OPEN LETTER

Over 100 experts and organisations call on the President and Minister of Finance to halt all planned budget cuts

As leading South African economists, researchers and civil society representatives we write this letter to state our opposition to National Treasury's attempts to force government entities and departments to significantly cut spending. National Treasury's instruction to government entities to immediately institute severe budget cuts is misguided, dangerous to our economy and well-being, and not supported by robust evidence.

The Minister of Finance and National Treasury officials have cited expected revenue shortfalls and budget overruns as grounds for this drastic action. This is being wrongly characterised as an imminent 'fiscal crisis'. National Treasury has also failed to acknowledge its own role in precipitating the budget mismatch. A sense of panic is being created in order to force through these rushed, chaotic and indiscriminate cuts in the Medium-Term Budget Policy Statement in November 2023.

If implemented, these cuts will slow economic growth, undermine service delivery, and curtail social protection thus exacerbating unemployment, hunger, and social instability, leading to a retrogression in the realisation of the socio-economic rights contained in our Constitution. This strategy is self-defeating as economic contraction resulting from such cuts would make debt repayment more difficult. Rather, the fiscus must be leveraged to set South Africa on a new economic path.

We call on the President and Minister of Finance to halt all budget cuts. The existing budget mismatches can be readily resolved through other measures. Instead, we urge the government to undertake a thorough, transparent and evidence-based budget review process over the next 12 months.

We note the following important context:

1. The revenue shortfall is not abnormally large. The shortfall is widely projected to be R53 billion.[1] This is of a similar magnitude to shortfalls in previous years, for example, of R61, R58, and R70 billion respectively in 2017/18, 2018/19 and 2019/20, and significantly below the revenue windfalls of R241 and R123 billion in the last two years.[2]

[1] Based on updated data from the first five months of the year both the Institute for Economic and Bureau for Economic Research (Stellenbosch University) project the revenue shortfall at R53 billion.
[2] These figures are in real terms, drawn from National Treasury Budget Reviews, and compiled by the Institute for Economic Justice in their policy brief - Is South Africa Facing a 'Fiscal Crisis'.

2. In addition to a revenue shortfall there is also an expenditure overrun. The expenditure overrun is predominantly due to the National Treasury failing to budget adequately for foreseeable expenditure and Departments should not be punished for this. The largest share of this is R37.5 billion from the predictable public sector wage bill increase. The overspend is also comparable to other years, although the revenue shortfall and expenditure overspend compound one another.

3. South Africa's debt is not unusually high although it is comparatively expensive. South Africa's debt-to-GDP ratio is 71.4% in 2022/23, compared with the emerging market and middle-income country average of 69%. However, on average upper-middle income countries in 2022 paid 2% of GDP in interest payments, compared with South Africa's 5%.[3]

4. Rushed, across-the-board, expenditure cuts will not lead to greater efficiency, or the improvement of poor-performing programmes. Rather, cuts will result in staff shortages across the public service, programmes seen as 'easy to close' irrespective of need or performance will face the chop, and programmes supporting patronage networks and corruption are likely to be jealously guarded.

5. Expenditure cuts are widely known to have negative social and economic outcomes. Recent research shows that fiscal contraction larger than 1.5% of GDP generates a negative effect of more than 3% on GDP even after 15 years. The drop in GDP reaches 5.5% for fiscal contractions larger than 3%.[4] Recent research by the IMF also highlights that, "[o]n average, fiscal consolidations do not reduce debt-to-GDP ratios".[5] Cutting spending will hamstring desperately needed economic growth, making it harder to service debt in the future.

6. South Africa faces multiple well-known social and economic crises, including low growth, poverty, inequality, hunger, unemployment, and crime. The immediate budget mismatches constituting National Treasury's 'fiscal crisis' should not obscure these dire pre-existing crises. Ill-conceived cuts would exacerbate these crises.

7. The only solution to secure the sustainability of public finances and address our social and economic crises is state-supported, inclusive, and sustainable economic expansion.

With this in mind we call on the President and Minister of Finance to undertake the following:[6]

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[3] United Nations Conference on Trade and Development (UNCTAD). 2023. A World of Debt. (Accessed on: 28 September 2023).
[4] Klein Martins. Guilherme. 2022. "Long-run effects of austerity". University of Massachusetts Amherst. Economics Department Working Paper Series. 342. DOI: 10.7275/h7q7-w307 (Accessed on: 28 September 2023).
[5] International Monetary Fund. 2023. World Economic Outlook. (Accessed on: 28 September 2023).
[6] For quantification of these proposals see Institute for Economic Justice. 2023. "Is South Africa Facing a 'Fiscal Crisis'?"

1. **Immediately** close the budget mismatch by drawing on reserves and increasing shorter-term, less expensive borrowing. This includes drawing on the R459 billion owed to the South African government in the SARB's Gold and Foreign Exchange Contingency Reserve Account. Even if the entire mismatch were closed through borrowing it would only increase debt levels by 1-2 percentage points and keep them well below recent estimates.

2. **In the next budget cycle** raise additional revenue. In doing so, take account of:
    - The Budget allocates R305 billion in income support to the highest earning 30%. Eliminating or reducing tax breaks for those earning above R750,000 per year could raise up to R83 billion.
    - The reduction of the corporate income tax rate from 28% to 27% has cost R11 - R13 billion a year.
    - Ineffective corporate tax subsidies remain in place, for example, the Employment Tax Incentive.
    - Raising VAT would make the tax mix more regressive; it has previously failed to raise the sums needed; and disproportionately burdens the poor and low-income earners.

3. **Reduce the cost of borrowing** by moving to shorter-term loans which are cheaper, and renegotiate the terms of particular debt. Explore other ways to reduce the cost of borrowing further, for example, via interest rate management and prescribed assets.

4. **Institute a transparent, consultative, and evidence-based expenditure review process.** This may result in expenditure cuts in particular areas and spending increases in others. It should include proposals to 'restructure the state' as suggested by National Treasury.

5. **In the medium term explore implementing a wealth tax**. Such taxes have been used in other countries in times of economic crisis and if the Treasury really believes this is a crisis then this is an opportune time;

With appropriate political will, the current budget mismatches are relatively straightforward to resolve. At the same time, we recognise that further pressures are on the horizon. The current impasse therefore provides an opportunity for fundamental reform of South Africa's fiscal framework. This needs to prioritise the role and potential of the budget in advancing developmental priorities. The budget's emphasis needs to be on service delivery, economic growth, employment creation, social protection, and structural transformation.

The rushing through of ill-considered budget cuts will undermine well-being, as well as South Africa's ability to thrive in the future, and must be halted.

Yours Sincerely,

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Organisations

1. **Institute for Economic Justice**
2. **Pietermaritzburg Economic Justice & Dignity Group**
3. **Ilifa Labantwana**
4. **Equal Education**
5. **RightfulShare**
6. **Equal Education Law Centre**
7. **Budget Justice Coalition**
8. **Socio-Economic Rights Institute**
9. **SECTION27**
10. **Alternative Information and Development Centre**
11. **Social Policy Initiative**
12. **Black Sash**
13. **Oxfam South Africa**
14. **350.org**
15. **#PayTheGrants**
16. **National Education, Health and Allied Workers Union (NEHAWU)**
17. **Open Secrets**
18. **Waterberg Women Advocacy Organisation**
19. **Workers' World Media Productions**

20. **Legal Resource Centre**
21. **Youth Capital**
22. **National Labour and Economic Development Institute (NALEDI)**
23. **Equality Collective**
24. **Institute for Economic Research on Innovation**