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Submission File

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Parliamentary Standing Committee on Finance (SCoF)
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Dear Sir and Madam

COMMENTS ON THE FISCAL RESPONSIBILITY BILL [B5 - 2020]

1. We hereby present the comments and submissions of the South African Institute of Chartered Accountants (SAICA) on the Fiscal Responsibility Bill [B5 - 2020] (the Bill). We once again thank the Standing Committee on Finance (SCoF) for the ongoing opportunity to provide constructive comments in this regard. SAICA continues to believe that a collaborative approach is best suited in seeking solutions to complex challenges.

Need for and purpose of the Bill

2. The 2021 Budget indicated that the national debt is set to increase from R3.95 trillion in 2020/21 to R5.23 trillion (87,3% of GDP) by 2023/24. The debt service costs will rise from R232.9 billion in 2020/21 to R338.6 billion in 2023/24. These costs are the fastest growing expenditure item on the national budget and are expected to consume 20.9% of gross tax revenue over the medium term.
3. Over the next three years, annual debt-service payments will exceed government spending on most functions, including health, economic services, and peace and security.
4. Considering these facts, the Bill seeks to stabilise the national finances of the country and create the confidence needed to assure investors that the government is committed to prudent fiscal management.
5. The Bill aims to achieve this objective by providing for a fiscal rule prescribing that, for each financial year from 2020/21 to 2023/24, net government guarantees expressed as a percentage of GDP must not be more than it was the previous year. A further fiscal rule is provided depending on the debt to GDP percentage (see point 16 below).

6. The Bill also provides for the following:

- 6.1 A review of the fiscal rule by the National Assembly every four years, beginning in 2023/24 by either amending, renewing or terminating the fiscal rule;
- 6.2 An annual Fiscal Responsibility Report to be tabled by the Finance Minister at the same time as the budget is tabled, setting out whether the fiscal rules were complied with or not, together with reasons for those outcomes, and recovery plans in the event of a failure to comply with the fiscal rule; and
- 6.3 An exemption from the fiscal rule to be granted in respect of a specific financial year, or years, by the National Assembly upon application by the finance minister, with good cause having been shown and on the recommendation of the Standing Committee on Finance.

7. Submission: We welcome governments sincerity to commit to fiscal responsibility by compelling by law a change in behaviour. Considering the concerning debt trajectory over the medium term and the effect this will have on the citizens of the country, we agree that there is clearly a need for a Bill of this nature to ensure that our national spending is managed appropriately and focused on economic and social priorities and not being redirected unnecessarily to pay local and overseas bondholders.

Exemption

- 8. An exemption from the fiscal rule can be granted in respect of a specific financial year, or years, by the National Assembly upon application by the finance minister, with good cause having been shown and on the recommendation of the Standing Committee on Finance.
- 9. The above exemption undermines the whole purpose of the Bill as it sets a very low threshold to create an exemption. As we have seen with Treasury procurement rules, the exception become the norm very quickly where such low standard exists.
- 10. If National Treasury is serious about this limitation by statute, they will ensure it is binding and lot more difficult to except its application.

11. Submission: As the fiscal policy and thresholds must be reviewed every 4 years, we propose that an exemption should only be possible through a legislative amendment process which will ensure that the proposal is not easily undermined and that would compel a public consultation process.

12. Where a national emergency or crisis arises an emergency bill can be tabled by the National Treasury.

Definitions

- 13. The terms “extra-budgetary government institution”, “government institution” and “social security fund” are defined in the Bill, yet these definitions are not mentioned in any other section in the Bill.

14. Submission: Clarity should be provided on why these terms are defined in the Bill yet not subsequently mentioned in the Bill.
15. We do, however, support the inclusion of extra-budgetary government institutions into the Bill. The application of a consistent fiscal framework to all levels of government and to public entities and public enterprises that are engaged in significant fiscal activities limits the scope for shifting fiscal policy implementation “off budget.”

Fiscal rules

16. The Bill proposes different fiscal rules depending on the percentage debt to GDP, that is, if it is between 50% and 55%, between 55% and 60% and greater than 60%, then different rules will apply. Regardless of the debt to GDP percentage, a real budget surplus (i.e. after finance costs) is required and in order to achieve this, the expenditure ceiling must be reduced and the government employee compensation must also be reduced (or not increased depending on the debt percentage).

17. Submission: The range of the debt to GDP percentages should be amended as currently the Bill refers to “between” and “greater than” resulting in a debt to GDP percentage of 50%, 55% or 60% not being catered for in the legislation.

18. Different fiscal rules have been used across the globe. Some countries use legislated “principles of responsible fiscal management” (such as New Zealand) whilst others use mandatory targets.

19. The suggestion of debt and surplus targets that are only required to be committed to by the government of the day would not suffice in the South African context. The fiscal rules proposed to manage debt (ensuring there is a surplus by reducing expenditure and limiting/reducing government employee compensation) thus is more in line with the mandatory targets.

20. Submission: Mandating budget surpluses is essential to reduce the country’s debt levels. Reducing expenditure to achieve this is necessary, but this reduction should be transparently reported on to ensure that essential spend is not jeopardised.

21. It would appear that a debt to GDP ratio starting at 50% has been identified as appropriate by other developing countries and thus appears reasonable.

22. Government employee compensation, as highlighted in our previous submissions to the Standing Committee on Finance, has been problematic and curtailing these expenses is necessary. However, this should be done based on performance monitoring and appraisals and not across the board.

23. Running a standard budget surplus can be offset by ad hoc/medium term strategic projects. This principle is applied in New Zealand and enables government to focus “excess” funds on strategic projects that are “tendered” for by multiple departments. This enables good competition and collaboration amongst departments and also ensures spending is directed at governments strategic priorities.

24. Internationally it has been found that legislated fiscal targets and rules have proved singularly ineffective in a wide range of jurisdictions. To overcome this, it is suggested that debt and surplus targets are required to be committed to by the government of the day but that this should be supported by transparency about the principles of fiscal responsibility and independent forecasts and accounts should be prepared – thus there should be sound procedural rules backing the fiscal rules.
 25. According to the International Budget Partnerships “Open Budget Survey”¹, South Africa is ranked number one in the world (tied with New Zealand) for budget transparency. The National Treasury should be commended for this! Thus, transparency is not a problem in the South African context. However, transparency is not enough on its own to ensure fiscal responsibility.
 26. Weaknesses in procedures surrounding fiscal responsibility have also contributed to many fiscal responsibility laws failing. Procedural issues have most certainly contributed towards the dilemma that South Africa finds itself in. Inaccurate forecasting and the reporting of the fiscal information as well as the lack of accountability for not achieving fiscal targets set in the Budget have most certainly contributed to the state that the country is currently in.
 27. South Africa’s revenue forecasts have over the last few years almost consistently been above those realised and expenditure has exceeded that originally budgeted for. A further problem in the South African context is that Generally Accepted Accounting Principles are not used in preparing the accounts - the modified cash basis is used. This allows for various inconsistencies in reporting and “creative accounting”.
 28. Furthermore, the Auditor General’s reports annually provide an account of mismanagement of government funds negating any fiscal prudence provided for in the Budget. No or very limited fiscal responsibility consequences flow to any level of government or SoEs for lack of fiscal responsibility.
29. Submission: To ensure fiscal responsibility and resilience, National Treasury should continue with its sterling job of transparently disclosing its forecasts and continue striving to make these forecasts as accurate as possible.
 30. Countries that have placed a strong emphasis on procedural and transparency rules that apply to all relevant levels of government and that are supported by well-developed public expenditure management and accounting systems tend to have strong fiscal performance².
 31. We therefore submit that greater procedural and transparency rules need to be implemented at the provincial and local levels of government. Furthermore, the move to GAAP by municipalities should be implemented as soon as possible to ensure a

¹ <https://www.internationalbudget.org/open-budget-survey/rankings>

² Fiscal Responsibility Laws, Ms. Ana Corbacho and Mr Gerd Schwarz, <https://isni.org/isni/0000000404811396>, International Monetary Fund

sufficiently developed fiscal institutional framework and so that the fiscal rules are not breached.

32. Furthermore, output needs to be aligned to budgets and future budgets need to be aligned to strategic projects.
33. Lastly, budgets and budget increases should be awarded based on compliance and performance levels to ensure service delivery.

Report on compliance

34. The Minister must, on an annual basis concurrently with the tabling of the national budget, table a report before the National Assembly indicating whether the fiscal rules were complied with or not in the relevant period, together with reasons for those outcomes, and recovery plans in the event of a failure to comply with the fiscal rules.
35. It appears that should the Minister not comply with the fiscal rules he merely has to provide a recovery plan. No mention is made in the Bill of the timelines needed to achieve compliance nor any further repercussions for not achieving the targets set.

36. Submission: The Minister should be required to include in the recovery plan the time needed to achieve compliance. Limits on the timeline for compliance and fiscal adjustment measures should also be implemented.
37. Given South Africa's poor history of compliance with similar reporting laws, there is a concern that without methods of enforcement there is a risk that the Bill could ultimately be ineffective despite its reporting mandates and outlined goals.
38. Enforcement measures such as penalties, sanctions, or incentives to discourage breach of fiscal responsibilities and meeting adjustments or timelines are needed to encourage compliance and ensure accountability and should be legislated for to ensure fairness and consistency.
39. These sanctions should be applied automatically when fiscal targets are not met and/or budgeted procedures are not followed.
40. Interestingly, Colombia fosters market enforcement mechanisms by applying bankruptcy procedures to municipalities and requiring main municipalities and departments to obtain credit ratings from private companies.
41. Certain countries/provinces in a country³ require the salaries of ministers to be reduced if the deficit for the year does not meet the targets, however, the law does provide for the repayment of these salaries if the deficit is eliminated in the future years. Other countries make the provision of guarantees in excess of the debt limits an offence.

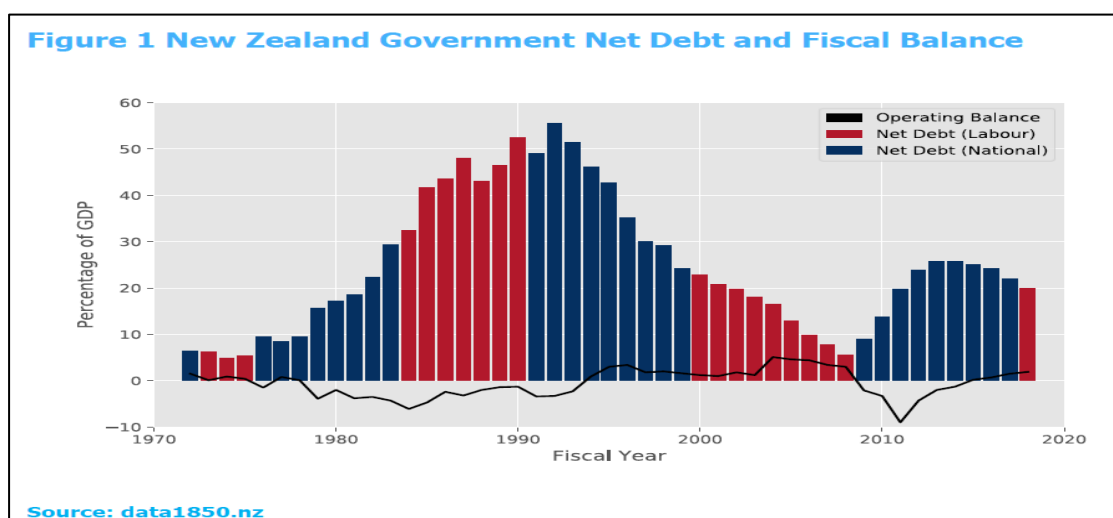
³ <https://web2.gov.mb.ca/bills/42-3/b048e.php>

Factors needed for the Bill to be a success

42. Internationally, many countries have introduced Acts of this nature. The prime example of this is New Zealand where, despite the non-binding nature of the Fiscal Responsibility Act 1994 (FRA), it has been an astonishing success.
43. NZIER, in their public discussion paper Working paper 2018/1 released in November 2018 on this Act, stated the for a financial responsibility act to be successful, it must be supported by political commitment and proper processes.

Political commitment

44. One of the key factors for the success of the FRA in New Zealand, as highlighted by NZIER, is the sustained commitment by the New Zealand Government to prudent fiscal management which has meant that New Zealand has one of the lowest public debt to GDP ratios in the OECD. New Zealand track's record since the FRA is of sustained fiscal surpluses and reducing public debt as is depicted in the graph below (prepared before the COVID pandemic occurred).



45. The FRA provided the foundations for the fiscal management regime. This helped keep fiscal strategy issues on the political agenda, bolstered by the Treasury's Fiscal Management Approach, and provided an independent scoring mechanism, which increased the credibility of political commitments to fiscal responsibility.
46. Submission: In order for the Bill to succeed, the principles highlighted in the Bill need to be supported by the commitment of the government to a fiscal strategy based on fiscal prudence and at a technical level by a fiscal management approach to operationalise the government fiscal strategy.
 47. The Bill also provides increased scrutiny by Parliament which is commendable as this has also been highlighted as one of the success factors of the FRA in New Zealand. Should this Bill be passed, it will be in the hands of Parliament to use these powers effectively and to ensure that the government is held to its commitments.



Proper processes

- 48. The roles, functions, and accountability of different actors involved in fiscal policy design and implementation should be clearly and transparently defined.
- 49. Independent monitoring and oversight of the of these roles is necessary. Political interference and governance issues should not be permitted to undermine credibility in the enforcement mechanisms.

- 50. Submission: Improving co-ordination and enforcement mechanisms should be undertaken to enhance the fiscal management and policy outcomes.
- 51. Liberal escape clauses, non-credible sanctions and enforcement mechanisms should be avoided

Conclusion

- 52. The reality is that if South Africa does not take the initiative in ensuring that its financial position is sustainable, it is more likely to have the adjustment imposed on it from the outside with far greater costs to its citizens.
- 53. Government sought this measure voluntarily to binds itself to the principles of a Fiscal Responsibility Bill. Taking the above suggestions into consideration, will provide a powerful commitment that can cement fiscal discipline by the government.

Yours sincerely

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