increase in per-child spending over the period.

The observed growth was predominantly driven by the growth in provincial spending. Table 3 shows the Children and Families programme at the provincial level by subprogramme. An especially encouraging observation is the shift of budget from departmental administration to service delivery – often a sign of cost-effective service delivery.

Of particular importance to UNICEF and South Africa’s children, is spending on Prevention and Early Intervention (PEI) within the social services sector. The rationale applied to PHC and ECD also applies here due to its association with a cost-effective system. The importance of these services is also communicated by South African legislation. Indeed, the Children’s Act mandates provinces to; from money appropriated by the relevant provincial legislature; provide and fund prevention and early intervention programmes for that province. The services of two sub-programmes within provincial DSDs closely align with PEI; 1. Care and Services to Families, and 2. Community-Based Services to Children.

South Africa’s social assistance programme forms the foundation of the state’s contribution to social development. Although there are various avenues through which government addresses social challenges, the social grants provided to those in need is at its core. This is evidenced by the fact that social grant spending constituted 85.7% of social development spending at both a national and provincial level in FY2019.

While the Care Dependency Grant (CDG) has received the same level of priority, the Foster Care Grant (FCG) and the Child Support Grant (CSG) has been decreasing. Importantly, although the share of CSG spending has declined, spending still grew in real terms over the analysis period (11.07% nominal growth per annum). The FCG, on the other hand, has been contracting in real terms (0.17% nominal growth per annum).
The value of both the CSG and CDG has been growing in real terms and growth in the number of recipients (higher proportion of the child population benefiting each year). The low growth in spending on the FCG is due to both sub-inflation growth in the grant’s value over time, and a contraction in the number of recipients.

### TABLE 1: Growth in grant value and recipients, FY2011 – FY2019

<table>
<thead>
<tr>
<th>Value</th>
<th>Grant</th>
<th>Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Child support grant</td>
<td>11.07%</td>
<td>6.30%</td>
</tr>
<tr>
<td>Foster care grant</td>
<td>0.17%</td>
<td>6.30%</td>
</tr>
<tr>
<td>Care dependency grant</td>
<td>12.19%</td>
<td>6.30%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Recipients</th>
<th>Grant</th>
<th>Child population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Child support grant</td>
<td>2.06%</td>
<td>0.90%</td>
</tr>
<tr>
<td>Foster care grant</td>
<td>-3.50%</td>
<td>0.90%</td>
</tr>
<tr>
<td>Care dependency grant</td>
<td>2.99%</td>
<td>0.90%</td>
</tr>
</tbody>
</table>

The social grant system was central to South Africa’s short-term response to the pandemic and might be subject to pressures during the recovery. All three child-focused grants benefited from the top-ups provided, causing a substantial jump in FY2020 spending. These top-ups were short-term, however. Over the MTEF, given that Social Protection is only planned to grow at 2.8% per year, both grant value and recipient numbers are likely to be more subdued.

#### FISCAL SPACE FOR CHILDREN’S PRIORITY EXPENDITURES: PROJECTIONS FOR FY2020 TO FY2022

To establish fiscal space for children’s programmes in the future requires assumptions about economic data, and on how economic variables might behave over time; hence such projections are subjected to uncertainty. Nevertheless, it provides a useful foundation to speculate how such changes are likely to affect financing for children’s programmes.

Four scenarios were examined, namely i) lower economic growth, ii) increased debt financing, iii) increased revenue, and iv) reduced spending on non-priority expenditures that are directly connected to children’s programmes. The graphic representation below provides the outcomes of these scenarios; in other words, if we have any one of the four scenarios, and the aim is to preserve priority spending for children, what are some of the remedial actions and interventions that must be taken and what possible implications does this have for spending generally, and for spending on children’s services, more specifically.

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x. (National Treasury MTBPS, 2020); (Estimates of Provincial Revenue and Expenditure, 2019)
xii. (National Treasury Supplementary Budget Review, 2020)

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LOWER ECONOMIC GROWTH

If the economy grows slower, due to the cumulative impacts of disruptive COVID-19 waves, protecting priority spending for children will come at a large public finance cost. This implies:

- Substantially higher debt servicing costs (growing to 5.7% of GDP by FY2022)
- Higher annual primary balance (deteriorating to -6.4% by FY2022)
- Debt-to-GDP ratios reaching extremely high values by FY2022 (close to 100%)

INCREASED DEBT FINANCING

If the increase in priority spending is to be achieved without any reprioritisation of the budget, and no expectation of increased revenues, it would have to be financed through increased debt, which means:

- The Debt-to-GDP ratio will have to be 3.4 percentage points higher than what was projected in the 2019 MTBPS; and
- The primary balance will be more negative than 5 per cent.

Although this scenario is not unlikely, the availability of concessional finance would reduce the overall costs. Also, this option would be more acceptable to policymakers in the context of a growing economy. **xiv**

INCREASED REVENUE

Increased revenue can make a difference: however, there are concerns about the decrease in tax buoyancy**, and hence a reduced expectation about what additional revenues will bring to the fiscal space equation.

Based on lower-than-expected tax buoyancy rates worked into our projections, the impact of additional revenue is considered marginal, which points to the much stronger impact of increased debt financing as providing more fiscal space.

REDUCED NON-PRIORITY SPENDING

To enable priority expenditure for children to grow to 12.7 per cent of the country’s GDP in FY2022, this implies that:

- Non-priority expenditures (those not defined as part of priority expenditures for children) must decrease from 21.1 per cent of GDP in FY2019 to 18.5 per cent in FY2022.
- Given the indirect links between this type of spending and children’s services, this is a hard sell and may not be realistic or practical.
- The attempted intervention by the national government to contain wages and limit the bailouts of the State-Owned Enterprises (SOEs) may be a possible avenue for such large reductions, but these are not without consequences (for example, salaries of health frontline workers and teachers).

What about a scenario in which the national economy grows faster than expected? At what rate should the economy grow to preserve priority spending for children? In terms of the fiscal model used, it implies that the economy should grow by close to 1 per cent more in FY2021 and by almost 2 per cent more in FY2022, to achieve the goal of protecting priority expenditures for children.

OPTIONS FOR INCREASING FISCAL SPACE FOR CHILDREN’S PROGRAMMES AND SERVICES

Irrespective of the measures undertaken to increase fiscal space generally, and fiscal space for children’s programme more specifically, a series of complicated decisions and trade-offs are needed to protect the country’s progressive spending on social services. It is best, therefore, not to think of single solutions, but rather several interconnected decisions that are needed to preserve child spending.

Three options are considered, namely budget reprioritising, increased government revenue through domestic resource mobilisation, and debt financing (internal and external). Each option is discussed within the present context and assessed as to the likelihood of its being implemented.

BUDGET REPRIORITISATION

While South Africa’s economy deteriorated for almost a decade, government spending grew continuously at above-inflation rates, leading to an ever-increasing debt burden. Between FY2014 and FY2019, consolidated spending grew at an average annual rate of 8.5% - 3.5 percentage points higher than inflation, over the same period. In the absence of sufficient economic and revenue growth, such expansionary fiscal policy is inevitably financed by debt. Debt-servicing costs have therefore severely crowded out other spending areas.

From the perspective of priority spending, the impact on basic education spending is most
disconcerting. Fortunately, Social Protection and Health spending have enjoyed some protection. Besides debt, increased university funding out of the fiscus has also played a significant role in shifting budgetary composition.

Recognising the fiscal position’s precarious nature, Treasury announced large and unprecedented austerity measures during the 2020 MTBPS. Over the MTEF, spending is planned to grow at only 3%. The crowding-out effect of debt-servicing costs becomes even more pronounced, and due to the budget’s focus on infrastructure (driving Economic Development and Community Development spending), the historical protection provided to Social Protection and Health falls away, and the decreasing budgetary priority of basic education endures.

In Budget 2021, reprioritising has focused on reducing salary costs of public servants and targeting the Goods and Services expenditure category (operational requirements for most social service sector budgets). Even if less than one hundred per cent of these measures were to be implemented, it would have a devastating impact on child-focused services, which are labour-intensive (basic education and health), and which require large cash investments (through the social grants system).

This suggests that budget reprioritisation, although a favoured option among policymakers, may not deliver the right kind of dividends, and may actually be harmful to the implementation of children’s services and programmes. What Budget 2021 suggests may not deliver the required reprioritising to keep child spending intact.

INCREASED GOVERNMENT REVENUE

Since FY2011 South African state revenue has consistently outgrown GDP (except for FY2012 and FY2017). The growth differential has led to an increase in revenue as a proportion of GDP from 27% in FY2011 to 29.2% in FY2019.

South Africa has several tax instruments, which include Personal Income Tax (PIT), Value-Added Tax (VAT), and Corporate Income Tax (CIT). However, the revenue growth observed since FY2011 has been driven by PIT. Moreover, the increasing share of PIT has decreased CIT’s share. The difference in growth over the period explains this shift. Between FY2011 and FY2019, PIT revenue collection grew at an average annual rate of 9.3%. Over the same period, CIT grew only 4.2%.

The pessimistic revenue expectations forecast in the MTBPS 2020, and Budget 2021 were moderated by the higher-than-expected increase in government revenue, due to the larger profits in the mining sector. How the additional revenues will be deployed remains an important policy question, especially also keeping in mind the warning from the Reserve bank Governor that this revenue windfall might be overstated and will have run its course soon.

At a minimum, one should expect cogent arguments for the perseveration of spending on children, but this is countered by government’s fiscal consolidation programme, which is removing large areas of available funds from social sector service programmes. The government’s wish to change the composition of spending towards a more investment focus may also work against additional revenues being deployed to the children’s sector.

DEBT FINANCING

Despite an increasingly austere expenditure growth path since FY2010, South Africa has been unable to consolidate its fiscal position. South Africa has been unable to recover from its aggressive fiscal stance in response to the 2008 Global Financial Crisis (GFS). In FY2008, as global demand plummeted, South Africa’s GDP growth dipped to 5.9% after averaging 13.6% during the preceding four years. Following suit, revenue contracted by 5% after also showing rapid growth during the lead-up. However, spending remained robust as South Africa’s strong fiscal position allowed for a counter-cyclical fiscal policy.

With low GDP and revenue growth, even while spending growth was being contained (averaging only 7.9% per annum compared to 15.5% during the lead up to the GFC), primary deficits became the new norm and the debt-to-GDP ratio set off and continued on its upward trajectory. Consequently, debt services costs became the fastest growing expenditure item, increasingly crowding out preferable discretionary public spending. Therefore, even though austerity measures had been put in place, South Africa failed to consolidate its fiscal position.

In the second quarter of 2021, the country managed to record a primary surplus, which was the first of its kind since 2018. This would have been achieved on the back of hard core reductions in spending (including child spending) and the robust growth of profits (and hence government revenue) in the mining sector. If one considers the cautionary remarks by the Reserve Bank Governor around inflation targeting and government’s reduced spending, then it is unlikely that this temporary growth will create further incentives for increased debt financing.

xvi. The Reserve Bank’s Monetary Policy Review October 2021 argued that commodity exports played a key role in the country’s macro adjustment over the past year. These surplus exports have helped with an improved fiscal position and helped turn the current account deficit into a surplus. See also https://www.news24.com/fin24/companies/banks/sa-cant-only-rely-on-commodities-for-economic-recovery-reserve-bank-20211005 for analyses on the pronouncements by the Governor of the South African Reserve Bank.

ECONOMIC GROWTH PROSPECTS

Sustained GDP growth can increase fiscal space by increasing tax revenue and growing the overall economy, thereby lowering the Debt-to-GDP ratio. Although not a policy mechanism, economic growth is an important driver of fiscal space, due to its relationship to other fiscal policy mechanisms. GDP growth can expand fiscal space through two avenues:

1. Revenue growth: As an economy grows, so too do wages, profits, and consumption; either of them or any combination of them. These improvements have the impact of raising revenues, even in the absence of changes to tax policy.

2. Debt financing: Economic growth can stabilise a country’s debt path, even while running primary deficits, which happens through two mechanisms:
   a. Consistent economic growth improves investor confidence, making them willing to accept lower rates of return. The lower interest payment requirement opens up fiscal space.
   b. The Debt-to-GDP ratio, or rather its trajectory, is contained, which is one of the most important indicators of debt sustainability. Even with increasing debt, if the economy grows faster than the debt is accumulated, this ratio can trend downwards.

The economic impacts of COVID-19 manifested in an economy already under pressure and, consequently, the medium-term expectation of economic growth is underwhelming. The key factor post-2020 will be the rate of recovery. The scenario analysis shows the fiscal impact of not achieving the growth rates currently projected by the National Treasury. If for instance, the OECD’s Double Hit Scenario occurs (third or fourth COVID-19 wave), the impact on fiscal space will be severe.

REFERENCES


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