

# Fiscal futures

Session 4

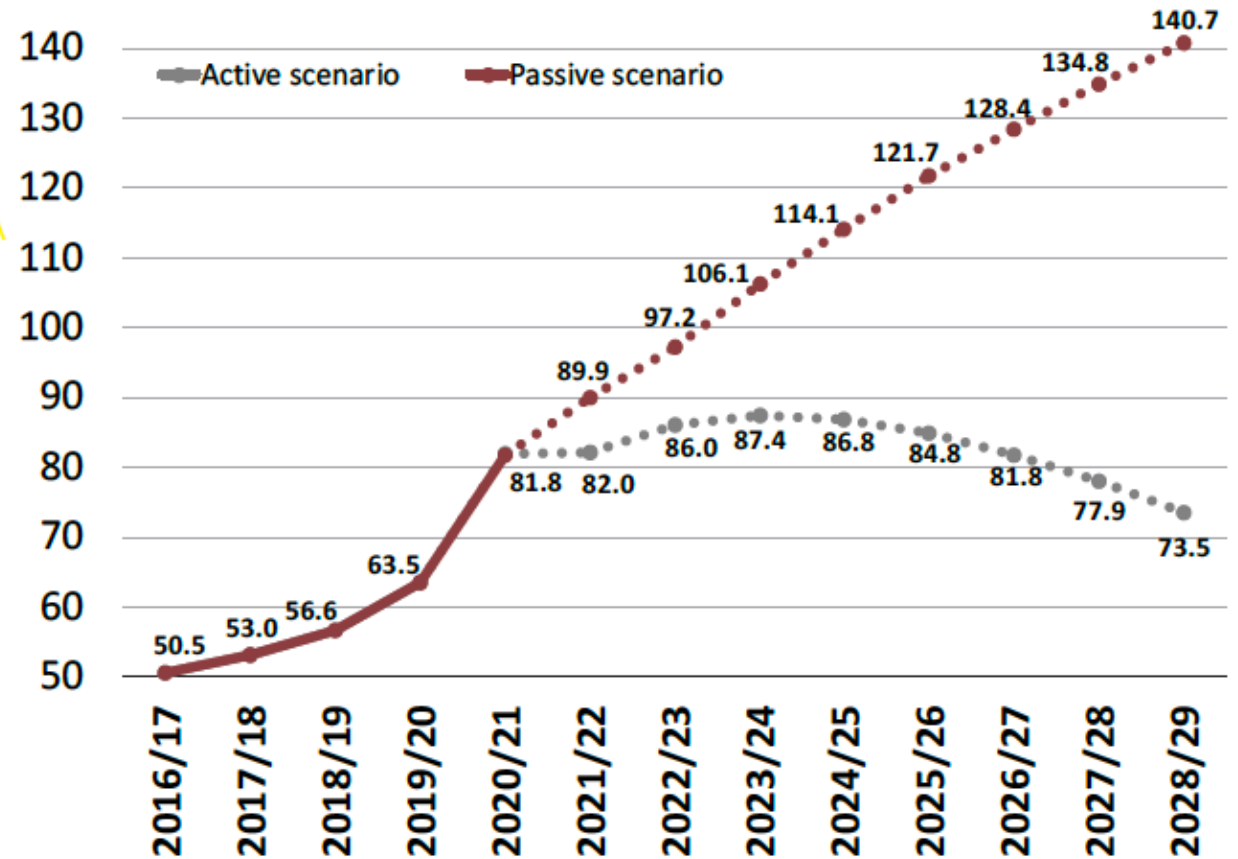
Matthew Simmonds

# Sustainability

Understanding financial sustainability in a developing country  
with an unsustainable economic (and social?) structure

# Is sustainability the apex priority?

- Passive scenario clearly unsustainable
- Active scenario is
  - But what about economic and service delivery effects?
  - Does fiscal sustainability exist independently of broader economic sustainability?



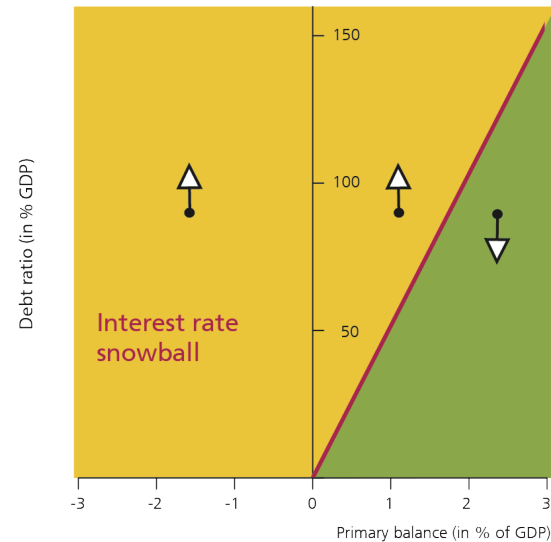
# Debt dynamics: $r$ versus $g$

- Interest  $>$  growth creates debt and interest cost pressure that must be offset through higher primary budget surpluses
- We always talk about growth being low, but maybe interest rates are high too?

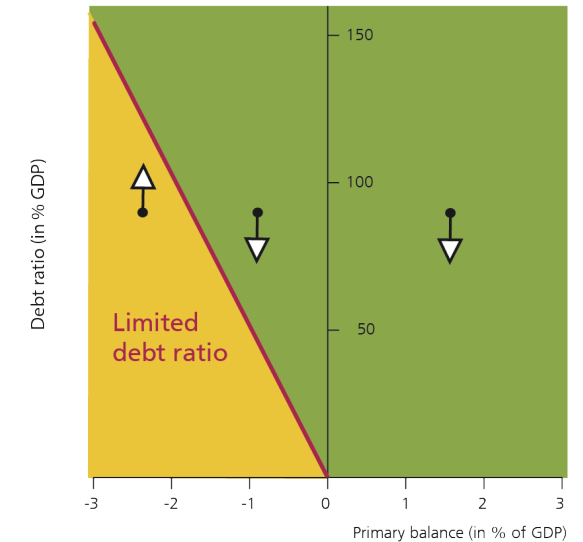
	Actual			Projections					
	2009-2017 <sup>2/</sup>	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	43.2	56.7	62.2	78.1	82.4	85.4	87.1	86.8	85.0
Public gross financing needs	10.7	11.6	14.7	21.5	21.2	20.7	19.0	17.2	16.2
Real GDP growth (in percent)	1.6	0.8	0.2	-7.2	2.6	1.5	1.5	2.1	2.3
Inflation (GDP deflator, in percent)	6.1	3.9	4.1	3.0	3.9	4.3	4.5	4.5	4.5
Nominal GDP growth (in percent)	7.8	4.7	4.2	-4.3	6.6	5.9	6.1	6.7	6.9
Effective interest rate (in percent) <sup>4/</sup>	7.5	7.0	7.0	7.2	6.8	6.8	7.1	7.2	7.2

IMF DSA, 2020

Situation with  $g = 3\%$  and  $r = 5\%$   
(in % GDP)



Situation with  $g = 3\%$  and  $r = 1\%$   
(in % GDP)



- Primary balance corresponding to debt ratio stabilisation <sup>1</sup>
- Rising debt ratio
- Falling debt ratio

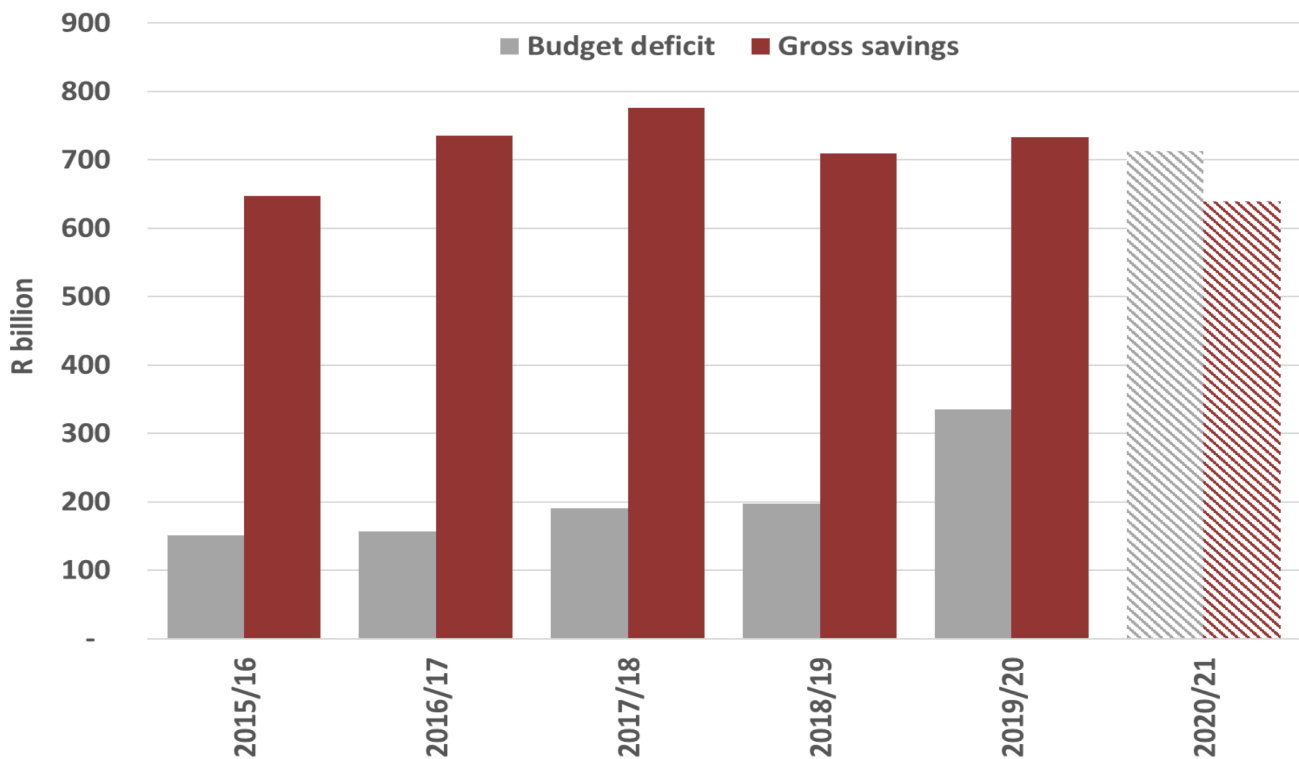
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DeBrun, X. Fiscal futures, 2020

# Financing the deficit

Financing important social and economic work when you don't have any money

# Financing requirement is unprecedented



National Treasury,  
Fiscal futures 2020

- Precovid, was already increasing
- Covid shock is extremely large and persistent
- How does the financing gap get closed?

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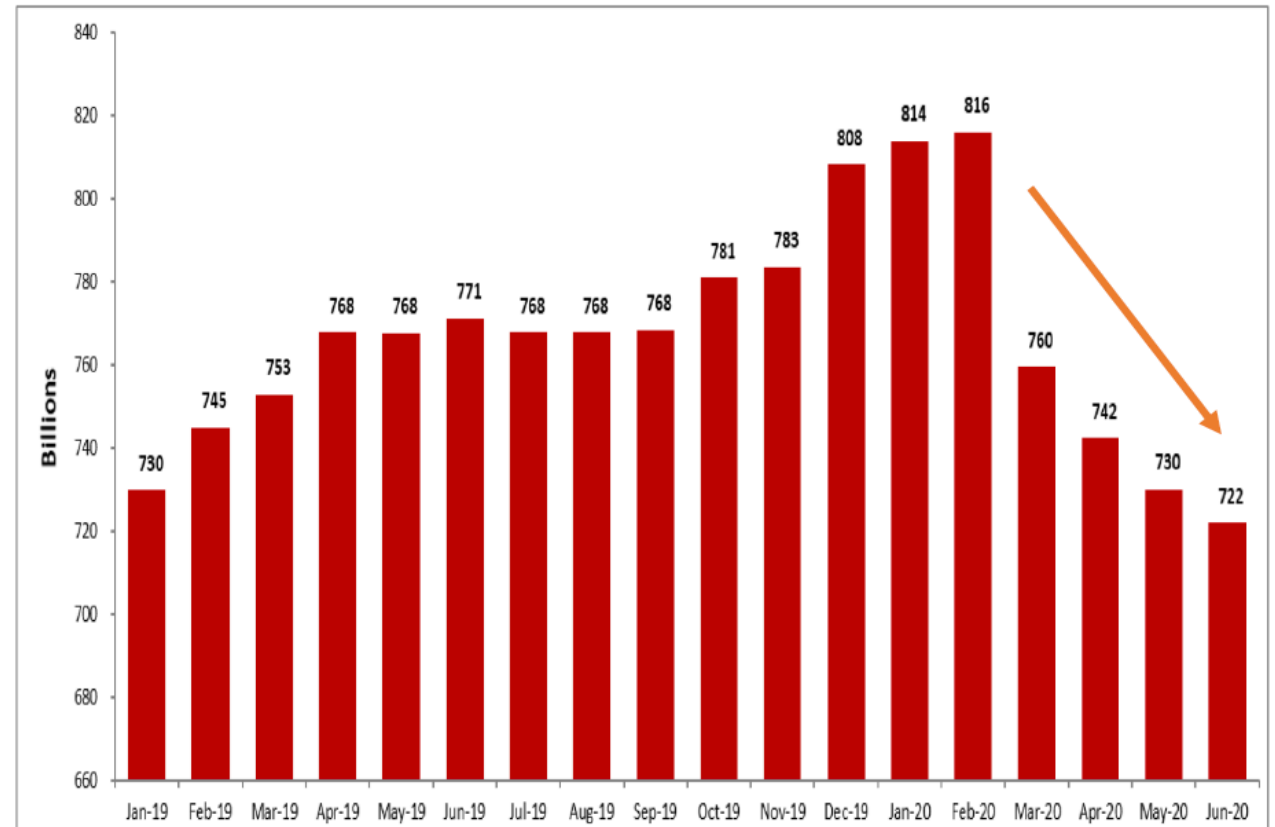
IMF DSA, 2020

# We have always relied on foreign investment

- But we now need even more
- And investors have been a declining share of the the domestic market
- Can we rely on global QE to save us? For how long?



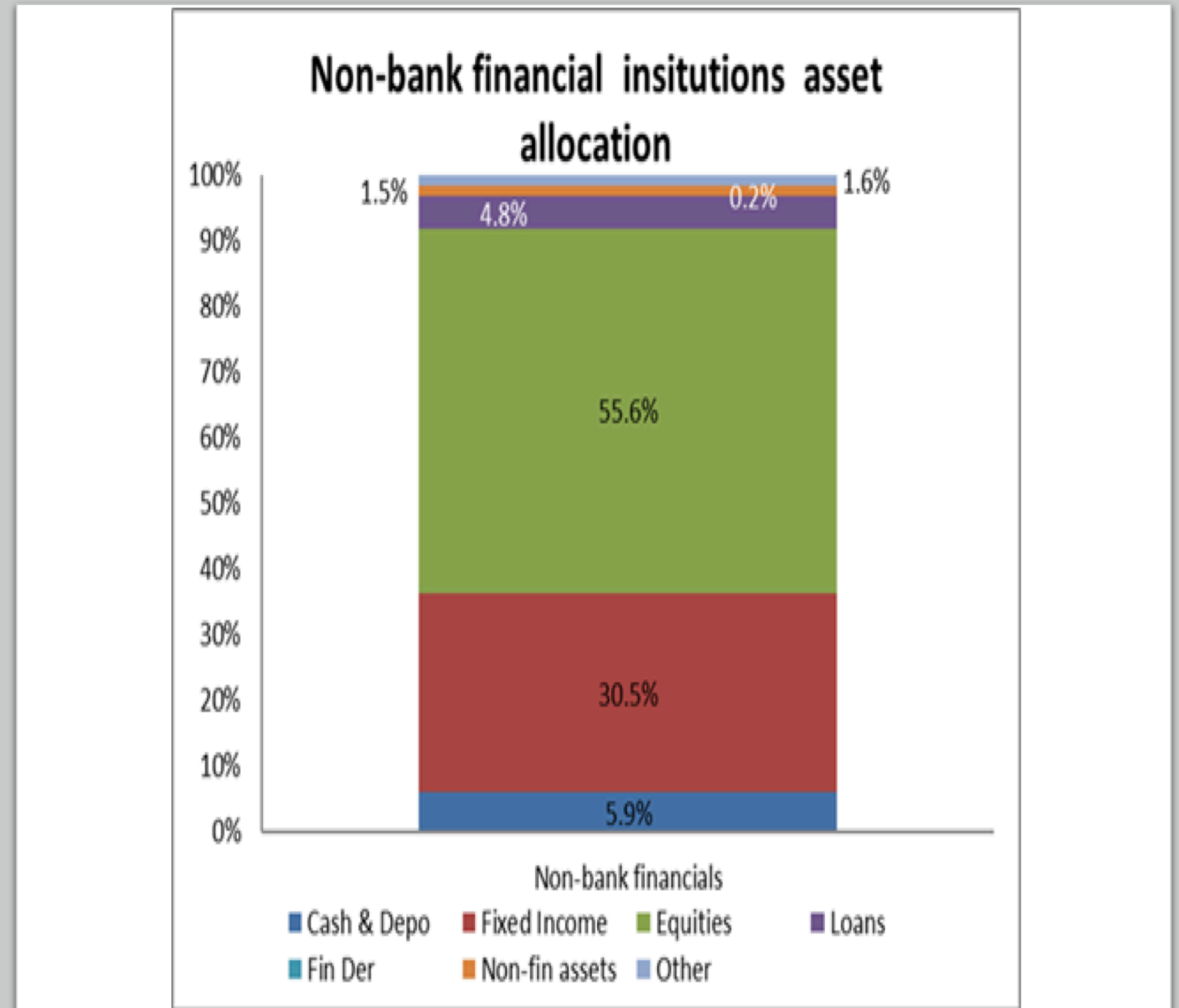
Non-residents domestic government bond holdings, 2019 -June 2020



National Treasury, Fiscal Futures, 2020

# Prescribed assets...

- Its really not as if savings are being stored under mattresses.
  - Tough to make the case that shifting private sector investment into the public sector will generate higher economic returns







# Expansion of the monetary base

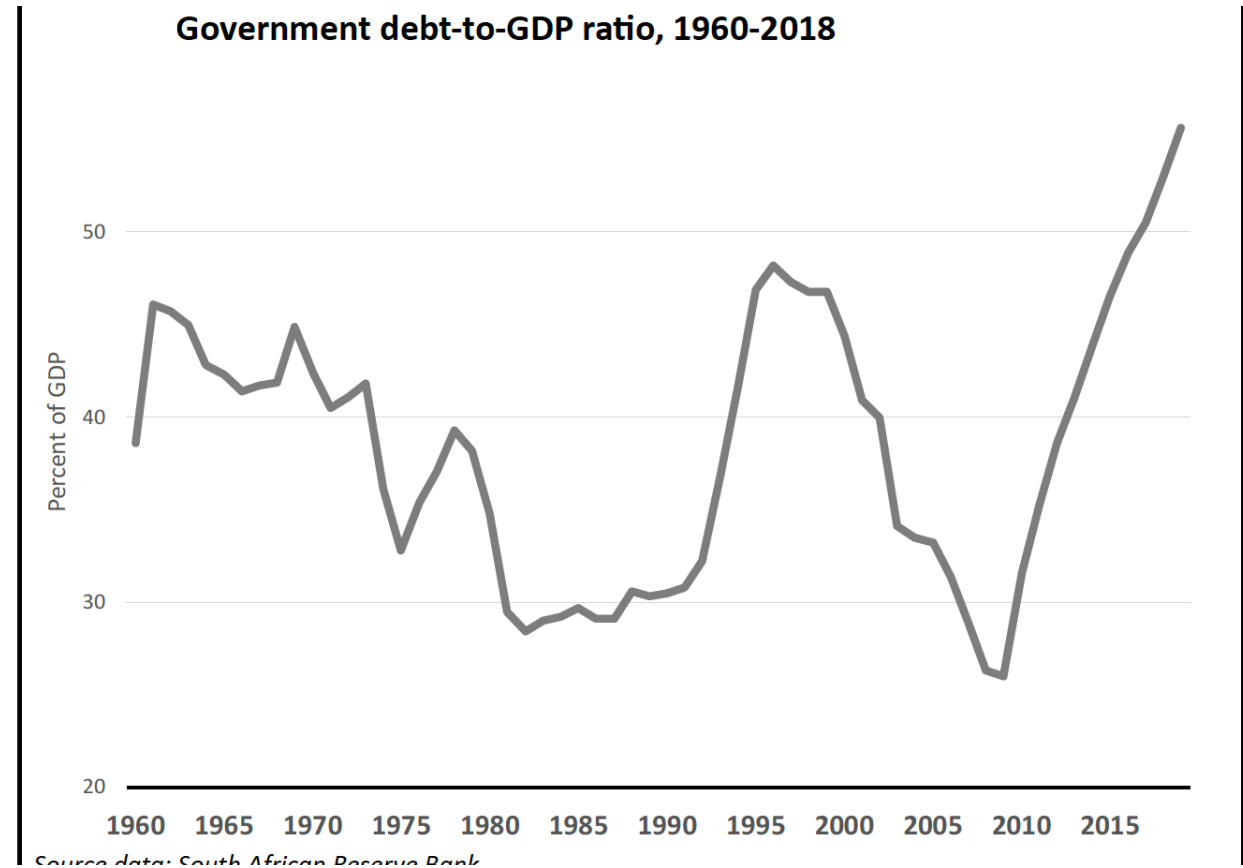
- Arguments “for” focus on the need to support government programmes and demand within the economy
    - An imperative necessary to sustain development
    - “Successfully” implemented by advanced countries
  - But we still have positive policy rates...
  - We still need foreign investment – so limit to what can be done
  - Doesn’t address the fundamental problem - stock of debt and cost of interest?
  - The “demand problem” does not exist independently of the supply problem
  - Are we saying that the economy should grow to “fit” the size of budget, rather than the budget being tailored to fit the economy?
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# Economic growth, fiscal policy and the budget

The role of government and fiscal policy in supporting an economy that can generate employment opportunities and finance its social and redistributive programmes.

# Its not a Covid issue. Covid just made it worse

- A significant and rapid expansion in the deficit
- Issue is not necessarily “was it right?”
- Issue should be “What did we get for it?”
  - Growth was low (declining)
  - Interest costs accelerating
  - Assets?
  - Declining productivity of public sector
  - Coverage of public goods has improved, but quality has declined
- If we want and need a big government, how do we get more from it?
- How big can government be?

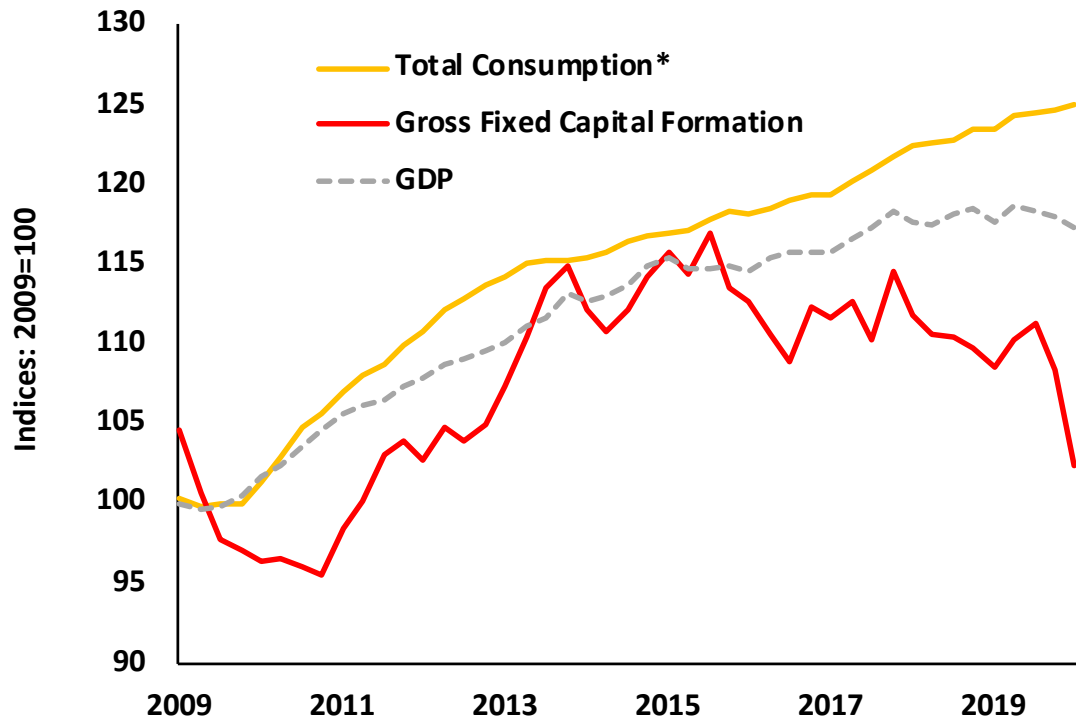


Sachs, M. “Both directions at once, fiscal policy in SA”, SARB data, 2020

Very simply, we have stopped investing in the economy

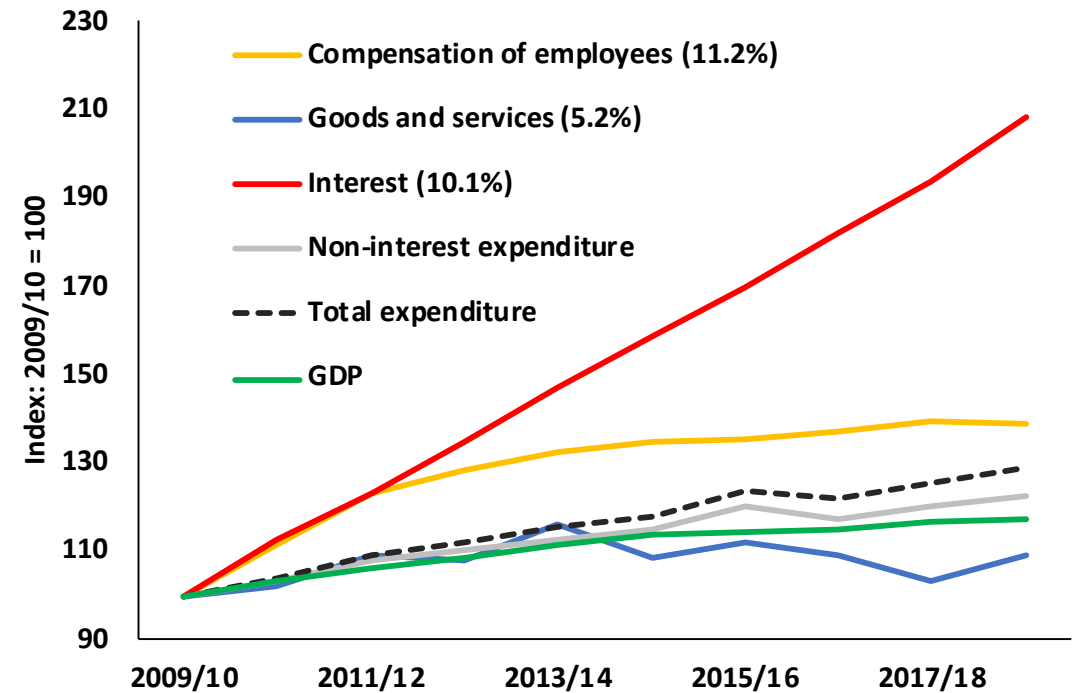
- Government has played a significant role
- How does one shift towards investment when already low savings are being consumed by wages and interest?

**Consumption and Investment**



\*Household + general government consumption expenditure  
Sources: Stats SA and SARB

**Real growth in selected items**



Note: Values in brackets denote average proportion of total expenditure over the 2010/11  
Sources: National Treasury and SARB



# Its not about austerity, its not about stimulus.

- Economic effects of bi-polar austerity and stimulus are catastrophic
- So what is it that is required?
  - A platform of economic reforms aimed at reducing the cost of living, doing business and finding work
    - Electricity sector reform
    - Regulation of network industries
    - Addressing drivers behind administered price growth

And on this platform the government must construct:

- Commit to significant expenditure restraint
  - An expenditure review programme aimed at reducing in consumption expenditure
  - Introduce a programme of well-planned investment, focused mainly in urban infrastructure
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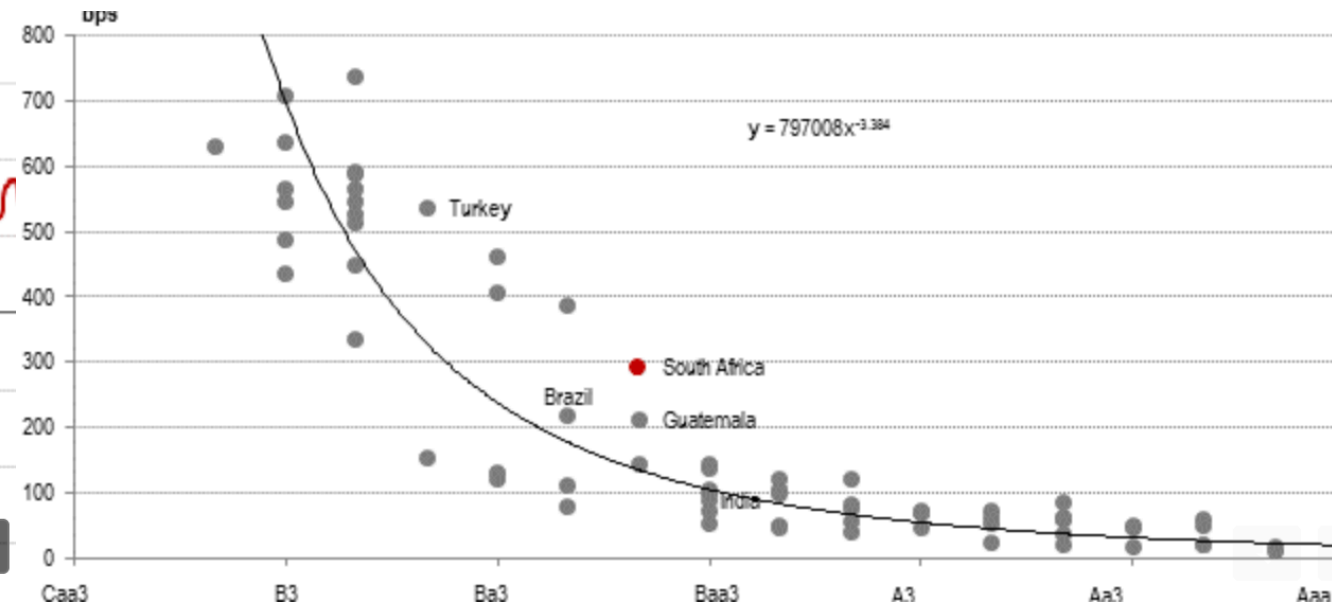
# But none of this is new!

- In fact, the Treasury (and government) has been advocating versions of this story for over 10 years now
- What is new:
  - Unprecedented economic deterioration
  - Financing constraint and the stock of debt
  - The emergence of fiscal stress

### SA vs EMBI bond yields



### Yields vs risk rating



So if the question is “how does government contribute to significantly growing employment, and resources for social spending and redistribution”, what is the answer?

And why don't we do it?

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