National government debt

7

Introduction

The government, like most other participants in the economy, must from time to time make use of credit to balance its books. The government's borrowing power is, however, restricted by the Public Finance Management Act, Act No. 1 of 1999 (previously by the Exchequer Act, Act No. 66 of 1975). This Act allows national government to borrow money to:

- finance the national budget deficit (i.e. the difference between revenue and expenditure of national government);
- refinance maturing debt or a loan redeemed before the maturity date;
- obtain foreign currency;
- maintain credit balances on a bank account of the National Revenue Fund; and
- regulate the domestic monetary situation should the necessity arise.

Domestic versus foreign debt

Government debt exists because the government has borrowed, implying that the government has a liability to the lender of the money. The lenders of money may be either residents of the country or non-residents. Money owed by government to residents is described as domestic debt, whereas that owed to non-residents is known as foreign debt. Both kinds of debt have to be repaid by or on a specified date and the details of the kind of debt and its repayment are recorded when the debt is contracted. At the end of March 2006 the national government's foreign debt amounted to only 12,7 per cent of its total debt, with the remaining 82,3 per cent sourced in the domestic market.

Nominal value

Debt is valued in nominal terms, i.e. the amount the government has to repay when the debt matures. The nominal value often differs substantially from the actual cash received because new debt issues may be sold at a premium or discount, i.e. at a higher or lower price than the nominal value, and outstanding debt may be redeemed through a repurchase transaction in the market at prices below or above the nominal value. The government has to pay interest on its outstanding debt, which varies according to the nature of the instrument. Some instruments earn interest at a coupon rate payable at specific time intervals, the yield on others which are sold at a discount or premium may differ from the coupon interest, and some instruments' earnings are capitalised over their lifetime and paid on maturity. At the end of March 2006 the annual interest costs on national government debt, as a percentage of total expenditure of national government, amounted to more or less 12 per cent.

Debt instruments

National government uses the following debt instruments to obtain funds in the domestic and foreign markets:

Domestic market

- Government bonds – Government bonds are the most important instruments used for financing purposes. South African government bonds (widely referred to as RSA bonds) are a negotiable and transferable instrument listed on the Bond Exchange of South Africa and are issued for various terms, with durations of up to twenty-five years. The South African Reserve Bank acts as agent of the government in placing new government bonds on auction through a system of primary dealers.
- Treasury bills – Treasury bills are short-term debt obligations which are in bearer form with a term not exceeding twelve months. Tender bills, with a tenure of 91 days, 182 days and 273 days, are allocated by the South African Reserve Bank on behalf of the government at a weekly tender on Fridays, for settlement the following week. The weekly Treasury-bill tender rate is a prime indicator of money-market conditions. Special tender bills are issued on any day of the week for varying periods of not longer than one year.

Other instruments include:

- Loan levies
- Special non-marketable bills
- Non-marketable bonds

Foreign markets

- Bond issues – these are public issues in international capital markets.
- Loans – these are loans negotiated with international banks and lending institutions.

Financial guarantees by national government

In addition to its direct indebtedness, the national government is also a guarantor of certain third-party loans. The national government has issued formal contractual guarantees in respect of certain indebtedness of wholly or partially state-owned entities. These guarantees are only transformed into actual indebtedness once the entities fail to meet their obligations and therefore constitute contingent liabilities.

Although government should, in theory, only incur debt to finance capital expenditure, the total debt of the government also includes debt incurred to finance current expenditure.

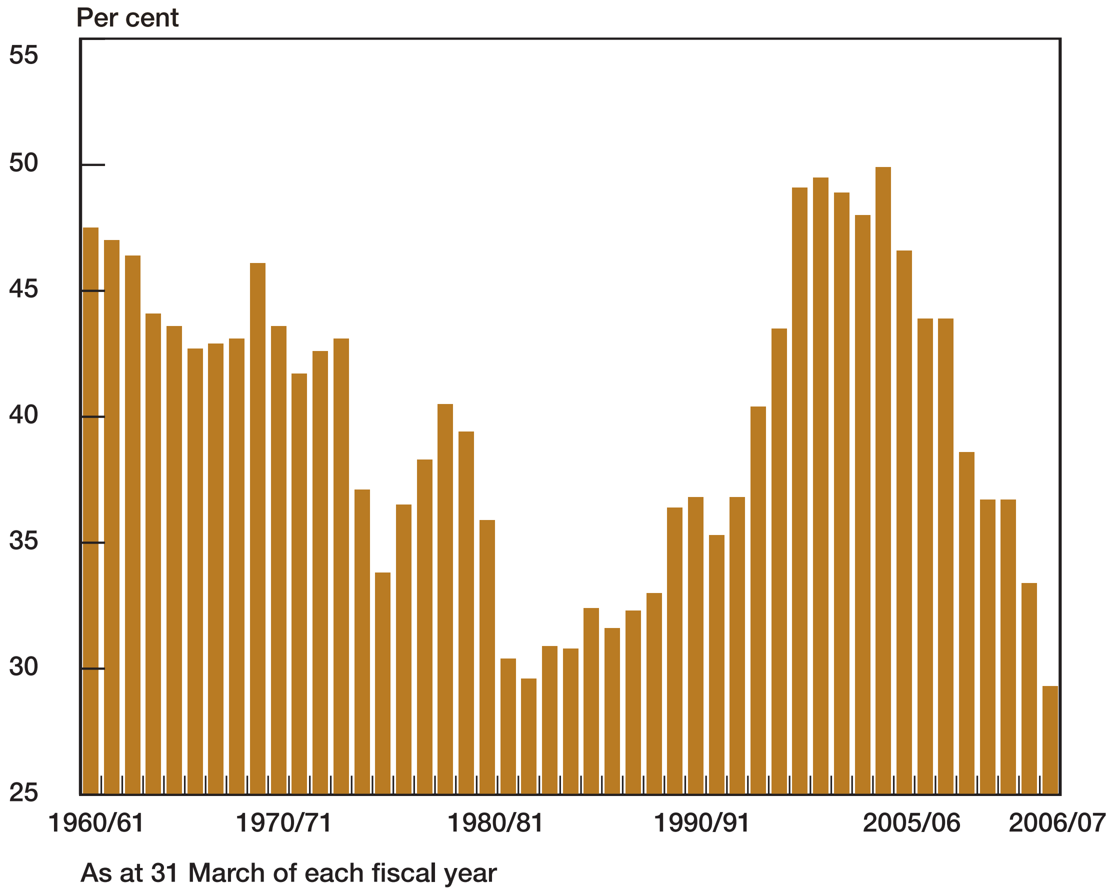
Debt management

Proper debt management is an important aspect of sound fiscal policy. Government strives to limit its borrowing requirement, to have a proper mix of government securities to minimise the interest and other costs related to government debt, and to develop a smooth maturity structure for government debt. An accumulation of capital redemptions scheduled for certain periods imposes excessive refinancing pressure on the market, with all the negative implications associated with such pressure.

Ratio of gross domestic product

Government debt as a ratio of gross domestic product is used throughout the world as a measure of fiscal discipline. If government debt exceeds 60 per cent of annual gross domestic product, it is deemed to be excessive in terms of European Union criteria. South Africa's ratio, which rose alarmingly during the 1980s and early 1990s, levelled off to around 33 per cent at the end of March 2006. A very high borrowing ratio implies that a high proportion of the productive sources of a country is utilised by government in its operations. As a result, the private sector has less access to funding for its operations, while it normally uses funds more productively than the government sector. This is called the crowding-out effect of government borrowing. It also implies rising interest costs for the government as well as the private sector, with the result that government has less funds available for funding other operations, such as education, policing and health. Government debt paper is mostly bought by pension funds and insurance companies. Ultimately, the workers of the country who save through pension funds for their retirement and individuals who save by taking out insurance policies with an investment component, are the owners of government debt.

Graph 1: Total national government debt as ratio of gross domestic product



This is the seventh in a series of fact sheets on the South African Reserve Bank, compiled by the Research Department: Information Division and distributed by the Executive Management Department: Communications Unit.

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Last updated: July 2007