

## CHAPTER 8

### SUMMARY, POLICY IMPLICATIONS AND FURTHER SUGGESTIONS

This study has shown that fiscal policy can only be evaluated and adjusted effectively after considering the cyclical aspects of the business cycle. When setting and monitoring fiscal targets, there is a need to take explicit account of the cyclical position of the economy and its effect on the budget. However, most of the discussion on fiscal policy in South Africa deals only with long-term sustainability issues, largely ignoring the effects of the economic cycle. As a result, serious policy mistakes could occur if purely cyclical improvements in the public finances are treated as if they represent structural improvements, or if structural deterioration is interpreted as a cyclical effect. Therefore, when assessing fiscal prospects, it is essential to adjust fiscal indicators for the effects of the economic cycle. Fiscal policy-making and analysis in South Africa could be improved by making use of alternative fiscal indicators, such as the cyclically adjusted budget balance that removes the effects of the business cycle from government revenues and expenditures.

In this study the countercyclical role of South African fiscal policy during the period 1970 to 2000 was analysed. More specifically, it presents theoretical and empirical analysis of the significance of automatic fiscal stabilisers in the South African economy and the calculation of the cyclically adjusted budget balance. Results for South Africa were also compared with six other developing countries, namely Chile, Mexico, Indonesia, India, Mauritius and Romania. Macroeconomic stabilisation and the potential of automatic fiscal stabilisers in the New Partnership for Africa's Development (NEPAD) were briefly touched on.

Fiscal policy could be used as a stabilising instrument to affect economic activity, either through the work of built-in automatic stabilisers, through discretionary tax or expenditure measures or through both. Discretionary fiscal policy should be interpreted as changes in fiscal variables due to a deliberate attempt of government (for example to smooth the business cycle), while automatic (or built-in) stabilisers could be defined as

the reaction of the government budget to economic fluctuations in the absence of any government action.

Many practical economic and political difficulties are encountered in discretionary fiscal stabilisation policy. The combined problems of time lags, crowding-out effects, political constraints, irreversibility, inflexibility, practical problems in measuring and forecasting the state of the economy and determining how much fiscal stimulus is needed at any particular point in time, all present very serious challenges for discretionary fiscal policy to have the desired stabilisation effect. Against this background, most economists have become highly sceptical about the potential benefits of “fine-tuning” the economy. Discretionary fiscal policies are often inappropriate demand management instruments, except in extraordinary circumstances such as where consolidation or fiscal structural reforms are required. Growing awareness of the limitations associated with macroeconomic fine-tuning has led to a worldwide trend towards the adoption of more rule-based institutional frameworks. These frameworks could provide authorities with specific mandates, i.e. clearly identified policy objectives, in order to set proper incentives at the decision-making level and ensure predictability of policy.

The inherently procyclical nature of many revenue categories (due to the dependency of most government revenue sources on current income) and the countercyclical behaviour of some expenditures act as automatic stabilisers. The two most important types of automatic fiscal stabilisers are personal income tax and unemployment insurance benefit payments. Automatic stabilisers help to smooth out fluctuations in the business cycle by automatically moving the budget towards a deficit or higher deficit during a recession and towards a surplus or higher surplus during an expansion. Government balances tend to increase when output is above trend, and decrease when output is relatively low. During an upswing, with growth in income, consumption, output and employment, government revenue will increase due to higher direct and indirect taxes and lower expenditure such as unemployment insurance benefit payments. During a recession, the opposite applies. Increasing government borrowing represents a net increase in domestic demand, with the result that economic downturns are moderated. Conversely, declining

government borrowing contributes towards dampening economic booms. As a result, tax revenue and unemployment-related social security expenditure fluctuate according to the business cycle and the budget balance responds automatically to the cyclical movements of the economy.

Automatic stabilisers are the appropriate way to stabilise output, as they have foreseeable, timely and symmetrical effects, helping economic agents to form correct expectations and enhancing confidence. Because they are not discretionary, automatic fiscal stabilisers are less likely to affect market expectations adversely. They react with an intensity that is adapted to the amount to which economic conditions deviate from what was expected when the budget plans were approved. These features of automatic stabilisers are almost impossible to replicate with discretionary reactions by policy-makers. However, there are drawbacks and limits to automatic fiscal stabilisation as well. Automatic fiscal stabilisers may not work, or may actually increase output variability if there are perverse effects associated with their functioning, such as where fiscal deficits during recessions give rise to increases in interest rates due to public debt risk or sustainability issues. Moreover, automatic stabilisers are useful to stabilise output in the case of temporary shocks, but large automatic stabilisers, in the case of permanent (mainly supply) shocks, may delay the inevitable structural adjustment and, if they are symmetric, imply a stronger response by the monetary authorities. Furthermore, sizeable automatic fiscal stabilisers could delay the adjustment of an economy because a high tax burden and generous social payments reduce incentives to work, invest and to be innovative, and thereby weaken economic activity.

The size of automatic fiscal stabilisers, which varies substantially across countries and over time, depends on many factors. These include, amongst others, the importance of the government sector in the economy, the composition of GDP growth, the tax and expenditure structure, the sensitivity of budget components to the cycle, the distribution of income across individuals, the effectiveness of stabilisation efforts in relation to the openness and structure of the economy, the significance of fiscal restraints, the

relationship between automatic and discretionary stabilisation and the nature of economic shocks that produce the boom or recession.

There is little consensus about the impact of fiscal policy on the economy. The Keynesian view assumes that individuals are short-sighted and credit-constrained and hence respond to variations in their disposable income brought about by fiscal policy on changing consumption. Under these circumstances, the government should actively use a countercyclical fiscal policy to offset demand shocks to the economy. In practice this may mean that the role of discretionary fiscal policy is greater when the economy is confronted by a large demand shock and automatic stabilisers is small. Moreover, the need for discretionary fiscal policy may also arise in special circumstances such as when monetary policy is constrained due to a fixed exchange rate regime or by the zero lower bound on the nominal interest rate. On the other hand, theories on consumer behaviour argue that fiscal policy is ineffective to the extent that temporary increases in the deficit will imply future tax increases, while permanent changes in fiscal policy to stimulate the economy will give rise to persistent deficits and high real interest rates that will crowd out private investment. In practice this means greater emphasis on automatic fiscal stabilisers and less on fiscal fine-tuning. Thus, the extent to which fiscal policy is effective in reality depends on a number of factors, including the instrument used and the wider economic and policy environment.

Tax revenue accounts for the bulk of total consolidated general government revenue in South Africa, while expenditure on goods and services accounts for the largest share of expenditure. Taxes on net income and profits and domestic taxes on goods and services are the most important sources of direct and indirect tax revenue, respectively. Although the role of the provincial governments has become increasingly more important since fiscal 1995/96, the national government plays the most important role in the South African public finances. Social security funds, of which the Unemployment Insurance Fund is the most important, only comprise a small portion of the income and expenditure flows of the consolidated general government.

When South Africa's public finances are compared with that of six other selected developing countries (Chile, Mexico, India, Indonesia, Mauritius and Romania), the results show that South Africa's average revenue to GDP and expenditure to GDP ratios are well above that of the six-country averages. South Africa's deficit to GDP ratio is nearly twice the size of the six-country average. The tax to GDP ratio in South Africa is much higher compared to that of the other developing countries and there are large discrepancies between the different countries with respect to the main sources of tax revenue. The average ratio of South Africa's taxes on net income and profits to GDP are much higher compared to that of the average for the other developing countries, while the ratio of taxes on international trade and transactions and the ratio of social security contributions to GDP are much lower than the six-country averages. South Africa's expenditure on goods and services and total current expenditure as a ratio of GDP are much higher than the average for the six other selected developing countries, while the country's capital expenditure to GDP ratio is much lower. The most striking difference between South Africa and the six other developing countries with regards to government expenditure is the fact that social security and welfare provision in the other developing countries (except for Indonesia) by far exceeds that of South Africa. The analysis of the structure of public finances in South Africa, therefore, suggests that the scope for automatic stabilisation is larger on the revenue side of the government budget, given the prominent role of tax revenue and more specifically taxes on net income and profits, which are highly responsive to economic fluctuations. On the other hand, automatic stabilisation on the expenditure side of the budget is limited due to the small role of cyclically sensitive expenditures, such as unemployment insurance benefits.

This study showed that tax revenue and unemployment insurance benefit payments operate as automatic fiscal stabilisers in South Africa and that the extent of automatic stabilisation could be measured. Given the revenue, expenditure and output projections that are published in the Medium-term Expenditure Framework (MTEF) and the Medium-term budget policy statement, it is also possible to publish estimates of the cyclically adjusted budget balance as an additional indicator next to other current indicators that are used in the policy-making processes. The study therefore argues that

the role and size of automatic fiscal stabilisers in South Africa must be recognised and quantified, their impact on the budget outcome be acknowledged, their effects be accounted for when analysing fiscal trends, and that their role and impact be evaluated against fiscal policy objectives, the structure of the economy and their relation to other macroeconomic policies and objectives. Although the extent of cyclical volatility, the size of government and the responsiveness of tax revenue and unemployment insurance benefits in South Africa create a platform for strong automatic stabilisation, their effects are sometimes countered or reduced due to procyclical discretionary policies, the policy mix, other fiscal policy objectives, a short-term political bias, the openness of the economy and supply-side shocks.

The timing and accuracy of past discretionary fiscal stabilisation policies in South Africa could have been adversely influenced due to the absence of any measure of the extent and role of automatic stabilisers in South Africa. The lack of measures of automatic stabilisation and the inadequate adjustment of the budget balance for economic cycles also made it difficult for the central bank to distinguish between the discretionary and non-discretionary components of fiscal policy, limiting its ability to assess fiscal trends and its impact on output and inflation and therefore to determine the appropriate monetary response. South Africa's ignorance with respect to the working and extent of automatic stabilisation can therefore be regarded as a major defect in previous budgetary and decision-making processes.

The results show that the cyclical fluctuations in revenue are much larger than those of expenditure, due to the small share of unemployment insurance benefit payments in the total public finances. Direct taxes have a larger volatility and are more sensitive to changes in GDP compared to indirect taxes. Moreover, the cyclical component of direct taxes is more than double the size of that of the cyclical component of indirect taxes. The estimates showed that unemployment insurance benefit payments move countercyclically, but that there is a procyclical response from other expenditure components. Results showed that the impact of the Unemployment Insurance Fund as an automatic fiscal stabiliser could be expected to be larger with the new UI legislation, but

that the overall impact would still be much smaller compared to the role of tax revenue in general. The destabilising effect of expenditure components partially offset the stabilising effect of revenue components, so that the budget balance has only a small stabilising impact on the economy. Although the cyclical component of the general government budget balance represents only a small part of the total balance, the results illustrate a more prominent role for automatic fiscal stabilisers during the latter half of the sample period, particularly since the 1990s.

The impact of the output gap on discretionary fiscal policy (measured by the structural component of the general government budget balance) and automatic fiscal stabilisers (measured by the cyclical component of the general government budget balance) varies significantly according to the chosen sample period. The general government budget balance moved procyclically over the whole sample period, but regressions over two sub-samples (1970-1985 and 1986-2000) indicate that it moved countercyclically during the first half of the sample period and strongly procyclically during the latter half of the sample period. The countercyclical behaviour of the budget balance during the first half of the sample period was the result of procyclical discretionary fiscal policy, which worked against the automatic fiscal stabilisers. The size of South Africa's cyclical tax revenue is more or less in line with five of the six selected developing countries and the trend in cyclical tax revenue for most of the countries (including South Africa) is broadly similar to their respective output gaps.

Compared to advanced economies, the role of automatic fiscal stabilisers in South Africa is relatively small, with discretionary fiscal policy interventions playing a dominant role. The analysis has shown that discretionary fiscal policies were frequently procyclical, overriding automatic fiscal stabilisers and possibly contributing to economic instability. The results show that fiscal policies in South Africa exacerbated economic fluctuations in some periods rather than moderating them. During these periods, fiscal contractions took place in periods of low growth, with fiscal expansions occurring during economic booms. Although the South African government was successful in its objective of decreasing its direct involvement in the economy – as reflected in the downward trend in the budget

deficit as a ratio of GDP since fiscal 1993/94 – these efforts had a destabilising impact on the economy as the consolidation efforts coincided with a period marked by negative and small positive output gaps.

The period 1972 to 1984 reflects neutral fiscal policy in South Africa, 1989 to 1993 expansionary fiscal policy and 1993 to 1999 fiscal consolidation. During the 1990s, fiscal policy was strongly countercyclical in 1992 and procyclical in 1994 and 1998. The policy mix (the combination of monetary and fiscal policies in place) varied a great deal in South Africa over the period 1991 to 2001. Overall, the policy mix seems to have contributed towards providing conditions for economic growth and macroeconomic stability. There is, however, no evidence that these policies were explicitly coordinated; it is more likely that the policies were the outcome of *ad hoc* responses to changes in fiscal and monetary conditions.

The national government balance shows the largest cyclical variation over time and tracks movements in the output gap more closely compared with the local and provincial government balances. While taxes on net income and profits (which have a high income elasticity) constitute the largest part of national government revenue, provincial government revenue is primarily sourced by grants from national government, while local government revenue is raised through property taxes and user charges for services rendered. The scope for automatic stabilisation at the provincial and local government level in South Africa is, therefore, very limited due to the nature of their role – and thus the composition of their revenue. The possibilities of the provincial and local governments in South Africa to run countercyclical policies are also limited given the existence of borrowing and budgeting restrictions. Due to the procyclical nature of the provincial and local government balances, there are good reasons to shield the income of these governments to some extent from cyclical fluctuations by assigning tax bases to them that are sufficiently stable over the cycle and by extending grants to them that correct for cyclical variability in own revenue. The national government is the appropriate level of government that should be assigned taxes that, among other things, have a higher income elasticity.



Automatic stabilisers are likely to be less important in African countries due to structural reasons. The revenue and expenditure to GDP ratios are usually far smaller compared to advanced countries. Within the smaller tax base, the share of income-elastic taxes is smaller, while consumption taxes and taxes on international trade are more important. Furthermore, automatic fiscal stabilisers on the expenditure side of African countries are limited due to the few countries that have significant social security spending. Moreover, in these relatively open economies fiscal multipliers may be small due to a high degree of external leakage. Under these circumstances, fiscal expansion to stimulate domestic demand is likely to worsen the current account balance, with adverse implications for external sustainability. Expansionary fiscal policies may also threaten long-run debt sustainability and raise inflation expectations that could adversely affect the monetary authorities' ability to control inflation. Moreover, improving automatic fiscal stabilisers poses an important challenge, as it would imply introducing additional welfare and unemployment programmes, which countries may be unable to afford without raising their fiscal deficits. In addition, higher unemployment insurance benefit payments might also have adverse effects on work incentives due to the extent of unemployment in this region.

Since automatic fiscal stabilisers seem to be less powerful in African countries, one could expect that a greater need exists for discretionary fiscal policy interventions. Discretionary fiscal policy, however, is likely to be harder to implement in African countries, for reasons such as poor tax administration and expenditure management, governance problems, volatile revenue bases (for example due to heavy reliance on trade taxes), long lags affecting fiscal policy and a greater deficit bias. It might also be hard to compute a satisfactory measure of the cyclically adjusted budget balance in African countries, given data constraints, imprecise knowledge about tax and expenditure elasticities and the fact that estimates of potential output are generally also believed to be less precise.

Empirical evidence concerning the effectiveness of automatic stabilisers in African countries is mixed. The results show a significant negative coefficient for the expenditure components (current primary expenditure as well as total expenditure), confirming its smoothing impact on the business cycle. On the other hand, the results suggest an insignificant procyclical response from tax revenue. This could possibly be ascribed to the small share of income-elastic taxes in the tax bases of many of the African countries.

The lack of adequate fiscal discipline in African countries has reduced the countercyclical role of fiscal policy to the point of rendering it procyclical. If applied flexibly, fiscal rules may be seen as restoring at least a moderate countercyclical role through the operation of automatic fiscal stabilisers. Expenditure rules in the form of *ex-ante* targets, for example, could play an important role in improving the management of public finances in African countries. These rules could help countries to better control expenditure items that are subject to overruns. Depending on their design, they could also contribute to other policy objectives, such as avoiding a procyclical loosening of fiscal policy in good times (via a discretionary increase in public spending) and improving the quality of the composition of public spending. Even a relatively weak expenditure rule could provide useful guidance and signals to actors involved in the budgetary process. Moreover, a fiscal policy rule could assist other financial policies, especially the utilisation of monetary instruments, in pursuing the stabilisation goal. Although automatic fiscal stabilisers are likely to be less important in African countries due to structural reasons, recognising the impact of the business cycle on the public finances, vigilance against the dangers of inappropriate discretionary policy and the implementation of suitable fiscal rules may make a valuable contribution to Africa's development.

Democratic budgetary processes tend to be biased towards short-term employment and output goals. To offset this political bias, it is necessary to focus fiscal policy on medium-term goals and commit the political authorities to formal institutional arrangements such as a deficit or debt rule. While in theory a discretionary policy can

achieve the same outcomes as fiscal rules and should in fact be superior because it allows greater flexibility, the practical experience is that electoral pressure may lead politicians to adopt a short time horizon. This could result in less disciplined and even unsustainable policies over time. A cyclically adjusted general government balance that is close to balance or in surplus, for example, will anchor long-term fiscal expectations and allow automatic stabilisers to play an effective countercyclical role. It will also broaden the planning horizon of the public institutions and thereby avoid the potential procyclical behaviour in the event of a budget adjustment, boost government saving and investment and maintain fiscal sustainability in the light of the government's contingent liabilities. Market confidence in South Africa's fiscal soundness will also be strengthened following the achievement of the targeted balance.

South Africa has no formal fiscal rules, but the budget-making process implicitly involves some controls on the spending and borrowing decisions as they are part of an agreed medium-term plan in the form of the Medium-term Expenditure Framework (MTEF) – the three-year spending plans of national and provincial governments. The medium-term horizon of South African fiscal policy gave fiscal policy some discipline without making it rule-based. Markets could easily detect any deviation from medium-term targets. South Africa's commitment to maintain medium-term fiscal sustainability through the MTEF enhanced its fiscal credibility. While the MTEF has played an important role in anchoring long-term fiscal expectations and helped to broaden the planning horizon of public institutions to the extent that the potential procyclical expenditure behaviour in the event of a budget adjustment can be avoided, more emphasis must be placed on automatic fiscal stabilisers so that they can be allowed to play an effective countercyclical role. Fiscal policy in South Africa should not only ensure the sustainability of the public finances over the medium to long term, but also allow the full operation of automatic fiscal stabilisers in the short term, enabling fiscal policy to support monetary policy in smoothing economic fluctuations. Prudent discretionary fiscal policy, conducted symmetrically over the economic cycle, could provide further support to monetary policy if necessary.

This study, however, highlights the need for continued caution in the use of discretionary fiscal policy, which, because of political constraints, tends to be irreversible, leading to a ratcheting effect of public spending. Discretionary fiscal policy should explicitly take into account the cyclical position of the economy and its effect on the government budget. It is proposed that greater emphasis be placed on making automatic fiscal stabilisers more effective in South Africa. Increasing the fiscal stabilisation role of government by strengthening the automatic stabilisers has the advantage that many of the difficulties encountered in using discretionary fiscal policy for stabilisation purposes do not apply to the automatic stabilisers. However, as already pointed out, many of the ways of strengthening the automatic stabilisers, such as by increasing the size of the government sector or the share of cyclically sensitive budget components, could have a negative impact on economic efficiency, because a higher tax burden or generous unemployment insurance benefits, for example, could reduce the incentive to work, invest and innovate. It is therefore not clear what the desired degree of automatic stabilisation would be for South Africa. A particular concern in the South African context with regard to automatic stabilisation is the downward trend in the contribution of direct taxes to the total cyclical component of the budget balance. This trend is likely to intensify given the significant personal income tax relief that has been granted since 2000 and further planned relief that might follow in the future. The South African government's efforts to bring down the tax burden in the pursuit of better efficiency and more flexible markets would therefore come at a cost in terms of less demand smoothing via the automatic fiscal stabilisers.

Automatic fiscal stabilisers in South Africa could play an important role as a complement to countercyclical monetary policy, since monetary policy could benefit from the predictable and automatic responses from automatic fiscal stabilisers. An inadequate adjustment of budget balances for economic cycles could adversely affect the central bank's estimates of the effects of fiscal policy. Thus, knowledge about the cyclical budget balance may provide important information for the conduct of monetary policy. The South African Reserve Bank should therefore use the cyclically adjusted budget

balance calculated in this study as an alternative measure of fiscal stance that is relevant to monetary policy.

The Washington Consensus emphasised the importance of maintaining prudent macroeconomic policies and balances. Monetary and fiscal policy must ensure macroeconomic stability to generate domestic and international confidence in the South African economy. There is as yet no consensus about what should be the appropriate role of fiscal policy over the business cycle. In the short run, the possible role that fiscal policy could play in stabilising output may occur through the operation of automatic stabilisers and/or discretionary fiscal policy, and the appropriateness and feasibility of either may vary according to the individual country circumstances. South Africa must therefore adapt an appropriate fiscal policy stance, taking the country's particular circumstances into account. Both fiscal discipline and flexibility are important. In fact, fiscal discipline and flexibility are complementary and interdependent features of budgetary behaviour. Fiscal discipline will allow the credibility of monetary policy to strengthen, while fiscal flexibility is required to deal with country-specific and other shocks. Since fiscal discipline is more or less confined in the MTEF framework, it is in the latter case where automatic fiscal stabilisers can play an important role.

Alternative definitions of the budget balance are unavoidable given the scope and operations of the public sector. There is no ideal measure of the budget balance, but rather a set of different budget balances that could be considered as more appropriate, each applicable to a specific circumstance. Despite some limitations, budget measures that separate out cyclical factors are useful for budget planning and analysis as they provide estimates of the extent to which changes in the budget are caused by normal movements of the business cycle and thus are likely to prove temporary. This study therefore proposes that the cyclically adjusted budget balance be used as an input for budgetary planning and analysis.

In the light of South Africa's weak automatic fiscal stabilisers, supply shocks, the openness of the economy, poor government performance with respect to discretionary

fiscal stabilisation policies and the country's historical context, in particular a deficit bias and rapidly rising debt levels and unsustainable deficits during the early 1990s, the country's experience may warrant a greater interest in fiscal policy rules. A fiscal policy rule such as a balanced budget rule can enhance South Africa's credibility due to a lasting commitment to fiscal discipline. Clear policy guidelines in the form of rules can provide a basis for systematic policy, reducing the element of discretion and ensuring that fiscal policy responses can operate in a transparent, credible symmetric and timely manner. Such a budgetary target should be assessed considering the cyclical position of the economy and should therefore be in cyclically adjusted terms. A close to balance or in surplus position will also facilitate the stabilisation objective of government by letting automatic fiscal stabilisers operate freely. In addition, when the extent of automatic stabilisation is too weak, discretionary fiscal policy, which takes account of the cyclical position of the economy and its effect on the government budget, could be allowed to operate symmetrically around the target.

However, further consolidation efforts that are needed to achieve a close to balance or surplus position might compromise the stabilising role of automatic stabilisers and it would make it difficult for South Africa to increase much needed social expenditure and to make important public infrastructure investments. Moreover, although rules seem attractive and straightforward to contain the spending and borrowing bias of profligate governments, it is by no means clear what institutional design and multi-annual budgetary targets are needed for it to be effective. Imposing a tight multi-annual framework may be dysfunctional for the stabilising role of public finances in South Africa to the extent that this should be based on discretionary policy measures.

The main contribution of the findings of this study for the conduct of fiscal policy in South Africa is therefore that the impact of automatic fiscal stabilisers on the budget outcome must be acknowledged and that these effects must be accounted for when analysing fiscal trends. An understanding of automatic stabilisation and the calculation, utilisation and publication of cyclically adjusted budget balance indicators by government and the South African Reserve Bank will enhance the quality and efficiency of decision-

making processes and policies in South Africa. The government should also carefully consider the impact that proposed changes in the composition of tax revenue and expenditure, intergovernmental fiscal relations, Unemployment Insurance legislation and other fiscal policy objectives might have on the extent of stabilisation provided by automatic fiscal stabilisers. Budget objectives must be clear and verifiable, taking account of underlying economic conditions and the effect of the economic cycle on the budget position has to be taken into account when assessing compliance with these budgetary commitments, and in particular, the adjustment path to a specific target. The institutional arrangements for fiscal policy in South Africa should be developed to ensure the clear identification of stabilisation policy from other policy objectives, and to ensure that discretionary fiscal policies operate symmetrically, minimise lags and enhances transparency. Hence, an understanding of the scale of automatic stabilisation and ways of evaluating targets is important when discussing fiscal policy in South Africa.

This study touched on several topics that deserve further investigation. The accuracy of the estimates depends on the underlying assumptions. Thus, ample scope exists for improving the current estimates of the budget elasticities and the level of potential output. Potential output estimates could be improved by means of alternative approaches, such as a production function approach, while allowing the elasticity estimates to vary over the sample period could enhance elasticity measures. The possibility of non-linear relationships in the working of automatic fiscal stabilisers, the incorporation of supply-side considerations, estimation within a dynamic framework and simulations of the effectiveness of automatic fiscal stabilisers in response to different shocks might also provide further useful insight into the working of automatic fiscal stabilisers in South Africa. Finally, further studies could also allow for a more refined assessment of the impact of the business cycle on expenditure and revenue items that are currently not cyclically adjusted.