FISCAL ANCHORS
DISCUSSION DOCUMENT

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REPUBLIC OF SOUTH AFRICA

EXECUTIVE SUMMARY

Macroeconomic stability is an essential precondition for sustainable economic development, but South Africa faces persistent fiscal imbalances between tax revenues and government spending. This has resulted in rapidly rising debt, which has surged from under 24 per cent of GDP in 2009 to 74 per cent in 2024. Over that period, debt service costs have grown from 9 per cent to 21 per cent of tax revenue, reducing fiscal space for essential public services.

The slowdown of average annual growth is a key driver of these outcomes, but the persistence of these imbalances and the rise of debt have increased the risks to long-term economic stability. Increased reliance on domestic financial institutions to fund government borrowing reduces lending to the private sector. Repeated attempts to stabilise debt have been undermined by delays in fiscal adjustments, leading to higher interest rates and slowing growth. Without intervention, high debt levels will constrain economic growth, deter investment, and continue to elevate borrowing costs.

It is in this context that government is considering whether a formal fiscal anchor could contribute towards returning South Africa to a more sustainable fiscal trajectory. Internationally, fiscal anchors have been used to curb excessive borrowing and improve public sector efficiency. A well-designed anchor can enhance fiscal credibility, strengthen budget discipline, and foster investor confidence, ultimately supporting economic growth and stability.

Fiscal anchors are tools that are sometimes contained in Fiscal Responsibility Laws (FRLs), of which there are three main kinds:

- FRLs that define a set of principles or standards for fiscal policy, with which governments must comply (Type I).
- FRLs that consist of procedural rules governing how fiscal policy is conducted, and defining a set of procedures, formal processes, and reporting requirements relating to fiscal policy (Type II); and
- FRLs that contain hard numerical targets and ceilings for key fiscal policy outcomes such as the deficit, the level of debt, or the rate of growth of spending, etc.

South Africa’s Public Finance Management Act, 1999 (Act No. 1 of 1999- “PFMA”) and Money Bills and Related Matters Act, 2009 (Act No. 9 of 2009- “MBARMA”) are FRLs that conform largely to Type II of the taxonomy. These acts set out procedures and reporting requirements for passing budgets and for developing fiscal policy. If these were to be strengthened with a formal fiscal anchor, the formal architecture of the anchor could take one of two forms:

- **A Numerical Fiscal Rule:** This approach would introduce binding limits on debt levels or fiscal deficits. A debt ceiling, for instance, would cap government borrowing at a predefined level relative to GDP, while a deficit rule would limit annual government borrowing. These measures would enhance policy predictability, curb excessive spending, and reassure a range of stakeholders. However, numerical rules can introduce rigidity, requiring well-defined escape clauses for economic downturns or emergencies. They can also create incentives for future governments to engage in “creative accounting” to achieve the appearance of compliance while avoiding the substance.

- **Parliamentary Procedures Model:** This approach would not rely on predetermined hard fiscal targets or ceilings. Instead, they would integrate fiscal sustainability principles into the process of tabling and voting on budgets. Each administration might be required, for example, to present a medium-term fiscal plan demonstrating compliance with a set of predefined sustainability standards. Once approved, the administration's fiscal plan would be used as a standard against which its own future budgets would be measured, ensuring greater accountability and oversight.

A well-designed fiscal anchor must strike a balance between discipline and flexibility, ensuring that fiscal policies remain sustainable while allowing necessary adjustments in response to economic fluctuations. The design of a future fiscal anchor – whether it includes hard numerical targets or ceilings or sets out a formal role for fiscal standards and principles in the design and implementation of fiscal policy – would need to address some key considerations. These include:

- **Ensuring Sustainability**: The fiscal anchor must be designed to ensure that debt levels remain manageable over time.
- **Balancing Flexibility and Discipline**: While fiscal rules provide stability, they must allow for necessary adjustments during economic downturns.
- **Institutional Strengthening**: Strengthening oversight bodies such as a fiscal council might enhance compliance and credibility.
- **Public Transparency**: Clear reporting requirements would build trust and facilitate informed debate on fiscal policies.

This discussion document aims to contribute to the debate on the most appropriate fiscal anchor for South Africa, ensuring that future administrations and generations are not burdened by the predecessors and forbearers unsustainable fiscal commitments. Government will continue engaging stakeholders to refine the fiscal framework, with potential legislative measures to be considered in the coming years.

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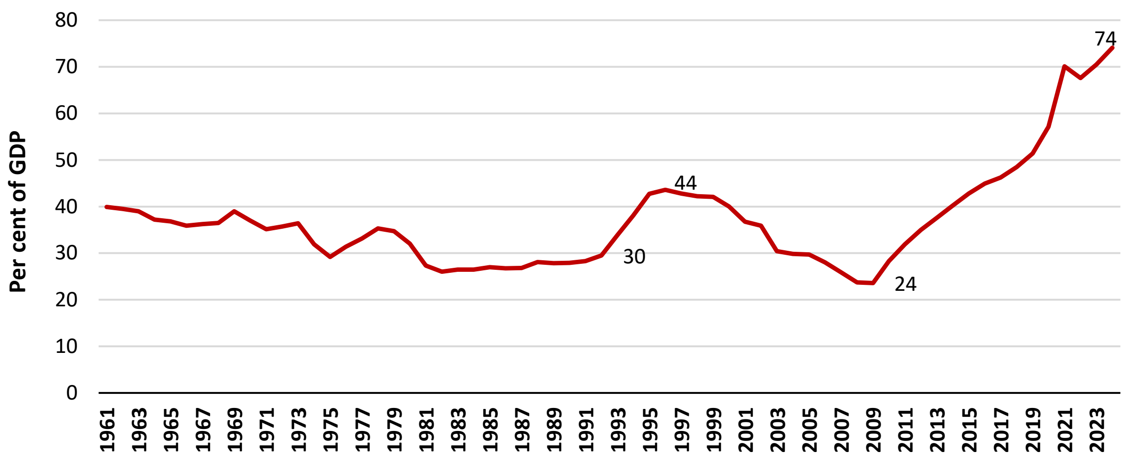
INTRODUCTION

In the 2025 Budget, the government articulates macroeconomic stability as one of its four economic priorities. Macroeconomic stability is a fundamental prerequisite for sustainable economic development and long-term national prosperity. Countries with deep, persistent macroeconomic imbalances face rising risks of crisis.[1] Even in the absence of a costly and disruptive crisis materialising, deep macroeconomic imbalances translate to slower economic growth as interest rates climb and investment levels fall. This is an important risk for South Africa because debt has built up over the past 15 years. Debt over this period has grown at both a faster rate and for a longer period than at any time since the 1960s.[2]

Figure 1: Gross debt to GDP, fiscal years, 1960/61 to 2023/24



Source: National Treasury

Between 2008/09 and 2023/24, South Africa's debt-to-GDP ratio increased from 23.6 per cent to 74.1 per cent and debt-service costs have gone from consuming 9 per cent of revenue to 21 per cent.[3] These developments have constrained the public finances. The growth in government's borrowing requirement has also crowded out the supply of credit to the private sector for investment and likely pushed up lending costs, making it more expensive to obtain funding.

[1] Carmen M Reinhart, Vincent Reinhart, and Kenneth Rogoff, 'Dealing with Debt', *Journal of International Economics* 96 (2015): S43–55; Carmen M. Reinhart, Kenneth S. Rogoff, and Miguel Savastano, *Debt Intolerance* (National Bureau of Economic Research Cambridge, Mass., USA, 2003).

[2] National Treasury, 'Macroeconomic Policy: A Review of Trends and Choices' (Pretoria: Government of South Africa, 2024); Ricardo Hausmann et al., 'Macroeconomic Risks after a Decade of Microeconomic Turbulence', *CID Faculty Working Paper Series*, 2022.

[3] National Treasury, '2025 Budget Review' (Pretoria: Government of South Africa, March 2025).

Figure 2 South Africa's debt trajectory compared with peers*

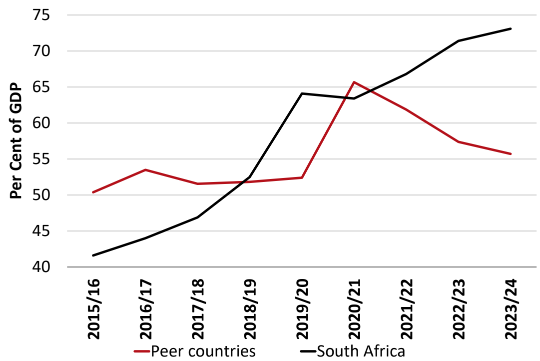
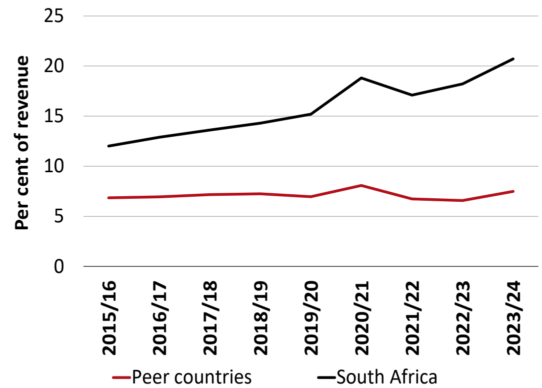


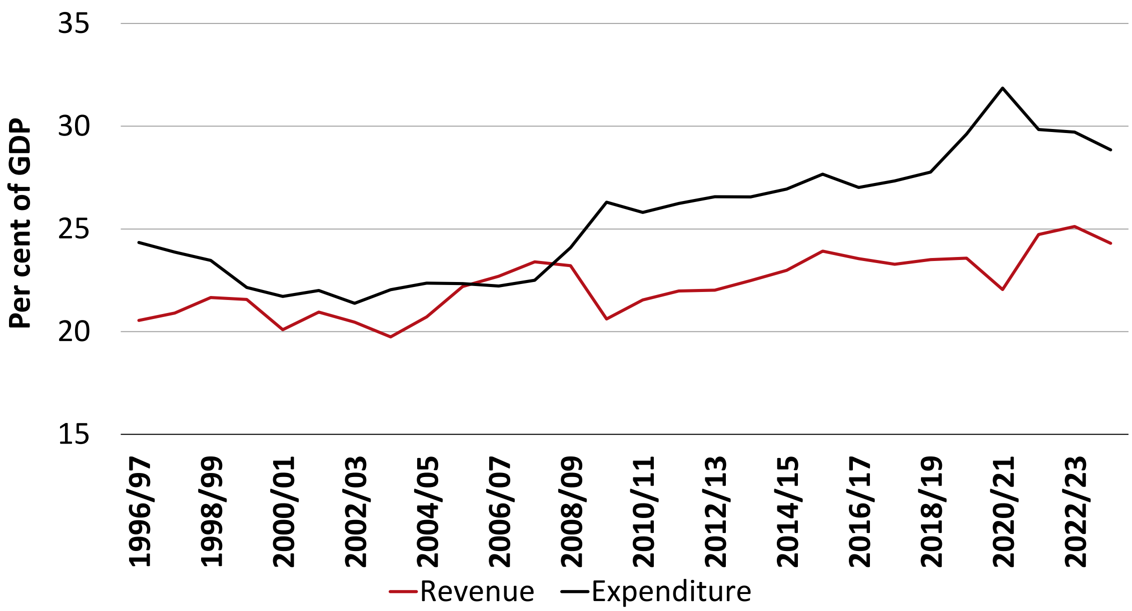
Figure 3 South Africa's debt service costs compared to peers*



** Consists of 94 emerging market economies*
Source: National Treasury

The increase in debt since 2008/09 is a consequence of the fact that growth rates have never recovered to the levels of the mid-2000s, accompanied by sustained growth in spending. The gap that opened between government spending and tax revenues at that time is only now beginning to close.

Figure 4: Main budget revenue and expenditure, 1994/95 to 2023/24



Source: National Treasury

Government interprets these trends as demonstrating the need to resolve existing fiscal imbalances. Their persistence also illustrates that steps need to be taken to ensure that large and structural deficits do not recur in the future.[4] Fiscal anchors can serve as a mechanism to achieve this if they set clear, measurable targets for debt, deficits, or expenditures.[5] Anchors such as these are embedded within Fiscal Responsibility Laws (FRLs), which provide a legal framework for ensuring fiscal sustainability. FRLs establish the institutional mechanisms and enforcement provisions necessary for the effective

[4] National Treasury, '2024 Budget Review' (Pretoria: Government of South Africa, February 2024).
[5] Krige Siebrits and Estian Calitz, 'Fiscal Anchors and Sustainable Fiscal Policy' (World Institute for Development Economic Research (UNU-WIDER), 2023).

implementation of fiscal anchors. FRLs also enhance transparency and accountability in public financial management. Well-designed FRLs provide a framework for ensuring that government spending remains sustainable over the long-term while maintaining the flexibility needed to respond to economic fluctuations. Internationally, fiscal anchors have been successfully implemented in various countries to curb excessive borrowing, reduce fiscal vulnerabilities, and enhance public sector efficiency.[6]

This discussion document examines the conceptual design, implementation framework, and potential benefits of fiscal anchors in the South African context. Drawing on international best practices, it provides a framework to discuss mechanisms for strengthening South Africa's already well-regarded macroeconomic institutions.

The document proposes that reforms that place the principle of sustainability at the centre of planning will strengthen the credibility of fiscal policy, deepen democratic debate, and bolster accountability. This would strengthen the setting of an affordability constraint that is a necessary feature of any effective budget process. At the same time, government's perspective is that this proposed reform is but one of several necessary budget process enhancements required to ensure that scarce public resources are allocated to where the social and economic impacts are greatest given South Africa's development ambitions. Policy reforms and improving the capability of the state are essential for economic growth and a major contributor to sustainably securing additional fiscal space for the state to play its essential developmental role.

OUTLINE OF THE DISCUSSION DOCUMENT

This document is structured in the following way: following the introduction, the next section describes South Africa's fiscal landscape, after which the document sets out the case for FRLs, including a discussion of why sustainability is necessary and desirable. The following sections describe the basic designs of FRLs and locate some of South Africa's fiscal policy choices within this framework. The document then turns to the question of what a fiscal anchor might look like in South Africa, focusing on two distinct approaches: one in which the anchor is a hard numerical limit and another in which the anchor is a set of procedural rules and norms that set expectations for fiscal responsibility and sustainability. The final section concludes with some of the key questions that might shape responses to this discussion document.

[6] Siebrits and Calitz; Barry Eichengreen et al., 'How Did Jamaica Halve Its Debt in 10 Years?', 2024.

SOUTH AFRICA'S FISCAL LANDSCAPE

In 2024, government assessed the outcomes of its macroeconomic policy over the past 15 years. In the review, it acknowledged two important trends. First, the average rate of economic growth has declined. Second, the ratio of debt to GDP has increased.[7] The review argued that these trends are interrelated. Slowing growth partially explains the fiscal deficit and rising debt ratio. Simultaneously, increasing debt impacted macroeconomic risk and interest rates.[8] This, in turn, contributed to declining growth. This happens through various mechanisms. These mechanisms include a rising risk premium and the crowding out of productive investment.

Slowing growth and rising indebtedness have together put a great deal of pressure on the public finances, with debt service costs rising quickly. In 2023/24, debt service costs consume 21 per cent of all tax revenues – a level exceeded only in the early 1990s when interest rates were high, and the bank rate averaged around 18 per cent.[9] The high level of borrowing sustained since 2008/09 has also led to a rapid increase in the annual value of debt redemptions. Heightened risks and higher global interest rates mean that debt that was financed at a real interest rate of around 2 per cent in 2014 must be replaced with debt with a real yield that is close to 5 per cent.[10]

Figure 5. Debt service costs as a share of main budget revenue

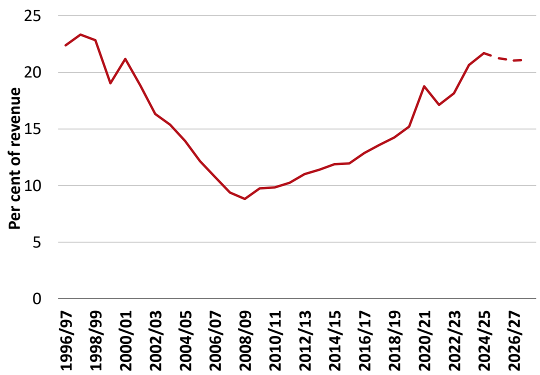


Figure 6. Debt redemptions

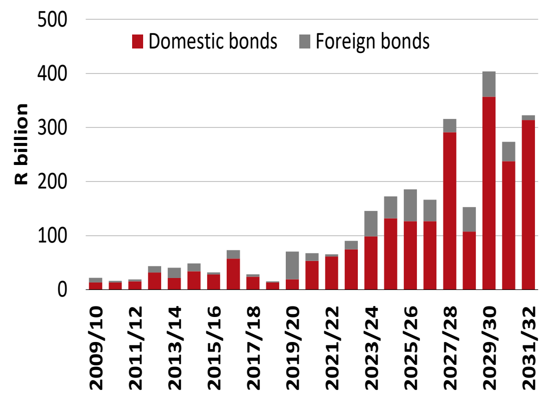


Figure 7. Risk premium

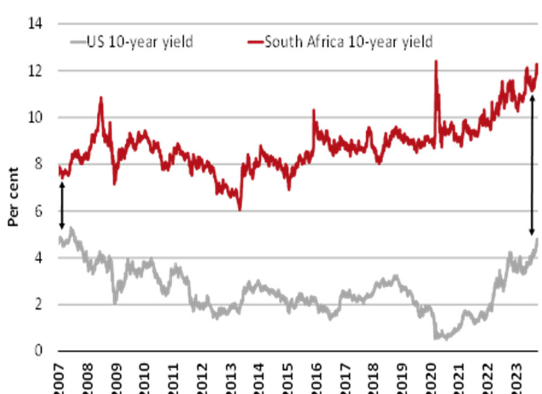
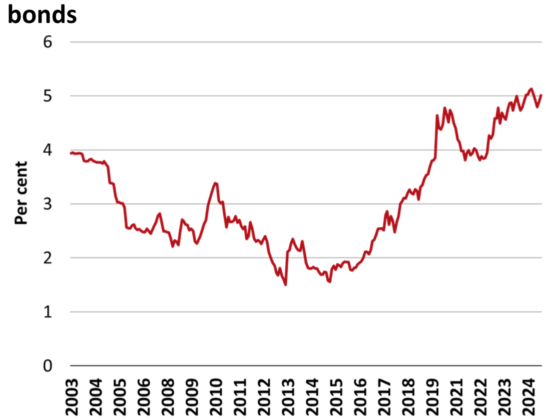


Figure 8. Real yield on 10-year government bonds



Source: National Treasury, South African Reserve Bank and Bloomberg

[7] National Treasury, 'Macroeconomic Policy: A Review of Trends and Choices'.

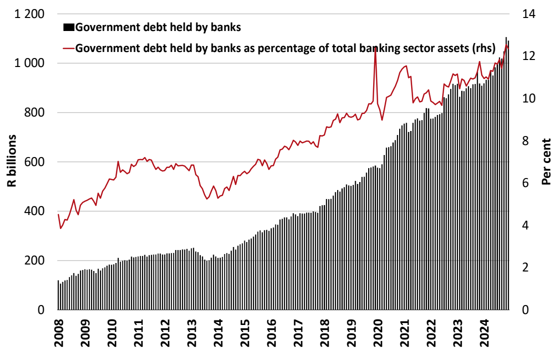
[8] National Treasury.

[9] South African Reserve Bank, 'December 2024 Quarterly Bulletin' (Pretoria, South Africa: South African Reserve Bank, December 2024).

[10] South African Reserve Bank.

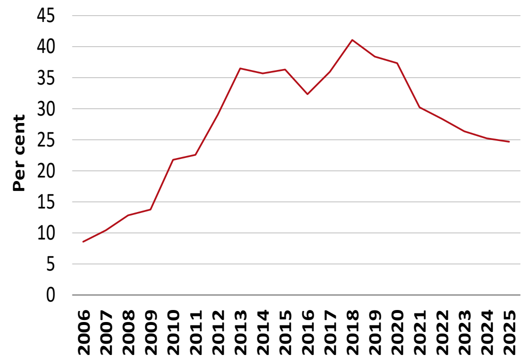
The increase in government's borrowing requirement, combined with deteriorating credit ratings, has meant that domestic financial institutions have taken on a larger share of debt. While this has allowed the government to fund its operations, the increased exposure of South African banks to government debt has significant economic implications.[11] Importantly, the country's savings have increasingly gone towards financing the government debt rather than financing private sector investment. At the same time, heightened risk to the financial sector arises from the fact that so much of its assets are exposed to the risk of sovereign credit downgrades, which, by reducing the risk-adjusted value of their assets, further reduces banks' capacity to extend credit.

Figure 9. Growth of SA government bonds in comparison to banks' total asset growth



Source: National Treasury and South African Reserve Bank

Figure 10. The proportion of government bonds held by non-resident investors



Government has sought to stabilise debt levels because it recognises this vulnerability.[12] Achieving this requires the generation of primary surpluses sufficient to stabilise the debt, the size of which is dependent on the rate of economic growth and the effective rate of interest on government debt. It has taken time for government to achieve this goal following the global financial crisis, with each budget prior to 2022 having to postpone the expected date of debt stabilisation and to raise the level at which this would be expected to be achieved.[13] This is reflected in the figure below, which demonstrates that, while most budgets have anticipated debt stabilisation in the near future, the Government has, until recently, been unable to achieve the fiscal adjustment needed to stabilise debt.[14]

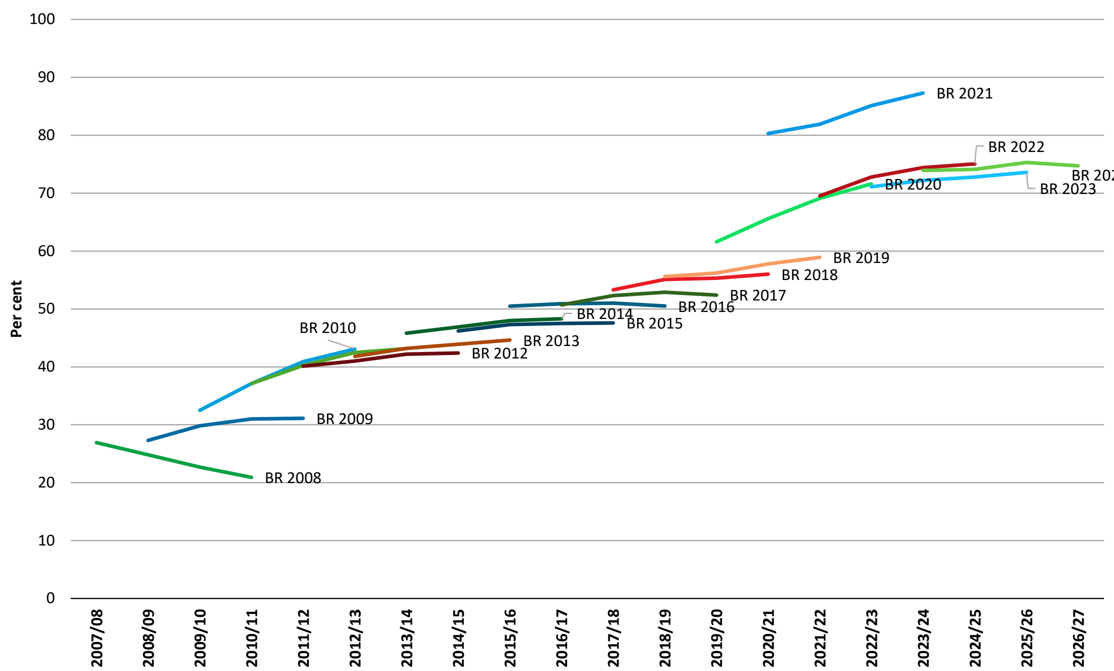
[11] South African Reserve Bank, 'Financial Stability Review October 2023' (Pretoria: South African Reserve Bank, 2023).

[12] National Treasury, '2025 Budget Review'.

[13] Philippe Burger and Estian Calitz, 'Sustainable Fiscal Policy and Economic Growth in South Africa', 2019.

[14] Philippe Burger et al., 'Fiscal Sustainability and the Fiscal Reaction Function for South Africa: Assessment of the Past and Future Policy Applications', *South African Journal of Economics* 80, no. 2 (2012): 209–27; Burger and Calitz, 'Sustainable Fiscal Policy and Economic Growth in South Africa'.

Figure 11. Changing estimates of the debt ratio over the MTEF in Budget Reviews since 2008



Source: National Treasury

Government recognises that there are significant costs associated with the constant deferral of debt stabilisation. Each year that stabilization is deferred, debt and interest rates accumulate, requiring larger and larger primary surpluses. These persistent increases in debt stock put pressure on the interest rate, reduce investment and ultimately slow growth in the economy. Simultaneously, rising debt-servicing costs impact negatively on socio-economic outcomes and make it harder to improve fiscal sustainability. This becomes a self-reinforcing cycle that needs to be broken.

Failing to stabilise the debt ratio also impacts the government's ability to respond to any shocks that may occur, be they foreign or domestic in origin. Maintaining the buffers needed to respond to the unanticipated is an essential goal of fiscal policy, but the increase in debt stock has significantly reduced the fiscal space available to government to respond to shocks to the economy and/or the public finances. Indeed, it is the fact that debt levels were relatively low at the end of the 2000s, for example, that meant that South Africa had the space needed to respond to the global financial crisis and, later, the Covid-19 emergency.

In response to these concerns, the Cabinet has since the 2023 Budget expressed renewed ambition to stabilise the ratio of debt to GDP by 2025/26. In the 2024 MTBPS, the Cabinet approved a fiscal framework that achieves this by 2025/26 as the fiscal strategy for the 2025 Budget. Further, the approved fiscal strategy aims to generate primary surpluses that will be large enough to reduce the debt ratio to 70 per cent by the end of the decade.[15] Achieving this would bring debt to a level

[15] National Treasury, '2025 Budget Review'.

consistent with an investment grade credit rating, which would, in turn, help contribute to faster economic growth.[16]

Figure 12. Average debt-service costs of peer countries by average sovereign credit rating in 2023

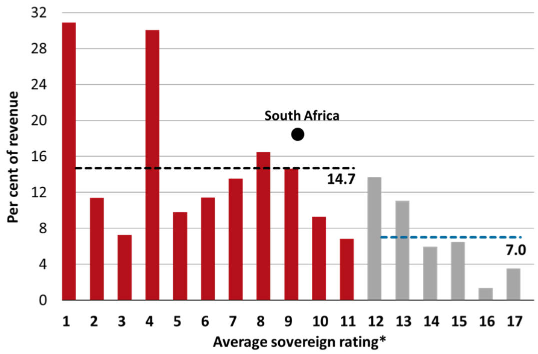


Figure 13. Average debt of peer countries by average sovereign credit rating in 2023

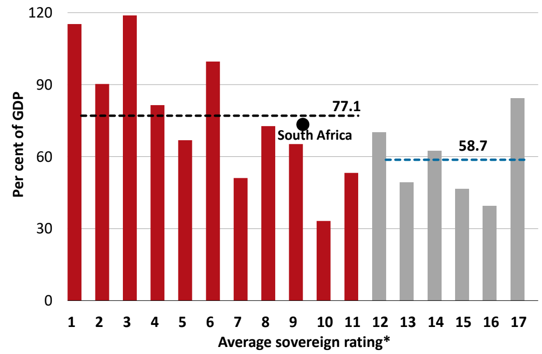


Figure 14. Average budget deficit of peer countries by average sovereign credit rating in 2023

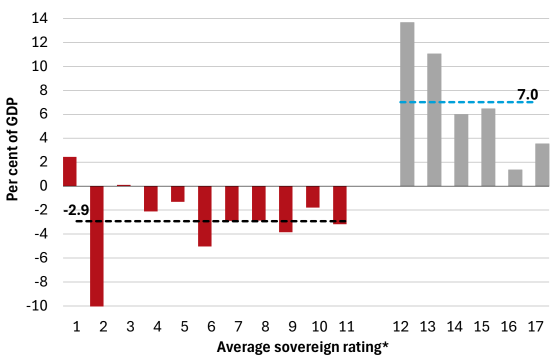
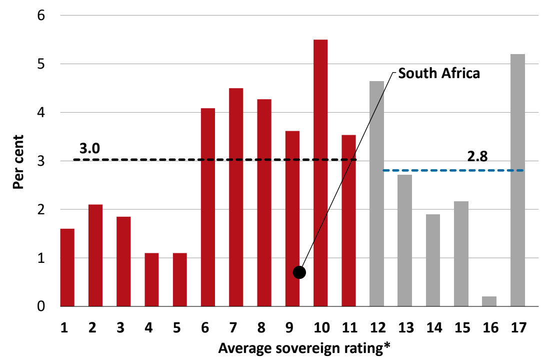


Figure 15. Average economic growth of peer countries by average sovereign credit rating in 2023



Non-investment grade   Investment grade
Average non-investment grade   Average investment grade

**Average sovereign credit rating refers to the average sovereign credit debt ratings on foreign denominated debt amongst Moody's, S&P and Fitch converted to a numerical scale from 1 (the worst) to 21(the best). A rating of 12 or higher is considered investment grade.*

Source: National Treasury and International Monetary Fund World Economic Database

[16] IMF, 'Staff Report for the 2023 Article IV Consultation', IMF Article IV (Washington, D.C.: International Monetary Fund, 2023).

THE ROLE OF FISCAL ANCHORS IN PUBLIC FINANCIAL MANAGEMENT

A fiscal anchor is a common feature of most modern systems of public financial management (PFM) and is generally accepted as an important element of best practice. [17] Its role is to set a clear objective for fiscal planning and to serve as a reference point for holding the government to account in its fiscal implementation.

Government's view is that fiscal anchors have several important benefits:

- They promote responsible macroeconomic management and serve as a measure of the sustainability of public sector debt;
- provide a framework for how revenue and expenditure should evolve thereby ensuring budget transparency and predictability. They also help ensure that fiscal variables reflect both government policy and government's affordability constraint;
- strengthen fiscal risk management which in turn creates space for fiscal discretion while reducing uncertainty. FRLs can allow for better planning of service delivery, more effective prioritisation, and higher allocative efficiency;
- reduce information gaps for economic agents, helping them understand the future direction of fiscal policy. This can lower the cost of borrowing by improving risk pricing; and
- serve as the basis of more informed debate about the budget constraint and provides a clear basis for assessing its performance in managing public finances.

The use of fiscal anchors is not an entirely new approach to South Africa's fiscal management. Indeed, government has sought to ensure that sovereign debt is sustainable since the 90s.[18] However, as the 2024 *Macroeconomic Review* identified, fiscal anchors in South Africa have not held firm, and pursuit of them has often fallen short of intention.

Government is investigating reforms that will strengthen the credibility of the fiscal plans and improve their implementation for this reason. Reforms may include the introduction of sustainability as a legislated policy goal. Operationally, this would require each administration to table in Parliament a five-year fiscal plan, the sustainability of which would need to be demonstrated and defended. Each year, with the tabling of the fiscal framework, Parliament would be able to assess the administration's fiscal policies against its stated fiscal plan and sustainability goals. If sustainability were not being achieved, corrective measures would be identified and implemented.

[17] Jason Harris et al., 'Medium-Term Budget Frameworks in Advanced Economies: Objectives, Design and Performance', *Public Financial Management and Its Emerging Architecture*, 2013, 137–74.

[18] Department of Finance, 'Growth, Employment and Redistribution: A Macroeconomic Strategy' (Pretoria, 1996); David Faulkner and Christopher Loewald, *Policy Change and Economic Growth: A Case Study of South Africa* (International Bank for Reconstruction and Development/The World Bank, 2008).

THE CENTRALITY OF FISCAL SUSTAINABILITY

Fiscal sustainability is a fundamental prerequisite for economic stability and long-term prosperity. This is particularly true of South Africa, where government spending plays a central role in supporting economic growth, ensuring service delivery, reducing poverty, and addressing structural inequalities. In this context, unsustainable policies will eventually undermine this model of growth, redistribution, and development.

Fiscal sustainability enhances a nation's creditworthiness, reduces borrowing costs, and strengthens investor confidence, all of which are crucial for sustained economic growth and societal resilience. By maintaining fiscal discipline, the government can secure favourable credit ratings, lower debt servicing costs, and channel resources into productive sectors that drive development, job creation, and economic expansion.

Prudent fiscal management is a precondition for the continued provision of critical social and economic programs over the long term. These include social grants, public healthcare, education, employment initiatives, public safety services, and infrastructure projects—programs that millions of South Africans depend on. Ensuring the long-term viability of these initiatives necessitates a careful balance between revenue generation and expenditure management. Failure to uphold fiscal sustainability could result in financial instability, an increased tax burden, or a reduction in spending.

Unsustainable fiscal policies also act as a brake on growth, creating a vicious cycle in which the rising difficulty (operational and political) in addressing fiscal sustainability increases the risk of crisis, which, in turn, reduces investment and growth.

Ultimately, South Africa needs a well-managed fiscal framework that ensures that public finances remain viable over the long-term. The risks associated with excessive debt accumulation result in deep and regressive hardship inflicted on those least able to protect themselves from the consequences of macroeconomic crisis.[19] Maintaining fiscal sustainability is therefore imperative for South Africa's economic resilience. Government can support sustained economic growth while safeguarding essential public services for future generations through responsible fiscal policy, efficient allocation of resources, and proactive debt management.

WHAT IS FISCAL SUSTAINABILITY?

Fiscal sustainability can be defined technically, but the basic idea relates to the ability of a government to maintain its spending without defaulting on its financial obligations. In some definitions, sustainability simply means that a government's debt can be repaid, which in turn means that existing debt can be refinanced so that the government will be able to continue to finance its operations.[20] More elaborate definitions might include further qualifications such as that the debt can be repaid without resorting to significant fiscal adjustment (such as major increases in taxes or large reductions in operational spending).[21] Ultimately, however, a baseline definition of sustainability is that debt

[19] Reinhart, Rogoff, and Savastano, *Debt Intolerance*; Armando Barrientos, 'Participation and Earnings of Older People in Argentina: Nice Work If You Can Get It?', *The Journal of Development Studies* 47, no. 7 (2011): 1061–79, https://doi.org/10.1080/00220388.2010.514333; John H Cochrane, 'The Fiscal Theory of the Price Level: An Introduction and Overview', *Journal of Economic Perspectives*, 2021; Serkan Arslanalp and Barry Eichengreen, 'Living with High Public Debt', in *Global Financial Flows*, 2023.

[20] Olivier Blanchard, 'Public Debt and Low Interest Rates', *American Economic Review* 109, no. 4 (2019): 1197–1229; Burger and Calitz, 'Sustainable Fiscal Policy and Economic Growth in South Africa'.

[21] International Monetary Fund, 'Review of the Debt Sustainability Framework for Market Access Countries', Policy Paper (Washington, DC: IMF, February 2021).

should not grow faster than the economy's capacity to service it indefinitely: at some point, the debt ratio must stabilise, or irresistible pressures will eventually force a crisis. In practice, therefore, a fiscal position that results in a sustained, rapid rise in debt levels is unsustainable. In simpler terms, debt is unsustainable if there is no credible plan to stabilise its growth relative to the growth of the economy.

Thought of in this way, government must formulate fiscal policy in awareness of the implications of their choices on future administrations: if policies require large additional expenditure that can only be financed through higher borrowings, future administrations will be faced with the choice of defaulting on their obligations, raising taxes, or radically reducing spending. Government recognises that these options are tough, and so today's fiscal policy must be premised on policy choices that are calculated not to create unduly onerous obligations on future administrations.

It is relatively straightforward to calculate whether policy increases the debt ratio as this largely depends on four variables: the rate of economic growth, the rate of interest on government debt, the size of the existing stock of debt, and the size of the primary surplus or deficit (the difference between tax revenue and non-interest spending). These variables work in the following way. All else being equal, when an economy's growth rate is greater than its interest rate, it is able to run a sustainable primary deficit – the size of which is dependent on how big the existing stock of debt is and the extent to which growth is higher than the effective interest rate.[22] When an economy's growth rate is less than prevailing interest rates, it needs to run a primary surplus to avoid continuous increases in debt and interest costs. If the stock of debt and the difference between the interest rate and growth is large, then the debt-stabilising value of the primary balance will be a relatively large surplus. There are important interactions between these variables: economies in which government debt is high tend to experience higher interest rates, which tends to slow growth, but each of these variables also impacts on sustainability independently of the others.

South Africa's fiscal dynamics are characterised by low growth and high interest rates.[23] At the same time, large and persistent historical deficits have created a significant stock of debt. Under these circumstances, the only way to stabilise the debt ratio is by ensuring that tax revenues exceed non-interest spending by a significant amount. If this is not done, it is a mathematical certainty that the debt ratio will rise.

It is important to note that, while moving from an unsustainable fiscal trajectory to one that is sustainable entails painful choices, the consequences of unsustainable policies are far more debilitating: faster inflation and higher interest rates, reduced investment and slower growth, increasing risk of macroeconomic crisis that would be enormously disruptive and costly. These outcomes undermine development now as well as in the future. They also impact disproportionately on the poor and the vulnerable, and they result in increasingly unbalanced public spending as debt service costs squeeze out critical spending on infrastructure and service delivery. Critically, unsustainable macroeconomic policies lead to self-reinforcing cycles of slower growth, weakened public finances and back to slower growth.[24]

[22] Blanchard, 'Public Debt and Low Interest Rates'; Olivier Blanchard, Alvaro Leandro, and Jeromin Zettelmeyer, 'Redesigning EU Fiscal Rules: From Rules to Standards', *Economic Policy* 36, no. 106 (2021): 195–236.

[23] Hausmann et al., 'Macroeconomic Risks after a Decade of Microeconomic Turbulence'; IMF, 'Staff Report for the 2024 Article IV Consultation', IMF Article IV (Washington, D.C.: International Monetary Fund, 2024); National Treasury, 'Macroeconomic Policy: A Review of Trends and Choices'; National Treasury, '2025 Budget Review'.

[24] National Treasury, 'Macroeconomic Policy: A Review of Trends and Choices' for more on the issue of the costs of unsustainable macroeconomic policies.

DESIGNING A FISCAL ANCHOR

Formal fiscal anchors are generally constituted through a fiscal responsibility law (FRL), a broad category of legal frameworks that institutionalise fiscal policies, processes, or arrangements into law.[25] Their primary objective is to enhance fiscal discipline, transparency, and accountability by committing governments to monitorable fiscal policy objectives and strategies. Though they differ significantly in substance, what unites them is that they require governments to adopt fiscal strategies that ensure sound financial practices over the medium and long term. By buttressing the structure of the management of public funds, FRLs help mitigate financial risks, provide a degree of certainty about the future course of fiscal policy, and foster economic stability through prudent fiscal behaviour.

FRLs seek to establish clear fiscal rules to prevent the emergence of unsustainable fiscal imbalances, enhance transparency through mandated disclosure of fiscal plans and outcomes, and strengthen accountability via regular monitoring and evaluation. Generally, they incorporate mechanisms for periodic review and adjustment, enabling governments to adapt to changing economic conditions while maintaining fiscal discipline. This structured approach fosters public and political engagement with the budget process, enhancing its credibility, and builds trust among citizens, financial markets, and international partners.

While FRLs include medium-term fiscal objectives or require governments to articulate these, the inclusion of numerical targets and ceilings varies depending on the legal and institutional framework.

TYPES OF FISCAL RESPONSIBILITY LAWS

FRLs can be classified into three broad categories based on their focus and level of prescriptiveness:

- **Type I: Principle-Based Frameworks** – These emphasise broad principles such as transparency, accountability, and sustainability without mandating specific procedural or numerical rules.
- **Type II: Procedural Frameworks** – These introduce requirements such as mandatory fiscal reports, fiscal policy statements, and medium-term budget or fiscal frameworks, encouraging fiscal planning without enforcing strict numerical constraints.
- **Type III: Numerical Rule-Based Frameworks** – These impose strict numerical targets or ceilings on fiscal aggregates, such as deficits, debt levels, or expenditure growth, and make these legally binding (albeit that there may be 'escape clauses' that are triggered in the event of an exogenous shock). Among the strongest – and most inflexible – of Type III FRLs are rules that set a hard limit for the quantum of debt that the government can accrue, and which render any further borrowing illegal. Systems of this kind operate, to varying degrees of success, in the United States, Germany, and Armenia.

[25] Holger Van Eden, Pokar Khemani, and RPJ Emery, 'Developing Legal Frameworks to Promote Fiscal Responsibility: Design Matters', *Public Financial Management and Its Emerging Architecture*, 2013, 79–105.

Countries adopt different FRL approaches based on their economic and institutional contexts:

- New Zealand and Australia employ principle- or standards-based approaches (Type I) that promote fiscal responsibility without rigid numerical constraints, albeit that governments are expected to provide a high degree of detail in explaining how their policies comply with the standards.
- Brazil, India, and South Africa have developed procedural frameworks (Type II) that emphasize transparency and structured fiscal management. These revolve around the provision of high-quality information about fiscal outcomes and details about plans that are expected to be implemented.
- Many European and advanced economies incorporate numerical limits (Type III) into their legal frameworks, including both ceilings of deficits and debt, though the effectiveness and suitability of these rigid constraints remain debated. Numerical limits are also often used by countries to establish fiscal credibility when facing difficulties in accessing financial markets.

THE DEBATE ON FRL EFFECTIVENESS

While it is generally accepted that all effective PFM systems should include strong procedural laws and regulations that foster fiscal sustainability (Type II rules), the extent to which these systems also embody aspects of principle-based (Type I) and numerical limit (Type III) approaches to fiscal sustainability varies considerably. There is also debate about the extent to which these systems achieve their stated goals.[26]

A key strength of the principle- or standards-based approach is its flexibility, allowing governments to set fiscal policies based on electoral mandates and economic conditions.[27] Policymakers can respond dynamically to the business cycle or exogenous shocks without being constrained by rigid numerical targets, which is particularly beneficial during economic shocks when discretionary fiscal adjustments are necessary. Additionally, principle-based FRLs foster a culture of responsible governance, encouraging long-term institutional development. That said, some fiscal standards can be quite precise and demanding: a standard that prohibited a government from borrowing to fund current spending, for example, is quite precise about what is and is not permissible without setting a hard numerical limit. The same is true of a fiscal rule-of-thumb that spending should grow no faster than the expected rate of growth of the economy which guided fiscal policy in South Africa after 2015.[28]

The effectiveness of principle-based FPLs heavily depends on the institutional culture in government, particularly with respect to the development of budgets, along with the presence of strong oversight mechanisms, including an independent press, active legislative scrutiny, and market accountability. Success also depends fundamentally on the depth of the commitment to sustainability in society and across political parties. In weaker institutional environments, and where the wider social consensus about the importance of sustainability is absent, principle-based FRLs may amount to little more than aspirational commitments without meaningful enforcement mechanisms.

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[26] Thomas Brändle and Marc Elsener, 'Do Fiscal Rules Matter? A Survey of Recent Evidence', *Swiss Journal of Economics and Statistics* 160, no. 1 (2024): 11; Zimbali Mncube, Liso Mdutyana, and Gilad Isaacs, 'Are Binding Fiscal Rules the Right Solution for Debt Sustainability in South Africa?', Discussion Paper (Institute for Economic Justice, October 2024).

[27] Burger and Calitz, 'Sustainable Fiscal Policy and Economic Growth in South Africa'.

[28] National Treasury, '1997 Medium Term Budget Policy Statement' (Pretoria: Government of South Africa, October 1997).

Proponents of numerical limits (Type III FRLs) argue that legally binding constraints, particularly deficit and debt ceilings, promote fiscal sustainability and enhance the credibility of fiscal policy.[29] They also provide valuable clarity about long-term fiscal plans, which facilitates more efficient functioning of the capital markets. These laws create predictability for investors and prevent fiscal crises by establishing clear rules.[30]

Critics, however, highlight that rigid fiscal limits can be counterproductive, particularly during economic downturns when increased government spending is necessary. Strict numerical constraints may also encourage "creative accounting" practices or lead to suboptimal policy decisions motivated by compliance rather than economic necessity. In addition, the effectiveness of removing fiscal target-setting from the executive and enshrining it in law remains uncertain, as compliance and enforcement still rely largely on political will.[31] In practice, many numerical constraints have been weakened or bypassed when political or economic circumstances demand flexibility. Because strict limits are not self-executing, in other words, their efficacy and value is not guaranteed.

THE ROLE OF FISCAL COUNCILS

Fiscal councils play a crucial role in enhancing fiscal performance and credibility under all three types of FRLs. These independent institutions provide objective assessments of fiscal policy and monitor compliance with fiscal rules:

- In Type I frameworks, fiscal councils reinforce transparency and accountability by facilitating scrutiny of government policies and providing an independent view of the extent to which fiscal policies have complied with fiscal standards, thereby fostering better-informed public debate on fiscal responsibility.
- In Type II frameworks, fiscal councils enhance procedural integrity by providing an independent view of the accuracy and comprehensiveness of fiscal data and of the extent to which medium-term fiscal plans adhere to stated goals.
- In Type III frameworks, fiscal councils uphold credibility by monitoring compliance with numerical constraints, assessing the sustainability of fiscal targets, and discouraging creative accounting practices. They may even have a role to play in determining whether fiscal rules have been breached and prescribing the changes that must be affected when this happens.

By offering independent oversight and policy advice, fiscal councils improve the effectiveness of FRLs regardless of their specific design, strengthening fiscal discipline and public trust in government financial management.

[29] Luc Eyraud et al., 'How to Calibrate Fiscal Rules A Primer' (Washington, D.C.: IMF, 2018); Luc Eyraud et al., *Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability* (International Monetary Fund, 2018); IMF, 'Staff Report for the 2024 Article IV Consultation'.

[30] Francesca Caselli et al., The Return to Fiscal Rules (International Monetary Fund, 2022).

[31] Francesca Caselli and Julien Reynaud, 'Do Fiscal Rules Cause Better Fiscal Balances? A New Instrumental Variable Strategy', European Journal of Political Economy 63 (2020): 101873; Brändle and Elsener, 'Do Fiscal Rules Matter? A Survey of Recent Evidence'.

FISCAL REFORM IN SOUTH AFRICA

South Africa has a history of fiscal reform and rules-based policy grounded in the Constitution of the Republic of South Africa, 1996. The most notable example of this is the PFMA, which set in motion a range of reforms aimed at strengthening transparency and accountability in budget-making and implementation, including the institutionalisation of medium-term budgeting and fiscal planning. In the language of the preceding section, these were Type II FRLs. This section notes some of the other initiatives that have been implemented over the past 30 years to strengthen rules-based fiscal policymaking.

The first such initiative was the Growth Employment and Redistribution (GEAR) programme, which committed fiscal policy to a tighter stance after a period of rapid debt accumulation.[32] The central fiscal proposal in GEAR was a commitment to narrow the consolidated budget deficit from 5.1 per cent of GDP in 1996/97 to 3 per cent of GDP in 1999/00.[33] To achieve this, GEAR proposed a reduction of government consumption expenditure and measures to improve the efficiency of tax collection. This involved reconfiguring the public service, reforming the fiscal planning framework and boosting economic growth to encourage public and private sector investment. Expenditure restraint and faster economic growth meant that main budget non-interest spending declined from 22 per cent of GDP in 1996/97 to 19 per cent of GDP in 2000/01.

The debt ratio, which was at 43 per cent in 1996 (the same level as it had been in 1994) did not begin to fall until the late 1990s but began to fall very quickly as growth accelerated in the 2000s, with net debt reaching a low of about 24 per cent in 2007. After the global financial crisis, however, a wide deficit opened between government's revenues and expenditure, leading to a very rapid rise in the debt ratio, which has reached over 70 per cent of GDP today. This is the context in which an increased focus has been placed on stabilising debt since 2011.

In 1997, government introduced the Medium-Term Expenditure Framework (MTEF) and the publication of the Medium-Term Budget Policy Statement (MTBPS) as part of its broader budget reforms, aiming to strengthen transparency, planning and political oversight.[34] This shift meant that three-year forward estimates were published on Budget Day, allowing departments to plan within clearly stated resource ceilings. Cooperative teams of officials from treasuries and line departments would review key sectors, present quantified policy options to Cabinet or Executive Councils, and refine spending priorities. Parliament, provincial legislatures and other stakeholders could then consider allocations in the context of medium-term projections, enabling more meaningful public debate and scrutiny of government's policy choices. These reforms also paved the way for further steps in budget modernisation, including the move toward programme-based budgeting, greater managerial autonomy within departments, and stricter accountability measures, all of which reinforced South Africa's commitment to rules-based fiscal policy.

It is important to note that both GEAR and the subsequent fiscal frameworks and fiscal policy decisions did not rely on, nor did they lead to, any statutory changes to the PFMA. Some substantial changes were introduced by the MBARM Act in 2009, however, this imposed new statutory rules on various

[32] Department of Finance, 'Growth, Employment and Redistribution: A Macroeconomic Strategy'; Faulkner and Loewald, *Policy Change and Economic Growth: A Case Study of South Africa*; Public Affairs Research Institute, 'Financing the Future: Budget Reform In South Africa: 1994-2004' (University of cape Town, 2015).

[33] Department of Finance, 'Growth, Employment and Redistribution: A Macroeconomic Strategy'.

[34] National Treasury, '1997 Medium Term Budget Policy Statement'; Public Affairs Research Institute, 'Financing the Future: Budget Reform In South Africa: 1994-2004'.

elements of the PFMA, it updated the legislation governing the MTBPS, the fiscal framework and various pieces of annual legislation related to the budget. In general, these changes remained consistently within the paradigm of Type II FRLs, dealing with the procedural processes governing how fiscal policy is developed and implemented. One important exception to this is that section 8(5) imposed several requirements on any changes that the legislature might make to the fiscal framework. These changes, which will be discussed below, set several fiscal standards/principles against which any changes made to the fiscal framework would be tested, thus introducing an element of FRL Type I into the architecture of fiscal policy.

Reforms to the Budget Process

The process of drafting its budget is one of government’s most challenging tasks, particularly in a highly unequal society characterised by high levels of unemployment and poverty in which cash transfers and government services constitute a significant fraction of poor households’ consumption. Both the level of public spending and its composition have profound effects on a range of critical variables ranging from the rate of growth to the levels of poverty, employment and inequality both in the present and into the future. Government has increasingly focused reforms on raising economic growth, not least because of the positive effect this has on government finances.

Government has recognised that there is a need to strengthen budget processes to improve both allocative (i.e. getting the optimal mix of spending) and operational/technical efficiencies (i.e. ensuring maximum value is derived from spending in each programme). To improve along both dimensions, government is seeking to make improvements to the budget process. These include:

- A heightened focus on identifying programmes the output of which is below the average for government, with a view to discontinuing those programmes where efficiencies can’t be improved
- Strengthening the capital budgeting process
- Protecting and preserving spending on the maintenance of public infrastructure to better manage life-cycle costs
- Improving procurement processes to improve value for money, and reduce fraud and corruption while ensuring that procurement spend helps transform the economy
- Tightening criteria for assessing requests for financial assistance from public entities and state-owned companies (SOCs) to reinforce the requirement that these entities conduct their business sustainably

In addition to the above, departments and public entities are expected to continuously review both the composition and efficiency of their spending to maximise impact.

In 2011, the government introduced fiscal guidelines that continue to shape fiscal policy today. These guidelines rest on three core principles: countercyclicality, ensuring that budget balances adjust to smooth out economic fluctuations; long-term debt sustainability, whereby spending decisions must guard against ever-increasing debt and interest costs; and intergenerational equity, which requires policymakers to consider the future costs of today’s programmes. To support debt stabilisation, a ceiling on non-interest expenditure was introduced in the 2012 Budget. It set a maximum level of expenditure that applied to national government departments, but excluded spending financed from dedicated revenue sources other than the National Revenue Fund.

A challenge with the expenditure ceiling is that its application has coincided with a deterioration in the composition of spending, in part because the ceiling did not always fully anticipate and accommodate the outcome of the negotiations of the public service wage agreements.[35] Retrospective measures were taken to ensure that government adhered to the ceiling, in particular the introduction of compensation ceilings and early-retirement offers.

A fiscal guideline to set the expenditure ceiling in the outer year of each fiscal framework was introduced in the 2015 MTBPS.[36] Under this fiscal rule of thumb, growth in the expenditure ceiling was aligned to long-run economic growth projections. Linking spending growth to potential growth ensures that debt does not grow more quickly than the economy's capacity to service it. By focusing on the rate of potential growth, the rule does not inhibit the adoption of countercyclical fiscal policies. The advantage of this rule was that it allowed for greater predictability and transparency in fiscal policy over the long term.

As a fiscal anchor, a preannounced expenditure ceiling (albeit one that does not have statutory force) is simple and transparent, and adherence to it is easy to assess. However, in the absence of a stated objective of stabilising debt, an expenditure ceiling may not result in the primary balances needed to achieve that goal. Secondary objectives relating to the need to maintain the composition of spending in support of the service-delivery objectives of fiscal policy may also be desirable.

The key concern about the expenditure ceiling, however, is that, by itself, it is no guarantee of sustainability and did not, in fact, ensure that debt levels stabilised (as described above). This was both because (a) the decline in average growth meant that the expenditure ceiling often assumed more rapid growth than materialised, and (b) the expenditure ceiling was not always adhered to in practice, with policy decisions, wage negotiations, and exogenous shocks often shifting spending growth above the ceiling's projections.[37] To correct this, the 2024 Budget adopted a debt-stabilising primary budget surplus as the anchor for fiscal policy over the medium term. In the context of high levels of debt, low growth, and relatively high interest rates on government debt, a reasonably large primary balance is needed to stabilise debt.

[35] Roy Havemann and Hylton Hollander, *Fiscal Policy in Times of Fiscal Stress: Or What to Do When R> g* (WIDER Working Paper, 2022).

[36] National Treasury, '1997 Medium Term Budget Policy Statement'.

[37] National Treasury, 'Macroeconomic Policy: A Review of Trends and Choices'.

DESIGNING A FORMAL FISCAL ANCHOR FOR SOUTH AFRICA

While fiscal sustainability has always been a stated goal of fiscal policy, there is currently no statutory framework that explicitly defines or prescribes this. The MBARM Act establishes procedural guidelines for budgetary processes and requires – section 8(5) provides that any amendment made by Parliament to a Money Bill must meet various sustainability conditions, but it does not impose fiscal sustainability as a requirement on budgets tabled by the Minister of Finance. Given the large and persistent deficits of the past 15 years and the associated rise in the debt-to-GDP ratio, there is a compelling argument for institutional reforms that prioritise fiscal sustainability, enhance transparency, and reinforce governmental accountability as it relates to the legislation tabled by the Minister.

One way to address this gap is to impose a formal, statutory requirement of a fiscal anchor. Such an anchor would have to balance fiscal responsibility with the flexibility needed for elected governments to fulfil their mandates. Two primary policy options warrant consideration: (i) the introduction of a statutory fiscal rule that defines a fiscal target or ceiling, compliance with which would ensure long-term debt sustainability (i.e. a Type III FRL, as described above), or (ii) a set of fiscal standards or principles that might include. One example would be a requirement that each administration submit a fiscal plan to Parliament and, when doing so, demonstrate that the borrowing plans contained are sustainable. Subsequent fiscal policy statements by the administration would be evaluated against these pre-commitments.

PRINCIPLES IN DESIGNING A FORMAL FISCAL ANCHOR

A robust fiscal anchor must address several key principles, the most important of which is that it must help ensure long-term fiscal sustainability. To do this, it must also reinforce fiscal credibility and transparency, while maintaining sufficient flexibility to respond to economic shocks.[38] Properly structured, a fiscal anchor would serve as a guiding mechanism that helps align government policy with economic stability while allowing for adaptive responses to changing conditions. It would provide a framework for maintaining fiscal discipline, preventing excessive debt accumulation, and ensuring that government policies contribute to sustainable economic growth.

A well-designed fiscal anchor helps manage debt levels and servicing costs, preventing an unsustainable fiscal trajectory. At the same time, it must not impose, implicitly or explicitly, any unrealistic or politically infeasible adjustment on future administrations. It should also be structured to discourage reliance on overly optimistic projections that could lead to delayed fiscal adjustments.

An unsustainable fiscal strategy is characterised by persistent debt accumulation without a credible path to stabilisation. To mitigate this risk, the anchor should promote disciplined fiscal behaviour, encouraging policies that balance short-term priorities with long-term economic stability.

A sustainable fiscal framework might also have to incorporate mechanisms to assess future liabilities and spending commitments, incorporate contingency planning, and ensure that government expenditures align with realistic revenue forecasts.

[38] Eyraud et al., 'How to Calibrate Fiscal Rules A Primer'.

Flexibility is essential for any fiscal anchor, but if the degree of flexibility permitted is too great, it would render the anchor ineffective.[39] A well-defined corrective mechanism should be in place to address deviations from fiscal targets while maintaining transparency in decision-making. Regular reviews and adjustments in response to economic changes help ensure the anchor remains relevant and effective in guiding fiscal policy.

The fiscal anchor must promote credible assumptions about growth, interest rates, tax revenues, and expenditures. If these forecasts are based on overly optimistic expectations about growth or about the ability of government departments to contain key cost drivers, its credibility weakens.

Independent oversight institutions that monitor fiscal performance and adherence to fiscal rules could potentially add value if they ensure accountability and foster public confidence in public finance management.[40] Furthermore, integrating independent fiscal assessments, such as evaluations conducted by a fiscal council or other non-partisan institutions, can strengthen the credibility of fiscal policy, ensure that public debate is well-informed and based on accurate information, and provide valuable insights into government decision-making.

Transparency is critical. The fiscal anchor should not incentivise questionable accounting manoeuvres or budgetary strategies that obscure substantive non-compliance. Clear and reliable fiscal forecasts, coupled with rigorous performance evaluations based on accurate data, are essential for maintaining trust in fiscal policy.

Routine publication of fiscal sustainability reports, active engagement with stakeholders, and fostering open discourse on fiscal policy decisions strengthen transparency. They help create a social consensus about the critical importance of fiscal sustainability, without which the credibility and effectiveness of fiscal anchors are undermined. Public participation in the fiscal process, such as consultations on budgetary decisions and accessibility to fiscal data, enhances accountability and allows for a more informed policymaking process. The National Treasury already does much of this work and is well-regarded the world-over for its transparency. Through enhanced accountability, policymakers can fortify the fiscal anchor's role in strengthening economic resilience and preventing fiscal mismanagement.

TYPE III FRLS: A NUMERICAL FISCAL RULE

The most stringent fiscal rules set numerical targets or ceilings for critical values in fiscal policy. Typically, these relate either to the debt ratio (or, less frequently, the quantity of debt) or the maximum permissible size of the deficit.[41] While both strategies aim to ensure fiscal responsibility, they function differently and can have different implications in different settings.

- A debt ceiling constrains the total level of public debt relative to GDP. In effect, it makes it impermissible for the government to borrow more than a pre-defined debt ceiling. Depending on economic conditions, a statutory debt limit implies a maximum permissible primary deficit or a

[39] Caselli and Reynaud, 'Do Fiscal Rules Cause Better Fiscal Balances? A New Instrumental Variable Strategy'.

[40] Caselli and Reynaud.

[41] Blanchard, Leandro, and Zettelmeyer, 'Redesigning EU Fiscal Rules: From Rules to Standards'; Siebrits and Calitz, 'Fiscal Anchors and Sustainable Fiscal Policy'.

minimum value for the primary surplus, depending on how fast the economy is growing, the effective rate of interest on government debt, and the stock of existing debt.

- Setting a maximum permissible fiscal deficit restricts annual government borrowing to a maximum permissible value but does not necessarily prevent rising debt levels unless the deficit target is calibrated for that purpose.

Both approaches offer significant advantages, particularly in terms of clarity and transparency. A well-defined numerical rule conveys easily understood information to policymakers, investors, society and households, allowing them to assess fiscal space and discipline. When such a rule is perceived as credible, it enhances policy predictability and helps lower borrowing costs by reducing uncertainty about government solvency. However, credibility is not automatic; it must be earned through consistent adherence to the rule, transparent reporting, credible enforcement mechanisms, and broad political ownership and social buy-in to ensure long-term compliance.[42]

The implementation of numerical fiscal rules is often accompanied by institutional reforms that improve budget planning and expenditure control. Establishing an independent fiscal monitoring agency, for example, or expanding the role of existing institutions, can strengthen compliance and enhance oversight. Moreover, the integration of automatic correction mechanisms—such as expenditure limits or debt brakes that might be triggered when government is in breach of the fiscal rule—can help adjust fiscal policy when warning indicators signal a deviation from sustainable levels.

Numerical fiscal rules can also introduce rigidity, particularly when deficit limits (or the implied values of the primary balance) are too strict. Overly rigid rules may constrain the government's ability to implement counter-cyclical fiscal policies during economic downturns, necessitating carefully designed escape clauses that allow temporary deviations in response to the business cycle or to economic shocks. In designing a Type III fiscal anchor, policymakers must strike a balance between fiscal discipline and the flexibility required to respond to crises, ensuring that economic stability is maintained without unnecessarily restricting public investment and essential expenditures.

A challenge with fiscal rules is the risk of circumvention. Governments subjected to these rules but unwilling to deliver the fiscal adjustments needed to comply with them have sometimes been tempted to bypass restrictions by shifting expenditures off-budget, thereby creating the appearance of compliance without its substance. This can have adverse consequences both in relation to the sustainability of fiscal policy and its credibility. The success of a fiscal anchor depends not only on its initial implementation but also on its long-term enforcement. To prevent loopholes, a Type III rule would have to be very clear about how various kinds of liability and spending commitment are to be accounted for in relation to the rule. Care needs to be taken, for example, to ensure that contingent liabilities are accounted for transparently and consistently. Similarly, attention needs to be paid to whether and how to account for the debts of subnational governments and SOCs. In this regard, a rule targeting the deficit on the main budget might have different consequences than a rule targeting the consolidated budget or public sector balance sheet. Questions might also arise about how to account for the long-term fiscal implications of existing policy commitments: The actuarial value of the long-

[42] Marina Azzimonti, Marco Battaglini, and Stephen Coate, 'The Costs and Benefits of Balanced Budget Rules: Lessons from a Political Economy Model of Fiscal Policy', *Journal of Public Economics* 136 (2016): 45–61.

term fiscal costs of commitments might be considered a liability that should be weighed in assessing the sustainability of current fiscal policies.

The complexity of these challenges should not be underestimated, but a failure to address them adequately could make a debt rule less credible.

Another important challenge is achieving political ownership and social buy-in. Fiscal rules must be perceived as legitimate and beneficial by both policymakers and the public. Without broad support, adherence to the rule may wane under political pressure, especially during economic downturns or electoral cycles. It is important, in this regard, not to assume that the precision of a hard numerical rule automatically renders it more credible: everything depends on whether future governments will feel constrained to comply with it, which, in turn, depends on the extent to which there is a social consensus in favour of sustainability.

HOW A TYPE III RULE MIGHT WORK

For a fiscal anchor of this nature to be effectively implemented, a decision would have to be taken about whether a numerical fiscal rule should target the debt ratio or the deficit or both, and this decision would also have to specify precisely how these terms are defined and how they will treat different elements of the public finances such as contingent liabilities, policy commitments, the debts of SOCs, etc. It is possible to imagine a wide variety of different specifications of these variables.

Having determined which elements of fiscal policy should be made subject to the rule, the next decision would be about the setting of the maximum permissible value that would constitute the rule. This would be a hugely consequential decision: setting a debt ceiling of 60 per cent of GDP would have enormously different implications for fiscal policy than setting a ceiling of 70 per cent. The same is true about timeframes: if a debt ceiling of 70 per cent were set, for example, the implications for fiscal policy would be very different if that ceiling were immediately enforceable or if it needed to be achieved by, for example, 2029/30. This is true also of a rule that sets a maximum permissible value for a deficit: what would that value be? Would it apply immediately, or would policymakers have a period of adjustment?

Clearly, how these debates are resolved matters a great deal for the plausibility and credibility of a numerical fiscal anchor, and decisions would have to be taken carefully. Having made the relevant decisions, several legislative amendments would be necessary:

- **Revisions to the PFMA and MBARMA:** The budget would have to adhere to a legally defined fiscal sustainability framework. Sustainability would be explicitly defined and would include an explicit numerical target for the ratio of debt to GDP and the maximum permissible size of the deficit. These terms would have to be defined clearly in the law, which would set out exactly what is and is not to be included in the calculation of the relevant values. To reinforce credibility, the annual budget processes might be reconfigured to require forward-looking assessments that estimate all the values that affect fiscal policy outcomes: growth, interest rates, cost drivers affecting spending commitments, fiscal risks, etc., over multiple years.
- **Minimizing Evasion and Enhancing Transparency:** The fiscal rule must be designed to prevent manipulation, such as the use of off-budget expenditures or shifting liabilities to state-owned companies. Oversight should be stringent, ensuring that fiscal policy remains transparent, with

escape clauses structured to allow deviation only under predefined exceptional circumstances. Establishing reporting requirements that mandate regular updates on fiscal rule compliance would further enhance transparency and accountability.

- **Enforcement and Compliance Mechanisms:** To ensure credibility, statutory provisions might have to require non-compliant budgets to undergo mandatory revision and may even prescribe the character of the changes to be affected. Independent fiscal institutions can be created and empowered to monitor adherence, assess risks, and provide oversight, reinforcing accountability and deterring any potential attempts to sidestep the rule.

- **Escape Clause:** These clauses should define clear, objective criteria for temporary deviations, such as severe economic downturns, natural disasters, or financial crises. The conditions triggering the clause must be transparent, and assessment of whether they have been triggered might be delegated to an independent agency of some kind to minimise the risk of abuse. The escape clause provisions might require that any approved departure from the rule must be accompanied by a concrete plan for returning to compliance within a reasonable timeframe to avoid undermining the rule's integrity.

A TYPE I FISCAL RULE: ROOTING THE FISCAL ANCHOR IN PARLIAMENTARY PROCESSES

A principle- or standards-based (Type I) fiscal anchor differs from a numerical anchor in that it sets out a series of principles against which the sustainability of fiscal policy is to be judged and then institutionalises the process of linking policymaking to those standards. To some extent, this is already a feature of South Africa's fiscal architecture, albeit that it is applied only to any amendments that Parliament might seek to make to Money Bills, the Division of Revenue, or the Fiscal Framework. In terms of section 8(5) of the MBARMA, any such amendments can be made only if:

- There is an appropriate balance between revenue, expenditure, and borrowing;
- debt levels and debt servicing charges are reasonable;
- the cost of recurrent spending is not deferred to future generations;
- there is adequate provision for spending on infrastructure development, overall capital spending, and maintenance;
- consideration is given to the implications of the amended fiscal framework, division of revenue, and national budget on the long-term growth potential of the economy and the development of the country;
- cyclical factors that may impact on the prevailing fiscal position are considered; and
- account is taken of all public revenue and expenditure, including extra-budgetary funds, and contingent liabilities.

One way to implement a Type I fiscal rule would be to extend principles and standards of this kind to the tabled fiscal framework and budget (not just to any amendments that Parliament might make to the budget), and then to embed the determination of the sustainability of fiscal policy in Parliamentary procedures. Under a model such as this, each administration would be required to table a comprehensive fiscal plan in Parliament within a prescribed timeframe after it comes into office, with the key expectation and requirement that the tabled plan demonstrate its sustainability by reference to the principles articulated. To do this, the tabled fiscal plan would also have to set out projections for revenue and expenditure growth, as well as the expected borrowing needs that are implied, alongside key economic assumptions regarding GDP growth, inflation, and interest rates.

This plan might then be the subject of parliamentary deliberation framed around the question of the extent to which it embodied or departed from the standards articulated in the FRLs. Debate would also address questions relating to the realism of the data, assumptions, and projections used in the fiscal plan, and their implications for long-term debt trajectories. In this way, the administration would be expected to demonstrate that its plans were sustainable and set out for the record why it believed it was not imposing undue burdens on future administrations and generations.

To prevent administrations from deferring necessary fiscal adjustments, Parliament might also ensure that any fiscal plan demonstrates that the borrowing plan is sustainable. Should a plan be deemed unsatisfactory, Parliament could reject it and require revisions. Once approved, the government would be required to draft annual budgets that were consistent with the plan, with any deviations requiring justification and being subject to legislative and public scrutiny.

Embedding fiscal sustainability within parliamentary oversight strengthens its credibility by institutionalising a structured process for defining sustainability, articulating ways in which this can be assessed, and reviewing whether budgets conform to this. This approach can be further reinforced through public consultations, enabling stakeholders, experts, and civil society to provide input. Public hearings and deliberative sessions would enhance transparency and ensure fiscal policy decisions are informed by diverse perspectives.

This approach also helps to balance fiscal discipline with policy flexibility. Requiring fiscal plans at the start of each administration's term ensures policies remain relevant to prevailing economic conditions while avoiding the imposition of rigid constraints. That said, flexibility introduces risks, including inconsistent fiscal trajectories between administrations. One concern with an approach of this kind, therefore, is whether markets would view the framework as sufficiently binding to ensure fiscal sustainability, and, if this were not the case, whether the implementation of a Type I fiscal anchor would reduce South Africa's sovereign risk premium.

HOW A TYPE I RULE MIGHT WORK?

For this fiscal anchor to function effectively, several legislative and institutional measures would have to be introduced, depending on the precise substance of the standards articulated in the FRL:

- **Defining Sustainability Metrics:** Legislation would have to set out the standards (including an operational definition for fiscal sustainability) against which fiscal plans would be assessed. These might include all, some, or none of the standards currently set out in the MBARMA.
- **Fiscal Plan:** The PFMA might be amended to insert a requirement that the first MTBPS of any administration would have to include a fiscal plan detailing a new government's expenditure and revenue projections and motivating for why this can be considered sustainable.
- **Mandating Parliamentary Oversight and Approval:** Every MTBPS and Budget would be assessed against the standards and against the administration's own fiscal. The onus would lie, in the first

instance, on the administration to demonstrate the consistency of any MTBPS/budget with the fiscal standards and its own fiscal plan. Parliament would be required to evaluate the extent to which the strategy aligns with the plan, recommending or requiring changes if it were to identify any inconsistency or if the projections lack credibility.

- **Enhancing Transparency through Public Hearings:** Parliamentary committees would scrutinise fiscal plans through public hearings, incorporating expert testimonies and civil society participation to strengthen accountability in fiscal policymaking.

Institutionalising Independent Fiscal Oversight: To enhance credibility, an expansion of the roles of the Finance and Fiscal Commission and Parliamentary Budget Office might be considered. One or both offices could be given responsibility for advising Parliament of the alignment of fiscal policy with the principles of the law, as well as assessing the realism of government projections, monitoring fiscal risks, and providing non-partisan evaluations of fiscal rule adherence.

ISSUES RAISED DURING INITIAL ROUNDS OF CONSULTATION

During a round of informal discussions about the desirability and design of a fiscal rule with various stakeholders and experts, two of the most frequently articulated concerns were:

- A fiscal rule might imply or require a fiscal adjustment that is unrealistically large.
- A fiscal rule would limit policymakers' choices when confronting South Africa's challenges.

WOULD A FISCAL RULE RESULT IN VERY LARGE CUTS IN SPENDING OR INCREASES IN TAXES?

It is evident from the literature on fiscal rules that it is not unusual for them to fail to achieve their stated goals of containing spending or stabilising debt. One of the reasons for this is that governments find themselves unable to make the fiscal adjustments needed to comply with the rule. This may be because the operational or political costs of implementing the spending cuts or tax increases needed are such that a government cannot give effect to them without imposing severe hardship on affected parties or risking a loss of confidence and support. If this is the case, the value of introducing a new fiscal rule is diminished: if the new rule requires action that a government cannot deliver, and if this is known in advance, the rule arguably serves no purpose and adds no value.

There are two kinds of responses to this concern:

- The fact that implementing a new fiscal sustainability rule requires action that a government may be unwilling or unable to take may impact on the value of the rule at that moment, but it also demonstrates retrospectively how valuable having such a rule would have been if it had been in place at the time when the fiscal policy first became unsustainable. Indeed, delaying a fiscal adjustment always increases the size of the needed adjustment unless growth accelerates in the interim. The earlier a fiscal rule raises the salience of concerns about sustainability, the greater its value to society.
- A second response is that it may be politically and operationally difficult to comply with a new rule if it requires a deep and rapid adjustment, but the political difficulty of making that adjustment does not in itself render an unsustainable fiscal position sustainable. The fact that it may be politically difficult to raise taxes, for example, does not reduce the burden of debt service costs on the fiscus. Indeed, one could argue that any arbitrarily high level of debt is repayable for a government that is able to impose arbitrarily high levels of taxes.

WOULD A FISCAL RULE LIMIT POLICYMAKERS CHOICES?

It is sometimes argued that the constraints that fiscal rules impose on policymakers are either illegitimate or that they result in suboptimal decisions.

It is true that numerical fiscal rules, by design, limit fiscal discretion, though the extent to which this is the case depends very much on the design of the rule itself. A rule that sets a maximum allowable ceiling on the size of the fiscal deficit, for example, might result in policymakers' having to choose between a suboptimal response to an economic downturn or violating the rule. Not all fiscal rules would do this, however: a rule targeting the debt ratio, for example, would not necessarily prevent policymakers from implementing a fiscal stimulus in the face of a cyclical downturn since debt-financed public spending in those circumstances should have a multiplier that is larger than one, resulting in a lower debt ratio than if no stimulus were implemented.

Thus, the extent to which a fiscal rule constrains policymakers depends on its construction. That said, the fact that a fiscal rule constrains policymakers' choices is, in fact, its purpose: a fiscal rule is supposed to make it harder to adopt policies that may have unclear or short-term benefits, but which create costs for future administrations and generations.

A different kind of criticism is that a fiscal rule might offend principles such as the sovereignty of the constitution or of parliament. In a democracy, fiscal policy should be debated to better reflect the diverse interests and priorities of citizens.[43] So, even as it sets some constraints on policymakers' choices, it is important to its own legitimacy and credibility that a fiscal rule does not stand in the way of democratic debate about taxation, public spending and public sector liabilities.

A related concern is that a fiscal rule might prevent government from delivering on its constitutional obligations to address socio-economic rights. This is an outcome that government is committed to avoiding, and, indeed, to the extent that there are concerns that fiscal sustainability is incompatible with rapid progress on socio-economic outcomes, the experience of the 1990s and early 2000s demonstrates the opposite: between 1997 and 2004, the debt ratio fell from 42 per cent to 30 per cent of GDP and debt service costs declining from 4.6 per cent to 2.9 per cent of GDP. Despite a narrower fiscal deficit, real per capita spending by government increased.[44] Between the late 1990s and the 2000s, public spending doubled in real terms, funding a large expansion of social and capital budgets. The period was also associated with dramatic improvements in a range of socio-economic indicators.

[43] Alberto Alesina and Andrea Passalacqua, 'The Political Economy of Government Debt', *Handbook of Macroeconomics* 2 (2016): 2599–2651.

[44] Faulkner and Loewald, *Policy Change and Economic Growth: A Case Study of South Africa*.

Figure 16. Life expectancy

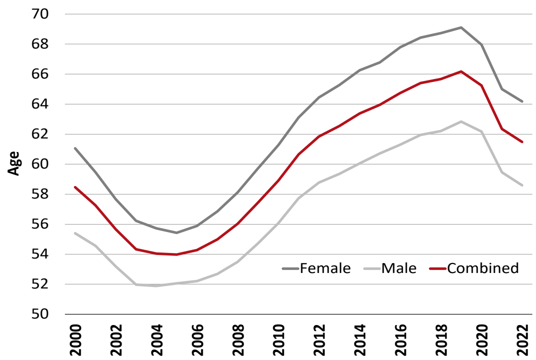


Figure 17. School enrolment

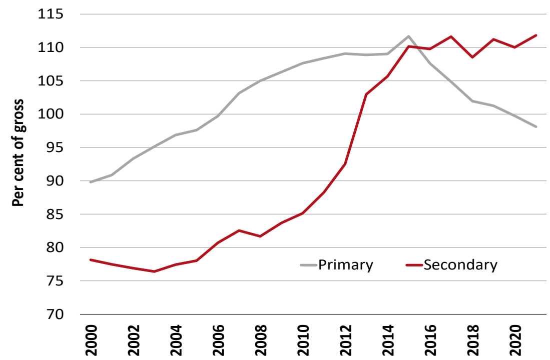


Figure 18. Infant mortality

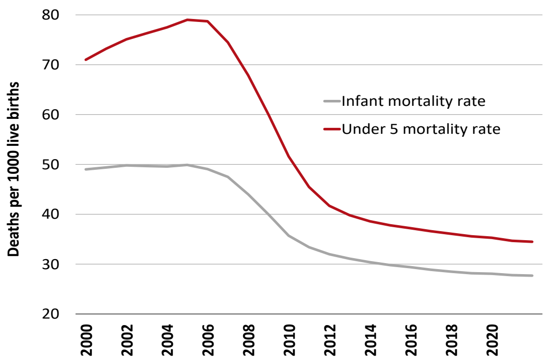
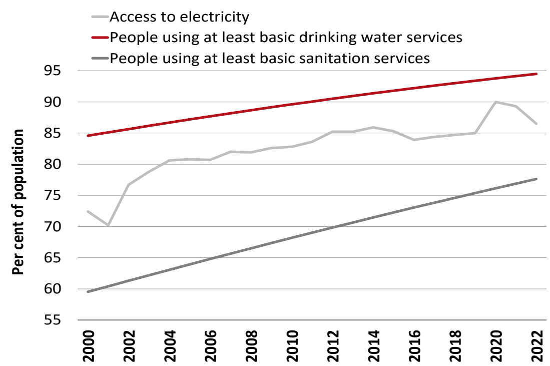


Figure 19. Access to basic services



Source: World Bank Developmental Indicators

Moreover, it is not just that sustainable fiscal policy is compatible with rapid improvements in socio-economic outcomes: unsustainable fiscal policies will undermine development by slowing growth and diverting scarce resources from developmental needs to servicing debt. Indeed, as noted above, debt service costs have risen from 9 per cent of tax revenues in 2008/09 to 21 per cent in 2023/24. Rapidly rising interest costs reduce the progressiveness of government spending by crowding out putting pressure on government budgets and reducing fiscal space available for priority expenditure programmes. Worse, unchecked growth in debt servicing costs could ultimately trigger a fiscal crisis which will disproportionately affect the poor.[45] Fiscal or financial crises would severely limit government's ability to finance the progressive realisation of rights.

In this regard, an important nuance that is sometimes lost in the debate about fiscal rules relating to the size of the deficit or the level of debt is that they target the amount of borrowing government engages in, not the level of spending. By themselves, high levels of spending would not violate a fiscal rule targeting the level of debt or the level of the deficit but would do so only if tax revenues were also substantially lower than spending levels. If there are political and economic constraints on raising tax revenues (including effects of higher taxes on growth), then spending levels need to be constrained to levels that can be sustainably financed, failing which a fiscal crisis will be inevitable.

[45] Barrientos, 'Participation and Earnings of Older People in Argentina: Nice Work If You Can Get It?'; Felix Rioja and Neven T. Valev, 'Does One Size Fit All?: A Reexamination of the Finance and Growth Relationship', *Journal of Development Economics* 74, no. 2 (2004): 429–47, https://doi.org/10.1016/j.jdeveco.2003.06.006.

CONCLUSION

South Africa has many socio-economic challenges that can be mitigated and resolved only if the economy grows both more quickly and more inclusively than it has done for the past 15 years. Absent sustainable public finances, however, it is all but inconceivable that economic growth will rise far enough and be sustained for long enough to generate the resources needed to address these challenges. Indeed, unsustainable fiscal policies, which impose large costs on the economy, are deepen South Africa's existing challenges by raising the risk of crisis, which, in turn, leads to less investment and higher interest rates.

Addressing the underlying causes of unsustainable policies requires strong institutions, a high degree of technical and political skill, and a measure of social consensus about the need to make the adjustments necessary to move to a sustainable trajectory. The challenges of doing this are not to be underestimated.

It is in this context that discussion about the desirability of a fiscal anchor should be located, and the key question to ask is whether and to what extent such an anchor will help ensure that fiscal sustainability is pursued and achieved. Even the most enthusiastic proponents of fiscal anchors do not see them as panaceas, so it is important to calibrate discussion about fiscal anchors appropriately: we should not ask whether a fiscal anchor would solve the problem of South Africa's unsustainable fiscal position, but whether an appropriately designed anchor would make it more likely that fiscal policies would become more sustainable. Framed this way, the evidence seems broadly favourable: while countries violate the terms of their fiscal rules relatively frequently, overall, countries with fiscal anchors have somewhat better fiscal outcomes than countries that do not.

It is plausible, of course, that the causality here runs in the opposite direction, and that countries with fiscal anchors are the ones that are less likely to adopt unsustainable fiscal policies. Even if this is the case, however, an important function of a fiscal anchor is that it is a potentially important driver of social and political engagement with the issue of sustainability and its importance. Adopting a fiscal anchor and/or debating the substance of the anchor provides an opportunity to address questions of sustainability, raise its political salience, and help build a consensus about what sustainability means and why it is important.

This, then, is one of the goals of the publication of this discussion document: it should be seen as a prompt for much greater engagement by social and economic actors about the underlying causes of our unsustainable fiscal trajectory, and what can be done about it. This, it is hoped, will make possible a fruitful debate about pros and cons of fiscal anchors in general, and of different kinds of fiscal anchors. National Treasury intends, therefore, to use this discussion document to engage a wide range of experts, institutions, and representative organisations about the challenges of sustainability and the desirability – or otherwise – of using a fiscal anchor to improve South Africa's fiscal outcomes and ensure that future administrations (and generations) do not have to bear the burden of unsustainable policies taken by earlier administrations.

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