ASSESSING FISCAL & STRUCTURAL POLICIES TO ADDRESS SOUTH AFRICA'S FISCAL AND ECONOMIC CHALLENGES

Core findings

- **Fiscal policy alone is unlikely to resolve the challenge:** Tax increases and spending restraint can help stabilize debt, but the model suggests they may also dampen growth and reduce social welfare.
- **Structural reform appears central to stronger growth:** Reforms in energy, logistics, and regulation could play a major role in raising GDP growth toward the levels needed for fiscal sustainability.
- **Investment over consumption:** A gradual shift in government spending from recurrent costs toward infrastructure investment could support long-term growth, particularly if paired with productivity-enhancing reforms.

Strategic recommendations

- **Prioritize growth stimulation:** Policymakers may wish to place greater emphasis on broadening the tax base through growth rather than relying primarily on additional revenue extraction. As growth stabilizes, options could include reassessing fiscal drag and the VAT path.
- **Accelerate productivity reforms:** A coordinated reform agenda could focus on improving electricity reliability, modernizing rail and port infrastructure through appropriate public-private partnerships, and reducing regulatory burdens on SMEs.
- **Consider a credible fiscal anchor:** A transparent debt-to-GDP framework, including a possible ceiling informed by model results, could help stabilize expectations and reduce the risk of sharp fiscal corrections.
- **Reorient spending:** Continued movement toward productive investment could improve long-term outcomes, provided it is accompanied by strong governance, transparency, and safeguards against inefficiency.
- **Limit reliance on further tax rate increases:** Given the concentration of PIT and CIT revenue, additional rate increases may carry risks. Greater emphasis on compliance, administrative efficiency, and base broadening may be more sustainable.

CONTEXT AND CORE CHALLENGES

South Africa enters 2025 with average real GDP growth of less than 1% over the past decade, unemployment above 30%, and youth unemployment approaching 60%. Public debt has risen to roughly three-quarters of GDP, and debt-service costs absorb over one-fifth of tax revenue. The tax base is highly concentrated: a small proportion of personal income taxpayers and an even smaller group of corporations contribute most of the revenue. At the same time, industrial competitiveness has eroded due to infrastructure bottlenecks, energy supply instability, rail and port inefficiencies, and declining total factor productivity (TFP).

These challenges are mutually reinforcing. Weak growth constrains revenue, rising debt crowds out productive expenditure, and limited public investment further undermines long-term productivity. The report therefore evaluates whether fiscal consolidation alone can break this cycle, or whether structural reforms are indispensable.

KEY FINDINGS

Four simulations were undertaken using the OG-ZAF model, these are the key findings:

VAT increases and fiscal drag are macroeconomically similar

The first two simulations show that a 1% VAT increase and the revenue gains from fiscal drag produce strikingly similar macroeconomic outcomes. Both raise tax revenue by approximately 1.5% in the medium term and reduce government debt. However, both also depress private consumption by roughly 0.7% over twenty years and have only negligible effects on GDP. The

short-term differences reflect phasing, but over time the macroeconomic equivalence becomes evident.

Fiscal consolidation alone stabilises debt but suppresses growth

When combined with expenditure reprioritisation (Simulation 3), fiscal measures produce stronger debt reduction but intensify the contraction in private consumption. GDP remains close to stagnation, and labour market outcomes show little improvement. Although public debt declines in the medium term, inequality indicators barely improve and consumption losses are broadly shared across income groups. The results suggest that consolidation without growth reform risks entrenching a low-growth equilibrium.

Structural reforms transform the macroeconomic trajectory

The fourth simulation—combining fiscal measures with a modest productivity boost—yields markedly different results. Medium-term GDP growth rises to approximately 3%, tax revenues expand organically through a broader base, and wage rates increase. Crucially, transfers (social grants) can rise while debt remains manageable, indicating that productivity-driven growth enables fiscal consolidation without sacrificing social support.

The modelling shows that even a relatively small TFP improvement—comparable to the gap between South Africa's long-run productivity trend and that of better-performing peers such as Rwanda and Mauritius—has outsized macroeconomic benefits. The productivity shock reduces the need for distortionary tax increases and alleviates the pressure on private consumption.

Growth, not taxation alone, is the decisive variable

Across all simulations, the critical determinant of improved fiscal sustainability is higher growth. Tax-based consolidation raises revenue but suppresses demand. By contrast, productivity reforms expand output, strengthen wages, and widen the tax base, enabling improved debt dynamics without severe trade-offs in consumption or equity.

IMPLICATIONS FOR POLICY

The modelling exercise points to an important policy implication: fiscal consolidation appears necessary, but may not be sufficient on its own. Without reforms that raise productivity, the economy could remain vulnerable to low growth, while debt sustainability may depend on continued pressure on consumption and expenditure. A reform package that improves energy reliability, streamlines regulation, modernizes rail and ports, and strengthens competition policy could help unlock higher growth and improve both fiscal and social outcomes.

The report therefore identifies five policy priorities for consideration:

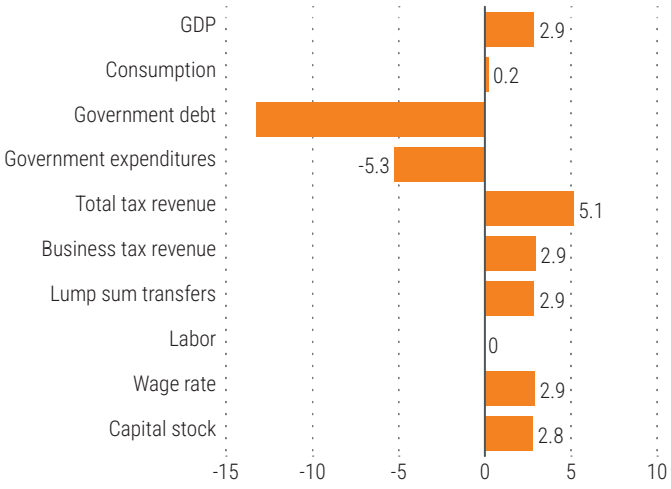
1. Shift from revenue extraction to growth expansion. Further reliance on fiscal drag or VAT increases could risk weakening consumption and investment.
2. Pursue productivity-enhancing reforms. Stabilising electricity supply, improving logistics, and reducing regulatory burdens are likely to be important for raising TFP.
3. Reorient spending toward productive investment. Capital formation could increase relative to current expenditure, with stronger governance to support efficiency.
4. Protect tax competitiveness. Given the concentration of the tax base, additional rate hikes may be counterproductive; emphasis could instead fall on compliance and base broadening.
5. Anchor fiscal credibility. A credible debt framework and transparent fiscal rules could help maintain investor confidence and macroeconomic stability.

CONCLUSION

The OG-ZAF simulations suggest that incremental fiscal adjustments alone are unlikely to reverse a decade of stagnation. A coordinated strategy combining disciplined fiscal management with productivity-enhancing structural reforms could place South Africa on a stronger path toward higher growth, more sustainable debt dynamics, and greater space for inclusive development.

The central policy implication is that productivity-led growth appears to offer the most durable route to addressing South Africa's fiscal and economic challenges.

Tax and productivity reforms raise GDP by 2.9%, lift annual growth to about 3%, and cut public debt by 13.2% between 2025 and 2044



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