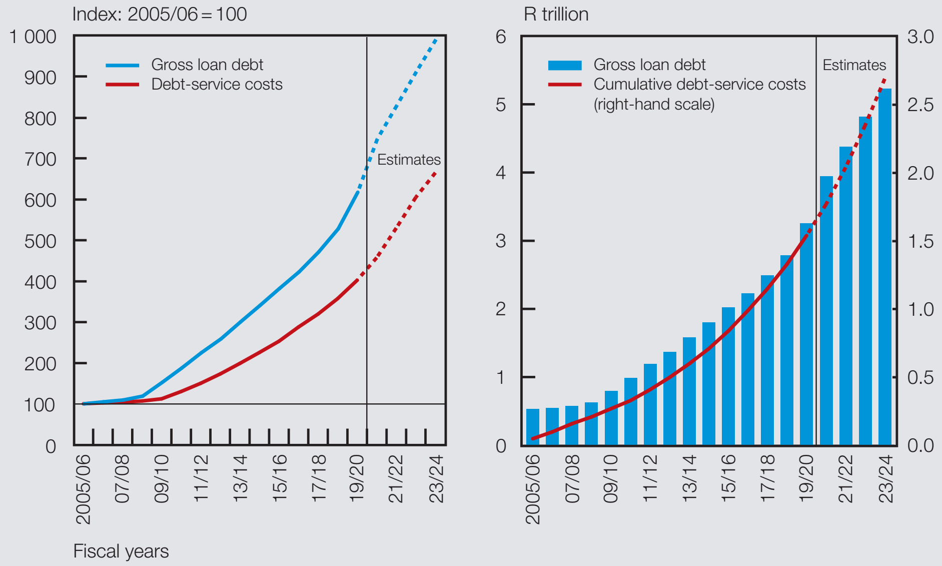
Box 4 Government's debt-service costs dilemma[1]

The marked increase in consolidated government's[2] debt-service costs is a direct consequence of persistent budget deficits over the past decade, which contributed to higher levels of outstanding debt. With debt-service costs currently being the fastest-growing expenditure category, and expected to increase at an annual average rate of 13.3% over the medium term, the dilemma for government is the draining away of resources from other much-needed spending priorities. From fiscal 2005/06 to 2020/21, the cumulative debt-service costs amounted to R1.8 trillion.

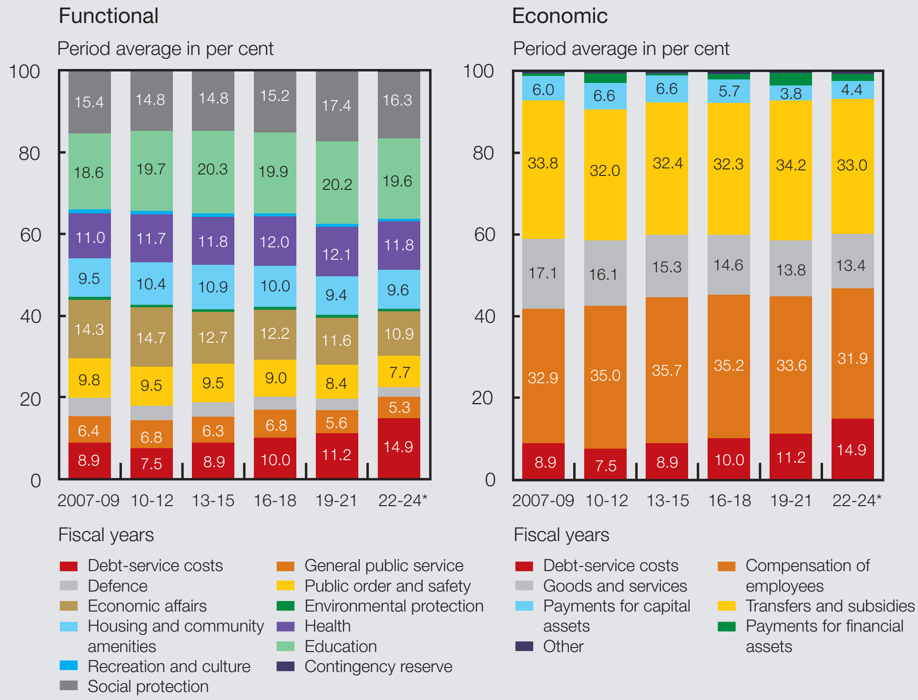
Debt-service costs and government debt



Source: National Treasury

With debt-service costs as a share of total government expenditure almost doubling since the 2008/09 global financial crisis (GFC), the contribution of other spending categories has either decreased or remained broadly unchanged from both a functional and an economic perspective.

Contribution to total expenditure



* *2021 Budget Review* estimates

Source: National Treasury

1 This analysis is based on National Treasury's statistics in the *2021 Budget Review.*

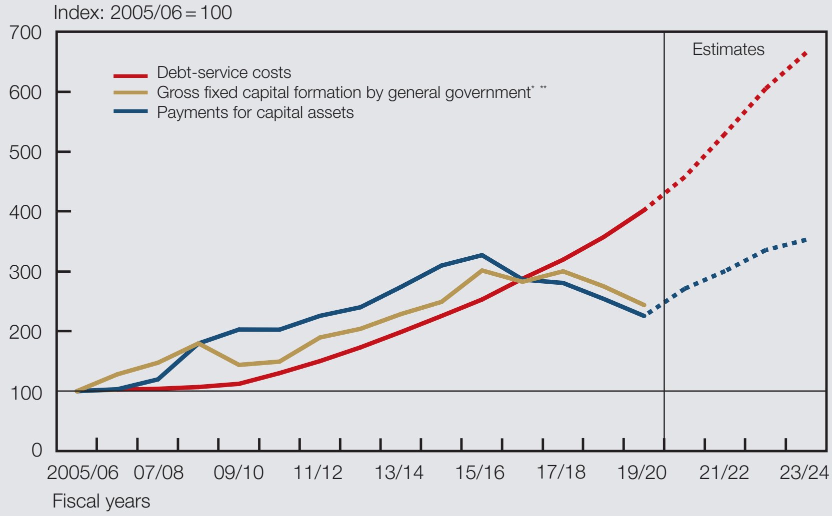
2 Consolidated government comprises national and provincial government, social security funds and selected extra-budgetary institutions, and excludes local government.

Encouragingly, the share of functional expenditure has been broadly maintained for social protection, education, health, housing and community amenities, whereas the share of spending on economic affairs, public order and safety as well as, in particular, defence has shrunk. From an economic-classification perspective, two expenditure categories, namely the compensation of employees as well as transfers and subsidies, each continued to account for about a third of total expenditure respectively, with spending on goods and services as well as capital assets shrinking.

The negative impact of reduced spending on capital assets is evident in the developments in gross fixed capital formation by general government. The continued underinvestment in capital goods does not sufficiently support the development of the economy's production capacity, which has a negative feedback loop through weak economic growth on revenue collections and the ability to service debt. The notable increase in debt-service costs also crowded out other spending priorities.

Investment spending and debt-service costs

Index: 2005/06 = 100



Fiscal years

* Calendar years   ** Excluding local authorities

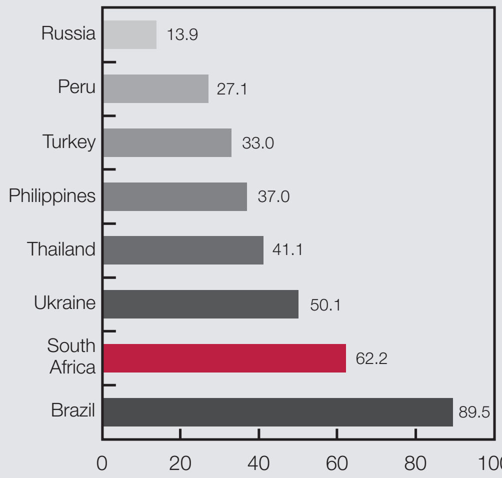
Sources: National Treasury, Stats SA and SARB

In recent years, these dynamics were exacerbated by the implementation of fiscal measures aimed at mitigating the negative consequences of the GFC and then, more recently, of those related to the coronavirus disease 2019 (COVID-19) pandemic, which necessitated spending reprioritisation in an already constrained fiscal environment.

A positive correlation between the stock of debt and debt-service costs is a common phenomenon globally, with South Africa ranking high among emerging market economies in terms of both gross loan debt and debt-service costs as a ratio of gross domestic product (GDP).

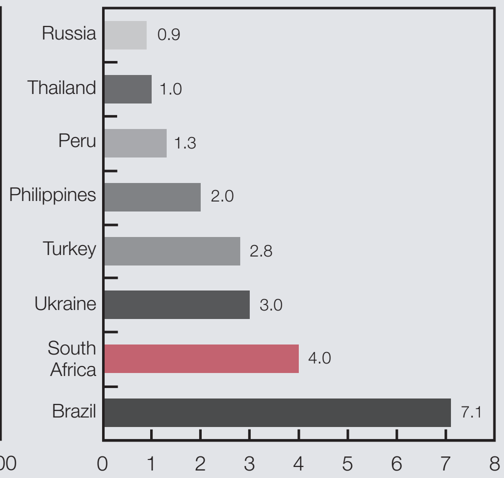
Gross loan debt in 2019

Per cent of GDP



Debt-service costs in 2019

Per cent of GDP



Sources: IMF and World Economic Outlook database

For government to continue providing the necessary social and economic services while achieving fiscal sustainability, the growth in debt-service costs needs to be contained as a top priority, primarily through debt-containing measures.