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## Final Submission on the draft SADC Model law on Public Finance Management

The request by the Acting Secretary to Parliament of South Africa, Ms P Tyawa for the Parliamentary Budget Office to provide a final submission on the draft SADC Model law on Public Financial Management refers,

The Parliamentary Budget Office submit that the requirement of a debt ceiling should be excluded from the draft Part 8 on Government Borrowing, to allow further considerations and take into account the various literature views on government borrowing.

The section on Rationales and Objectives in the draft explains that an overarching objective of the Model Law is "to ensure that SADC national Parliaments are enabled to conduct their legislative, budgetary and oversight functions for public financial management in a way that is transparent, efficient and responsive to the needs of SADC citizens". The PBO is concerned that the requirement of a debt ceiling may, actually in reality, serve to undermine transparency, lead to inefficiency in the management of public finances within countries and potentially force governments to inadequately allocate resources to addressing the needs of SADC citizens.

The ability to manage debt appropriately should be sufficiently covered if Section 91 on the Debt Ceiling is excluded from Part 8 on Government Borrowing, particularly when Section 8 is read together with Section 65 on Sustainable Fiscal Policy in Part 7 on the National Budget.

If one assumes that most countries in the SADC region will not have unexpectedly large increases in gross domestic product (GDP) and government revenues, the imposition of a debt ceiling would require governments to reduce expenditure enough to achieve budget surpluses. These surpluses would be used to pay off debt and thus reduce the debt stock. Budget surpluses would have to be achieved over many years in order to sufficiently reduce the debt stock enough to achieve the relatively low debt-to-GDP ratios mentioned in the draft model law.

If one further assumes that in the short-term, most SADC countries will not be able to find very large amounts of savings through increasing efficiency of government expenditure and reducing wasteful expenditure and corruption then the amount of money available to governments for expenditure in real terms (i.e., after taking into account inflation) will decline. And, even if there are large improvements in efficiency of spending, including waste and corruption, a strategy to pursue budget surpluses to reduce debt stock will in all likelihood be a major obstruction to addressing the needs of SADC citizens, including the pursuit of the Sustainable Development Goals (SDGs).

To make matters worse, the imposition of a debt ceiling in the form of a debt-toGDP ratio creates the untenable situation where instead of ensuring that governments are fiscally responsible, the imposition of a debt ceiling makes the budgeting process dependent on two key macroeconomic variables outside of the control of governments:

- Nominal GDP of the country, and
- The exchange rate that influences the local currency value of government debt in a country

The proposed fiscal rules will make government's policy-making and budgetary decisions arbitrary and susceptible to exogenous factors, including amongst others:

- Natural disasters, climate related extreme weather events, and pandemics;
- Financial, economic, political, geopolitical, and health problems in other countries and regions that affect global and economic performance of SADC countries;
- Exuberance or negative sentiment in global financial markets that increase exchange rate volatility;
- Regulatory & policy change in other countries affecting global financial liquidity; and
- Bank and financial crises and contagion outside of the SADC region

In short, the imposition of the suggested debt ceiling would most likely lead to the requirement of perpetual revisions to countries' fiscal frameworks. The imposition of this arbitrary metric would force repeated revisions to expenditure and adversely affect the efficacy of government programmes and ability to plan.

The Parliamentary Budget Office describe the setting of a debt ceiling as an arbitrary metric because there is no agreed upon level within the economics literature of government debt-to-GDP ratio that would be described as unsustainable and harmful to GDP (lack of consensus on optimal level of debt). For example, one of the most influential relatively recent published articles by Reinhart and Rogoff (2010)[1] that estimated that debt-to-GDP levels of 90% would have a negative impact on GDP was shown to be incorrect. Herndon, Ash and Pollin (2014)[2] replicated the calculations of Reinhart and Rogoff, they "find that selective exclusion of available data, coding errors and inappropriate weighting of summary statistics lead to serious miscalculations that inaccurately represent the relationship between public debt and GDP growth" (p.257). Their estimates after correcting these errors in Reinhart and Rogoff's calculations and using their estimation method and the same sample of countries found that "over 1946–2009, countries with public debt/GDP ratios above 90% averaged 2.2% real annual GDP growth, not −0.1% as published" (ibid).

Another recent influential article that seemed to persuade many policymakers to pursue fiscal consolidation to reduce government spending, deficits and debt was Alesina and Ardagna (2009)[3]. Alesina and Ardagna claimed to find empirical evidence over a large sample that successful government budget reductions and reduced debt is associated with higher growth. Their view was of "expansionary austerity" and they theorised that when governments decreased expenditure and debt they increased credibility with private sector business people and that this increased confidence of business in government supported increased private sector investment. It turned out that Alesina and Ardagna's empirical work was

[1]Reinhart, Carmen M and Kenneth S Rogoff (2010),"Growth in a Time of Debt", *American Economic Review: Papers and Proceedings 100* (May 2010): 573-78.
[2] Herndon, Thomas, Michael Ash and Robert Pollin (2014), "Does high public debt consistently stifle economic growth? A critique of Reinhart and Rogoff", *Cambridge Journal of Economics*, 38(2): 257–279.
[3] Alesina, Alberto and Silvia, Ardagna (2009), "Large Changes in Fiscal Policy: Taxes Versus Spending", National Bureau of Economic Research (NBER), Working Paper No 15438.

seriously flawed. The International Monetary Fund (IMF 2010)[4] exposed that the data used by Alesina and Ardagna to classify fiscal policy as being expansionary or contractionary had very little connection with actual fiscal policy changes in their sample countries. It is generous to conclude that the empirical work on "expansionary austerity" was valueless for policy but unfortunately it remains influential in policy discussions about government deficits and debt.

Given the arbitrary nature and potential impact of exogenous factors on the proposed debt ceiling, the Parliamentary Budget Office add that the approach to fiscal sustainability should also take into account the needs of SADC citizens, including measures to achieve the SDGs taking into account the need to create decent work opportunities and to significantly reduce high levels of poverty and inequality. The pressure to pursue budget surpluses will increase attendant pressures to (amongst others):

- Increase taxation;
- Further cut government spending; and
- Reduce public sector COE

The Parliamentary Budget Office is concerned that measures to reduce and maintain an arbitrary debt-to-GDP ratio, and the potential risk it creates for perpetual revisions of budgets are going prove to be not socially or politically feasible, thereby further damaging fiscal credibility, because they may to lead to:

- significant public opposition to the possibility of reduced expenditure and tax increases;
- potentially damaged relations between government managers and workers as public sector wages and headcounts may have to shrink (as well as the possibility of increased inefficiency and corruption related to reduced morale amongst public sector employees); and
- the heightened potential for increased economic uncertainty

The Parliamentary Budget Office is further concerned that the narrow economic perspective to impose a debt ceiling within a law on public finance management is informed by a specific approach to mainstream macroeconomic theory and how it informs macroeconomic policy. In other words, the Budget Office is concerned that by drawing only on this narrow macroeconomic perspective the draft model law fails to take account of alternative views of fiscal policy, deficits and debt of a great many mainstream and heterodox macroeconomists.

Mainstream economists have increasingly questioned and critiqued the orthodox approach to fiscal policy since the late-1990s and these debates have intensified since the global financial crisis and recently with the economic difficulties experienced during the Covid-19 pandemic across the world. In fact, the changes in the practise of fiscal policy, particularly in developed countries, has in some cases preceded the changes in macroeconomic theory. Even before the pandemic, there was a strong view amongst senior policymakers in many countries that a new view of fiscal policy and government debt was required. For example, Furman (2016)[5], who at the time of writing was the Chairperson of President Obama's Council of Economic Advisers, (pointing to similar views in earlier articles by the International Monetary Fund (IMF) and Organisation for Economic Cooperation and Development(OECD)), explains a shifting "tide of expert opinion" and an emerging new consensus on fiscal policy. With regard

[4]IMF (2010), "From Stimulus to Consolidation: Revenue and Expenditure Policies in Advanced and Emerging Economies", mimeo. (Available from https://www.imf.org/external/np/pp/eng/2010/043010a.pdf)
[5] Furman, Jason (2016), "The New View of Fiscal Policy and Its Application", presented at the Global Implications of Europe's Redesign Conference in New York, NY, USA on 5 October 2016.

to deficits and debt, the new mainstream macroeconomic expert opinion has shifted against what is referred to as the "Ricardian equivalence" thesis, which claimed that the overhanging burden of increased debt (and behaviour due to the expectation by taxpayers that they would have higher taxes in the future) caused by an effort by government to use fiscal expansion to stimulate an economy would cancel out that stimulative effect. It also recognises empirical work over many years that raises serious critiques of the generalisation that increased government debt crowds out the private sector's ability to borrow and use that borrowing for investment. Furman (2016: 2) says that the new view of fiscal policy recognises that fiscal stimulus "is often beneficial for effective countercyclical policy as a complement to monetary policy" and that discretionary fiscal policy "in some circumstances can even crowd in private investment". He adds, that this new view is that "fiscal space is larger than generally appreciated because stimulus may pay for itself". Of interest to SADC countries, this new view asserts that "there may be larger benefits to undertaking coordinated fiscal action across countries" (ibid).

The aftermath of the global financial crisis of 2008 and the experience with fiscal policy in response to the Covid-19 pandemic has heightened debate about discretion and rules in fiscal policy. The Office share the views of a recent influential article by well-known macroeconomists (including an economics nobel laureate) Orszag, Stiglitz and Rubin (2022: 282)[6] that succinctly summarises the problem with top down fiscal rules:

> *"We have grown skeptical about the usefulness of basing fiscal policy on any top-down anchor. Such anchors are supposed to promote fiscal sustainability, but it is hard to know where any such sustainability threshold is. Even if we knew the critical threshold value, budget outcomes are subject to very wide confidence intervals even over a window as short as a few years. Even if we knew that there would be deep concerns if debt or deficits exceeded a given top-down anchor, that knowledge by itself would not provide much guidance about what we should do today".*

They propose a new approach that combines automatic adjustment to economic conditions supported by fiscal discretion; they advocate a view that "… fiscal discretion is retained but exercised after making the budget adjust more automatically and rapidly in areas where there is broad consensus that doing so is consistent with achieving broader societal goals" (ibid).

In summary, the Parliamentary Budget Office submits that the SADC draft model law of PF requires a different perspective from its current view of imposing a top down approach to fiscal rules, particularly the imposition of a debt ceiling on governments. The Office has presented practical arguments to show why this approach may be untenable. The Office also offer different perspectives against a debt ceiling that have become very influential amongst mainstream macroeconomic experts and policymakers that is forming the new mainstream macroeconomics consensus with regard to fiscal policy and government debt.

[6] Orszag, Peter R, Robert E Rubin, Joseph E Stiglitz (2022) "Fiscal resiliency in a deeply uncertain world: The role of semiautonomous discretion", *Industrial and Corporate Change*, 31(2): 281–300.

The Parliamentary Budget Office has been established in terms of the Money Bills and Related Matters Act (Act 9 of 2009). The Parliamentary Budget Office provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills (Macroeconomic and fiscal policy). The Office supports the implementation of the Money Bills and Related Matters Act by undertaking research and analysis for the Parliament of South Africa.

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