South Africa: The time to reform has come

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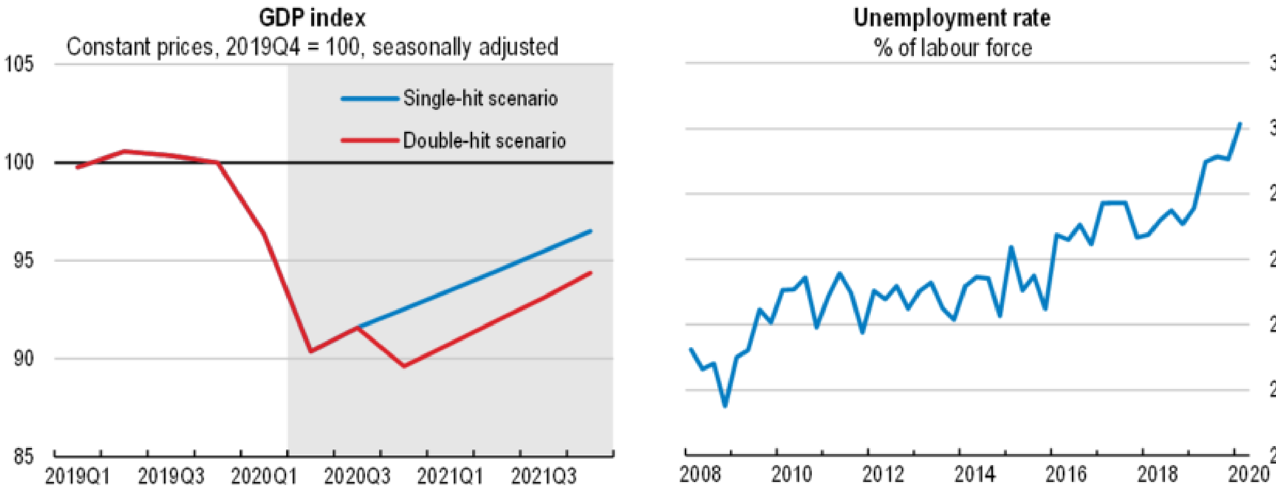
The COVID-19 pandemic and the ensuing lockdown have led to a sharp economic contraction and rising unemployment, particularly affecting youth (Figure 1). The government reacted swiftly to mitigate the fall in household consumption, but investment will decline to a record low level.

The crisis also deepens existing fiscal challenges as it follows a sharp deterioration in fiscal accounts over the past three years. The government deficit will reach around 15% of GDP in 2020. In the absence of consolidation, debt will exceed 100% of GDP in 2022, raising sustainability risks in a context of low growth and high government borrowing rates. South Africa thus has to cope, in the short-run, with the impact of the coronavirus and support the economy, while adopting reforms to restore debt sustainability and spur growth in the medium-term.

Figure 1. Growth has collapsed following a modest performance in the past decade



Source: OECD Economic Outlook 107 database; Statistics South Africa.

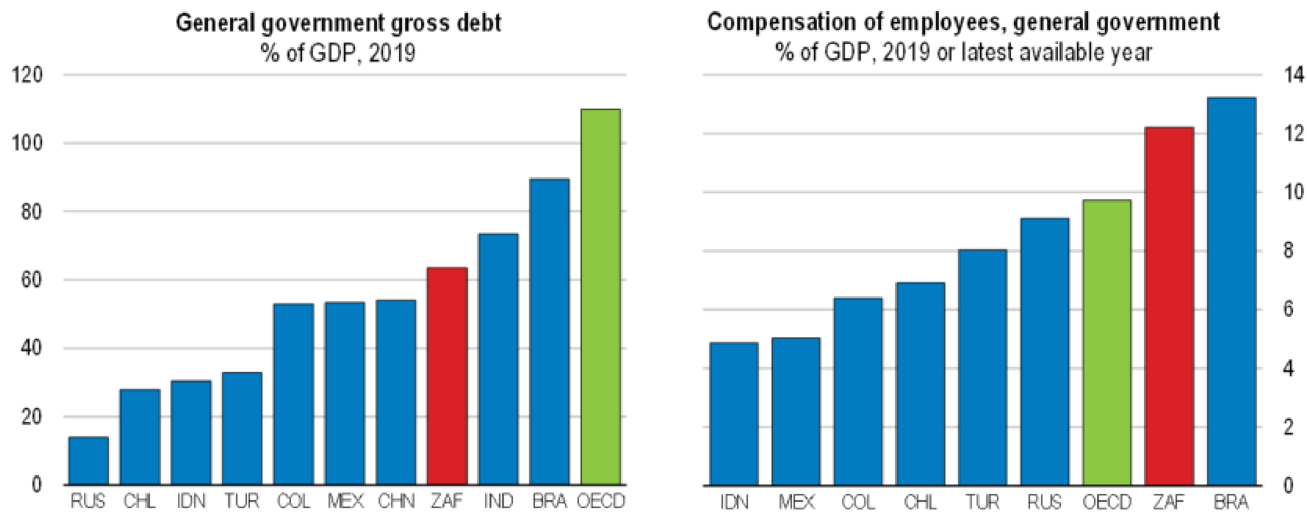
Fiscal reforms are urgently needed

Restoring fiscal sustainability will require measures that will curtail wage bill growth and SOE financing, as well as contain spending growth in higher education, raise revenue and improve the efficiency of public spending.

Managing spending pressures: the government wage bill

The general government wage bill, at 12% of GDP, is one of the highest among OECD and partner countries (Figure 2). At 38% of total consolidated government spending, the compensation of employees was the largest spending item in 2019 (National Treasury, 2020). Public sector wage increases are the main driver of government spending rather than increases in employment. Wage negotiations have systematically granted above-inflation increases over the past decade. Moreover, promotion policies contributed to wage bill increases. The government could consider indexing public sector wages below inflation for three years. An inflation minus 2 percentage points in the public service could generate around ZAR 30 billion savings over three years. Given the wage gains of recent years, the real cost to civil servants would be limited as they would still benefit from annual progression in the pay scale. Such a measure could create fiscal space for much-needed investment in infrastructure and education.

Figure 2. High government wage bill is contributing to the deficit and debt increases



Source: National Treasury, 2020 Budget Review, 2020 Supplementary Budget Review; IMF, World Economic Outlook April 2020 database; OECD Economic Outlook database; IMF, Government Finance Statistics Database.

Reforming state-owned enterprises to limit government contingent liabilities

Government financing of state-owned entities is high and represents risk to debt sustainability and public finances. The COVID-19 crisis is worsening the financial situation of many SOEs. The underperformance of SOEs is widespread due to mismanagement, corruption, overstaffing and uncontrolled spending. The government has started to reform key SOEs. New boards and executives have been appointed at several of these entities and public inquiries into state corruption have started. Nevertheless, South Africa still needs to establish an effective governance framework for SOEs that clearly sets company-specific goals in terms of profitability, capital structure and non-financial objectives.

Managing spending pressures: financing higher education

South Africa has severe skills shortages and poor basic education outcomes despite high levels of public spending (OECD, 2015 and 2017). Higher education has been a growing component of expenditure. With the introduction of fee-free higher education from poor and working class families (announced in 2017), government spending on higher education is expected to increase from 1.3% of GDP in 2017/18 to 2.6% in 2022/23.

Reducing financial barriers for access to higher education is an important objective in South Africa’s context. However, alternative financing mechanism could alleviate students’ credit constraints while reducing the impact on fiscal resources. Under the current grant system, 95% students are receiving the same support, regardless of household income. Student loans could be designed as income – contingent loans backed up by the government to ensure that students are not constrained in their educational choices due to access to financial resources. Efficient administration of the scheme, including collection of repayments, is crucial.

Structural reforms should be accelerated to unlock growth

Supporting the economic recovery in the short-run while undertaking reforms to increase potential long-run growth is key. Regulatory restrictions are still relatively high. Reform should include reducing the high level of government involvement in the economy, barriers to domestic and foreign entry, complex rules for licences and permits, and less protection of existing businesses from competition, for instance, in legal services and network industries. In addition, in the medium term, developing tourism and boosting transport infrastructure investments can contribute to growth and job creation during the recovery. These policy options are detailed in the new OECD Economic Survey of South Africa (OECD, 2020b).

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