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SOUTH AFRICA`S FISCAL OUTLOOK AMIDST COVID-19 PANDEMIC

Abstract:

This study seeks to provide an overview of South Africa’s fiscal outlook amidst the Covid-19 pandemic. To achieve this, the study will explicate the discrepancies between general government revenue and expenditure, and between government debt and budget deficit in light of South Africa’s low economic growth. The study utilised publicly available secondary data (2000-2020), and it employed a descriptive research design and quantitative research method. The results indicate that the biggest discrepancy between government revenue and expenditure yet recorded is in 2020, evidenced by the 12.25% budget deficit. The outlook and expected recovery do not appear positive, and it may last for years, as is the case with crises of this magnitude. The results further demonstrate that even before the pandemic in 2019, the debt-to-GDP ratio was beyond the 60% threshold, and is already displaying unfavourable trends with the pandemic’s effects beginning in 2020. For fiscal sustainability, ensuring the debt-to-GDP ratio is in check over the medium term by limiting expenditures and stimulating investment should be considered.

Keywords:

Fiscal outlook, debt-to-GDP ratio, budget deficit, tax revenue, expenditure

JEL Classification: E60, E00, E27

1. INTRODUCTION AND BACKGROUND

The health and human toll caused by the Covid-19 pandemic is vast and is continuing unabated. In terms of its impact on the world economy, the World Bank, as early as June 2020, in its Global Economic Prospects report, painted a bleak picture of the world economy. The report indicated that "the COVID-19 pandemic has, with alarming speed, dealt a heavy blow to an already-weak global economy, which is expected to slide into its deepest recession since the second world war, despite unprecedented policy support" (World Bank, 2020). The report further elaborated that the global economic downturn could be worsened if countries do not take appropriate measures soon enough and if the financial stress caused by the pandemic triggers defaults by some countries, or if the pandemic causes prolonged negative effects on individuals and businesses.

Covid-19 is not the first pandemic of its kind; the world has faced several pandemics in the past. Major pandemics in the past include the influenza outbreaks of the 20th century (1918, 1957 & 1968), which devastated the world economy at that time due to its prolonged economic crises. The 1918 influenza pandemic (H1N1), which occurred over a century ago (four years after World War I had begun in 1914) is believed to have caused extensive health issues in the world, which resulted in an estimated 50 million lives lost to the pandemic (Johnson & Mueller, 2002). The pandemic ensued in three major pandemic waves (Simonsen, Chowell, Andreasen, Gaffey, Barry & Olson, 2018). Saunders-Hastings and Krewski (2016) state that the world economy at that time was devastated by the war and the time was characterised by poor sanitation, overcrowding, and limited health services associated with trench warfare. The advancements in medicine and medical care were not equipped to handle such pandemics at that time (Jester, Uyeki, Jernigan & Tumpey, 2019). Subsequent pandemics include 1957 (H2N2) and 1968 (H3N2), which also originated in Asia. The H2N2 that originated in the winter of 1957 caused 1.1 million deaths worldwide, and the 1968 influenza pandemic (H3N2) is believed to have caused between one and four million deaths globally (Honigsbaum, 2020). These two pandemics in comparison to the 1918 pandemic were less severe and had less impact (McDonald, Scott, Edmunds, Beutels & Smith, 2008).

2. LITERATURE REVIEW

The South African economy

South Africa has the most developed economy in Africa. It was also the biggest economy until Nigeria took over in 2014. The services sector, which includes finance, real estate and business services is the biggest contributor in South Africa, which accounts for approximately 73 per cent of the country's GDP, followed by manufacturing (13.9%), mining and quarrying (8.3%) and agriculture at a mere 2.6 per cent. (Trading Economics, 2021). With a population of about 60 million, according to the World Bank, South Africa is regarded as an upper-middle-income country with over 300 billion US dollars GDP and 6748.23 US dollars GDP per capita. As the discussion focuses mainly on the impact of the Covid-19 pandemic, it must, however, be emphasised that South Africa entered into this pandemic with low levels of economic growth, high levels of unemployment and poverty, and with the world's greatest income inequality as measured by the Gini-coefficient.

Impact of Covid-19 on the South African economy

There is little doubt that the immediate impact of the South African government's lockdown policies on household spending, exports, and investment, as well as the related macroeconomic shocks, will have knock-on repercussions that will spread across the economy (Arndt, Davies, Gabriel, Harris, Makrelov, Robinson, Levy, Simbanegavi, van Seventer & Anderson, 2020). As elucidated earlier, going into this Covid-19 crisis, the South African economy was already in its weakest shape and form. South Africa's finance minister at the time, Tito Mboweni, forecasted that the country's GDP will drop by 7.2 per cent in 2020, down from a slight expansion predicted in February, pulled down by the ravages of the Covid-19 outbreak, the country's worst contraction in 90 years (Mathe & Maeko, 2020). As the pandemic continues to spread, with South Africa amid the Covid-19 third wave with its Delta variant, fundamental questions about the pandemic's impact on the economy and budgetary prospects should be raised and addressed. That is precisely what this research tries to accomplish. This study is, to some extent, a revisit of the issue of the sustainability of public debt and budget deficit in South Africa, which was previously published by the same author (Redda, 2020A). The current study, however, is primarily concerned with the budgetary prognosis in light of the Covid-19 pandemic.

Any country's fiscal policy is inextricably linked to its politics. This is because such policies have a significant impact on resource redistribution throughout society, regions, and generations, and they are frequently sources of conflict (Alesina & Passalacqua, 2015). Government expenditure, tax revenue and government debt are all important macroeconomic variables in fiscal policy. Policymakers, lenders and borrowers are often faced with the challenge of determining the optimal level of debt-to-finance expenditure and development goals (Naraidoo & Raputsoane, 2014).

Definition and description of key concepts

The total expenditures for all final goods and services produced over a given period are equal to the GDP measures of national income and output for a certain country's economy. Investors use the debt-to-GDP ratio, which is stated as a percentage of GDP, to assess a country's ability to make future debt payments, affecting the country's borrowing costs and government bond yields. A government budget, which can be defined as an itemised accounting of the payments collected by the government (taxes and other levies) and the payments made by the government, is of critical importance to both investors and governments (purchases and transfer payments). The annual government budget plan is an expression of the government's fiscal policy that outlined government expenditures, tax revenues and borrowing requirements (Gounder, Narayan & Prasad, 2007).

A budget deficit occurs when a government spends more money than it can collect in tax revenues; a budget surplus is the inverse of a budget deficit, and when the two are equal, we say the budget is balanced. The two most important factors in fiscal policy are government revenue and government expenditure. Fiscal policy changes, such as proportional changes in government revenue and expenditure, have a direct impact on the budget deficit, whether from the expenditure side, the revenue side, or both sides (Carneiro, Faria & Barry, 2004).

Prudent macroeconomic policy is considered to be keeping the debt-to-GDP ratio and the budget deficit at acceptable minimums. The South African government is dedicated to maintaining a sustainable debt-to-GDP ratio while also lowering debt payment costs. A generally accepted norm is that the debt-to-GDP ratio should not exceed 60% unless the debt ratio is falling at a sustainable rate toward the stated aim and the government budget deficit does not exceed 3% of GDP (SADC, 2016; Darvas & Szapáry, 2008, 2010; Redda, 2020B). It is said that a rise in government spending as a percentage of GDP is frequently connected with faster economic growth, but only up to a point (Forte & Maggazino, 2016). At greater levels of government spending/GDP ratio, the opportunity cost of higher levels of government expenditure rises, contributing to a less optimum allocation of resources in the economy, resulting in a negative link between government expenditure/GDP growth (Asimakopoulos & Karavias, 2016; Hajamini & Falahi, 2018). In as far as fiscal consolidation is concerned, Dellepiane-Avellaneda and Hardiman (2015) posit that the scope and sustainability of deficit reduction efforts are considered to be influenced by the mix of fiscal consolidation. Fiscal consolidation based on spending reductions is thought to be more long-term since it is more likely to promote growth. The rationale is based on non-Keynesian effects: whereas a

Keynesian analysis would show that aggregate demand drives growth, this method suggests that private investor confidence is the primary driver of growth.

Research questions

The following key questions have been formulated to guide this research:

- *Research question 1:* How sustainable is government expenditure in light of South Africa's tax revenues and economic growth?
- *Research question 2:* How sustainable is South Africa's debt-to-GDP ratio in light of the budget deficit outlook?

Research objectives

The primary goal of this study is to provide an overview of South Africa's fiscal outlook amidst the Covid-19 pandemic. In view of South Africa's low economic growth, the study will explain the differences between general government revenue and expenditure, as well as between government debt and budget deficit.

3. RESEARCH METHODOLOGY

For the analysis, annual time series data from 2000 to 2020 was used, as well as projected data until 2026. This sample duration is adequate for the type of analysis performed in this study and for achieving the study's research goal. The macroeconomic factors considered for the study include government revenue, spending, GDP and the debt-to-GDP ratio.

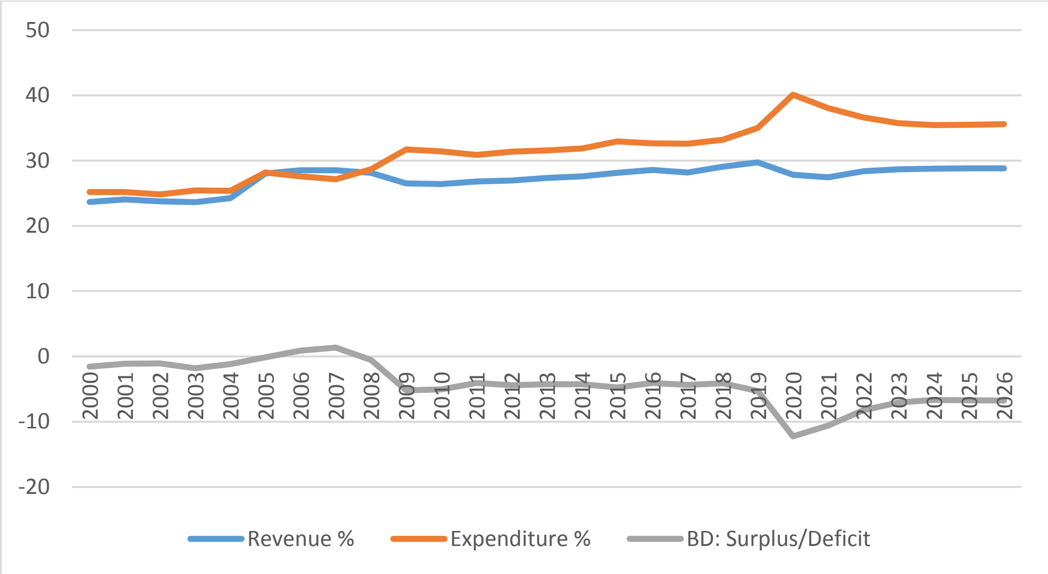
4. RESULTS AND DISCUSSION

The discrepancy between general government revenue and expenditure

Figure 1 demonstrates the discrepancy between general government revenue and expenditure, and also reflects the budget deficit or surplus over the specified period. Data shows that it was only before the 2008/9 financial crisis that South Africa maintained a budget deficit below the three per cent threshold. The budget deficit increased from 0.5 per cent in 2008 to 5% in 2009, and it has remained between four and five per cent ever since. This clearly demonstrates that the effects of such crises are felt long after they have passed. The biggest discrepancy between government revenue and expenditure yet recorded is in 2020, evidenced by the 12.25% budget deficit. Tax relief measures, tax clearing status, tax debt payment arrangements, and a debt relief finance scheme for qualifying enterprises have been available to businesses, which could have been the main reason for the decline in tax revenue collections. Individuals who had previously received no form of support were eligible for the R350 per month special COVID-

19 social relief of distress grant. This, along with increasing healthcare and vaccination costs, were some of the reasons for increased government spending. The outlook and recovery projected do not look promising, and it may persist for a number of years to come as is the case with crises of this magnitude.

Figure 1: Discrepancy between general government revenue and expenditure

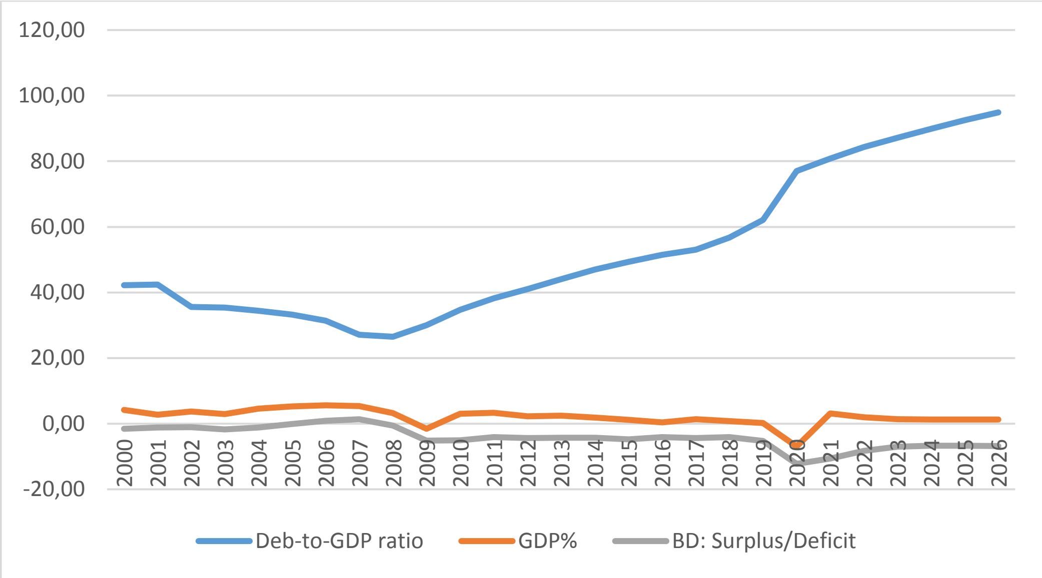


Source: Researcher's own work

Debt-to-GDP ratio, GDP and budget deficit outlook

Investigating the implications of the deteriorating budgetary constraints on the country's debt and economic development is crucial. The debt-to-GDP ratio, GDP and budget deficit outlook are illustrated in Figure 2 to highlight this relationship. As can be observed, the debt-to-GDP ratio is showing a steeper positive slope with less encouraging economic growth evidenced with low levels of GDP projections. This is because what is not financed through tax revenues, has to be financed through government borrowing, which inevitably pushes the debt-to-GDP ratio even further as the country's economic growth does not support its expenditure requirements. It should be emphasised that even before the pandemic in 2019, the debt-to-GDP ratio had beyond the 60% threshold, and is already displaying unfavourable trends with the pandemic's effects beginning in 2020.

Figure 2: Debt-to-GDP ratio, GDP and budget deficit outlook



Source: Researcher's own work

Table 1 reports the averages of government revenue, expenditure, budget deficit/surplus, a debt-to-GDP ratio over a 21-year period (2000-2021), actual figures of the five recent years (2016-2020) as well as the projected five years (2021-2025). Tax revenue showed a decrease from 29.74 per cent to 27.86 per cent between 2019 and 2020, while expenditure rose from 35 per cent to 40 per cent during the same period. As a result, the budget deficit jumped from 5.27 per cent to 12.25 per cent, far exceeding the three per cent threshold multiple times. The debt-to-GDP ratio increased from 62.15 per cent to 77.06 per cent, above the threshold.

Table 1: Averages and outlook of revenue, expenditure, budget deficit, debt-to-GDP ratio and GDP

Macroeconomic variables	Past five years					Mean (21 yrs)	St. Dev.	Five-year outlook				
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025
Revenue %	28,59	28,20	29,08	29,74	27,86	26,94	1,94	27,46	28,37	28,70	28,79	28,81
Expenditure %	32,66	32,59	33,20	35,01	40,11	30,14	3,91	38,06	36,63	35,75	35,47	35,51
BD-Surplus/Deficit %	-4,07	-4,38	-4,12	-5,27	-12,25	-3,20	2,96	-10,60	-8,26	-7,06	-6,69	-6,70
Deb-to-GDP ratio	51,47	53,02	56,71	62,15	77,06	42,52	12,55	80,78	84,35	87,21	89,88	92,53
GDP%	0,40	1,42	0,79	0,15	-6,96	2,18	2,79	3,10	1,97	1,40	1,30	1,30

The Covid-19 pandemic, along with government restrictions, has dealt a catastrophic blow to the South African economy. Several businesses were forced to close for a period of weeks or even months, while others were forced to reduce their opening hours or close permanently. These had a direct impact on unemployment and poverty levels, as well as government tax collection. As a result, the government's potential tax collection from businesses and individuals has been considerably diminished. In such a situation, the South African government was forced to make a variety of interventions to assist businesses and individuals directly affected by the pandemic, which raised its expenditures and widened the gap, resulting in the 12.25 per cent budget deficit. For years to come, this massive budget deficit will have a knock-on effect on the debt-to-GDP ratio in the form of capital repayment and interest on borrowing.

5. CONCLUSION AND RECOMMENDATIONS

From the analysis, it can be concluded that the budget deficit grew from 0.5 per cent in 2008 to 5% in 2009, and it has stayed between four and five per cent since then. This illustrates that the consequences of such crises are felt for a long time after they have passed. The largest gap between government revenue and expenditure has yet to be recorded, as indicated by the 12.25 per cent budget deficit in 2020. The outlook and expected recovery do not appear positive, and it is possible that it will last for years, as is the case with crises of this magnitude.

It was also noted that the debt-to-GDP ratio is showing a steeper positive slant, indicating less encouraging economic development as demonstrated by low GDP estimates. This is because what is not covered by tax revenues must be covered by government borrowing, which inevitably raises the debt-to-GDP ratio as the country's economic development does not keep pace with its spending needs. For years to come, the 12.25 per cent disparity between government revenue and expenditure will have a knock-on effect on the debt-to-GDP ratio in the form of capital repayment and interest on borrowing.

Maintaining the debt-to-GDP ratio in check over the medium term through reducing spending and increasing investment should be considered for fiscal sustainability. Efforts should be made to lower the budget deficit and improve the composition of spending, particularly by reducing wage bill increases.

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