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Fiscal consolidation: facing up to reality

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If tax increases are to be avoided in this year's revised Budget, there will have to be clear commitments to expenditure adjustments. In this Econ3x3 opinion piece, former Treasury official Andrew Donaldson argues for proactive measures by the Treasury to reduce or curtail spending plans that are not currently subject to effective budgetary oversight.

If the Treasury's proposed VAT increase to narrow the gap between expenditure plans and revenue is unacceptable, the spotlight must fall on government spending. But there is no point in falling back on artificial solutions – decisions must be taken on real fiscal excesses and alternatives.

We are told that a pension contribution holiday[1] is under consideration that would lower nominal expenditure in 2025/26 by over R60 billion, which is what the two-percentage point VAT increase might have raised.

The apparent fiscal benefit in this is entirely spurious. There would be no resulting reduction in government consumption, transfers to households or capital spending. There would be no resulting change in income flows from households or businesses to the national revenue fund. The economic impact of a pension contribution holiday, by comparison with a tax-funded deficit reduction, would operate through the financial nexus between saving and investment – capital markets would see a reduction in investible funds, flows into the bond and equity markets would shrink, and interest rates would rise.

Nominal government debt might be stabilised initially, but the cost of servicing debt would increase.

[1] The proposal under discuss is that the "employer" contribution to the Government Employees Pension Fund should be withheld for the 2025/26 year, which would save national and provincial governments about R68 billion in compensation of employee costs. Because it is a defined benefit fund, pension rights would not be directly affected, though it would lead to a reduction in the actuarially calculated funding level of the GEPF.

This is not to say that consideration should not be given to the case for adjusting ongoing pension contribution rates based on actuarial advice. If this is warranted, it would yield a permanent saving in government's remuneration cost. But it would amount to nowhere near the savings currently sought.

The idea behind the pension fund holiday is that it would provide time for a comprehensive expenditure review to be conducted. But this is to defer decisions that need to be taken now.

Here are some examples of spending measures on which political agreement should be sought before next week's revised budget. It might take some months for the details to be worked out, but the first steps should be taken in terms of powers embedded in the Public Finance Management Act, which include both general functions and powers related to the national budget (section 6) and regulatory responsibilities related to the budgets of public entities (section 53(5)).

The Department of Employment and Labour should be instructed to terminate its funding of the temporary employer/employee relief scheme and other labour activation programmes out of the surpluses of the Unemployment Insurance Fund. The financial statements of the UIF reveal that it has already lost some R3 billion in failed business investments.[2] It has no expertise in enterprise development and the decision processes around these programmes are entirely untransparent. The DEL also plans to hire a further 20,000 inspectors, utilising monies contributed by workers and their employers. The statutory authority and regulatory framework behind these efforts are hopelessly inadequate. But the more fundamental point is that some R20 billion a year in discretionary spending is planned by the DEL for the period ahead, outside of the expenditure planning processes and disciplines over which the Treasury has oversight. This is exactly how fiscal disasters evolve.

A straightforward exercise of Treasury oversight is also needed in respect of the spending plans of the National Skills Fund and sector education and training authorities that report to the department of higher education and training. Like the UIF, these are funded through a dedicated tax and have spent less than they have received in revenue for many years. Their accumulated funds amount to over R40 billion and they are planning to spend R5 billion a year more than their skills levy receipts. This includes a new student loan plan to be administered by the National Student Financial Aid Scheme. But the Minister of Finance has already indicated that the skills training levy system should be reviewed. It is an expensive and unnecessary statutory arrangement for reimbursing businesses for what they would in any event do themselves in pursuit of productivity and competitiveness. If the system is to be reviewed, then instructions should be issued to embargo new initiatives and invest unspent funds in treasury securities. The intent of the review – to eliminate waste and withdraw fiscal resources from activities best left to the private sector – must be made clear from the outset.
There are many other arms-length agencies that must come under closer scrutiny.
It is more than twenty years since the Road Accident Fund Commission's three-volume report was tabled, but the transition to a more affordable scheme has not yet been completed. In recent years the Treasury has declined to increase the RAF's levy income, but it is its expenditure commitments that have to be checked.

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[2] Successive annual reports of the UIF disclose losses of investments intended to preserve jobs and avoid business closures, amongst others, in Edcon, Daybreak Farms and Glacier Trading (Bounty Brands). If the UIF were subject to standards of prudential fiscal oversight appropriate for social security funds, it would not be permitted to make investments of this kind.

There has been a proliferation of public entities over the past decades. Many pay salaries to executive staff far exceeding the highest pay of civil servants or political office-bearers. Institutional rationalisation must be systematically pursued, and Treasury control of remuneration must be re-established.

Fiscal discipline also requires effective collection of fees and charges through which costs are recovered from users of public services. Free basic services must be properly subsidised through the fiscus, but this must be accompanied by better revenue collection from households that can afford to pay. In health and education, similarly, progressive expansion of services depends in part on tariffs and fees that complement tax-based funding.

Review of the Southern African Customs Union formula is long overdue, as it is both too variable annually and too costly in its effective subsidisation of neighbouring states.[3]
In the fiscal consolidation budgets of the past decade, the intent to conduct a comprehensive review of expenditure has been a regular refrain. Useful studies have been conducted, and more analysis is needed. While reviews can support the decision process, they are not a substitute for political intent and the courage to make tough choices.

In the wider complexity and diversity of public administration and development programmes there are many tough decisions that must be taken to achieve a better balance between revenue and spending.

There is one very large decision, already taken, that now constrains the way forward. In accepting this year's 5.5% wage increase agreement for public servants, government is already locked into an across-the-board salary cost increase that exceeds the *nominal* growth of the South African economy in 2024.

Though this year's VAT proposal is now under review, the Minister of Finance ultimately has the responsibility for the tax decisions that affect all South African's real disposable income. He also has the statutory powers and responsibility to ensure that waste and unnecessary spending programmes are curtailed. The challenge now is to review options and take decisions expeditiously.

[3] Payments from South Africa to the SACU partner countries amounted to R43.7 billion in 2022/23, increasing to R89.9 billion in 2024/25. The volatility in payments is in part a consequence of delayed adjustments to past estimates of customs and excise revenue. The customs component of the SACU formula includes a substantial over-compensation to neighbouring countries. In 2024/25, SACU payments *exceeded* South Africa's actual customs duty revenue.