A FISCAL STIMULUS FOR SOUTH AFRICA

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by
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For the Institute for Economic Justice

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PREFACE

This paper is published at a moment in which the world faces, due to the COVID-19 pandemic and the extraordinary measures taken to stop the spread of the virus, what may be the largest economic crisis in modern history. This crisis has occurred against the backdrop of decades of fiscal conservativism, resulting in the rollback in social provisioning. The crisis has highlighted the crucial role for the state and the desperate need for fiscal expansionism.

This paper was drafted prior to the onset of COVID-19 as part of the Presidential Jobs Summit process. In 2018, the Presidential Jobs Summit, under the auspices of the National Economic Development and Labour Council (NEDLAC), was launched to discuss how to accelerate the creation of jobs. The Institute for Economic Justice (IEJ) produced 22 policy briefs for Labour for the first phase of the Jobs Summit discussions, either drafted directly by the IEJ, or commissioned from other researchers and organisations.[1] This paper has been written as second phase to the ongoing discussions. The research for this paper was undertaken between June 2019 and February 2020 to develop a medium-term fiscal stimulus. In the paper, the authors grapple with hard realities while seeking creative pro-worker proposals that advance a developmental agenda for South Africa.

Given that the drafting of the paper precedes the COVID-10 crisis it does not make proposals regarding the short-term recovery of the economy, nor do the medium-term measures speak directly to the crisis. Rather, it establishes a case for, and a way in which we must think about, fiscal stimulus, while showing its viability. The principles outlined are adapted in forthcoming work that speaks more directly to the current moment.

This longer-term thinking and the current crisis are, however, connected. The current moment calls for an immediate economic rescue, as the IEJ has put forward elsewhere.[2] It also makes more essential a medium-term fiscal stimulus. The emergency rescue measures should be distinguished from a fiscal stimulus package which aims to expand both production and consumption in the economy, although the two must build off and strengthen each other.

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[1] Institute for Economic Justice. (2018). Jobs Summit Policy Briefs. Retrieved from https://iej.org.za/jobs-summit-policy-briefs/.

[2] Institute for Economic Justice. (2020). COVID-19 – An emergency rescue package for South Africa. Retrieved from: https://iej.org.za/covid-19-an-emergency-rescue-package-for-south-africa/

The future poses great challenges. The role of stimulatory state spending must be one of the issues at the heart of the work between social partners. We hope this paper contributes in this regard.

EXECUTIVE SUMMARY

South Africa's economy is failing. South Africa's growth has trended downwards since 2010/11, averaging just 1.7% between 2011 and 2018. Unemployment has risen to its highest level since the start of 2008 – 29.1% in Q3 2019 (expanded definition: 38.5%). Poverty remains unconscionably high. South Africa has a world-leading level of inequality as measured by the Gini coefficient.

The national budget is one means through which to tackle these challenges. However, spending cuts have been justified on the basis of rising debt levels. Since at least 2014/15, the South African government has introduced austerity measures, under the auspices of 'fiscal discipline', in an attempt to reduce debt levels and under pressure from financial markets and credit rating agencies. The dominant narrative is that cutting expenditure will help to address South Africa's 'runaway' debt.

The assumption that cutting government spending has relatively little adverse effect on aggregate demand has been discredited. In fact, the effect of government spending cuts on output has proved to be larger than anticipated during recessionary times. Further, fiscal stimulus packages have increased growth, reduced unemployment, and lower debt-to-GDP ratios.

THE VIABILITY OF A FISCAL STIMULUS FOR SOUTH AFRICA

Space exists for an expansion of spending in the South African economy. South Africa's debt levels are in line with her peers, with the overwhelming majority of this denominated in Rands. Inflation is falling in South Africa and capacity utilisation is below optimal level, indicating that the economy could absorb additional expenditure, particularly if targeted in a manner that doesn't worsen the current account balance. There is, however, concern over the cost of servicing debt, indicated by South Africa's high bond rates relative to other emerging markets.

There is considerable room to increase domestic resource mobilisation in South Africa. Increasing tax revenue would entail raising income tax rates on high-income earners, taxing wealth and income derived from wealth more effectively, reducing tax deductions for the rich, more effectively taxing large corporations, clamping down on tax avoidance and illicit financial flows, and rebuilding capacity within the South African Revenue Service. Other domestic resources include mobilising quasi-state funds, such as the those accumulated in the Government Employees Pension Fund, and better utilising Development Finance Institutes. Lastly, there is room to improve efficiency, capacity and/or performance of government resources. Addressing quality of spend requires capacity building which also requires additional resources.

Fiscal space can be generated by abandoning the narrow policy tools that are not facilitating growth and exploring the greater use of monetary policy tools. Importantly, a well spent fiscal stimulus can reduce the debt-to-GDP ratio through spurring economic growth and building state capacity.

THE IMPACT OF A FISCAL STIMULUS IN SOUTH AFRICA

Using input-output table modelling we find that the average fiscal multiplier for South Africa in 2018 is equal to 1.68, meaning that a fiscal stimulus of R1 billion would grow the economy by R1.68 billion and spur 6,900 new jobs.

The potential impact of four different scenarios are assessed: a stimulus of 3%, 5%, 7% and 10% of GDP. A stimulus of just under R500 billion (10% of GDP) would stimulate economic expansion over R800 billion and generate almost 3.5 million new jobs. Depending on the compositions of spending, these multipliers would change.

WHAT SHOULD A FISCAL STIMULUS LOOK LIKE IN SOUTH AFRICA?

We argue that a fiscal stimulus in the South African context it should aim to boost both growth and employment in a sustainable and equitable manner. The impact on employment is as important as the impact on growth, and particular forms of employment – high productivity, higher-paying, decent jobs – should be prioritised. This is linked to the need for the stimulus to promote the diversification of the economy towards higher-value added and high-productivity sectors, including diversifying export sectors. This will allow the stimulus to be spent in a manner that raises domestic output. The stimulus must target both the expansion of aggregate demand and aggregate supply.

Deciding how the money should be spent requires careful and detailed budgetary analysis. What we advance here is ten principles that should guide design of a fiscal stimulus for South Africa.

PRINCIPLES

1. **Target spend where there is highest impact (highest marginal value of public funds):** Achieving "bang for the buck" is obviously an important consideration. This needs to take account of the effectiveness and impact of government expenditure to date.

2. **Target spend where there are high growth and employment multipliers:** Given low growth and the unemployment crisis in South Africa, sectors with high growth and employment multipliers should obviously be targeted.
3. **Target spend where it is most likely to be spent immediately and thereby to boost demand:** Fiscal transfers have been shown to stimulate aggregate demand to the extent that they reach households with a high marginal propensity to consume on domestically-produced goods and services.
4. **Improve livelihoods for the most vulnerable:** A fiscal stimulus should take into account that economic growth, given structural inequalities, impacts various groups differently, particularly the most vulnerable groups.
5. **Raise supply and advance structural transformation:** A stimulus programme must channel resources to productive sectors to expand the economy's productive capacity in the long run. It must change the structure of the economy for long-term sustainability.
6. **Undo the harm caused by austerity thus far:** Ending austerity does not by itself reverse the harm already imposed. A meaningful impact assessment of past austerity policies is required to shape future fiscal stimulus packages.
7. **Reduce inequality:** Fiscal policy should distribute resources equitably and improve livelihoods. Fiscal stimulus should challenge, not reproduce structural inequalities.
8. **Environmentally progressive**: The stimulus must pave way for environmental sustainability and move the economy away from a reliance on fossil fuels, while investing in measures to mitigate the worst consequences of climate change.
9. **Social compact that protects jobs:** Fiscal stimulus should be part of creating a new economy and it is important to have buy-in from different stakeholders into what this new economy looks like.
10. **Promote long-term economic sustainability in terms of growth and debt:** A well-designed stimulus should pay for itself in the medium to long term. Fiscal stimulus needs to be timely, time-bound, and well targeted. This requires flexibility that is guided by monitoring and evaluation.

There are a number of areas of expenditure that directly align with multiple principles enlisted above. We provide examples of three: expanding social grants, supporting care work, and revitalising electricity infrastructure.

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1 THE CONTEXT: AUSTERITY AMIDST CRISIS

Despite the looming threat of recession and multiple socio-economic crises, South Africa's National Treasury, at the end of 2019 and start of 2020, reaffirmed an acceleration of its austerity programme, endorsed by the International Monetary Fund (IMF) and much of the business press.[3] Austerity is defined as fiscal policy implemented by a state aimed at solving debt and growth problems during a period of economic stagnation. In the South African context, the government is undertaking austerity through fiscal consolidation, meaning expenditure cuts. This poses grave risks to the economy.

1.1 THE ECONOMY IS FAILING

South Africa's growth has trended downwards since 2010/11, averaging just 1.7% between 2011 and 2018.[4] In 2019, growth reached a decade low of 0.2%. The South African economy shrank by 0.8% in the third quarter (Q3), and 1.4% in the fourth quarter (Q4), of 2019, plunging the country into its third recession since 1994.[5] Precipitating factors include: the global downswing following the 2007/8 global financial crisis (GFC), declining commodity prices, deindustrialisation, state capture, budgetary cuts, restrictive macroeconomic policies, slowed investment as a result of economic stagnation, and the electricity crisis, amongst others. Growth forecasts in South Africa have been chronically overestimated, resulting in downward revisions.

Unemployment has risen to its highest level since the start of 2008 – 29.1% in Q3 2019 (expanded definition: 38.5%).[6] Black African women, with an unemployment rate of over 34.5% (expanded definition: 46.2%) and youth aged 15–24 years, with an unemployment rate of 58.2% (expanded definition: 746%), are the most vulnerable groups. Youth unemployment is up from 32.7% in 2008, making it one of the highest in the world.[7]

[3] International Monetary Fund. (2020). IMF Executive Board Concludes 2019 Article IV Consultation with South Africa. Retrieved from https://www.imf.org/en/News/Articles/2020/01/29/pr2023-south-africa-imf-executive-board-concludes-2019-article-iv-consultation.

[4] National Treasury. (2019). 2019 Budget Graphs and Tables. Own calculations.

[5] The first recession since 1994 took place from Q4: 2008 to Q2: 2009. The second took place over Q1 and Q2 of 2018.

[6] Data collated from Statistics South Africa Quarterly Labour Force Surveys 2008-2019. Retrieved from http://www.statssa.gov.za/?page_id=1854&PPN=P0211.

[7] International Labour Organization. (2018). ILOSTAT Database. Retrieved from https://ilostat.ilo.org/topics/employment/

Poverty remains unconscionably high. Between 2011 and 2015, an additional 2.9 million people were pushed into poverty. In 2015, over half (55.5%) of the population — 30.4 million people — lived below the official poverty line of R992 per person per month (2015 prices),[8] higher for female-headed households than male-headed households (49.9% versus 33.0%). A quarter — 13.8 million people — lived in 'extreme poverty', unable to afford enough food to meet their basic physical needs.[9] Teenage girls living in rural parts of the Eastern Cape and Limpopo were recorded as the most vulnerable to poverty. Since 2015, these trends have almost certainly continued as the economy has dipped in and out of recession, unemployment has continued to rise, food prices spiked due to the drought, and the cost of living increased compounded by VAT and fuel levy hikes. While unemployment is a strong driving factor of poverty, in 2015, 54% of full-time workers earned below the 'working poverty line' of R4 125 (the amount needed to bring them and their dependents above the poverty line) – wage levels in the economy are therefore below acceptable levels.[10] One-third of wage inequality is attributable to households where there are no employed adults.[11] Research has also shown that "almost half of people who co-reside with a wage earner live in households that are below the poverty line. Therefore, having access to wages does not guarantee household income per capita will rise above the poverty line".[12]

South Africa has world-leading level of inequality, with a Gini coefficient for income distribution of 0.7.[13] Wealth is even more unequally distributed with a Gini coefficient of 0.95 – estimates indicate that the wealthiest 1% of the population own half of all wealth, while the top decile owns at least 90–95%.[14]

1.2 DEBT AND RESOURCE MOBILISATION

The national budget is one means through which to tackle these challenges. However, spending cuts have been justified on the basis of rising debt levels.

[8] Upper bound poverty line (UBPL). Statistics South Africa. (2017). Poverty Trends in South Africa. Retrieved from https://www.statssa.gov.za/publications/Report-03-10-06/Report-03-10-062015.pdf

[9] Statistics South Africa. (2017). Poverty Trends in South Africa. Retrieved from https://www.statssa.gov.za/publications/Report-03-10-06/Report-03-10-062015.pdf.

[10] Finn, A. (2015). National Minimum Wage Research Initiative. Working Paper Series No. 1.

[11] Leibbrandt, M., Woolard, I., Finn, A. & Argent, J. (2010). Trends in South African income distribution and poverty since the fall of apartheid. OECD Social, Employment and Migration Working Papers, No. 101. Paris: OECD Publishing.

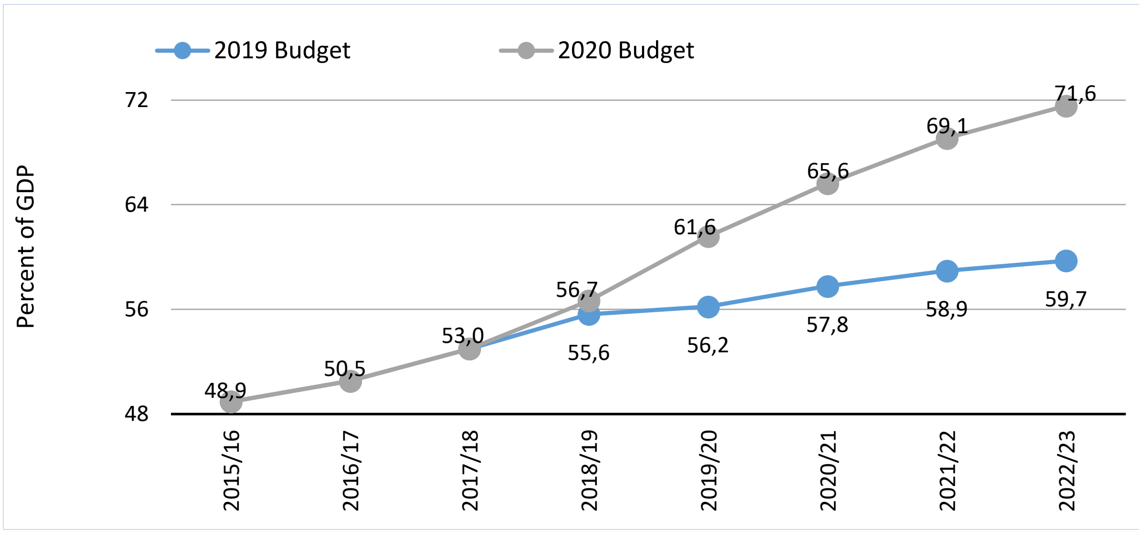
[12] Finn,A. (2015). Op cit.

[13] Davis Tax Committee Final Reports (2018). Feasibility of a Wealth Tax in South Africa.

[14] REDI3x3. (2016). Wealth inequality on South Africa: Evidence from survey and tax data.

Economic stagnation and relatively high borrowing costs underlie our rising debt-to-GDP (Gross Domestic Product) ratio, which has risen rapidly since 2008. The debt-to-GDP ratio rises if GDP falls, irrespective of actual levels of borrowing, although borrowing has also increased. Between 2011/12 and 2018/19, the fastest growth in consolidated spending has gone to debt servicing costs.[15] In real terms, debt servicing costs increased by 8.1% during that period.[16] South Africa's rising debt-to-GDP ratio is not an anomaly. It has been reported that global debt has increased by 50% in the ten years following the financial crisis.[17] The debt position of key State Owned Entities (SOEs), in particular, Eskom, has raised concern over South Africa's risk profile. Some of the debt of SOEs is a contingent liability in the national accounts, meaning that if they default government must still pay the debt holders. In the 2020 Budget the debt-to-GDP ratio is projected to increase to 71.6% by 2026/27 (including substantial financial assistance to Eskom from the fiscus), which is 11.9% higher than had been anticipated in the 2019 Budget. This is projected on the basis of continued low GDP growth. Debt-service costs as proportion of main budget revenue are projected to increase from 15.9% in 2019/20 to 18.35% in 2022/23. These debt trends will be analysed in more detail in an accompanying paper.

FIGURE 1: GROSS DEBT-TO-GDP OUTLOOK



Source: National Treasury (2019)

[15] National Treasury MTBPS. (2019). Graphs and Tables.

[16] Ibid. Own calculations.

[17] Cox, J. (2019). Global debt is up 50% over the past decade, but S&P still says next crisis won't be as bad. *CNBC*. https://www.cnbc.com/2019/03/12/global-debt-up-50-percent-since-the-financial-crisis-sp-says.html.

Tax revenue has increased from 29.1% as a percentage of GDP in 2011/12 to 30.6% in 2018/19, in large part due to poor GDP growth.[18] At the same time, revenue collection has fallen short of budget targets over the past five fiscal years. For the financial year ending 31 March 2019, SARS collected an amount of R1 287.6 billion, against the 2019 Budget estimate of R1 302.2 billion resulting in a deficit of R14.6 billion (-1.1%).[19] SARS attributes the short fall to poor economic performance and higher refund payments, although National Treasury lists "administrative challenges at SARS, and increased tax avoidance and evasion" as additional reasons for these shortfalls.[20] The inability to maximise tax collection has been further undermined by tax evasion and profit shifting.[21] The Southern Africa – Towards Inclusive Economic Development (SA-Tied) project suggests that 98% of the tax that is not collected is linked to profit shifting by the biggest 10% of multinational corporations. The weakening of SARS – aimed at gutting its capacity to tackle high-profile crime and hence expose both tax evasion and corruption – has had disastrous consequences. Tax revenue for 2019/20 is expected to be significantly lower at a tax-to-GDP ratio of 26.3%.

1.3 AUSTERITY

Since at least 2014/15, the South African government has introduced austerity measures in an attempt to reduce debt levels and under pressure from financial markets and credit rating agencies. Austerity budgets during the fifth democratic administration – entailing real cuts to per capita social spending – have severely undermined the provision of essential social service and the realisation of socio-economic rights.

Between 2016/17 and 2018/19, the increase in average non-interest expenditure (total government expenditure less debt servicing costs) has been 0.9% versus a 1.6% increase in population growth (see Table 1).[22] Despite government's commitment to a countercyclical stance – which involves saving in periods of strong economic growth while sustaining spending in downturns – expenditure trends have been procyclical, meaning cut backs during periods of weak growth. The 2018 increase in the VAT rate from 14% to 15% represents a clearly retrogressive measure, which, when combined with spending cuts, imposes a greater burden on the poor.

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[18] National Treasury MTBPS. (2019). Graphs and Tables.

[19] Republic of South Africa. (2019). SARS announces preliminary revenue outcome for 2018/19 financial year. Retrieved from https://www.gov.za/speeches/preliminary-revenue-outcome-31-mar-2019-0000.

[20] National Treasury. (2018). Budget Review, 39.

[21] Also known as tax avoidance.

[22] Authors calculations based on National Treasury budget 2019 data.

TABLE 1: GDP, POPULATION AND NON-INTEREST EXPENDITURE GROWTH 2016/17-2018/19

	2014/15	2015/16	2016/17	2017/18	2018/19	Average growth
Revenue growth	2.7%	5.1%	0.6%	-1.0%	2.7%	2.0%
Non-interest expenditure growth	1.7%	4.6%	-0.2%	0.3%	2.6%	1.8%
Population growth	1.6%	1.6%	1.6%	1.6%	1.6%	1.6%

Source: National Budget Review 2016 -2019

There has been a collapse in public investment in South Africa[23] with public investment in the nation's infrastructure falling by 4.0% and 8.2% in 2017 and 2018 respectively;[24] public-sector capital expenditure slipped to a level last seen in 2014. This has been combined with the collapse of SOE investment spending, in part as a result of rampant state capture.[25] Eskom remains the single largest contributor to total public-sector capital expenditure, even after reducing spending in 2018.

Social-sector investment has also plummeted. For example, in health and education:

- Despite servicing 83% of the population, spending per uninsured person has only increased by 1.7% on average (in real terms) from 2014/15 to 2018/19 in the context of a rising burden of disease and high medical price inflation.[26]
- Learner spending has been steadily decreasing for years, largely unnoticed – it fell by 8% in real terms from R17 822 in 2010 to R16 435 in 2017.[27] This is despite 78% of Grade 4 learners being unable to read for meaning.

The logic of austerity dominates government thinking. The president's 2018 'fiscal stimulus plan' contained no new spending, the 2019 Medium Term Expenditure Framework (MTEF) proposed cut backs of 5%, 6%, and 7% in real baseline expenditure respectively in 2020, 2021, and 2022. This translates to a net real cut of approximately R48 billion (that is, taking into account areas of additional spending and the difference between projected nominal expenditure and what an inflationary increase would be).

[23] Trade and Industrial Policies. (2019). POLICY BRIEF: 2/2019 The National Treasury economic policy discussion paper.

[24] Stats SA. (2019). Public capital expenditure continues to fall. Retrieved from http://www.statssa.gov.za/?p=12705.

[25] Trade and Industrial Policies. (2019). POLICY BRIEF: 2/2019 The National Treasury economic policy discussion paper.

[26] National Treasury. (2019). Budget Review.

[27] Ibid.

The National Treasury's 2019 'discussion paper', while focusing mainly on microeconomic reforms, reasserts its current macro-economic policy stance.

1.4 THE NARRATIVE AND LOGIC OF AUSTERITY

South Africa is implementing these measures despite a large body of international evidence that has shown that austerity is not economically viable.[28] Globally, austerity has been used to legitimise a desire to shrink the (social welfare) role of the state, deregulate labour markets, emphasise private markets as the drivers of growth, and enable a reconfiguration in the interests of capital, particularly finance capital.[29]

However, across the globe, austerity has generated a downward spiral of shrinking GDP and continued increases in sovereign debt. Austerity measures have also led to rising unemployment, falling incomes and increased inequality. The most marginalised groups in society, including women, children, minorities, migrants and the poor, feel the biggest impacts. Women carry a greater burden of social provisioning and require more access to public services, which austerity undermines.[30] Governments across the world are increasingly rejecting this approach, while others are facing mass unrest in response to austerity policies. Stimulatory policies have been implemented in the United States, the Eurozone, Japan, Brazil, China and other countries across multiple regions. South Africa's macroeconomic policy stance is racing rapidly in the opposite direction.

The dominant narrative is that cutting expenditure will help to address South Africa's 'runaway' debt. The national budget is continuously compared to a household. This is relatable, but economic nonsense. For example, a household improves its financial position by saving, but a national economy's failure to borrow and spend can shrink the economy and make its financial position worse.

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[28] Sibeko, B. (2019). The cost of austerity: Lessons for South Africa. Institute for Economic Justice Working Paper Series, No 2. https://iej.org.za/the-cost-of-austerity-lessons-for-south-africa/.

[29] Farnsworth, K & Irving, Z. (2018), Austerity: Neoliberal Dreams Come True? *Critical Social Policy* 38, No. 3, 461–81. https://doi.org/10.1177/0261018318762451.; and Jensen, T. "Tough Love in Tough Times". *Studies in the Maternal* 4, no. 2 (July 1, 2012): 1–26. https://doi.org/10.16995/sim.35.; and Allen, Kim, Mendick, H, Harvey, L, & Ahmad, A. "Welfare Queens, Thrifty Housewives, and Do-It-All Mums: Celebrity Motherhood and the Cultural Politics of Austerity." *Feminist Media Studies* 15(6), 907–25. https://doi.org/10.1080/14680777.2015.1062992.

[30] Himmelweit, S. (2016), Conclusion: Explaining Austerity and its Gender Impact, in Bargawi, H, Cozzi, G, and Himmelweit, S (eds.) *Economics and Austerity in Europe. Gendered Impacts and Sustainable Alternatives*. London: Routledge.

The logic of 'fiscal discipline' is premised on appeasing creditors and credit rating agencies; declining public trust and scepticism around government's capacity to stimulate meaningful economic activity; and current poor quality spending and under spending – even if it means reducing investment in critical social needs, such as early intervention against cervical cancer.[31] While some of these are valid concerns, they are also ammunition for those who oppose a 'large' role for the state in the economy – from the extension of welfare services to SOEs. Eskom's debt crisis has added fuel to the fire. While Eskom does pose a real risk to the economy, the crisis is being used to moralise austerity by making the public believe that there is no other alternative than 'shared pain'.[32]

Cutting spending can – and often does – make relative debt levels higher. This is because government spending is a large part of GDP, directly, and indirectly. Our roads, healthcare, electricity, ports, and education are the lifeblood of the economy. If we cut back on spending the economy *will* shrink.[33] This will have the likely consequence of *increasing* debt-to-GDP levels. Government spending spurs growth, government cuts kills growth.

1.5 STIMULUS NOT AUSTERITY

The economic situation – including relative debt levels – will continue to worsen without proactive measures to stimulate the economy – in the short to medium term a fiscal stimulus package that adequately mobilises resources by the state is essential.

Figure 2 demonstrates the various approaches available. Scenarios 1, 2 and 3 show ways in which debt ratios will increase – by borrowing more with the same size economy (Scenario 1), by borrowing the same within a shrinking economy (Scenario 2), and by borrowing less but within a shrinking economy (Scenario 3). Scenarios 4 and 5 show ways to reduce debt levels – by borrowing less but keeping the economy at the same level (Scenario 4) and by borrowing more but growing the economy (Scenario 5). Scenario 4 is government's pipedream – gradually cut borrowing and government spending but somehow magically keep the economy the same size and have the debt-to-GDP ratio fall. If we aim for Scenario 4, we will end up with Scenario 2 or 3 – a smaller economy with either the same or greater debt ratios.

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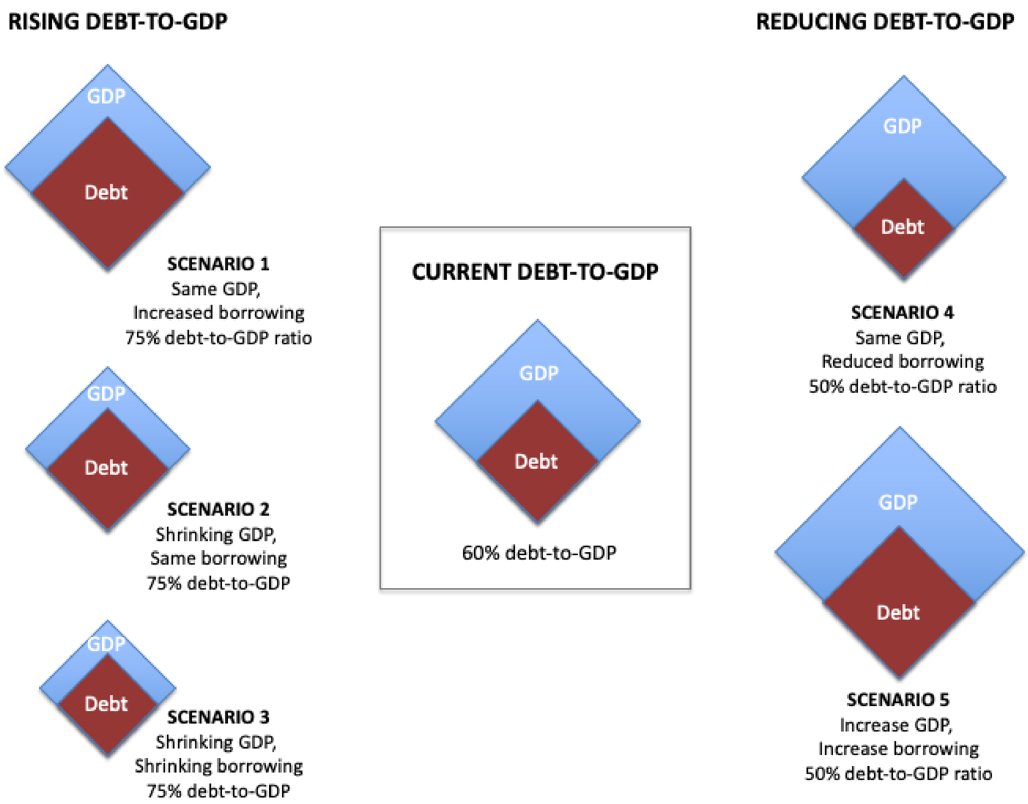
[31] Budget Justice Coalition. (2019). 2019 MTBPS submission to the select and standing committees on finance https://budgetjusticesa.org/assets/downloads/BJC-MTBPS-Finance-Submission-2019.pdf.

[32] Clarke, J. & Newman, J. (2012). The Alchemy of Austerity. *Critical Social Policy.* 32(3). 299–319. https://doi.org/10.1177/0261018312444405.

[33] Sibeko, B. (2019). Op cit.

What this paper argues is that we need to be aiming for Scenario 5 – increase revenue, through taxation and borrowing, to grow the economy, and the economy will expand and debt-to-GDP levels will fall.

FIGURE 2: FIVE SCENARIOS OF DEBT TO GDP



Source: Authors

This stimulus must be combined with, and complemented by, other policies that seek to structurally transform the economy. A carefully crafted stimulus package can promote growth, and generate the virtuous cycle of expansion, growing revenue, increased spending, rising investment, and falling debt; it can break the current downward spiral, and create the space for more systemic interventions. It "can simultaneously protect the most vulnerable people, communities, and industries, and have a stimulatory effect through circulating money and raising demand in local township and rural economies."[34]

[34] Coleman, N. (2019). Part Two: Building blocks for a new economy Retrieved from https://www.dailymaverick.co.za/opinionista/2019-06-12-part-two-building-blocks-for-a-new-economy/.

2 A PRO-EMPLOYMENT MACROECONOMIC POLICY FRAMEWORK: SOME THEORY TO INFORM POLICY

Macroeconomic policy in South Africa has generally been packaged as aimed at achieving 'macroeconomic stability' – low inflation, low debt, moderate tax levels, liberalised markets, and stable spending. This assumes that employment is not the primary concern of macroeconomic policy; bizarre, given that macroeconomics began as the investigation of ways to reach full employment.

Instead, we argue that *pro-employment macroeconomic* policy requires a three-pronged – and interrelated – approach that sees macroeconomic policy: 1) directly spur employment where possible; 2) resolve macroeconomic imbalances that retard employment; and 3) advance structural transformation while supporting complimentary sectoral and labour market policies.

At the heart of this approach is the recognition that macroeconomic tools can be used to stimulate both aggregate demand and aggregate supply, and maximise the positive relationship between economic growth and employment ('Okun's Law').[35]

Macroeconomic policy must aim to achieve both 'internal balance' – 'full employment' – and 'external balance' – a sustainable balance of payments. The balance of payments is a country's relationship to the rest of the world; if the trade balance (part of the current account within the balance of payments) is in deficit then it means the country is importing more than it exports. A sustainable balance of payments is important because a country wants to produce more domestically and export, and needs foreign exchange to import. Policies that aim to raise employment through increasing demand in the economy should avoid making the balance of payments chronically worse. So, increasing demand in the economy should go hand in hand with attempts to stimulate more domestic production – that is, increasingly supply capacity – rather than excessively sucking in imports. This cannot be applied mechanically – for example, even export-facing sectors may require imports of capital or other goods at the outset – but the long-run aim should be to expand domestic capacity. Put simply: use

[35] Okun's law: observed the relationship between changes in the unemployment rate and the growth rate of real gross domestic product (GDP). Okun noted that, because of ongoing increases in the size of the labour force and in the level of productivity, real GDP growth close to the rate of growth of its potential is normally required, just to hold the unemployment rate steady. To reduce the unemployment rate, therefore, the economy must grow at a pace above its potential.

macroeconomic policy to 1) increase demand in the economy, 2) without unduly increasing imports, and 3) expand domestic supply in the economy.[36]

Aggregate demand increases the level of employment through changing the level and composition of expenditures. Supporting aggregate demand to increase employment sustains the expansion of markets for consumption and investment goods, thereby allowing firms to grow through achieving (static and dynamic) economies of scale. This leads to sustained productivity growth within firms and the economy; the most proximate determinant of long-term economic growth.

- Policies to increase aggregate demand for full employment (internal balance above) are called **expenditure-raising policies**, they target the level of expenditure, which in turn drives aggregate demand. Expenditure raising policies might include:
    - Levels of government spending;
    - Revenue mobilisation;
    - Composition of government spending (consumption vs. investment);
    - Spending which impacts the distribution of income; and
    - Income policies, such as tax breaks or government transfers
- Policies to improve the trade balance (external balance) are called **expenditure-switching policies**, they target the type of expenditure by changing relative costs, that is, they make imports more expensive than domestically produced goods and exports more competitive. This drives the relative demand for exports over imports. Expenditure switching policies might include:
    - Exchange rate management;
    - Multiple and dual exchange rates;
    - Import and export taxes and quotas to discourage imports and encourage exports, either targeted (focusing on particular products or sectors) or general; and

[36] Institute for Economic Justice. (2020). Macroeconomic and Sectoral Policies for Employment Generation and Structural Transformation.

- Capital controls and interest rate mechanisms to attract or repel capital flows (thereby impacting pressures on the exchange rate).[37]

Aggregate supply measures target employment growth through increasing the availability and quality of production and the factors used to engage in production. Proposals advanced by the National Treasury in its 2019 'discussion document' can largely be characterised as targeting aggregate supply. Aggregate supply measures target employment growth through increasing the availability and quality of production and the factors used to engage in production. National Treasury tends to focus on improved infrastructure and 'unblocking' bottlenecks in industrial supply changes. As valuable as these are, a wider range of measures increase aggregate supply. For example, by spending on health or education human capabilities can be raised, similarly, spending on physical infrastructure can increase productivity. This increases employment through economic expansion.

The implementation of supply-side and demand-side policies can reinforce each other and can play a role in spurring structural transformation and the inclusion of marginalised groups, if done correctly. For example, raising employment of health-care professionals through increasing the expenditure level could improve aggregate supply through a healthier workforce. Similarly, infrastructure investment is critical to a growing economy. An expansion of supply (production) in the economy can in turn raise revenue and create greater fiscal space.

In this paper we focus specifically on the benefits of increasing the level of expenditure via fiscal stimulus and what that should look like.

[37] Capital controls and interest rates might be thought of as two additional tools, to exchange rate depreciation, which can be used to offset current account deficits through encouraging net capital inflows through the financial account. In general, the greater the degree of capital mobility that is permitted, the more capital inflows from abroad can be drawn on to offset current account deficits. However, excessive capital openness can also lead to a sudden-stop then outflow of capital from the domestic economy, which can severely impair the ability for a country to run a sustainable balance of payments. The use of interest rates to achieve net financial inflows to fund any current account deficit is possible in theory: higher interest rates relative to the global risk adjusted return required by investors will lead to a net capital inflow. The problem with this is that the interest rate will in turn impact the domestic economy in other ways, which may be undesirable. Moreover, under fixed exchange rates monetary policy instruments – and the interest rate – must be devoted to maintaining the nominal value of the exchange rate against the currency or basket of currencies to which it is pegged.

3 THE SUCCESS OF FISCAL STIMULUS

Government spending on goods and services is a major component of stable growth of aggregate demand by fuelling demand for goods and services, including those produced or provided by government employees.[38] In 2019, consolidated government spending reached a historic high of 36% of GDP.[39]

The assumption that cutting government spending has relatively little adverse effect on aggregate demand[40] has been discredited by a range of studies which have shown that the effect of government spending cuts on output was larger than anticipated during recessionary times, as well as under the pressure of globalisation.[41] For example, in an IMF Working Paper, Blanchard and Leigh highlight the issue of growth forecast errors and fiscal multipliers, showing that in advanced economies fiscal consolidation was strongly associated with lower growth.[42]

In assessing how fiscal policy has contributed to stable growth of aggregate demand, findings show that:[43]

- Public investment contributes to building productive capacity and enhancing overall efficiency, thus encouraging private activity.
- Investing in human capital formation – for example, skills, health and livelihoods – has long-term growth-enhancing economic benefits.
- Countries with greater public investment have higher levels of social cohesion.
- Spending that increases incomes for lower-income groups (with higher consumption propensities) as well as demand for goods from domestic firms, has the strongest effects.

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[38] Blanchard, O & Leigh, D. (2013). Growth forecast errors and fiscal multipliers. 13(1) International Monetary Fund.; Kraay, A (2014). Government spending multipliers in developing countries: Evidence from lending by official creditors. American Economic Journal: Macroeconomics. 6(4), 170–208. Mittnik, S and Semmler, W (2012). Regime dependence of the fiscal multiplier. *Journal of Economic Behavior & Organization.* 83(3), 502–522.

[39] National Treasury. (2020). Budget Review.

[40] UNCTAD. (2019). Trade and development report 2019: Financing a global green new deal. Retrieved from https://unctad.org/en/PublicationChapters/tdr2019ch3_en.pdf

[41] IMF. (2012). World Economic Outlook: Coping with High Debt and Sluggish Growth. International Monetary Fund. Capaldo, J. and Izurieta, A. (2013). The imprudence of labour market flexibilization in a fiscally austere world. *International Labour Review.* 152(1), 1–26. & UN DESA (2008). *National Development Strategies – Policy Notes*. United Nations Department of Economic and Social Affairs. New York. Available at https:// www.un.org/en/development/

[42] Blanchard, O. & Leigh, D. (2013). Op cit.

[43] Blanchard, O. and Leigh, D. (2013). Kraay, (2014). Mittnik, S. and Semmler, W. (2012). UNCTAD. (2019). Op cit.

- Taxation has the highest potential of contributing to demand growth and economic stability when it targets high incomes (which are largely saved) and speculative activities.
- Although (corporate) tax cuts are sometimes advanced as a fiscal stimulus – on the premise that companies and the rich would spend more – international evidence has shown that productive investment has not increased despite repeated bouts of corporate tax cuts across developed and emerging economies between 2009 and 2019. Further, these cuts have increased inequality.
- Indirect taxation, especially VAT, tends to have a detrimental effect on aggregate demand because it weighs heavily on spent income (such as the incomes of the poorest groups) rather than saved incomes (such as by the richest groups).

Countries that have implemented fiscal stimulus have experienced increased growth, reduced unemployment and lower debt-to-GDP ratios. Similarly, in South Africa, Duma Gqubule has argued, it was expansionary fiscal and monetary policies that led to growth and job creation between 2003 and 2008. The following changes were observed:[44]

> "Interest rates fell by 650 basis points between June 2003 and April 2005. Public investment increased 16.3% a year between 2003 and 2008. It rose to a high of 7.9% of GDP in 2008. Public investment crowded in private investment. As a result, gross fixed-capital formation increased by an average of 12% a year during the five-year period. As a percentage of GDP it reached a high of 23.5% in 2008. The economy grew 4.8% a year between 2004 and 2008. It created 1.9-million jobs between September 2003 and September 2008, despite all the structural problems in the economy. Jobs were created in every sector except mining and agriculture."

Although the economic context has changed and South Africa's fiscal position has deteriorated, South Africa faces the choice between austerity that hurts growth and stimulus that can spur growth *if done correctly*.

Stimulus was the dominant paradigm until the 1970s.[45] Classic cases of early stimulatory policies begin with the New Deal which was enacted in 1933 in the United States and the Marshall plan which was effective in post-war Europe in 1948. To recover from the Great Depression of the 1930s, the United States Federal government implemented "programmes addressed what historians call the "3 Rs" of dealing with

[44] Gqubule, D. (2019). Ramaphosa's stimulus plan will need out-of-the-box thinking. Retrieved from https://www.businesslive.co.za/bd/opinion/columnists/2019-05-14-duma-gqubule-ramaphosas-stimulus-plan-will-need-out-of-the-box-thinking/

[45] Blyth, M. (2013). Austerity: The History of a Dangerous Idea. Retrieved from https://pdfs.semanticscholar.org/7d9a/51239fa1ad803cf68d7456a7cd6201c2f975.pdf.

the depression, Relief, Recovery, and Reform—*relief* for the poor and jobless, *recovery* of the economy, and *reform* of the nation's financial system to safeguard against future depressions".[46] The New Deal itself did not end the great depression but it did ensure the economic security of Americans. Winkler notes that: "It created the framework for a regulatory state that could protect the interests of all Americans, rich and poor, and thereby help the business system work in more productive ways. It rebuilt the infrastructure of the United States, providing a network of schools, hospitals, and roads that served us well for the next 70 years."[47] It was the rapid increase in defence expenditure that subsequently changed the trajectory of the country.

Following World War II, the United States provided Western Europe with a fiscal stimulus worth $15 billion through the Marshall Plan. Over four years, the stimulus was used to reconstruct cities, industries and infrastructure heavily damaged. By the end of the programme, economic growth in the countries that had received funds had surpassed pre-war levels – their gross national products rose 15-25% during this period.[48] Asia, the first region to recover from the GFC, experienced a strong and fast recovery due to large monetary and fiscal stimulus packages that increased the demand for goods and services and promoted growth.[49] The average growth rate of GDP during the four-year period after the crisis was about 5% – not quite back to the pre-crisis average, but a strong economic performance by most standards. Asian governments learnt from the 1997 financial crisis, responding with aggressive and timely fiscal expansion. The leading fiscal stimulus programmes as a share of GDP included Thailand (17.2%), China (13.3%), Vietnam (9.7%), and the South Korea (6.6%). There was increased expenditure on infrastructure spend. Often targeted tax cuts were also central to the stimulus programmes. It is, however, now widely recognised that tax cuts are less effective than government expenditure and have adverse distributional consequences. The Asian Development Bank, for example, found that monetary policies and increased government expenditure had a significant and positive impact in supporting economic growth, whereas tax cuts were insignificant (using a sample of

[46] Kelly, M. (2019). Top 10 New Deal Programs of the Great Depression. Retrieved from https://www.thoughtco.com/top-new-deal-programs-104687.

[47] Winkler, A. (2009). The new deal: accomplishments and failures. Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs March 31, 2009.

[48] History.com Editors. (2009). Marshall Plan. Retrieved from https://www.history.com/topics/world-war-ii/marshall-plan-1; The Editors of Encyclopaedia Britannica. (2020). Marshall Plan. Retrieved from https://www.britannica.com/event/Marshall-Plan.

[49] Asian Development Bank (ADB). (2010). Asian development outlook 2010: Macroeconomic management beyond the crisis. ADB South Asia Working Paper Series. Retrieved from https://think-asia.org/bitstream/handle/11540/1407/impact-asia-and-emerging-consensus.pdf?sequence=1.

eight major industrialised countries, six non-Asian developing countries, and ten developing Asian countries).[50] While tax cuts were meant to increase consumption expenditure, the income saved was only partly consumed by households and firms.[51]

In terms of monetary policy, authorities across the region responded decisively by adding additional liquidity, implementing measures to safeguard the stability of the banking system, and adopting monetary easing by lowering policy rates.[52] The Asian region's policies were successful overall in offsetting the loss of exports and kept regional 2009 GDP from dropping.[53]

In a 2010 study of 37 countries, the United Nations Economic and Social Commission for Asia and the Pacific found that fiscal stimuli led to positive outputs.[54] They found that between 7 and 11 million jobs were saved due to the G20's 2009 fiscal policies, representing 29-43% of the G20's total unemployment in the first half of 2009. Similarly, a 45-country analysis of Sub-Saharan Africa (SSA), suggests that fiscal stimulus packages worth close to US$2 trillion, implemented between 2009 and 2010, helped to smooth income losses by offsetting about a quarter of losses due to the financial crisis. In addition, the stimulus implemented by developed countries – either directly or indirectly – would have had a positive impact on the SSA economies.[55]

After a period of austerity measures, many countries are returning to stimulus. In 2015, Portugal implemented a recovery plan which abandoned austerity for new economic policies to stimulate the economy.[56] The policy reforms sought to reverse austerity policies, which had included regressive taxes, cancelled public holidays, plummeting public sector wages, and pensions. Some new measures were also introduced such as

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[50] Brunschwig, S. et al. (2011). The Global Financial Crisis: Impact on Asia and Emerging Consensus. Retrieved from: https://think-asia.org/bitstream/handle/11540/1407/impact-asia-and-emerging-consensus.pdf?sequence=1.

[51] United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP). (2010). Economic and social survey of Asia and the Pacific 2010: Sustaining recovery and dynamism for inclusive development. (Thailand: UN Office). 29-30.; Brunschwig, S. et al (2011). Op cit.

[52] Brunschwig, S. et al. (2011). Op cit.

[53] United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP). (2010). Economic and social survey of Asia and the Pacific 2010: Sustaining recovery and dynamism for inclusive development. (Thailand: UN Office). 29-30.

[54] Ibid.

[55] Barrell, R.; Holland, D.; te Velde, D. (2009). A Fiscal Stimulus to Address the Effects of the Global Financial Crisis on Sub-Saharan Africa. National Institute of Economic and Social Research, NIESR Discussion Papers.

[56] Gomes, J. & de Asssancau, J.B. (2018). Portugal's Economic Recovery: The Impact of Ditching Austerity. Retrieved from knowledge.wharton.upenn.edu/article/portugals-economic-recovery-how-much-came-from-ditching-austerity/.

luxury charges, increased minimum wages, and increased social security. As a result, the nation's economy grew by 2.7% in 2017 — a 17-year high. Unemployment more than halved to 6.8% between 2015 and 2017 and now stands at 6.2%. Such positive conditions mean that the government now estimates that the public deficit will be close to 0% in 2019 (compared to 4.4% of GDP in 2015). Even the United Kingdom, which has championed austerity for a decade has now turned to stimulus. In November 2019, all parties in the UK pledged to increase spending as part of the general election campaign.[57]

4 THE VIABILITY OF A FISCAL STIMULUS FOR SOUTH AFRICA

In assessing the viability of a fiscal stimulus programme a number of indicators are crucial. At the forefront is often the government's ability to finance additional spending – the ill-defined notion of 'fiscal space' – relating to debt levels, tax revenue, and the ability to mobilise other funds. Equally important is the economy's ability to absorb additional spending. Here inflation and capacity utilisation – the extent to which the economy has room to expand output – are essential. We explore these in turn. This paper forms part of a larger series that analyses – in more depth – issues of debt management, taxation, leveraging development finance institutions, and monetary policy. Here we provide a preliminary discussion of some of these matters, with the proviso that many require further analysis.

4.1 CONCEPTUALISING FISCAL SPACE

Fiscal space is commonly defined as the budgetary room that allows a government to provide resources for public purposes without undermining fiscal or debt 'sustainability' (itself a relatively ill-defined notion).

Fiscal space is not a given – governments can either create or diminish fiscal space through their policies and actions.[58] By modifying sources and levels of funding,

[57] Atkinson, A. (2019). Johnson Victory Heralds Gradual End to U.K.'s Era of Austerity. Retrieved from https://www.bloomberg.com/news/articles/2019-12-14/johnson-victory-heralds-gradual-end-to-u-k-s-era-of-austerity.

[58] Van der Linde, G. (2018). An Incomplete Transition Overcoming the Legacy of Exclusion in South Africa. Retrieved from http://www.treasury.gov.za/publications/other/AfricanFiscalForum/english%20version/Session3/3a/Notes%20-%20World%20bank%20-%20Gert%20vd%20Linde.pdf.

governments are able to generate new internal or external resources on a sustainable basis. By using existing or new resources efficiently the state can generate different outcomes.[59] As UNCTAD notes:[60]

> "[F]iscal space cannot be identified as a predetermined level of resources in any economy. Rather, it is dependent on past and current fiscal policy choices, such as the extent of the government's spending, its savings and the level of its debt relative to GDP. What matters most is the flow of revenue that accrues to the government over a period of time as a result of tax and expenditure changes and their subsequent impact on GDP through the fiscal multipliers. While fiscal space is "endogenous" in this sense, it can still be materially constrained by limits to productive capacity, which can shift dynamically over time."

The ILO, UNICEF and UN Women argue that even the poorest of countries can create fiscal space, albeit for social investment in particular.[61] Their work highlights eight financing alternatives to increase the overall size of a country's budget.[62]

The World Bank suggests the four main components of assessing fiscal space are:[63]

1. Official Development Assistance (ODA) through aid and debt relief;
2. Domestic revenue mobilisation through improved tax administration or tax policy reforms;
3. Deficit financing through domestic and external borrowing; and
4. Reprioritisation and raising efficiency of expenditures

Country specific factors also matter, including whether the country is a 'sovereign-currency' issuer (whether it can issue debt in its own currency) and the effectiveness

[59] Duran-Valverde, F. & Pacheco, J. (2012) Fiscal space and the extension of social protection: Lessons learnt from developing countries. Retrieved from https://www.social-protection.org/gimi/gess/RessourcePDF.action?ressource.ressourceId=34168.

[60] UNCTAD. (2019). Trade and development report 2019: financing a global green new deal. Retrieved from https://unctad.org/en/PublicationChapters/tdr2019ch3_en.pdf.

[61] Ortiz. Et al. (2017). Fiscal Space for Social Protection and the SDGs Options to Expand Social Investments in 187 countries.

[62] (i) expanding social security coverage and contributory revenues, (ii) increasing tax revenues, (iii) eliminating illicit financial flows, (iv) improving efficiency and reallocating public expenditures, (v) tapping into fiscal and foreign exchange reserves, (vi) managing debt: borrowing or restructuring sovereign debt, (vii) adopting a more accommodative macroeconomic framework, and (viii) increasing aid and transfers.

[63] This has been at the core of subsequent frameworks by the World Bank, IMF and some other UN agencies. In 2018, UN/DESA published a paper called *Towards a more comprehensive assessment of fiscal space* which sought to strengthen how fiscal space assessments are conducted. Cheng, H.W.J & Pitterle, I. (2018). Towards a more comprehensive assessment of fiscal space. Retrieved from https://www.un.org/esa/desa/papers/2018/wp153_2018.pdf.

of fiscal policy in boosting growth (measured by the size of the 'fiscal multiplier'). This makes cross-country analysis complicated.

Our assessment below is that fiscal space does exist in the South African context and further space can be generated.[64]

4.2 FISCAL SPACE IN SOUTH AFRICA

4.2.1 SOUTH AFRICA'S DEBT

A debt crisis in South Africa has been mainstreamed in public discourse and justifies the need to cut expenditure. However, South African debt is, at the time of writing, not excessive by international standards. According to the IMF, emerging market and middle-income country debt levels are projected to reach, on average, 57.6% in 2023, while advanced country debt averaged at 105.4% of GDP in 2017.[65] South Africa's debt-to-GDP ratio is expected to increase from 65.6% of GDP in 2020/21 to 71.6% of GDP in 2022/23.

South Africa's debt also remains in line with its credit rating peers (particularly when Eskom is excluded).[66] As of 2018, South Africa's debt-to-GDP figure is well below that of Brazil, who has seen rapid increases in their ratio from 2014. Turkey, by contrast, has seen their debt-to-GDP ratio decrease by almost 16% since 2009 following the financial crisis.[67] This was driven by fiscal stimulus and an increase in foreign borrowing over the period, combined with strong institutional and macroeconomic reforms, most notably expanding access to public services. South Africa, who has taken the austere approach, has seen debt levels rise near 26% over the comparative period (2009-2018). As shown in Figure 3 below, South Africa's debt-to-GDP is the eighth highest in the

[64] In recent assessments of South Africa, the IMF and World Bank has concluded that South Africa does not have fiscal space and that it should strengthen fiscal consolidation efforts to address debt.

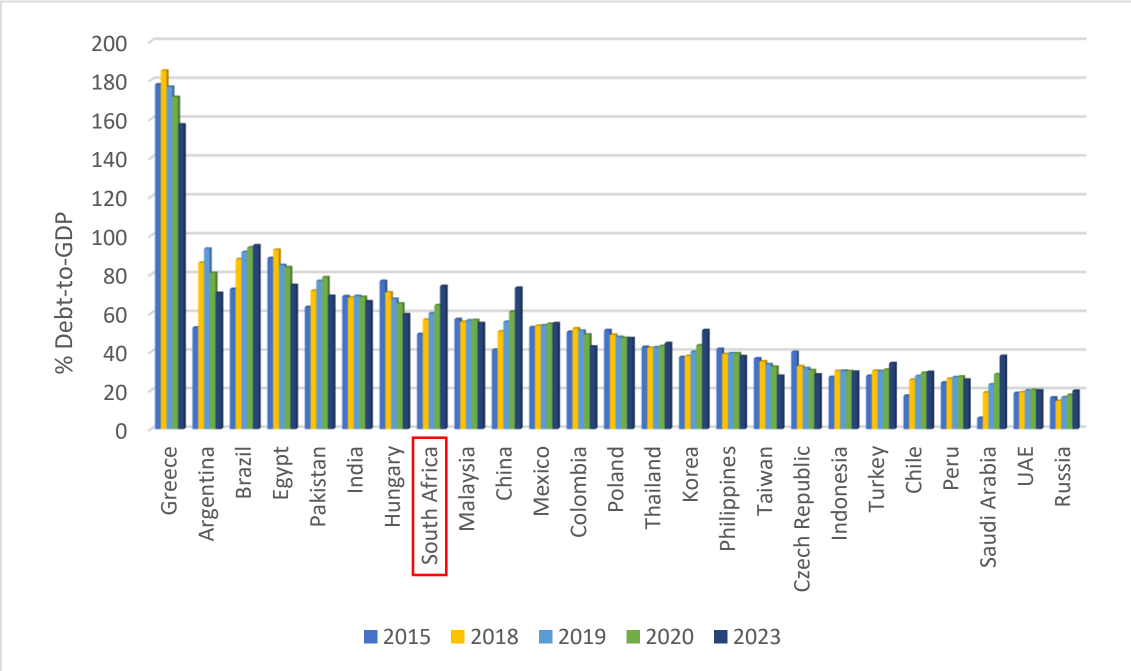
[65] CESR, IEJ, SECTION27. (2018) Joint Submission to the Committee on Economic, Social and Cultural Rights on the occasion of the review of South Africa's first period report at the 64th Session, October 2018. Retrieved from https://iej.org.za/joint-submission-to-the-committee-on-economic-social-and-cultural-rights/.

[66] Moody's Investor Service. (2019). South Africa Government of credit rating. Retrieved from https://www.moodys.com/credit-ratings/South-Africa-Government-of-credit-rating-686830?stop_mobi=yes.

[67] World Bank. (2019). A decade after the global recession: Lessons and challenges for emerging and developing countries. Retrieved from http://pubdocs.worldbank.org/en/799211574200483232/Recession-Chapter-3.pdf.

group of 25 emerging markets.[68] Greece has the highest debt-to-GDP ratio of over a 170% and is the exception within the group, whereas Russia's debt-to-GDP ratio falls below 20%. South Africa's 2019 debt levels were similar to those of Hungary, India, and Mexico at around the 60% mark. South Africa's 2019 debt levels are higher than the median (47.8%) and the mean (53.8%) of the group. Chinese and South African ratios are forecast to be of a similar 74% as of 2023, with Chinese debt levels increasing at a greater rate than that of South Africa. Despite the heavy focus on fiscal consolidation, debt-to-GDP continues to rise.

FIGURE 3: EMERGING MARKET DEBT-TO-GDP RATIOS 2015 - 2023



Source: IMF (2020). Note: Historic figure from 2015-2018, current 2019, and 2020 and 2023 projections.

While reducing debt-to-GDP and debt service payments is an acceptable goal there is little evidence to sustain the proposition that South Africa has unsustainable levels of government borrowing, although debt servicing costs may be more of a concern (see forthcoming paper on debt). There is also much evidence that debt reduction through austerity does massive economic harm, which will impede on fiscal space as well as having very real negative effects on human capital development.

[68] International Monetary Fund. (2020). Data Mapper. Retrieved from https://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/OEMDC/ADVEC/WEOWORLD/ZAF; Own data compilation.

In 2010, Reinhart and Rogoff claimed that rising levels of government debt are associated with much weaker rates of economic growth, indeed negative ones, arguing that a 90% debt-to-GDP ratio threshold applies.[69] This influential claim was utilised by austerity-minded politicians, particularly in Britain and Europe, to advocate for austerity policies. This study was subsequently exposed by Herndon, Ash and Pollin as being statistically inaccurate.[70] This was widely accepted as a debunking of the Reinhart and Rogoff research, and by extension the claims made by the World Bank, causing great embarrassment.[71]

Perceptions of debt have recently changed and even the OECD has encouraged its members to utilise debt to create fiscal space for expansion.[72] As noted above, in the global economic discourse there seems to be a gradual return to stimulus fiscal policy after years of austerity. It has even been argued that the GFC has induced a 'Keynesian turn' within the IMF.[73] It is now once-again acknowledged that short-term increases in borrowing, if wisely spent, can be positive for the economy and medium-term relative debt levels.

There is, however, no consensus on how much debt is optimal and no country can necessarily borrow endlessly. When debt levels are considered high by the market, combined with other factors, creditors do start demanding higher interest rates to compensate them for the higher risk because that's when creditors become concerned that the country will default on its debt.

Interest paid on South Africa's debt, is high relative to peers, as shown in Figure 4. South Africa has the third highest bond rates relative to other emerging markets.[74] The country's 2, 5 and 10-year bond rates are 6.7, 7.5 and 8.5 respectively. These values are higher than the emerging market means of 4.1, 4.3 and 4.8 for those year bonds. South

[69] Cassidy, J. (2013). The Reinhart and Rogoff Controversy: A Summing Up. Retrieved from https://www.newyorker.com/news/john-cassidy/the-reinhart-and-rogoff-controversy-a-summing-up

[70] Herndon, T Ash, M & Pollin, R, (2014). Does high public debt consistently stifle economic growth? A critique of Reinhart and Rogoff. *Cambridge Journal of Economics.* 38(20).

[71] In a 2018, IMF paper, Barrett concludes that: "Point estimates of the long run average interest-growth differential in advanced economies are frequently negative. If true, the consequences are rather unpalatable: unless governments can commit to infinitely large deficits, they can issue as much debt as they like without becoming insolvent." Barrett asserts that what is important is term structure and the management of rollover risk. Although his study only includes six advanced economies with long and stable histories, the findings present an argument against austerity.

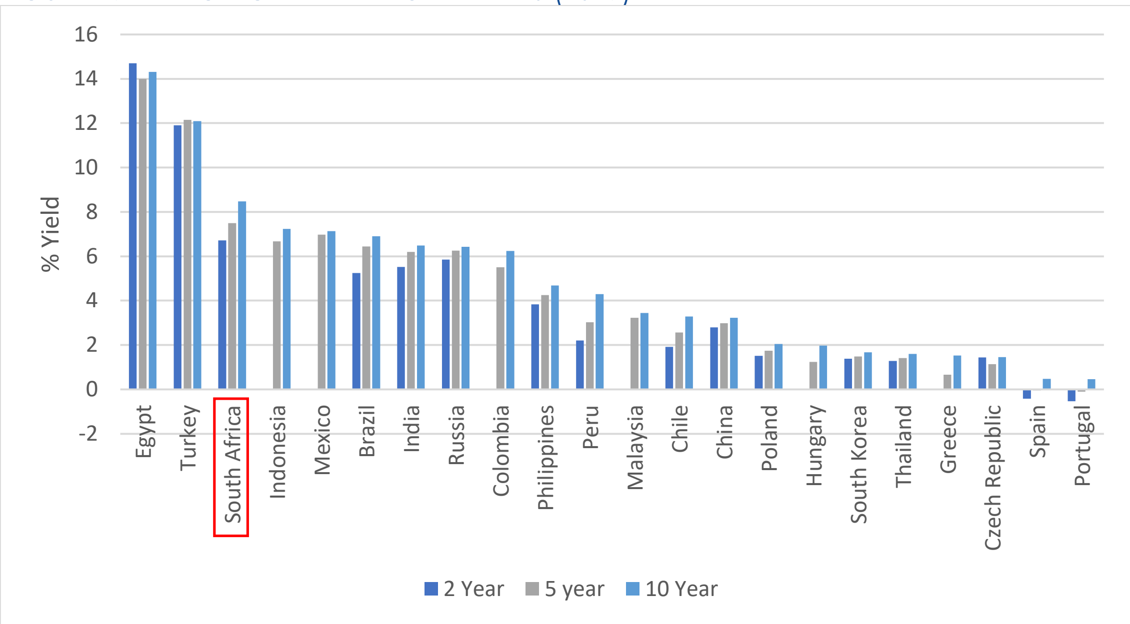
[72] OECD. (2016). Chapter 2: Using the fiscal levers to escape the low-growth trap. OECD Economic Outlook.

[73] Cornel, B. (2014). Is There More Room to Negotiate with the IMF on Fiscal Policy?,

[74] Own calculations using investing.com data.

Africa has higher rates than the median which ranges between 2.5 and 3.9 for the respective year-bonds. This means that South Africa's cost of borrowing is relatively high.

FIGURE 4: EMERGING MARKET BOND RATES (2019)



Source: Investing.com
Note: 2 December 2019 rate date
Note: Argentina real interest rate is 41.6% which was excluded for ease of reading

This also compares favourably to a wider sample of countries. Trend data based on 36 advanced economies and 84 emerging markets and developing economies shows that long-term interest rates between 2009 and 2018 – based on average long-term nominal government bond yields (with 10-year maturities) – averaged 2.3% and 6.7% respectively.[75] Global interest rates have been low and are expected to be sustained into the medium term. This can mitigate some of the risks associated with high debt.

Despite the above, there is widespread concern over borrowing costs and credit rating agencies. While such ratings are (unfortunately) a concern, a comparative study shows that South Africa's debt is below the levels at which comparator countries lost and regained their investment-grade rating.[76]

[75] Kose, A. et al. (2020). Global Waves of Debt: Causes and Consequences. Retrieved from https://www.worldbank.org/en/research/publication/waves-of-debt; Own calculations.

[76] CESR, IEJ, SECTION27 (2018) Op cit.

South Africa benefits from being able to issue debt in Rands. In light of concerns raised about dollar-dominated debt, which make us vulnerable to exchange rate fluctuations, only 10.1% of South African debt is in foreign currency.[77] This compares favourably to Turkey, who had 45.6% of their central government debt stock denominated in foreign currency as of 2018, and Hungary, who stood at 18.25% in 2019.[78] Morocco stood at 36.2% as of 2018.[79] . Further, the maturity period – the length of time over which debts have to be paid back – is much greater than our peers. At a term-to-maturity of 13 years, South Africa has a longer period than Hungary, Romania, Columbia, Indonesia, India, and Morocco who are of the same or higher investment grade.[80] These countries have a maturity period range between three and nine years.[81] This is an advantage for South Africa because there has been a "lack of adequate long-term financing has become an important and challenging issue in many developing economies, particularly since the global financial crisis of 2008-09".[82] Long term financing is beneficial because it allows for long-term investments as well as to reduce rollover risks and the potential for runs.

International conditions, at the time of writing, are also potentially favourable. The world is currently "in this era of low volatility and extremely low global real interest rates, both the private and public sectors in emerging markets have been borrowing at a strong pace".[83] However the impact of COVID-19 on this is an evolving issue, and the impact of looming recessionary conditions needs to be considered.

In the Indlulamithi South Africa scenarios 2030 simulation of South Africa's growth prospects by ADRS, they found that higher spending was not associated with increases in debt-to-GDP because "the boost to GDP from higher government investment and current expenditure will be larger than the public debt taken to finance it".[84] They

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[77] National Treasury. (2020). Op cit.

[78] Republic of Turkey, Ministry of Treasury and Finance. (2019). Public Debt Management Report. Retrieved from https://ms.hmb.gov.tr/uploads/sites/2/2020/02/Public-Debt-Management-Report-2019-1.pdf and International Monetary Fund. (2019). Hungary selected issues https://www.imf.org/~/media/Files/Publications/CR/2019/1HUNEA2019002.ashx.

[79] Bank Al-Maghrib. (2018). Annual report. Retrieved from http://www.bkam.ma/en/content/download/667171/7639427/RA_2018_ENG.pdf.

[80] Moody's Investor Service. (2019). Op cit.

[81] Ibid.

[82] Peria, M. & Schmukler, S. (2017). Understanding the Use of Long-term Finance in Developing Economies. International Monetary Fund.

[83] Kose, A. et al. (2020). Op cit.

[84] Abiad, M.A., Furceri, D. & Topalova, P. (2015). The macroeconomic effects of public investment: evidence from advanced economies. Washington, D.C.: International Monetary Fund. 15(95).

conclude that an increase in public investment will reduce debt and that the bigger concern is how to increase output.

The current conditions are therefore enabling for borrowing and South Africa could consider a (partially) debt-financed stimulus.

4.2.2 TAXATION

Taxation remains the central means through which revenue is raised. However, as noted above, South Africa's revenue collection has consistently fallen short of projections, and while it is argued that our tax-to-GDP ratio is comparatively high, these comparative figures are often distorted because *de facto* taxation may be ignored in comparator countries. As Philippe Burger, notes: "one has to cast the net wider to understand the real tax burden of a country, as central government tax revenue excludes social security contributions and taxes collected at lower tiers of government, such as provinces and local authorities".[85]

While South Africa's tax structure is moderately progressive overall, meaning richer households generally contribute a higher percentage of their income in tax than poorer ones, it is insufficiently so. According to a recent World Bank evaluation, South Africa does comparatively poorly. Although direct taxes (predominately income tax) in South Africa are working to redistribute, they face strong headwinds from the underlying inequality in earnings.[86] The increase in the VAT rate from 14% to 15% as of April 2018 has made the overall tax mix less progressive.

Therefore, there remains space to raise additional tax revenue that can finance stimulus spending. Both wealth and high-income earners are undertaxed in South Africa. Capital gains tax is comparatively low; below the OECD and BRICS norm. Tax on inheritance – estate duty – is levied at only 20% and raises revenue worth 0.05% of GDP compared with the OECD average of 0.2%.[87] Despite South Africa's market capitalisation to GDP ratio being almost triple the OECD average, revenue from securities transaction tax (STT) lags behind the OECD average.[88] No net worth tax is in place.

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[85] Bisseker, C. (2019). Are South Africans taxed to the max? *Business Live*. Retrieved from https://www.businesslive.co.za/fm/features/2019-03-14-are-south-africans-taxed-to-the-max/

[86] Inchauste, G et al. (2015). The Distributional Impact of Fiscal Policy in South Africa. World Bank Group Policy Research Working Paper No. 17.

[87] SACTWU and COSATU. (2017). Submission to the Davis Tax Committee on Possible Wealth Taxation in South Africa.

[88] CESR, IEJ, SECTION27. (2018). Op cit.

High income earners in South Africa have experienced significant growth in their income over the last couple of years. The top 1%, for example, saw an average "compounded growth rate of 5.43% over the years 2003-2015". By contrast, "the majority (at least 80% of income earners in South Africa) have experienced declining negative growth in income over the same period".[89] As of 2017, The top 1% of high incomers took home 19.2% of all the country's income pre-tax. The top 10%'s income was approximately 65%.[90] Despite this stark inequality, effective PIT rates have fallen considerably over the last three decades accompanied by tax breaks for higher earners.[91] This contrasts with indirect taxation where between 2010/2011 and 2018/2019 there was an average *real* annual increase in excise duties of around 2.5% for the products selected and an average *real* annual increase of 3.8% and 4.5% for the fuel levy on petrol and diesel. As noted, VAT rose from 14% to 15% in 2018. This indicates that taxes that hit the poor hardest are rising at a faster rate than taxes that mainly target higher-income earners and companies. There also exist a number of tax breaks for higher-income households, e.g. on pensions and medical aid (see above), and potentially ineffective corporate subsidies and loopholes.[92]

As we shall discuss further below, the undermining of capacity within SARS has posed a very real limitation on raising tax revenue. Similarly, illicit financial flows (IFFs) and tax evasion remains high, with an estimated R7 billion lost annually.[93] Finally, although all people in the country pay taxation, e.g. via VAT or fuel levies, the data indicates that South Africa suffers from a narrowing income tax base. The number of taxpayers taxed has declined and the average income tax paid has increased. Ultimately this can only be rectified by increasing employment and raising wages, a fiscal stimulus supports this.

4.2.3 DFIS AND OTHER FORMS OF PUBLIC FINANCE

In the wake of the GFC, there has emerged increased support worldwide for development finance institutions (DFIs) to play a more active role, as the problems of

[89] AIDC. (2019). Personal Income Taxation in South Africa: The Struggle Against Inequality and Poverty in an Era of Crisis. Retrieved from http://aidc.org.za/personal-income-taxation-south-africa-struggle-inequality-poverty-era-crisis/.

[90] World inequality Database. (2020). South Africa. Retrieved from https://wid.world/country/south-africa/.

[91] Budget Justice Coalition. (2018). Submission to the Standing Committee and Select Committee on Finance with respect to the proposed 2018 National Budget.

[92] IEJ. (2018). Mitigating the impact of VAT increase by extending zero-rating. Retrieved from https://iej.org.za/mitigating-the-impact-of-the-vat-increase-can-zero-rating-help/.

[93] Donnelly, L. (2019). Giants cost SA billions in lost taxes. Retrieved from https://mg.co.za/article/2019-01-11-00-giants-cost-sa-billions-in-lost-taxes/.

funding investment via the private finance sector alone became more evident. In South Africa the leading DFIs are the Industrial Development Corporations (IDC) and Development Bank of Southern Africa (DBSA), with a strong complementary role for the Public Investment Corporations (PIC).

In contributing towards financing fiscal stimulus in South Africa, these DFIs face a number of challenges. First, their loan books are too small. Second, they raise capital on the open market and so are unable to take the risks that developmental lending requires. Third, and consequently, their loan books are overly geared towards large established businesses, often in monopolistic sectors of the economy; the same is true of PIC investments. This means that DFIs and the PIC play an insufficiently developmental role and are inadequately used to complete fiscal expenditure. This is despite the Government Employee Pension Fund (GEPF) (the largest fund under management by the PIC) currently having a surplus of R454 billion (approximately 9% of GDP).[94] In 2018, the combined assets of IDC and DBSA amount to just over 5% of GDP, small in size relative to comparator countries. The assets of the China Development Bank, and Brazilian Development Bank alone come up to about 14% and 16% of GDP respectively, while the German Development Bank is even larger with assets of about 17% of GDP.[95]

South Africa is also the only emerging market country that does not have an export-import (EXIM) bank. EXIM banks are a key tool used to boost the competitiveness of exports through provision of various forms of direct financing to foreign buyers. Similarly, South Africa lacks a developmentally-orientated state bank.

4.2.4 MONETARY POLICY

Monetary policy is able to play a supportive role to an expansionary fiscal stance. However, this is not currently the case in South Africa. The current inflation-targeting regime means that monetary policy is unnecessarily contractionary. In January 2020, the South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) decided to reduce the repo rate by 25 basis points to 6.25% from 6.5%. This still makes South African interest rates excessively high and facilitates short-term speculative inflows while limiting access to productive credit in the domestic economy. This is despite

[94] Government Employee Pension Law of 1996 (GEP Law), requires the funds of GEPF to cover 90% of all liabilities at any point in time. On 31 March 2018, the R1 802 billion in financial assets managed by Public Investment Corporation (PIC) covered 108% of GEPF's liabilities to working and retired members. GDP as per 2019 estimate.

[95] IEJ (2018). Op cit.

deflationary trends – that is, inflation is falling not rising. In November 2019, inflation was 3.7% which was the lowest rate in eight years.[96] Lower interest rates are required to reinforce a fiscal stimulus strategy.

Similarly, the SARB makes use of a narrow range of monetary policy tools, relying mostly on open-market transactions with the aim of containing inflation. By contrast, central banks, including in Africa, have a long history of supporting and reinforcing fiscal stimulus measures. Alice Amsden has shown that medium and long-term finance facilitated by central banks was a key contributing factor to the success of the 'East Asian miracle' Measures used in Africa, East Asia and elsewhere have included: providing capital to development institutions, such as industrial and agricultural development banks; extending credit to development banks and purchasing their securities; buying a small part of the equity of development banks; establishing a 'securities regulation fund' to create a market for the securities of various development finance institutions, by using the profits from the ordinary operations of the central bank; using differential discount rates to allocate credit to capital development projects; 16 the establishment of portfolio ceilings on activities having a low priority; various types of reserve requirements, including differential reserve requirements to influence the allocation of credit; and using import deposit requirements (primarily intended to deal with balance of payments difficulties), to also influence the allocation of bank credit.

4.3 INFLATION AND CAPACITY UTILISATION

As noted above, other variables help us assess the capacity of the economy to productively absorb fiscal stimulus and expand output in a growth-enhancing manner. The South African picture shows a need for fiscal expansion.

Low economic growth and unemployment suggest considerable underutilisation of productive capacity in the South African economy and this, in turn, could be taken to indicate that there is considerable space for non-inflationary fiscal stimulus.

According to Stats SA, utilisation of production capacity is on the decline. Between 2018 and 2019, production capacity declined by 2% with eight out to ten manufacturing sectors showing a decrease.[97] Stats SA also found that compared with 2018, 2019's utilisation of

[96] Statistics South Africa. (2019). Inflation the lowest in over eight years. Retrieved from http://www.statssa.gov.za/?p=12768.

[97] Stats SA. (2020). Manufacturing: Utilisation of production capacity by large enterprises, November 2019. Retrieved from http://www.statssa.gov.za/?page_id=1854&PPN=P3043.

production capacity by large enterprises recorded losses in various sectors, with glass and non-metallic mineral products experiencing the largest decline at 3.5%.[98] South African factories are running on four-fifths capacity.

Actual economic growth in South Africa is considerably below potential growth and the South African economy is not functioning near full capacity, as is argued by Makrelov, Arndt, Davies and Harris.[99]

This is not the view of the South African government and the IMF, however.[100] While accepting that South Africa's actual growth is considerably below potential growth, the IMF argues that South Africa's economic growth is mostly constrained by supply-side factors, including infrastructural bottlenecks (in electricity generation and supply), over-regulated (formal) labour markets, and increases in product market concentration (as witnessed by rising profit markups). The National Treasury makes similar claims.[101] While South Africa does suffer from various supply-side constraints, in particular a lack of diversification, this typical over-emphasis of supply-side factors ignores demand shortages and the role that fiscal policy can play in alleviate supply-side blockages. As argued in Section 2, a pro-employment macroeconomic policy framework sees sustainable expansionary fiscal expenditure as playing a positive role in diversifying the economy, raising human and physical capital development, and expanding supply. Underutilisation of capacity indicates that using fiscal expenditure in this way can be extremely fruitful.

Falling levels of inflation also indicate the capacity of the economy to absorb fiscal stimulus without undue inflation. Between 2018 and 2019, inflation has fallen below SARB's midpoint of 4.5%. Inflationary pressures typically emerge when the overall demand for goods and services grows faster than the supply which indicates that South Africa has a demand issue. Some analysts have argued that capacity utilisation rate is an indicator of inflationary pressures. These economists argue that "inflation will rise as long as capacity utilisation is above the stable-inflation rate. Conversely, inflation

[98] Ibid.

[99] Makrelov, K., Arndt, C., Davies, R. & Harris, L. (2018). Fiscal multipliers in South Africa. The importance of financial sector dynamics. WIDER Working Paper No.6. Helsinki: UNU-WIDER.

[100] International Monetary Fund. (2020). IMF Executive Board Concludes 2019 Article IV Consultation with South Africa. Retrieved from https://www.imf.org/en/News/Articles/2020/01/29/pr2023-south-africa-imf-executive-board-concludes-2019-article-iv-consultation.

[101] National Treasury. (2019). Towards a growth agenda for SA. Retrieved from http://www.treasury.gov.za/comm_media/press/2019/Towards%20an%20Economic%20Strategy%20for%20SA.pdf.

will fall whenever capacity utilisation is below the stable inflation rate".[102] Past economic research found that the stable inflation capacity utilisation rate in the manufacturing sector was about 82% for the United States.[103] The numbers would need to be calculated for South Africa, but one can argue that declining inflation is indicative of falling capacity utilisation. On all these levels, the South Africa economy has room for fiscal stimulus without adverse macroeconomic ramifications.

4.4 INSTITUTIONAL REQUIREMENTS FOR A SUCCESSFUL STIMULUS

A fiscal stimulus in South Africa is not viable if the correct institutional requirements are not built.

Public distrust in state spending is not misplaced. The state has become viewed as predatory, and engaged in large scale rent-seeking and corruption. Any stimulus may be undermined by spending inefficiency. Corruption and state capture have placed a massive burden on the fiscus and severely undermined both expenditure and revenue raising while exacerbating the effects of austerity through diverting public funds away from service delivery. Strong institutions and effective public governance are key for a successful fiscal initiative. At the same time, sequencing is important. In the short term, government needs to provide a stimulus to get the economy moving, build confidence, and lay the basis for more systemic interventions. In the long term, capacity needs to be built.

4.4.1 REVENUE INSTITUTIONAL REQUIREMENTS

The weakening of SARS – aimed at gutting its capacity to tackle high-profile crime and hence expose both tax evasion and corruption – has had disastrous consequences. Open Secrets South Africa estimates that R100 billion was lost in tax revenue as a result of state capture.[104] Since 2010, there have been ten probes into the allegations surrounding the supposed unlawfully established SARS 'rogue unit', which was set up to combat tax evasion/fraud.[105] This has been a cover for undermining the ability of the High Risk Investigations Unit's probes into tax avoidance and corruption. Although the Nugent Commission of Inquiry into Tax Administration and Governance by SARS has

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[102] Garner, C. A. (n.d). Capacity Utilization and U.S. Inflation. Retrieved from http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.201.56&rep=rep1&type=pdf.

[103] Ibid.

[104] Open Secrets South Africa. (2020). The Enablers: The bankers, accountants and lawyers that cashed in on state capture. Retrieved from https://www.opensecrets.org.za/the-enablers/

[105] Cowan, R. 2019. SARS and the 'rogue' unit: the ultimate guide. *Fin24*. Retrieved from https://www.fin24.com/Economy/sars-and-the-rogue-unit-the-ultimate-guide-20190705.

been completed and the head of SARS has been replaced, many other problematic appointees remain and capacity remains low.

SARS has established a dedicated revenue recovery capacity campaign that seeks to identify revenue leakage, pursue delinquent taxpayers and practitioners, strengthen customs surveillance at ports of entry, and address compliance. The campaign is also geared towards addressing the prevailing culture of intimidation and distrust of leadership, amongst other factors. If this is done correctly, this can boost revenue collection to finance the stimulus and serve as a basis for long-run capacity strengthening within SARS.

4.4.2 EXPENDITURE REQUIREMENTS

Quality of spend is also a key concern. Tackling wasteful, fruitless, irregular and unauthorised expenditure requires a long-term strategy.

The Auditor General (AG) has issued various measures for improving performance – these must be implemented. There needs to be an overhaul in financial management, and reporting needs to be strengthened.[106] In 2018/19, auditees that substantially did not comply with legislation increased from 64% to 72%. The AG said the lapse in oversight and controls in the area of compliance was evident in a number of areas, including supply chain management (SCM), and led to increased irregular expenditure. Unauthorised expenditure increased from 2017/18 to 2018/19 by 38%, 86% of which was a result of overspending or fruitless and wasteful expenditure. Irregular expenditure remains a significant problem.[107]

Better financial planning mechanisms need to be considered. In 2018/19 almost a third of the departments had claims against them in excess of 10% of their next year's budget. The key issue is that "[d]epartments do not budget for such claims, which means that all successful claims will be paid from funds earmarked for the delivery of services, further eroding the ability of these departments to be financially sustainable".[108] Additionally, 41% of public entities expenditure exceeded their revenue. A fiscal stimulus can redirect public employment towards strengthening the capacity of municipalities and poorer provinces to spend effectively.

[106] Auditor General South Africa. (2019). Auditor-general reports an overall deterioration in the audit results of national and provincial government departments and their entities. Retrieved from https://www.agsa.co.za/Portals/0/Reports/PFMA/201718/MR/2018%20PFMA%20Media%20Release.pdf.

[107] Ibid.

[108] Ibid.

In terms of underspend, there is concern that while there is a lack of service delivery, departments are not spending the money allocated to them. At the MTBPS 2019, the departments of police, higher education and health had declared and projected underspending of close to R2 billion.[109] While the pace of spend is not an indicator of quality, there is a need to investigate underspending in the context of service delivery. In the fourth quarter of 2018/19, 24 departments had failed to spend 100% of their allocated budget. In a briefing to the Standing Committee on Appropriations on is spending for the first quarter of the 2019/20 financial year, Treasury attributed underspend to poor planning, in terms of procurement or delays in the planning or execution of capital projects, delays in hiring people, poor management in terms of contracts, and "unnecessary" delays in the processing of invoices from service providers.[110] These all point to issues of capacity which a fiscal stimulus can be used to address by allocating the appropriate personnel to develop and implement systems that ensure that departments are actually adequately resourced to utilise state resources allocated to them.

4.5 MACROECONOMIC POLICY SPACE

The analysis of macroeconomic space in South Africa indicates that space exists and can be created for a fiscal stimulus. South African economic policy has been characterised by attempts to achieve stabilisation, liberalisation, privatisation, and rationalisation. The paradigm has been that a "stable" macroeconomic environment – low inflation, floating exchange rates, liberalised capital markets, lightly regulated financial sector, high real interest rates, and low fiscal deficits – will lead to growth and investment. Government has implemented austerity measures to demonstrate a government's commitment to "fiscal discipline" in an effort to appease creditors and credit rating agencies. Yet, despite all efforts at fiscal consolidation, debt is increasing.

Total debt is not what is closing South Africa's macroeconomic space. An analysis of South Africa's rising debt levels demonstrates that while South Africa is in line with peers, there is a cause for concern in terms of debt servicing costs as indicated by South Africa's high bond rates relative to other emerging markets. This, coupled with low global interest rates and South Africa's comparatively favourable size of dollar-denominated debt mean that there is scope to reduce borrowing costs for government. Global and local conditions can mitigate some of the risks associated with high debt.

[109] National Treasury. (2019). MTBPS AENE. Authors own calculations.

[110] Omarjee, L. (2019). Treasury laments 'poor planning' behind spending problems in govt departments. Retrieved from https://www.fin24.com/Economy/treasury-laments-poor-planning-behind-spending-problems-in-govt-departments-20190827.

Stagnating or declining tax revenues, and the hollowing out of the capacity of the SARS constitute a serious challenge for macroeconomic expansion. Fiscal space exists to progressively raise and/or collect taxes without endangering market access and putting debt sustainability at risk. Policies that address the administrative challenges, and tackle avoidance and evasion can expand the current space for a stimulus which should yield to increased revenues.

There are domestic resources to finance a stimulus in South Africa. Significant resources are contained within and can be channelled to DFIs which aren't necessarily being leveraged in ways that have the optimum impact on jobs and development. In addition, the country has other sources of public finance that can be mobilised. Furthermore, macroeconomic space in South Africa is currently constrained by the narrow policy tools that are not facilitating growth. Space can be created by exploring unconventional monetary policy tools that do not negative ramifications for the economy.

Lastly, there is room to improve efficiency, capacity and/or performance of government resources. Addressing quality of spend requires capacity building which also requires additional resources.

A well spent fiscal stimulus can actually reduce the debt-to-GDP ratio through spurring economic growth and building state capacity. This assessment of fiscal space demonstrates the need for a reforms in policies for economic transformation and development. South Africa has the macroeconomic space to implement stimulus without harming the economy.

5 WHAT SHOULD A FISCAL STIMULUS LOOK LIKE IN SOUTH AFRICA?

A number of factors should be considered when designing a fiscal stimulus package. These include:

- What variables the fiscal stimulus should be targeting;
- How a fiscal stimulus can be targeted in a manner that it is not unduly spent on imports or create other macroeconomic imbalances;
- What the measurable impact of government spending on the identified targets can be;
- The optimal size of the stimulus; and
- Considerations regarding the composition of the fiscal stimulus.

5.1 VARIABLES TO TARGET

The purpose of the fiscal stimulus is context specific, and in the South African context it should aim to boost both growth and employment in a sustainable and equitable manner.

This means that the impact on employment is as important as the impact on growth. It also means that certain forms of employment – high productivity, higher-paying, decent jobs – should be prioritised. This is linked to the need for the stimulus to promote the diversification of the economy towards higher-value added and high-productivity sectors, including diversifying export sectors. This will allow the stimulus to be spent in a manner that raises domestic output. It implies the stimulus must target both the expansion of aggregate demand and aggregate supply.

As noted above, aggregate demand increases the level of employment through changing the level and composition of expenditures and sustaining the expansion of markets for consumption and investment goods, thereby allowing firms to grow through achieving economies of scale and hence productivity growth. As noted, aggregate supply measures target employment growth through increasing the availability and quality of production and the factors used to engage in production. For example, by spending on health or education human capabilities can be raised; similarly, spending on physical infrastructure can increase productivity. This increases employment through economic expansion. If done correctly, these demand and supply side policies positively reinforce each other.

Government expenditure should target investment expenditure, inclusive social sectors, and consumption expenditure. Investment expenditure increases the demand for domestic inputs; absorbs and enhances labour's productive capabilities; and should target the expansion of supply capacity and sectoral diversification. Targeting inclusive social sectors means investment in, for example, the health or care sectors. These have been shown to have as good, if not better, employment multipliers to investing in construction, plus employment outcomes are more inclusive. These sectors also build human capabilities and hence expand supply capacity. Consumption expenditure via public-sector employment also stimulates aggregate demand, offers more secure employment opportunities, and often includes a high number of women workers. Social security transfers have the potential to stimulate aggregate demand and support human capital development.

5.2 MAINTAINING MACROECONOMIC BALANCE

The above has already indicated how fiscal stimulus can be targeted in a manner that improves, rather than worsens, macroeconomic imbalances. This is particularly important with regards to: the balance of payments, via promoting domestic output and export-facing sectors; inflation; and the debt-to-GDP ratio. The first has been largely dealt with above and if domestic supply is sufficiently supported then inflationary pressures will not result.

It is worth noting again that actual economic growth in South Africa is considerably below potential growth and the South African economy is not functioning near full capacity.[111] It is true that the economic expansion may run into infrastructural constraints (e.g. shortage of electricity), but such shortages could be overcome if the fiscal expansion is targeted at removing and/or easing these infrastructural bottlenecks. And to the extent that the fiscal stimulus will prove to be inflationary, this may well lower real interest rates and 'crowd in' additional private-sector investment, as pointed out by Makrelov, Arndt, Davies and Harris.[112] In this case the fiscal stimulus and induced private investment will raise the economy's rate of potential growth, because the investment expands the economy's productive capacity.[113] There is a growing recognition, also within the IMF, that a programme of fiscal stimulus can have a permanent impact on a country's growth.[114]

Regarding the debt-to-GDP ratio, the argument already made is that economic expansion will, in the medium-term, reduce the debt-to-GDP ratio even if the stimulus is partially debt financed as taxes rise and the economy grows.

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[111] Makrelov, K., Arndt, C., Davies R., & Harris, L.(2018). Fiscal multipliers in South Africa. The importance of financial sector dynamics. WIDER Working Paper No. 6. Helsinki: UNU-WIDER.

[112] Ibid.

[113] Storm, S. (2019). The secular stagnation of productivity growth. INET Working Paper No. 108. New York: Institute for New Economic Thinking. Retrieved from https://www.ineteconomics.org/uploads/papers/Storm-WP-108-The-Secular-Stagnation-of-Productivity-Growth.pdf

[114] Girardi, D., Paternesi Meloni, W, & and Stirati, A. (2018). Persistent effects of autonomous demand expansions. INET Working Paper No. 70. New York: Institute for New Economic Thinking.; Kopp, E., D. Leigh, S. Mursula and S. Tambunlertchai. (2019). U.S. Investment since the Tax Cuts and Jobs Act of 2017. IMF Working Paper No. 120. Washington, DC: IMF.

https://www.ineteconomics.org/research/research-papers/persistent-effects-of-autonomous-demand-expansions

5.3 CALCULATING THE INCOME AND EMPLOYMENT IMPACTS OF FISCAL SPEND ON THE ECONOMY[115]

Knowing the potential impact of fiscal expenditure is an important precursor to designing a stimulus package. The impact can be calculated with regards to both GDP growth and employment. This is commonly done using income and employment "multipliers". Essentially, these shown the extent to which each Rand of additional expenditure raises (or not) GDP or employment.

5.3.1 USING MULTIPLIERS

The primary tool for calculating fiscal multipliers are input-output models. These are based on input-output tables which construct a grid which demonstrate the impact of a change in one sector of the economy – in this case government spending – on all other sectors. This can be used to yield results for multiple variables, including growth and employment.

The input-output model is widely used to investigate the extent to which changes in final demand, given the structural relations between industries, generates changes in other economic variables such as income and employment. This approach is known as impact analysis. This approach is useful, and often used, because of its simplicity and the relatively few controversial assumptions that need to be made.[116] While it captures direct, indirect and induced effects (see below) and includes some feedback between changes in spending and income, consumption and investment, it is not a full dynamic model of the economy. Another limitation is that it is difficult to disaggregate the impact of different forms of government expenditure. Nevertheless, it allows us to assess, on an empirical and straightforward basis, the impact of government spending in the economy.

[115] This section draws extensively from a Research Note produced by for the IEJ by Enno Schröder and Servaas Storm it can be accessed at: https://iej.org.za/fiscal-policy-in-south-africa-closed-input-output-income-and-employment-multipliers/. The IEJ is grateful for this contribution.

[116] The input-output model treats final demand as exogenous. It assumes that industries use inputs in fixed proportions in the double sense, see Picek, O. & Schröder, E. (2018). 'Spillover effects of Germany's final demand on Southern Europe.' *World Economy.* 41, 2216-2242. The industries are assumed to use all inputs in fixed proportion to output (constant returns to scale), and they use all inputs in fixed proportion to each other (no factor substitution). In other words, the technical coefficients, which determine the quantities of intermediate inputs necessary to produce one unit of gross output, are fixed. The input-output model furthermore assumes that additional supply is always able to meet an exogenous increase in final demand—the economy operates below full capacity.

Estimating country-specific fiscal multipliers are crucial for macroeconomic projections and policy design. These allow us to understand the economic impact of each additional Rand spent. For this stimulus, we specifically consider fiscal and employment multipliers:

- **Fiscal multipliers** are the short-term impact of discretionary fiscal policy on economic output. Generally, they are defined as the ratio of a change in output (ΔY) to a discretionary change in government spending or tax revenue.[117] The fiscal multiplier measures the effect of a R1 change in spending or a R1 change in tax revenue on the level of GDP.[118]
- The **employment multiplier** measures the amount of direct, indirect and induced jobs created (or lost) due to the change in government expenditure. Direct jobs are related to the specific industry, indirect jobs are those that support the industry, and induced jobs are those that occur as a result of direct/indirect employee's spending money in the economy.

5.3.2 PREVIOUS ESTIMATES OF MULTIPLIERS IN SOUTH AFRICA

Many studies on fiscal multipliers in South Africa assume from the outset of the analysis that the economy is supply-constrained and, predictably, find that only interventions which directly target the supply potential of the economy lead to positive multiplier impacts.[119] However, these models do not capture the fact that the South African economy is performing considerably below potential (there is a significant negative output gap) nor that unemployment is very high.

In contrast, Makrelov, Arndt, Davies and Harris find (using a stock-flow-consistent model for South Africa for the post-2008 period) that the fiscal multiplier has a value of 2.5 under the conditions of a large negative output gap, a lack of supply-side constraints, a well-functioning financial sector and relatively low government debt levels.[120] These authors argue that the high fiscal multiplier is due to the fact that higher public expenditure does increase aggregate demand and employment, which in turn pushes inflation (expectations) up. Higher inflation reduces real interest rates, and this 'crowds in' business investment — and raises economic growth further. The high fiscal

[117] Batini, N. et al. (2014). Fiscal Multipliers: Size, Determinants, and Use in Macroeconomic Projections.

[118] The interpretation of the fiscal multiplier is complicated by the fact that it is a function of structural parameters and policy reaction parameters.

[119] Mabugu, R., Robichaud, V., Maisonnave, H & Chitiga, M. (2013). Impact of fiscal policy in an intertemporal CGE model for South Africa. *Economic Modelling.* 31, 775-782.

[120] Makrelov, K., C. Arndt, R. Davies and L. harris. (2018). Fiscal multipliers in South Africa. The importance of financial sector dynamics. WIDER Working Paper No. 6. Helsinki: UNU-WIDER.

multiplier is mostly the result of the additional business investment, *induced* by the fiscal stimulus. This presumes the monetary authority does not raise interests rate to such an extent as to counter this stimulus.

Burrows and Botha estimate the closed input-output income multipliers for South Africa using a time-series of seven input-output tables for the period 1980-2010.[121] Their closed-income multiplier estimates (appearing in Table 2) include the direct effect, the indirect effects and the induced consumption effect (but *not* the induced investment effect). The average (fiscal) income multiplier for the period 1980-2010 is 1.72, which means that an increase in public expenditure of R1 billion raises South Africa's GDP by R1.72 billion. But as can be seen in Table 2 (which reproduces their main findings), South Africa's closed-income multiplier shows a declining time trend – going down from 1.82 in 1980 to 1.60 in 2010. Burrows and Botha attribute this decline to the increasing openness of South Africa's economy (after the end of apartheid) and the stagnation of household incomes (which has lowered the induced consumption effect).[122] However, even in 2010, the income multiplier is estimated to be equal to 1.6.

TABLE 2: CLOSED INPUT-OUTPUT INCOME MULTIPLIERS FOR SOUTH AFRICA, 1980-2010:

	1980	1985	1990	1995	2000	2005	2010
Closed IO income multiplier	1.824	1.874	1.783	1.714	1.673	1.579	1.600

Source: Burrows and Botha (2013), Table 3. These closed income multipliers do include the direct effect, the indirect effects and the induced consumption effect (but not the induced investment effect).

In 2019, the United Nations Conference on Trade and Development (UNCTAD) estimated that South Africa's fiscal multiplier is 1.47.[123] From the previous study by Burrows and Botha, this would indicate a continued declining trend.

5.3.3 NEWLY UPDATED MULTIPLIERS IN SOUTH AFRICA

Storm and Schröder have developed a similar (closed) input-output model to estimate fiscal multipliers for the South African economy in 2018. As with all input-output

[121] Burrows, L.R. & Botha, A.P. (2013). Explaining the changing input-output multipliers in South African: 1980-2010. Retrieved from file:///C:/Users/sstorm/Downloads/essa2013_2636.pdf.

[122] Ibid.

[123] UNCTAD. (2010). Op cit.

modelling they include both the direct effect, for example, direct jobs created within the sector being considered – in this case the public sector – and indirect effects, for example, jobs created in related industries from which the public sector may purchase goods and services. The closed input-output model also takes into account that the relationship between the impact of government spending on output is not static (final demand is not entirely exogenous) and the role of consumption spending.[124] Increasing demand in the economy (via government spending) will initiate additional production, with additional production requiring more labour input. The higher demand for labour services will increase labour income and this will cause higher consumption spending. In input-output economics, this treatment ('endogenisation') of household consumption is known as closing the model with respect to households.[125] The total effect of increasing government spending (an exogenous increase in final demand) is therefore composed of (a) the direct, (b) the indirect, and (c) the induced consumption effect. The induced consumption effect represents the change in output/income/employment that arises from households spending the increased labour income earned in (say) the car industry and in supporting industries.

Storm and Schröder's model also considers an 'induced investment effect'. This represents the change in output/income/employment that arises from firms investing a fraction of the additional profits earned in the car industry and in supporting industries. Taking the investment response to higher GDP and higher profit income into consideration is clearly an improvement, as the multiplier estimate becomes more comprehensive. However, data limitations meant that they could not distinguish private-sector and public investment and therefore endogenised total investment (rather than merely private-sector investment). Because of this limitation, they think this method may over-estimate the fiscal multiplier. For this reason, they report three different multipliers. (The data used was the balanced 90-industries input-output table for 2018 (in basic prices) provided by Quantec.)

Table 3 shows that for all three measures used the impact of additional government spending on GDP and employment is significantly positive – a fiscal stimulus will benefit the economy. According to these results, a stimulus of R1 will raise South Africa's GDP by R1.5, when we only take the *induced household consumption effect* into account. This estimate can be directly compared to the closed multipliers estimated by Burrows and

[124] Picek, O. & Schröder, E. (2018). Spillover effects of Germany's final demand on Southern Europe. *World Economy.* 41, 2216-2242.

[125] This step can be likened to the addition of industry-specific Keynesian consumption functions to the input-output model.

Botha (see Table 2). It can be seen that the trend decline in the fiscal multiplier observed by Burrows and Botha — from a multiplier value of 1.82 in 1980 to a value of 1.60 in 2010 — has continued. The *employment multiplier* using this technique is 6.1, meaning that each R1 billion of additional spending will create 6,100 new jobs. Table 3 also gives the output for the multipliers including the induced investment effect. In this case, each R1 billion in additional spending will grow the economy by R1.87 billion and create 7,700 new jobs. Finally, the table also gives the 'average' of the two multipliers as a compromise. The average fiscal multiplier for South Africa is equal to 1.68 in 2018, meaning that a fiscal stimulus of R1 billion would grow the economy by R1.68 billion and spur 6,900 new jobs; this we regard as the preferred measure. These findings are in line with those reported by other studies above.

TABLE 3 CLOSED INPUT-OUTPUT INCOME AND EMPLOYMENT MULTIPLIERS FOR SOUTH AFRICA, 2018

	Income	Employment
average multiplier	1.68	6.9
direct + indirect + induced consumption effect	1.50	6.1
direct + indirect + induced consumption effect + induced investment effect	1.87	7.7

Source*:* Calculated by authors.
Notes: The income multiplier is the extra income generated in the economy as a result of an increase in public spending by R1. The employment multiplier gives the number of jobs created by an increase in public spending of R1 million.

The findings imply that the proposed cut in public expenditure by R48 billion will likely reduce South Africa's GDP by R81 billion over the next three years 2020-2022. This amounts to a decline in GDP by around 0.6 percentage a year, accompanied by the likely destruction of approximately 330 000 jobs. The 2020 austerity Budget is socially and economically destructive.

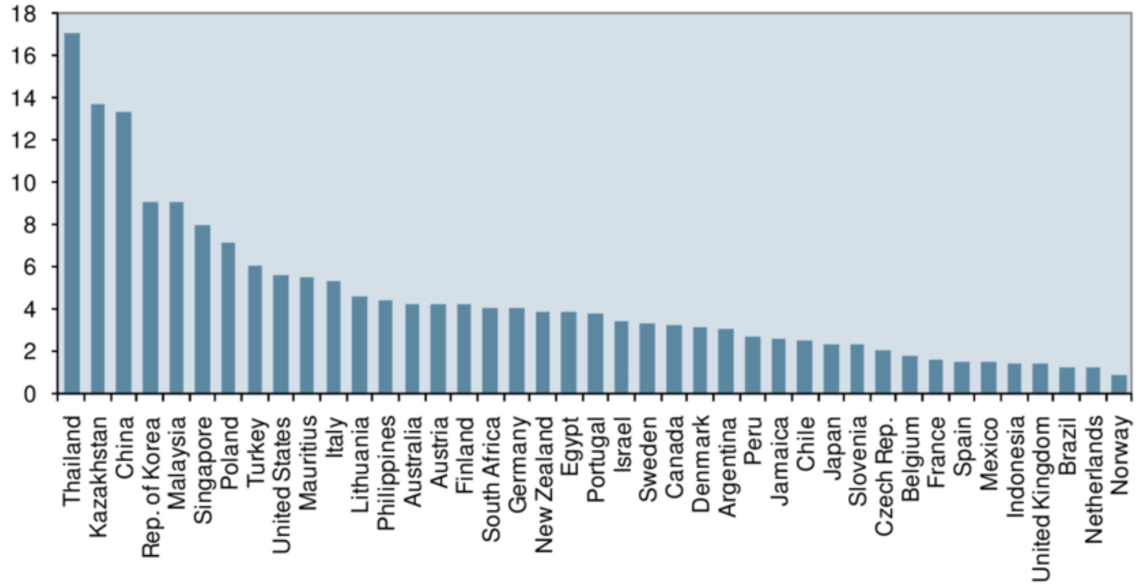
5.4 DETERMINING THE SIZE

Now that we have determined the positive benefit and viability of a fiscal stimulus in South Africa, we consider the question of what scope it should take. This is a difficult question to answer conclusively in this preliminary analysis as a number of interacting factors would need to be considered. Here we present some comparative international statistics.

The size of the fiscal stimulus has varied significantly across countries. Roosevelt's First New Deal in 1933 created the Public Works Administration, at a cost of $3.3 billion, equivalent to approximately 5.9% of GDP at the time. After the financial crisis, the OECD notes that "Asia put in place comparably large stimulus packages. Asia and the Pacific, not including Japan and Korea, spent 9.1% of its 2008 GDP on stimulus efforts (weighted average by country size). China was the main driver of the stimulus spending in Asia as it had a stimulus package worth 12.7% of its 2008 GDP. Meanwhile, advanced economies spent 3.4% of their 2008 GDP on stimulus."[126] Among the G20 countries alone, the size of fiscal stimulus amounted to $2 trillion – roughly 1.4% of the world GDP.[127]

5 below demonstrates the variation in post financial crisis stimulus package sizes. In some cases, e.g. Thailand, Kazakhstan and China, the measures as a percentage of GDP far exceed 10%. Whereas countries such as Norway, Brazil and the United Kingdom were below 2%. Out of the 41 countries reported below, South Africa had the 17th largest stimulus, at approximately 4% of GDP in 2009.

FIGURE 5: FISCAL STIMULUS PACKAGES AS A PERCENTAGE OF GDP IN 2008



Source: Eichhorst, Werner & Escudero, Veronica & Marx, Paul & Tobin, Steven. (2010). The Impact of the Crisis on Employment and the Role of Labour Market Institutions.

Note from source: the definition and contents of the policy measures vary from country to country and therefore the size of these packages may not be comparable across countries. This is complicated by the fact that the stimulus packages, especially in many developing countries, do not take into consideration

[126] OECD. (2016). Chapter 2: Using the fiscal levers to escape the low-growth trap. OECD Economic Outlook, Volume 2016 Issue 2.

[127] Ibid.

the use of automatic stabilisers, e.g. increased use of existing programmes such as unemployment benefits.

In South Africa, in 2018, the President announced a 1% stimulus for South Africa. Even Moody's stated that the tiny size of South Africa's stimulus programme meant that it was unlikely to have much of an impact.[128] In 2018, the IEJ proposed a R500 billion fiscal stimulus over three years, approximately 3% of GDP in 2018 per annum.[129]

Using the average multipliers identified in Table 3 above, Table 4, gives the potential impact of four different scenarios: a stimulus of 3%, 5%, 7% and 10% of GDP. The larger the stimulus the higher the average income and employment multipliers. Depending on the sectoral composition of the stimulus, the multipliers could be higher.

TABLE 4: FOUR STIMULUS SCENARIOS FOR SOUTH AFRICA AND THEIR INCOME AND EMPLOYMENT IMPACTS

Fiscal Stimulus size	Income (billion)	Employment
3% of GDP (R147.7 billion)	R248.1	1 019 130
5% of GDP (R246.1 billion)	R413.5	1 698 090
7% of GDP (R344.5 billion)	R578.8	2 377 050
10% of GDP (R492.2billion)	R 826.9	3 396 180

Source: Calculated by authors.

5.5 COMPOSITION

Deciding how the money should be spent also requires careful and detailed budgetary analysis. What we advance here is ten broad principles which we argue could guide a fiscal stimulus for South Africa. We then illustrated how these could be applied in three different spending spheres. In practice, these principles would then need to be applied in constructing detailed national and departmental budgets.

5.5.1 PRINCIPLES

1. TARGET SPEND WHERE THERE IS HIGHEST IMPACT (HIGHER MARGINAL VALUE OF PUBLIC FUNDS)

[128] Moody's. (2019). Moody's changes South Africa's outlook to negative from stable, affirms Baa3 ratings. Retrieved from https://www.moodys.com/research/Moodys-changes-South-Africas-outlook-to-negative-from-stable-affirms--PR_412385.

[129] Institute for Economic Justice. (2018). Op cit.

Achieving "bang for the buck" is obviously an important consideration, this is known as the "Marginal Value of Public Funds (MVPFs)". This needs to take account the effectiveness and impact of government expenditure to date and should be country specific. In the United States for example, an analysis of 133 historical policies over the last century, finds that expenditures on children from early childhood education to child health insurance to college expenditures yielded the largest results.[130]

2. TARGET SPEND WHERE THERE ARE HIGH GROWTH AND EMPLOYMENT MULTIPLIERS

Given low growth and the unemployment crisis in South Africa, sectors with high growth and employment multipliers should obviously be targeted. This should include support for labour-intensive sectors, such as Japan implemented via the Employment Adjustment Subsidy Programme (EASP) – one of the largest, in budgetary terms – to avoid job losses and retain workers.[131] Storm and Schröder's results show that the following sectors in South Africa have very high multipliers: forestry (10.16); catering and accommodation services (10.00); business activities (12.39); Sewerage, refuse, sanitation (16.02); and, other activities (24.78).

3. TARGET SPEND WHERE IT IS MOST LIKELY TO BE SPENT IMMEDIATELY AND THEREBY TO BOOST DEMAND

It is desirable that fiscal expenditure within a fiscal stimulus be spent within the economy, rather than saved, soon after being paid by government. Fiscal transfers, therefore, have been shown to stimulate aggregate demand to the extent that they reach households with a high marginal propensity to consume (MPC) on the domestic economy.[132] Many empirical studies have shown that the marginal propensity to consume is higher among households with low level of 'cash on hand', and among households who are most likely to be liquidity constrained.[133] This can be pursued either by putting cash in the hands of low-income households or creating jobs. In the United States, for example, between 2008 and 2011, through the American Recovery and

[130] Hendren, N. & Sprung-Keyser, B. (2019). A Unified Welfare Analysis of Government Policies. Harvard University. doi: 10.3386/w26144.

[131] International Studies for Labour Studies. (2009). A review of global fiscal stimulus. EC-IILS Joint Discussion Paper Series No. 5. Retrieved from https://www.ilo.org/inst/research/addressing-crisis-challenges/discussion-paper-series/WCMS_194175/lang--en/index.htm

[132] Acconcia, A. & University of Naples Federico II. (2015.). How targeted fiscal transfers can speed up economic recovery. Retrieved from https://www.weforum.org/agenda/2015/08/how-targeted-fiscal-transfers-can-speed-up-economic-recovery/.

[133] Ibid.

Reinvestment Act (ARRA), an estimated $48 billion was allocated to the Supplemental Nutrition Assistance Programme (SNAP) which provides assistance to low-income families in the form of food vouchers. The majority (97%) of SNAP vouchers were used at local grocery stores or farmers' markets within 30 days from transfer. According to the Department of Agriculture, in 2009, every $5 in new SNAP benefits was generating $9.20 in total community spending. Another programme which followed a similar principle was in South Korea, where the government targeted 250 000 households with incomes below 120% of the minimum level considered necessary to cover basic costs of living, and assets below a certain threshold, in the "Hope Work" programme. Hope Work provided temporary jobs to low income households which supported the recovery of local economies.

4. IMPROVE LIVELIHOODS FOR THE MOST VULNERABLE

A fiscal stimulus should take into account that economic growth, given structural inequalities, impacts various groups differently particularly the most vulnerable groups. For example, the OECD has called for countries to think of migrants and refugees as opportunities rather than as a burden because they contribute to the societies in many ways. Their efforts help to sustain and grow economies. In an article, Phillipe Legraine argues that "in economies where demand is depressed, this increased investment acts like a small fiscal stimulus, yielding an immediate demand dividend".[134] Other vulnerable groups must be considered.

5. RAISE SUPPLY AND ADVANCE STRUCTURAL TRANSFORMATION

A stimulus programme must divert resources to productive sectors to "expand the economy's productive capacity in the long run".[135] Paul Krugman argues that "there's a very good case for putting a sustained, productive programme of stimulus in place as soon as possible, instead of scrambling to come up with short-term measures every time bad things happen".[136] A fiscal stimulus programme must change the structure of the economy for long-term sustainability and for the development of a robust economy. From the 1960s, for example, Asian economies invested in their supply capacities and facilitated long run structural transformation.

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[134] Legrain, P. (2017). Refugees are not a burden but an opportunity. Retrieved from https://www.oecd.org/migration/refugees-are-not-a-burden-but-an-opportunity.htm.

[135] Krugman, P. (2020). The Case for Permanent Stimulus (Wonkish). Retrieved from https://www.nytimes.com/2020/03/07/opinion/the-case-for-permanent-stimulus-wonkish.html.

[136] Ibid.

6. UNDO THE HARM CAUSED BY AUSTERITY THUS FAR

It has already been established that austerity policies cause great harm and that this often falls disproportionately on vulnerable groups and exacerbate inequality. The UK Women's Budget Group, for example, found that the biggest falls in disposable income as the result of austerity policies since 2010 had been borne by the most vulnerable women – single mothers, single women pensioners and single women without children.[137] Women carry the burden of unpaid care work in the economy and initiatives that alleviate this and free them to participate in the labour market or provision of social protection in the long run should they choose to engage in this work should be explored. South Africa's Gender Responsive Budgeting has been neglected since the late 1990s. Ending austerity does not by itself reverse the harm already imposed. A meaningful impact assessment of past austerity policies is required to shape future fiscal stimulus packages.

7. REDUCE INEQUALITY

Fiscal policy should distribute resources equitably and improve livelihoods. In recent times, inequality has emerged as a key concern in the global economy. Many have acknowledged that "fiscal policy is the government's most powerful tool for addressing inequality. It affects households 'consumption directly (through taxes and transfers) and indirectly (via incentives for work and production and the provision of public goods and individual services such as education and health)".[138] While there is no consensus on the relationship between inequality and growth, there is "a growing body of evidence on why inequality might be harmful for an economy".[139] Fiscal stimulus should challenge, not reproduce structural inequalities. Stimulus packages have been gender-blind, largely male-biased, whereby measures have been "primarily directed at male-dominated industries (i.e. automobile or construction). This has been the case also in countries, such as South Africa, that have used gender budgets".[140]

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[137] Pearson, R., & Elson, D. (2015). transcending the impact of the financial crisis in the United Kingdom: towards plan F—a feminist economic strategy. *Feminist Review*. 109(1), 8–30. doi: 10.1057/fr.2014.42.

[138] Clements, B. et al. (2015). Inequality and fiscal policy. International Monetary Fund. ISBN: 9781513567754.

[139] Strauss, I. & Isaacs, G. (2016). Labour compensation growth in the South African economy: assessing its impact through the labour share using the Global Policy Model. Working paper no. 4. National Minimum Wage Research Initiative. University of Witwatersrand.

[140] Caglar, G., Prügl, E and Zwingel, S. (2013). Feminist Strategies in International Governance. Feminist Strategies in International Governance. Retrieved from https://books.google.co.za/books?id=0Nfp2nFfjXgC&dq=feminist+fiscal+stimulus&source=gbs_navlinks_s.

8. ENVIRONMENTALLY PROGRESSIVE

The world faces a looming climate crisis. Talk of a Green New Deal has recognised the need for fiscal stimulus efforts to transform our economies away from a reliance on fossil fuels and towards environmentally sustainable paths, while investing in measures to mitigate the worst consequences of climate change. Post the GFC, Asian nations, particularly China and the Republic of Korea, were surging ahead in 'green' investments as a major part of their economic and employment recovery packages.[141] The United Nations Environment Programme, estimated that China was spending a third of its stimulus on areas such as high-speed rail and boosting growth in wind and solar power and energy-efficient lighting. Korea had allocated 95% of its fiscal stimulus to its environmental sectors including low-emission vehicles. For both countries, their investments were equivalent to 3% of GDP.

9. SOCIAL COMPACT THAT PROTECTS JOBS

Fiscal stimulus should be part of creating a new economy and it is important to have buy-in from different stakeholders into what this new economy looks like. It should therefore, where possible, be discussed and developed within social dialogue processes. This may mean that different groups accept costs and benefits in the process.

10. PROMOTE LONG-TERM ECONOMIC SUSTAINABILITY IN TERMS OF GROWTH AND DEBT

A well-designed stimulus should pay for itself in the medium to long term. Summers and DeLong argue that fiscal stimulus spending can self-finance because of increases in both consumer spending and investment, which, in turn, raises future incomes and tax payments, offsetting more government spending.[142] This is not always the case, therefore flexibility in programmes that are not yielding the desired outcomes need to be evaluated in a timely manner. Monitoring and evaluation play a key role in designing a stimulus that will yield the desired outcomes. Fiscal stimulus needs to be timely, temporary, and well targeted.[143]

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[141] Barbier, E. (2010). A Global Green New Deal: Rethinking the Economic Recovery. UNEP.

[142] Delong, J. & Summers, L. (2012). Fiscal Policy in a Depressed Economy. Retrieved from https://www.brookings.edu/wp-content/uploads/2012/03/2012a_delong.pdf.

[143] Elmendorf, D. & Furman, J. (2008). If, When, How: A Primer on Fiscal Stimulus. The Brookings Institute. Retrieved from https://www.brookings.edu/research/if-when-how-a-primer-on-fiscal-stimulus/

5.5.2 APPLYING THE PRINCIPLES IN THE SOUTH AFRICAN CONTEXT: SELECTED EXAMPLES

There are a number of fiscal stimulus programmes that can be instituted that directly align with multiple principles enlisted above. We provide examples of three.

5.5.2.1 SOCIAL GRANTS

R175.2 billion was spent in 2019/20 on social grants in South Africa.[144] Increasing social transfers is shown to be effective on a number of levels. First, it targets a population group which is likely to spend immediately (Principle 3 above). Lower income deciles, the recipients of social grants, have a higher propensity to spend. A study on the child grant estimates the marginal propensity to consume to be 0.7.[145] This means that households that receive child grants spend 70% of the money on consumption. The authors also note that this value is probably higher with families not diverting funds to saving. Funds spent on income transfers therefore flow back into the economy and stimulate growth. Second, such spending improves the lives of the most vulnerable (Principle 4 above). Social grants comprise the largest share of income for the 40% of individuals with the lowest incomes.[146]

Third, social grant spending can advance supply capacity and structural transformation in two ways – through human capital development and local expenditure (Principle 5 above). On human capital development, social grants are an important way to allow the poorest to invest in health and education, "supporting and strengthening livelihood strategies and productive activity, including informal sector activity, domestic labour, child, ill, disabled and elderly care". Further, they "allow for flexibility in which the income can be used to support economic activity and mitigate against shocks".[147] An assessment of the child support grant concluded that grants are "consumption expenditure that enhances intergenerational equity and also promotes productive efficiency and human capital".[148] On structural transformation, analysis undertaken

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[144] National Treasury. (2020). Op cit.

[145] Bengtsson, N. (2012). The Marginal Propensity to Earn and Consume Out of Unearned Income: Evidence Using an Unusually Large Cash Grant Reform. *The Scandinavian Journal of Economics*. 114(4), 1393-1413, 2012. SSRN: https://ssrn.com/abstract=2181270

[146] Finn, A. (2015). Op cit.

[147] SPII. (2013). The role of social grants in supporting local economic development (LED). Retrieved from http://spii.org.za/wp-content/uploads/2013/12/The-role-of-social-grants-in-supporting-local-economic-development-LED-Policy-Brief-January-2012.pdf

[148] FFC. (2014). Chapter 2: Economic and Social Value of social grants. Retrieved from file:///C:/Users/Busi%20Sibeko/Downloads/2014-15_Chapter_2_Economic_and_Social_Value_of_Social_Grants.pdf

using the Living Conditions Survey 2014/2015 and Quantec's Republic of South Africa's Standardised Industry Data Trend Tables 2017[149] shows that individuals' consumption spending has a lower propensity to lead to imports than the spending in the economy as whole. Further, poorer decile spending has an even lower import propensity and greater forward and backward linkages in the economy. For example, the poor mostly spend on food items which are produced locally. Higher-income deciles spend on things like insurance, fuel, cars, telecommunication, accommodation and catering.

Undoing austerity therefore requires real increases to social grants and the extension of those covered. Between 2014/15 and 2018/19 there were "limited increases or declines in the real value of social grants, on which the lowest-income households rely".[150] During this period old age pension and child support grants rose below CPI inflation twice each, and below food price inflation on all but one occasion for the old age pension and two occasions for the child support grant. Real rises in fuel levy outstripped the increases to social grants by large margins in all but one instance (the same is true for excise taxes). It is also worthwhile to note that the value of the grants, as a share of different poverty lines, has fallen. In 2011/12, the child support grant would have covered 79% of the cost of basic foodstuffs necessary to avoid hunger. By 2018/19 it only covered 71% of the cost of these goods. Similarly, the value of the old age pension grant, had been declining relative to the upper-bound poverty line between 2014 and 2019.[151]

5.5.2.2 CARE WORK

Fiscal stimulus that invests in the care economy also fits well with the principles outlined above. Research by the International Trade Union Confederation (ITUC) on South Africa shows that multipliers are high in the care economy (Principle 2). If 2% of GDP were invested in the health and care sector, it would generate increases in overall employment of over 400 000. A similar level of investment in construction would increase overall employment by 511 000.[152] Investing in the care economy also helps to improve equity (Principle 7) by changing the distribution of unpaid work. The 2000 time-use survey confirmed that "women were found to spend much more of their time on unpaid, reproductive type work while men were more likely to be engaged in paid

[149] We would like to thank Josh Rosenberg for his contribution to this analysis.

[150] Budget Justice Coalition. (2018). Submission to the Standing Committee and Select Committee on Finance with respect to the proposed 2018 National Budget.

[151] Ibid.

[152] ITUC. (2017). Investing in the Care Economy Simulating employment effects by gender in countries in emerging economies. Retrieved from: https://www.ituc-csi.org/IMG/pdf/care_economy_2_en_web.pdf

work".[153] In further analysis of this data, researchers have argued that unpaid work obligations "affect women's employment options and their ability to look for paid work".[154] Spending on care work improves livelihoods for the most vulnerable. ITUC, for example, argues that the "lack of provision of formal care puts an enormous burden on elderly members of the community" in the context of high HIV/AIDs prevalence. They argue that to achieve formal long-term care provision for the elderly, South Africa needs to increase the number of formal care workers by 86 000 which is five times the current long-term care work force.

Not only is investment in care (childcare, elder, education and health) critical for jobs, it also enables services that raise women's participation in direct employment, increasing supply capacity in the economy (Principle 5) and improving equity (Principle 7). Many gender activists have argued that "unlocking the potential offered by many millions of women joining the formal workforce builds stronger economies and wealthier households".[155] Such investment can also undo the harm caused by austerity (Principle 6). International evidence has shown that women disproportionately bear the burden of austerity policies - women carry more of a burden in social provisioning and require more access to public services which austerity takes away. [156]

5.5.2.3 ELECTRICITY INFRASTRUCTURE

The South African energy crisis is two-fold. First, Eskom's inefficiencies, corruption and mismanagement has meant a power utility in unsustainable debt and with insufficient energy capacity. Second, South Africa is heavily reliant on coal-fired power, and as the 14th largest per capita producer of greenhouse gases is on an environmentally unsustainable growth path.[157] What is less widely recognised is that investing in solving these problems has the potential to have massive benefits to the economy.

In the context of weak economic growth South Africa's government can use the fiscal stimulus to pave a Green New Deal for the country. At the heart of this would be a green industrialisation programme investing in the production of green energy technologies

[153] Stats SA. (2001). A survey of time use. Retrieved from http://www.statssa.gov.za/publications/TimeUse/TimeUse2000.pdf

[154] Floro, M, and Hitomi K. (2011). Gender and Work in South Africa: What Can Time-Use Data Reveal?." Feminist Economics 17 (4). 33-66. Retrieved from https://microdata.worldbank.org/index.php/citations/7595

[155] ITUC. (2017). Op cit.

[156] Sibeko, B. (2019). Op cit.

[157] Carbon brief. (2018). The Carbon Brief Profile: South Africa. Retrieved from https://www.carbonbrief.org/the-carbon-brief-profile-south-africa.

that are able to have high multipliers (Principle 2), strong forward and backward linkages and create new export sectors (Principle 5). COBENFITs, for example, argues that with appropriate investment into green sectors "employment can be expected to increase by an additional 40% in the period 2018 to 2030, accounting for 580,000 jobs". [158] The jobs would be concentrated in the services, construction, and manufacturing sectors. The mining sector would also benefit. Renewable power generation will generate high-skill, high-productivity jobs.[159] Social ownership of some renewable energies would also mean improving the livelihoods of the most vulnerable (Principle 4) and increasing equity (Principle 7). This could be an essential component of a new social compact (Principle 9).

6 STRUCTURE OF A PROPOSED STIMULUS

The details of a fiscal stimulus must be context specific. As noted in the preface, the COVID-19 pandemic has, in some respects, radically altered the economic landscape. As also noted, this paper was drafted prior to the onset of COVID-19 and the subsequent economic crisis. These recommendations do not pertain to the COVID-19 rescue response and would need to be further considered in light of the new economic realities emerging.

Nevertheless, the need for a medium-term stimulus in South Africa remains as urgent, if not more urgent, than before the crisis. National Treasury's Towards a Growth Agenda for South Africa which maintains a posture of fiscal austerity, needs to be revised in line with the following considerations.

1. **Size, timeframe and framework**

    1.1. We propose a medium-term fiscal stimulus of R1 trillion, 7% of 2019 GDP per annum, be introduced over three years. This excludes any additional off-balance sheet financing that can be leveraged for renewable energy projects; rescue measures necessary to restructure Eskom's debt; as well as the rescue package introduced in response to COVID-19. As noted in Table 4 an annual stimulus of R345 billion is estimate to translate, annually, into GDP growth of approximately R580 billion and 2.4 million jobs.

    1.2. The current MTEF would need to be redrawn to ensure an increase in real per capita non-interest expenditure.

[158] COBENEFITS. (2019). Future skills and job creation through renewable energy in South Africa Assessing the co-benefits of decarbonising the power sector.

[159] Ibid.

1.3. An impact assessment of the effects of previous austerity measures should be undertaken. The impact analysis must take into account impacts along the lines of race, class, gender, age etc. The impact on the realisation of constitutional rights should be front and centre.

2. **Domestic resource mobilisation efforts need to be undertaken through progressive tax increases, leveraging development finance, and monetary policy reforms.**

2.1. Raise immediate revenue through short-term measures. These include: reducing tax breaks for higher-income households, e.g. on pensions and medical aid (see above); eliminating ineffective corporate subsidies; closing loopholes; and raising indirect taxes when this can be done progressively, e.g. via an increased VAT rate on luxury goods.[160]

2.2. Tax wealth. South Africa insufficiently taxes wealth across the board. Capital gains tax is comparatively low; below the OECD and BRICS norm. Tax on inheritance – estate duty – is levied at only 20% and raises revenue worth 0.05% of GDP compared with the OECD average of 0.2%.[161] Despite South Africa's market capitalisation to GDP ratio being almost triple the OECD average, revenue from securities transaction tax (STT) lags behind the OECD average.[162] No net worth tax is in place.

2.3. Raise income tax on high income earners. Between 2010/2011 and 2018/2019 there was an average *real* annual increase in excise duties of around 2.5% for the products selected and an average *real* annual increase of 3.8% and 4.5% for the fuel levy on petrol and diesel. This indicates that taxes that hit the poor hardest are rising at a faster rate than taxes that mainly target higher income earners and companies. Effective PIT rates have fallen considerably over the last three decades accompanied by tax breaks for higher earners.[163]

2.4. Rebuild capacity within SARS. All the measures to increase revenue must be combined with deliberate steps to rebuild SARS capacity. We discuss this issue further below.

2.5. Clamp down on illicit financial flows (IFFs) and tax evasion. An estimated R7 billion is lost annually to tax avoidance by multinationals, alone.[164] In 2017, the

[160] IEJ. 2018. Mitigating the impact of VAT increase by extending zero-rating.

[161] SACTWU and COSATU, 2017. Op cit.

[162] CESR, IEJ, and SECTION 27. (2018). Op cit.

[163] Budget Justice Coalition. (2018). Op cit.

[164] Donnelly, L. (2019). Giants cost SA billions in lost taxes. https://mg.co.za/article/2019-01-11-00-giants-cost-sa-billions-in-lost-taxes/

Global Financial Integrity indicated that $1 of every $5 that is sent out of South Africa in trade, is actually done illicitly.[165] This equates to $10 billion in lost taxes annually. South Africa needs to implement the recommendations made by the High Level Panel on Illicit Financial Flows from Africa (HLP) and sign on to more transparency initiatives.[166]

2.6. Broaden the income tax base. All people in the country pay taxation, e.g. via VAT or fuel levies, but the data indicates that South Africa suffers from a narrowing income tax base. The number of taxpayers taxed has declined and the average income tax paid has increased. Ultimately this can only be rectified by increasing employment and raising wages. A fiscal stimulus supports this.

3. Resourcing development finance

3.1. The IDC and DBSA need to be scaled up. These institutions need to be given a government guarantee, and stable, low-cost source of funding, so that they are no longer beholden to commercial performance criteria and can supply targeted subsidised credit.

3.2. Switch the lending practices of existing DFIs away from large established corporates, or municipalities, and towards smaller, and/or potentially riskier, businesses, including those that are owned by previously disadvantaged groups, youth, women, and people with disabilities. In order to do so, these DFIs will need to accept some level of losses.

3.3. Leverage DFIs for strategic state investment in infrastructure. This has the potential to provide increased funding for essential projects without the negative consequences of leveraging private sector financing through public-private partnerships (PPPs) or other forms of 'financing for development' which have become popular and amount to the state subsidising and de-risking investment by the private sector.

3.4. Consider utilising the Government Employee Pension Fund (GEPF) and/or the Unemployment Insurance Fund (UIF) for funding. At the end of 2019, the GEPF

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[165] Hogg, A. (2020). $10bn lost annually as illicit financial flows ride through South Africa – Rowden https://www.biznews.com/premium/2020/03/04/illiicit-financial-flows-trade-sa

[166] UNECA. (2019). Report of the High Level Panel on Illicit Financial Flows from Africa. Retrieved from: https://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf

had a surplus of R454 billion.[167] The UIF has assets of about R174 billion.[168] UIF funding should target employment programmes and/or assistance to the unemployed.

3.5. Establish an export-import (EXIM) bank. South Africa is the only emerging market country that does not have an EXIM bank. EXIM banks are a key tool used to boost the competitiveness of exports through provision of various forms of direct financing to foreign buyers. An EXIM bank could be established, either within an existing DFI or as an independent entity.

3.6. Move ahead with the creation of a state bank, however with a developmentally orientated mandate as opposed to the 'commercial principles' proposed by the National Treasury.

4. Supportive monetary policy

4.1. The SARB should revise its monetary-policy targets. These should include a "real targeting framework for monetary policy [that] adds one or more important real variables, such as real GDP growth, or a stable and competitive real exchange rate (SCRER), or "full employment", to nominal variables, such as the rate of inflation, as a goal of monetary policy".[169] A range of policy measures would flow from revising the targets in this way. Amongst others, these would include: targeted capital management techniques; lower real interest rates; and more active exchange rate management. These will be explored in further monetary policy specific work.

4.2. Use monetary policy to reduce the cost of debt, including through the SARB purchasing government bonds.

4.3. Address the lack of competition in the banking sector, and the very high spread of 3.5% between the Reserve Banks repo rate, and the prime rate charged by commercial banks. This spread makes the cost of credit unacceptably high.

5. Invest in long-term economic infrastructure

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[167] Government Employee Pension Law of 1996 (GEP Law), requires the funds of GEPF to cover 90% of all liabilities at any point in time. On 31 March 2018, the R1 802 billion in financial assets managed by Public Investment Corporation (PIC) covered 108% of GEPF's liabilities to working and retired members

[168] Gqubule, D. (2020). DUMA GQUBULE: Cosatu's plan to get Eskom out of debt. Retrieved from https://ewn.co.za/2020/02/18/duma-gqubule-cosatu-s-plan-to-get-eskom-out-of-debt

[169] Epstein, G. (2009). Rethinking Monetary and Financial Policy: Practical suggestions for monitoring financial stability while generating employment and poverty reduction. https://www.ilo.org/public/english/employment/download/wpaper/wp37.pdf

5.1. Resources need to be allocated towards the maintenance and expansion of electricity, water, transport, and communications infrastructure, which are critical. The problems of effective implementation, skills, accountability, and capacity of the state need to be addressed. These should appropriately contribute towards industrial restructuring, for example, transport networks should support targeted industries. Other objectives, such as equity, should also be prioritised, for example through the distribution of mobile/broadband access.

5.2. Resolve Eskom debt crisis by removing R250 billion off its balance sheet. This should be done leveraging climate funding, DFI funding, and quasi-state off balance sheet resources like the GEPF. Specific work on this matter is forthcoming.

5.3. Safe, reliable public transport must be developed. This is particularly important in the context of spatial apartheid legacies. Corruption in the transport sector, in particular within Passenger Rail Agency of South Africa (PRASA) must be decisively dealt with and perpetrators held accountable.

6. Close the gap in critical social infrastructure

6.1. Real per capita increases to social infrastructure which includes education, health, and care work expenditure should be implemented. Townships and rural communities should be prioritised.

7. Increase and extend social transfers

7.1. Social grants should be increased in real terms to take account of the real cost of living. Government should review and benchmark the CSG (R 445) and Foster care (R1 040) against the poverty line of R1 227.

7.2. Given high rates of unemployment and inequality, some form of universal social security / universial basic income will need to be phased in. A "work-seeker's grant" may be a first step in this direction.[170] These efforts should bolster domestic demand and supply.

7.3. A guaranteed work scheme should be considered, but should not be implemented in a manner that undermines permanent employment or creates a misguided notion that social security is dependent on performing work.[171]

8. Better resourced industrial policy with a focus on green industrialisation

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[170] Institute for Economic Justice (2018). Op cit.
[171] Ibid.

8.1. Large-scale investment in green energy technologies, production, and rollout is required. This should be part of a mass industrialisation plan and focus on current coal mining areas, such as in Mpumalanga.[172]

8.2. Industrial policy requires additional resources, human and financial. It should prioritise: sectors that meet the criteria laid out above, new entrants and black-owned firms, and building capacity to see its effective implementation which is currently weak.

8.3. Support to business should encourage other objectives, such as, the reduction of wage inequality through maximum wage ratios and employee ownership.[173]

9. Invest in the care economy

9.1. Resources should be allocated towards physical infrastructure and social infrastructure in the care economy. This includes moving towards funding the socialisation of childcare and elderly care through communities or direct state or business provision. It also includes improving the wages and conditions of work for current workers in the care economy, such as community health workers and early childhood development practitioners.

10. A new social compact

10.1. Government, labour, business and other social partners need to engage substantively on the contours of the stimulus. Real participation and transparency needs to be enacted. NEDLAC's plans to consult with all social partners to review NEDLAC's constitution to "promote greater inclusivity" should be concluded.[174]

11. Sequencing and timeframes

11.1. A staged approach will need to be adopted, allowing for strategic priorities, logical sequencing and state capacity to drive the implementation process.

[172] Swilling, M. (2019). Unlocking a just energy transition for South Africa. https://lifeaftercoal.org.za/about/just-transition

[173] Francis, D. (2017). Tackling wage inequality in South Africa: the components of a national minimum wage for South Africa pay ratios and capping pay. National Minimum Wage Research Initiative. Wage Inequality Policy Brief No. 1 http://nationalminimumwage.co.za/wp-content/uploads/2018/01/NMW-RI-Wage-Inequality-Policy-Brief-1-Web.pdf

[174] Smit, S. (2019). Nedlac struggles with inclusivity. *Mail & Guardian*. Retrieved from https://mg.co.za/article/2019-08-02-00-nedlac-struggles-with-inclusivity/

11.2. Monitoring, evaluation, and (where necessary) reform should be at the core of the proposed measures. Successful stimulus packages are those that are adapted as new lessons emerge.