Lockdown Economics: Key Challenges Facing the South African Economy

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Introduction

The COVID-19 pandemic has led many governments across the world to introduce and impose restrictions on social mobility and interaction with the primary aim of curbing the spread of the virus. Following the declaration of a National State of Disaster on 15 March 2020, South Africa's number of confirmed COVID-19 cases passed 100 just three days later and a complete national lockdown was imposed for five weeks from 27 March until 1 May 2020 when a risk-adjusted, phased re-opening of the economy was introduced. Such a lockdown policy, however, is expected to lead to substantial welfare losses to individuals and households. Changes in labour market conditions with respect to employment, working hours, and earnings are expected to play a key role in such transitions in welfare, particularly for already vulnerable groups such as low-wage workers and those who cannot feasibly work from home. On the 15th of October, President Cyril Ramaphosa presented the government's Economic Reconstruction and Recovery Plan (ERRP) to restore the South African economy following the devastation caused by the pandemic. In this light, this note presents a brief overview of some of the pandemic's economic effects that have so far been observed in South Africa, with a focus on five of the most significant issues the economy faces, based on the latest available data.

The Outlook for Economic Growth

Already prior to the pandemic, as Table 1 below indicates, the South African economy was predicted to only marginally grow, as indicated by National Treasury (NT)'s forecast of just 0.9% for 2020, followed by a tepid recovery of 1.3% for 2021.

Table 1: Macroeconomic Model Forecasts: A Comparison

Source	**Date of Forecast**	**GDP**	
		2020	2021
	Pre-Crisis Forecast		
National Treasury	26-Feb	0.9	1.3
	Current Forecasts		
HSBC	02-Apr	-6.7	4
BER	08-Apr	-7	5.1
SA Reserve Bank	14-Apr	-6.1	2.2
IMF	15-Apr	-5.8	4.0
Nat. Treasury	15-Jun	-7.2	2.6

Source: IMF (2020); HSBC (2020); SARB (2020); BER (2020b); National Treasury (2020)

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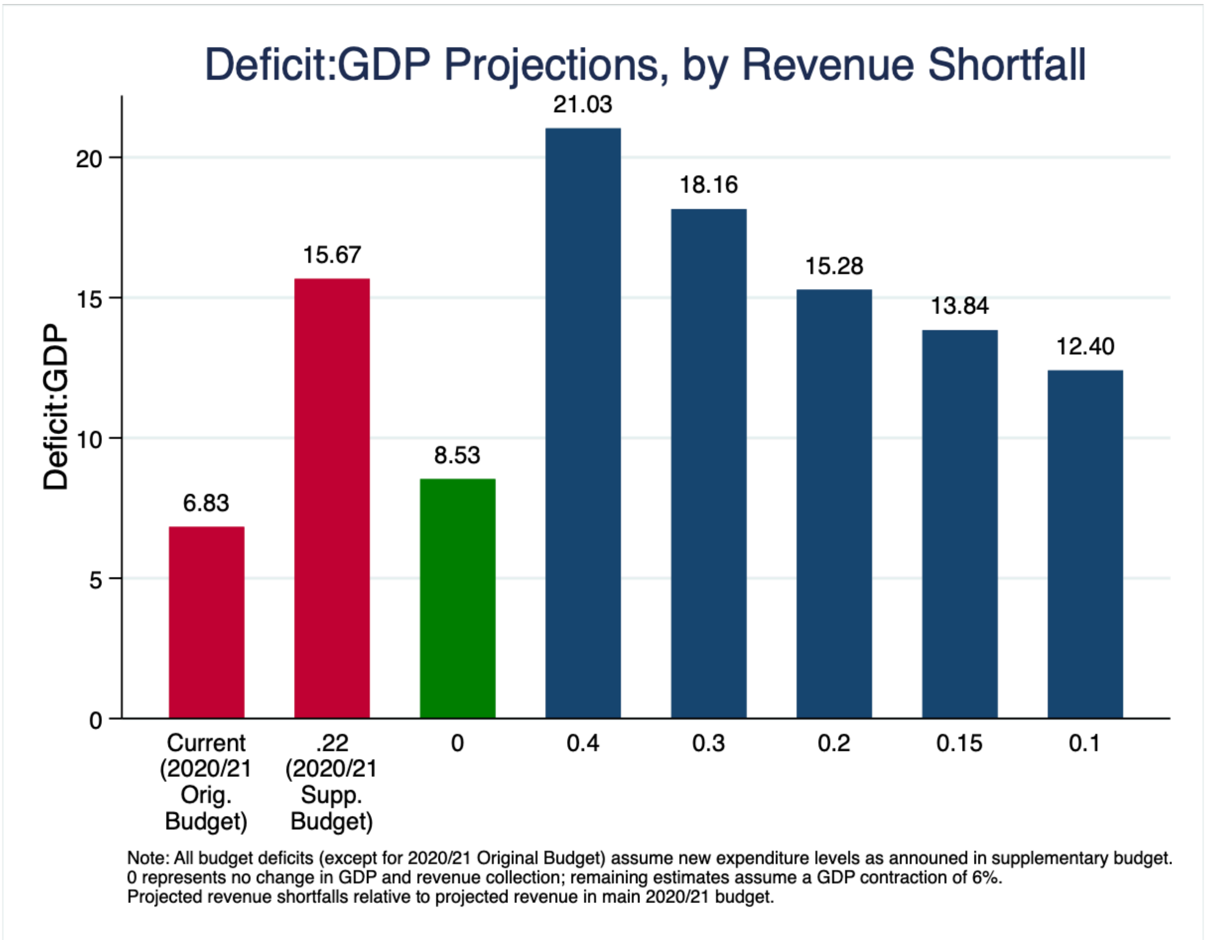
Following the onset of the pandemic, National Treasury's forecasts for 2020 were revised significantly downwards to a contraction of 7.2% as of 15 June, with an expected bounce-back of 2.6% in 2021. If we consider estimates from several other models used by the HSBC, BER, SARB, and IMF, we see forecasts ranging from a lower- bound of -5.8% to an upper-bound of -7.2%, resulting in a simple average of a 6.6% expected decline in GDP. Importantly, the bounce-back is expected to be between 2.2% and 5.1% in 2021. Variation in these forecasts largely stem from differences in important model assumptions, such as the length and intensity of the national lockdown as well as the progression of the pandemic. As such, it should be emphasised that these models need to be updated as new data becomes available, given how novel, heterogenous and dynamics this type of shock has been to the world economy.

The Fiscal Deficit Spike

Considering South Africa's fiscal outlook, what is particularly important to keep in mind is the evolution of the fiscal deficit. The pre-pandemic context included a deficit which amounted to 6.83% of our GDP, as indicated by the left-side red bar in the figure below. If government experienced no change in the quantum of revenue it collected and the economy remained on the same growth path, the deficit would have increased by approximately 2 percentage points to 8.53%, as indicated by the green bar. In the 2020/21 Supplementary Budget, NT announced a projected deficit of 15.67%.

Figure 1: Deficit:GDP Projections, by Revenue Shortfall Assumptions



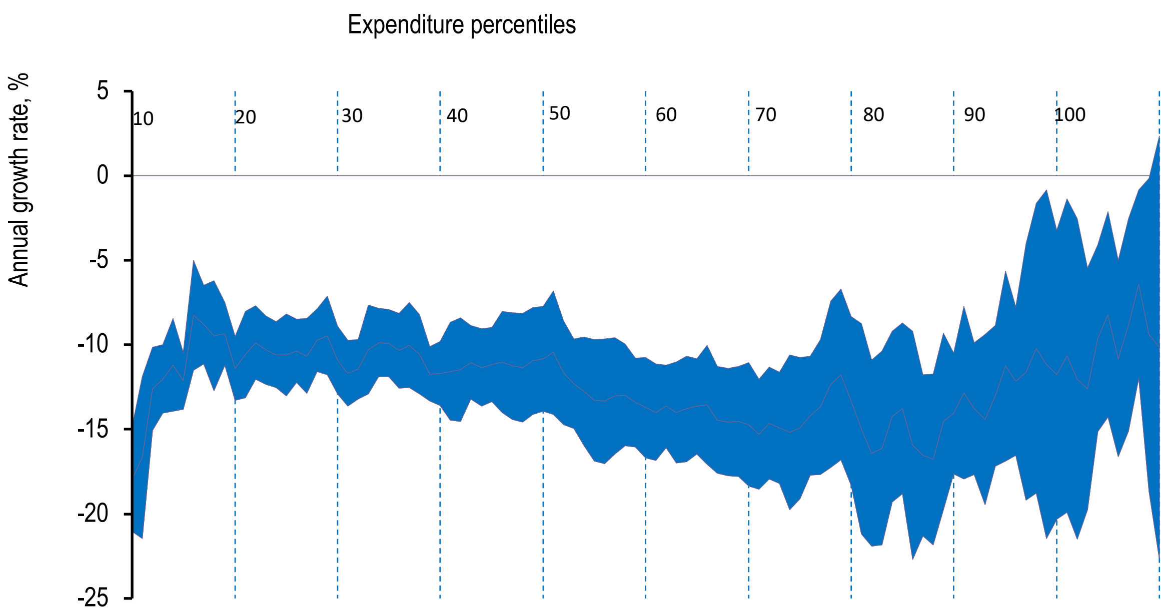
Source: National Treasury, 2020 and own calculations.

What is important to consider now is how the deficit is expected to vary based on different revenue shortfall scenarios. We consider this with the set of blue bars. If for example, a revenue shortfall of 20% is projected, accompanied by a GDP contraction if 6%, the deficit will rise to 15.28% - close to National Treasury's current projected fiscal deficit. If a larger shortfall of 40% is projected, again coupled with the same GDP contraction, one would expect the deficit to rise to over 21%. As such, apart from hoping that economic growth kickstarts in the remainder of 2020, one of the key things to improve out deficit is to quickly improve the efficiency and effectiveness of revenue collection. Closer attention to closing South Africa's significant tax gap will go a long way toward taking some pressure off the expenditure side of the deficit and the longer run fiscal consolidation path being pursued by government.

Employment and inequality: The COVID-19 Impact

Considering the employment and distributional effects of the pandemic, the below figure – generated using data and a macro-econometric model used by the World Bank for South Africa - is particularly enlightening. The figure shows the expected annual decline in household spending across the expenditure distribution. It is clear that there is an expected negative welfare effect for all households in the economy, with some heterogeneity in the extent of income shocks across the distribution

Figure 2: Simulated Impact of Lockdown on Incomes, By Percentile



Source: Sulla, V. (et al), World Bank, April 2020

What's particularly interesting is the hollowing out of the middle of the distribution, suggesting that workers nearer to the 7th and 8th decile of the distribution will experience larger effects relative to those in poorer deciles. This implies that the crisis will reinforce both overall inequality in South Africa, as well as erode the income in the middle of the distribution.

We next consider changes in labour market outcomes in the second quarter of 2020 (2020:2), relative to the same quarter in 2019, using the nationally representative Quarterly Labour Force Survey (QLFS) data. We present these estimates in the table below. The data shows, in the first instance that by June 2020, the economy had 2.2 million fewer jobs relative the 2nd quarter of 2019. A similar magnitude of job loss is observed if we compare 2020Q2 to 2020Q1. This number is about equivalent to the amount of jobs the South African economy created in the last 10 years.

Table 2: Changes in employment by industry and occupation, 2019Q2 – 2020Q2

	2019Q2	2020Q2	Change		Employment shares (%)		Share of change
			Absolute	%	2019Q2	2020Q2	
Industry							
Primary	**1 223 144**	**1 172 236**	**-50 908**	**-4.2**	**7.5**	**8.3**	**2.3**
Agriculture, etc.	842 062	799 033	-43 029	-5.1	5.2	5.7	2.0
Mining and quarrying	381 082	373 203	-7 879	-2.1	2.3	2.6	0.4
Secondary	**3 303 486**	**2 634 571**	**-668 915**	**-20.2**	**20.3**	**18.7**	**30.6**
Manufacturing	1 789 388	1 455 825	-333 564	-18.6	11.0	10.3	15.3
Utilities	151 339	112 926	-38 412	-25.4	0.9	0.8	1.8
Construction	1 362 759	1 065 820	-296 939	-21.8	8.4	7.5	13.6
Tertiary	**11 780 270**	**10 314 562**	**-1 465 709**	**-12.4**	**72.2**	**73.0**	**67.1**
Trade	3 428 621	2 946 463	-482 158	-14.1	21.0	20.9	22.1
TSC	982 502	884 683	-97 819	-10.0	6.0	6.3	4.5
Finance	2 495 239	2 234 281	-260 958	-10.5	15.3	15.8	11.9
CSP	3 622 492	3 243 976	-378 517	-10.4	22.2	23.0	17.3
Private households	1 251 416	1 005 159	-246 256	-19.7	7.7	7.1	11.3
TOTAL	**16 306 900**	**14 121 369**	**-2 185 531**	**-13.4**	**100.0**	**100.0**	**100.0**
Occupation							
High-skilled	**2 367 575**	**2 360 096**	**-7 479**	**-0.3**	**14.5**	**16.8**	**0.3**
Legislators	1 527 944	1 287 769	-240 175	-15.7	9.4	9.1	10.8
Professionals	839 631	1 072 327	232 696	27.7	5.1	7.6	-10.5
Semi-skilled	**9 228 963**	**7 790 407**	**-1 438 556**	**-15.6**	**56.6**	**55.3**	**64.6**
Technical professionals	1 436 393	1 213 133	-223 259	-15.5	8.8	8.6	10.0
Clerks	1 708 008	1 470 386	-237 622	-13.9	10.5	10.4	10.7
Service workers	2 687 359	2 301 782	-385 577	-14.3	16.5	16.3	17.3
Skilled agriculture	53 782	67 454	13 671	25.4	0.3	0.5	-0.6
Craft	1 957 006	1 520 915	-436 091	-22.3	12.0	10.8	19.6
Plant and machine operators	1 386 415	1 216 737	-169 678	-12.2	8.5	8.6	7.6
Low-skilled	**4 715 050**	**3 935 253**	**-779 797**	**-16.5**	**28.9**	**27.9**	**35.0**
Elementary occupations	3 720 516	3 190 566	-529 950	-14.2	22.8	22.7	23.8
Domestic workers	994 535	744 687	-249 847	-25.1	6.1	5.3	11.2
TOTAL	**16 311 588**	**14 085 756**	**-2 225 832**	**-13.6**	**100.0**	**100.0**	**100.0**

Source: QLFS 2019Q2 and 2020Q2. Authors' own calculations.
Notes: [1] Sample restricted to working-age population (15 - 64 years). [2] All estimates weighted using relevant sampling weights. [3] Industry and occupation totals do not sum because sample here excludes workers in 'Other' industries and occupations.

Disaggregating this employment contraction at the sectoral-level, suggests in the first instance that two in every three (67%) of all jobs lost emanated from the tertiary sector, and 30% from the secondary sector. Crucially though, a disproportionate share of job losses relative to their share in the economy, emanated from the manufacturing and construction sectors. Whilst constituting about 18% of employment in 2020:2, these sectors though accounted for about 30% of all jobs shed in the first quarter of the Covid-19 pandemic. In terms occupation - one in every four (or 250 000) domestic workers lost their jobs. If we consider employment shifts by skill-level, the overwhelming decline was amongst semi-skilled (65%, or 1.4 million) and low-skilled workers (35%, or 800 000) – also representing disproportionate shares of aggregate job loss. The net high-skilled job loss effect was close to zero.

When we consider employment shifts over the annualised quarterly period by individuals characteristics of labour market participants, we find that African males, aged 15-34, dominated job losses. Indeed half of all jobs lost due to Covid-19, struck young workers under the age of 34.

Table 4: Changes in employment by select demographic and labour market groups, 2019Q2 – 2020Q2

	2019Q2	2020Q2	Change Absolute	Change %	Employment shares (%) 2019Q2	Employment shares (%) 2020Q2	Share of change
Total	**16 312 706**	**14 148 215**	**-2 164 491**	**-13.3**	**100.0**	**100.0**	**100.0**
Race							
African/Black	12 250 320	10 554 996	-1 695 324	-13.8	75.1	74.6	78.3
Coloured	1 686 611	1 412 289	-274 322	-16.3	10.3	10.0	12.7
Indian/Asian	530 391	488 224	-42 167	-8.0	3.3	3.5	1.9
White	1 845 384	1 692 706	-152 678	-8.3	11.3	12.0	7.1
Gender							
Male	9 179 612	7 977 963	-1 201 649	-13.1	56.3	56.4	55.5
Female	7 133 094	6 170 252	-962 842	-13.5	43.7	43.6	44.5
Age group							
15-34	5 964 514	4 869 685	-1 094 829	-18.4	36.6	34.4	50.6
35-54	8 749 069	7 866 851	-882 219	-10.1	53.6	55.6	40.8
55-64	1 599 122	1 411 680	-187 442	-11.7	9.8	10.0	8.7
Formality							
Formal	12 012 387	10 881 660	-1 130 727	-9.4	73.6	76.9	52.2
Informal	3 249 666	2 435 950	-813 716	-25.0	19.9	17.2	37.6
Private households	1 273 358	1 019 109	-254 249	-20.0	7.8	7.2	11.7
Sector							
Private	13 629 880	11 599 189	-2 030 691	-14.9	83.6	82.0	93.8
Public	2 843 080	2 698 836	-144 244	-5.1	17.4	19.1	6.7
Unionisation							
Member	3 948 660	4 203 095	254 436	6.4	24.2	29.7	-11.8
Non-member	9 339 867	7 280 290	-2 059 577	-22.1	57.3	51.5	95.2
Do not know	475 084	320 010	-155 074	-32.6	2.9	2.3	7.2

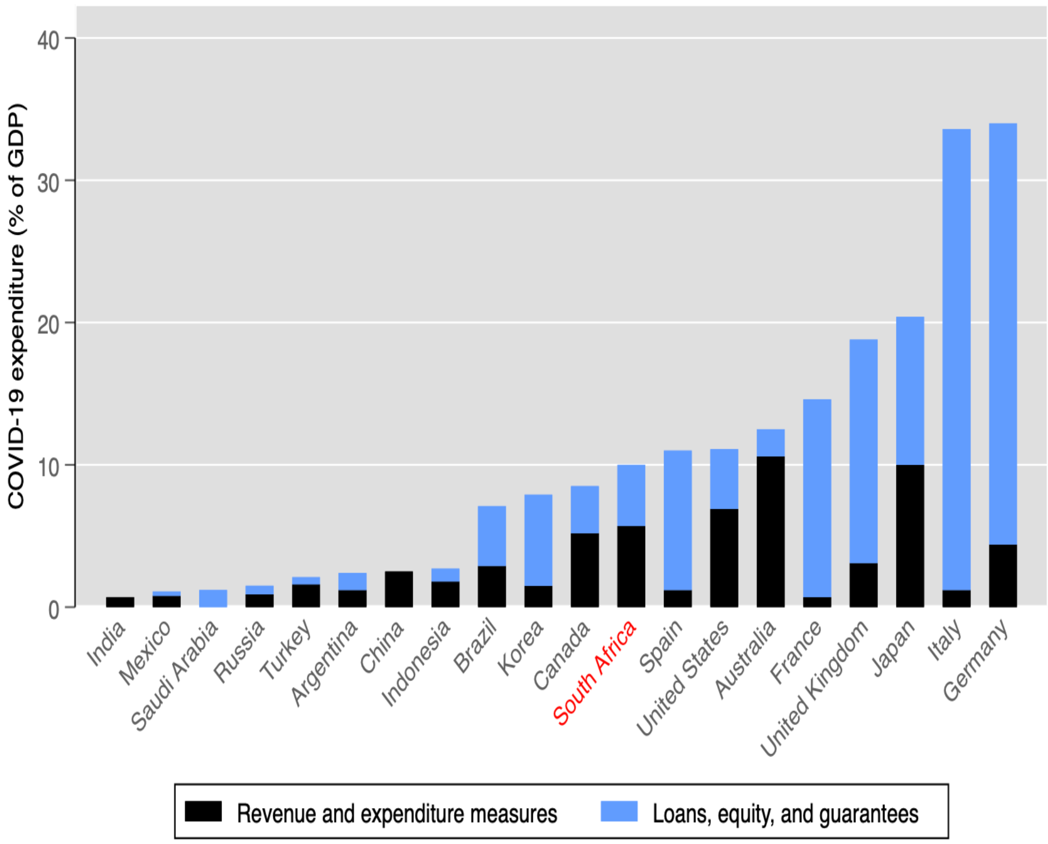
Source: QLFS 2019Q2 and 2020Q2. Authors' own calculations.
Notes: [1] Sample restricted to working-age population (15 - 64 years). [2] All estimates weighted using relevant sampling weights.

One important nuance around South Africa's employment contraction due to Covid-19 though deserves closer attention: the data above shows that over a million jobs – or close to 50% of the total employment contraction – were in informal or domestic employment. Both sectors arguably are low barrier to entry (and exit) sectors. Certainly, the global literature supports this for the informal sector. With that in mind, and with a presumed recovery predicted for 2021 combined with South Africa's ongoing easing of lockdown restrictions – there is some positive possibility that many of these jobs will come back onstream. Interestingly, the data also suggests that no jobs were lost for union workers or those in the public sector. This would suggest that non-unionised, formal sector workers – together with informal and domestic workers – constitute the majority of all jobs lost during the early period of the Covid-19 pandemic.

The Ramaphosa Stimulus Package

When we consider the South African government's stimulus package to mitigate the economic effects of the pandemic, we see that it amounts to approximately R500 billion, or 10% of the economy's GDP. As a share of GDP, this represents the highest amount of spending in the emerging market world, and notably larger than several high-income countries including South Korea and Canada.

Figure 3: Covid-19 Stimulus Expenditure, Percentage of GDP By Country



Clearly, the notion that not enough has been spent in terms of a Covid-19 response package is empirically incorrect. Indeed, this result is true even when only examining the so-called 'above-the-line' expenditure by government.

In terms of the composition of this spending, about 10% of the stimulus package, or R50 billion, was allocated to social assistance. That is, the package included an expansion of cash transfers or social grants on both the intensive (the amount of every existing social grant was increased) and extensive (a new, special COVID-19 Social Relief of Distress grant was introduced) margins, for six months from May to October 2020. The President's recent announcement also included a further extension of the availability of the COVID-19 grant, given its impressive reach (4.2 million preciously unreached individuals) in just four months (equivalent to the growth of the grants system in the last 10 years) and subsequent poverty-reducing effects.

Table 4: Covid-19 Social Relief Package, by Grant Type

Grant Type	Amount	Time Period	Coverage (Type)	Approx. Coverage (Size)	Approx. Cost
CSG	R300	May	Beneficiaries	13 million	R3.9 billion
	R500	June-October	Recipients	8 million	R20 billion
All Other Grants	R250	May-October	Beneficiaries	5 million	R7.5 billion
Covid-19 SRD Grant	R350	May-October	All Eligible Applicants*	Up to 10 million*	Up to R3.5 billion per month at 100% take-up
Totals	***R250-R500***	***May-October***		***36 million*** ***(61%)***	***R62.4 billion***

Source: NIDS (2017), GHS (2018), Department of Social Development (2020).
Notes: *: The assumptions around eligibility and take-up for the Covid grant are discussed in Bhorat, Oosthuizen & Stanwix, 2020

Given the eligibility criteria for the grant and a few assumptions pertaining to take-up, we estimate that the grant has the potential to reach up to 10 million individuals. Together, with the existing grants in the system which reach 13 million children and 8 million caregivers through the Child Support Grant and 5 million recipients through other grants, President Ramaphosa's package has the potential to provide much-needed support to about 36 million people, or 61% of the South African population.

Post-COVID-19 Debt Dynamics

In terms of fiscal policy, it is clear that non-discretionary costs are crowding out complementary inputs to service delivery and infrastructure. Currently 35% of total state expenditure is accounted for by transfer payments, 34% by the public wage bill, and 12% on debt servicing costs. This means that just 19% of the fiscus is available for goods, services, and capital spending. Ultimately this would be suggestive of a fiscal trajectory defined and driven by consumption expenditure. This fiscal stance is not amenable or feasible for any kind of crowding-in of private sector investment through increased capital expenditure. What also deserves attention is the efficiency of revenue collection, particularly in relation to the contribution of revenue shortfalls to the fiscal deficit identified above. In addition though, such improved revenue collection methods should encompass the continuum of national, provincial and local government, together with state-owned enterprises.

Additionally, in terms also of improving welfare outcomes in the society through current fiscal outlays - efficiency gains in current expenditure ought to be considered. On example will suffice: If we consider the relationship between per-pupil education spending against performance on literacy and numeracy standardized assessments by country, the data shows that South Africa's test scores are substantially lower other countries spending a similar amount on education. Put differently - the returns to education we observe are too low relative to what the country sends on human capital. There is thus substantial room available to improve the efficiency of government spending across a variety of spending areas in the fiscus.

Conclusion

Ultimately, the South African government has responded admirably in the face of a global pandemic - the likes of which the planet's population has never seen. The stimulus package has been large by global standards and the reach in terms of support to the poor and vulnerable has been impressive. However, such support has come at the expense of a massive rise in the fiscal deficit. Any further stimulus packages are likely to prove fiscally unsustainable. The challenge now - for government and policy makers - shifts to finding instruments on both the revenue collection and expenditure side to placing the country onto a measured and optimal fiscal consolidation path. Ultimately though, much more concerted efforts are required to removing the barriers to long-run economic growth, whilst also ensuring that the private sector is appropriately incentivised to both invest and create sustainable employment.