A fiscally viable stimulus package

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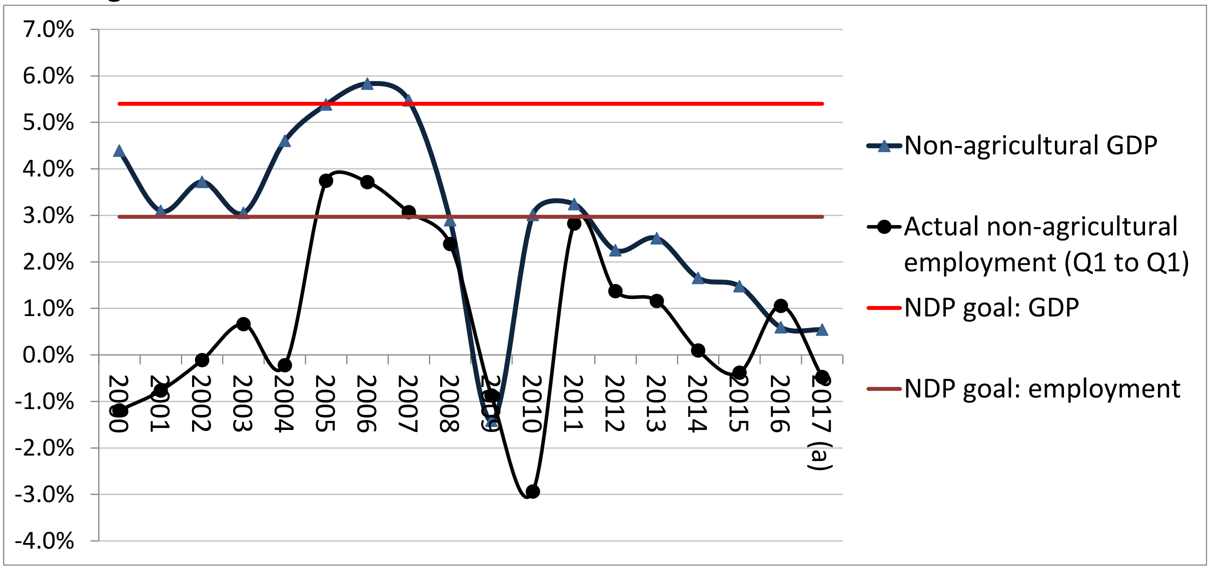
1 Problem statement

As the following graph shows, both the GDP and jobs growth have slowed substantially since the end of the commodity boom in 2011.

Graph 1. Non-agricultural GDP and employment growth, year to first quarter, compared to NDP targets



(a) Employment growth for year to third quarter 2017. *Sources:* GDP growth calculated from Statistics South Africa. GDP data in excel format. Quarterly data in constant (2010) rand. Downloaded from www.statssa.gov.za in December 2017. Employment growth from South African Reserve Bank. Interactive dataset. Indices of growth in non-agricultural employment. Downloaded from www.resbank.co.za in December 2017.

A core challenge in the slowdown is how the government can act to strengthen aggregate demand in the context of slow global growth. Normally it could increase spending, but the relatively high deficit that remains from the 2008/9 global financial crisis effectively rules that out. Given these constraints, more innovative measures to support aggregate demand have to be explored.

Stimulus measures must also include urgent support for poor and working communities affected by the slowdown. Already high unemployment means the slowdown in job creation adds to the pressure on both wage workers and the self-employed. At the same time, fiscal consolidation limits improvements in government services.

While the fiscus is constrained by the deficit, the UIF has accumulated a surplus of over R130 billion in the past 15 years. In effect, the rates set for the UIF have been excessive compared to spending, acting as a form of forced savings for workers and employers. In these circumstances, an effective stimulus package could draw on UIF resources for largescale short-term interventions focused on strengthening aggregate demand and job creation, in line with the UIF's legal mandate. These measures could be combined with efforts to strengthen state procurement from local producers rather than imports, which would strengthen the multiplier from existing state spending.

Specific measures could for instance comprise:

1. A two-year reduction in UIF contributions to near zero for employers and employees, which would both increase workers' take home pay and by extension aggregate demand, and reduce the cost of employment, providing a modest stimulus to job creation.
2. Funding of a guarantee fund at the IDC to leverage industrial finance for small and medium business.
3. Returning a share of the excess contributions to low-income workers – for instance, R200 a month to workers earning below the minimum wage for a period of two years. This would mitigate the effects on employers of the minimum wage.
4. A re-launch and rapid expansion of the Community Work Programme on its original model, which was rooted in establishment of community institutions to manage the programme.

These proposals, taken together, are estimated to reduce the UIF surplus from R138 billion in 2018 to R119 billion in 2019, with a recover to R127 billion in 2020.

In addition, the fiscal stimulus could be strengthened through more rigorous efforts to ensure local procurement where the benefits, including externalities in the form of job creation, higher investment and tax revenues, outweigh the costs. To start with, departments should be required

- to track their procurement of imports and
- to give local producers the opportunity to match the prices of imports in all procurement processes.

Local procurement would be facilitated by an open tender process for larger tenders, which would also help control corruption.

2 Jobs impact

If the stimulus package increases growth and formal non-agricultural job creation to say 1,5% in 2019 and 2020, a level last seen around 2013, then the number of jobs created would climb from virtually zero, according to Statistics South Africa's Quarterly Employment Statistics, to 150 000 in the year to March 2020.

3 Theory of change

Under the proposal on the UIF, government would work with the NEDLAC constituencies to utilise a modest reduction in the UIF surplus to increase incomes for the working poor through a two-year reduction in contributions and by repaying them a share of the surplus generated over the past 15 years; to expand community-based public employment schemes; and to increase industrial financing for small business and co-ops.

The assumptions underlying this proposal are:

- The total stimulus, at around R35 billion, would be sufficiently targeted to promote a modest improvement in growth in the GDP and employment creation, while improving conditions for low-income households;
- The transfers to households and the return to a higher level of UIF contributions could be managed without an excessive shock to households and employers, in large part because the economy should have returned to stronger growth in two years.

The proposal for local procurement holds that if government procures more goods from local suppliers, it will reduce leakages and increase the multiplier from its spending. The assumptions underlying this proposal are:

- Government procurement of imports that can be replaced with local products is sufficiently large to make a difference to economic growth and job creation, and
- Local suppliers have the capacity to produce a significant share of currently imported goods without a significant increase in the costs of procurement.

4 Existing initiatives/experience

In South Africa, the rapid growth in the UIF surplus in the past decade is a relatively recent phenomenon. The UIF's legal mandate empowers it to support employment creation. In this context, it has successfully made loans to support the infrastructure programme, but it has not yet engaged in targeted promotion of job-creating activities or determined whether the surplus could be utilised to that end.

In Brazil, the equivalent of the UIF has long been a key source of funding for the main development finance institution, BNDES. This approach is rooted in the argument that promoting employment through higher industrial finance will effectively reduce joblessness, in turn ameliorating demands for unemployment insurance. A similar rationale underpins the legal mandate to the UIF to support employment creation.

In terms of local procurement, considerable success has been achieved in localising production of infrastructure inputs. The experience points to the importance of ensuring that the external benefits are local procurement are internalised consistently in the procurement process, without playing an undue burden on the procuring agency. It also underscores the need to ensure greater transparency in procurement and to upgrade coordination across the relevant state departments. Finally, it demonstrates the importance of upgrading the capacity of supply chain management to identify potential local suppliers and manage tender specifications to support local production.

5 Constituency participation in implementation

The UIF proposal would require support from business and labour. The CWP entails community support. Local procurement by government needs support from business.

6 Benefits

Group	Job creation	Other benefits	Time frame for success
Jobless	If formal non-agricultural employment growth rises to 1,5% year, the economy would generate 150 000 additional new jobs a year (compared to net zero new jobs in 2017 according to the QES/SARB) CWP would also generate a million additional opportunities lasting up to six months each		Stimulus: 1 year CWP: 6 months
Workers	As above	Take home pay would increase for all workers based on reduced UIF contributions, with a higher increase for workers earning under R3500 a month Stimulus effect should enable higher pay increases	2 years
Employ-ers/ business	As above	Increased industrial finance for small/medium business through loan guarantee scheme Stimulus would expand business opportunities	1 year
Govern-ment	As above	Greater social cohesion	1 year
Communi ties	As above	CWP promotes community cohesion and agency	6 months

7 Cost and potential sources of funding

What social/economic groups would bear the cost of implementing the proposal directly or indirectly? Please use the following table, and do not list more than 5 groups. Please describe the costs as precisely as possible. In the case of financial costs, who would pay them?

Group	Anticipated costs	Potential sources of funding to implement the project	Time frame for impact
UIF (as an institution)	Reduction in surplus from R139 bn in 2018 to R127 bn in 2020	UIF surplus	2 years
Listed companies	UIF would reduce holdings, which could depress JSE prices – offset however by stimulus effect leading to higher overall economic growth		2 years
CWP	R4 bn for expansion to 1,5 mn	UIF surplus	Immediate
Government agencies	Admin burden of finding local suppliers and letting them match import prices	Fiscus	Immediate

8 Risks

The main risks are:

- The stimulus is too modest to compensate for the end of the commodity boom, so growth remains sluggish.
- Trade or military conflict or some other unforeseen factor disrupts the global economy, leading to a recession and countering the local stimulus.
- The UIF Board refuses to co-operate despite its legal mandate to promote job creation.
- At the end of the two-year period, workers and employers resist efforts to increase UIF contributions and phase out the return of surplus payments to low-income workers.
- Government does not implement the CWP on the original model, leading to lower than hoped for job creation.
- Government procurement of goods is too limited to stimulate growth, and/or local business cannot provide alternatives to imports at a competitive price even taking external benefits of local production into account.
- Departments are not compensated for higher cost of procurement in order to internalise benefits of local production.

9 Risk mitigation

- Ensure stimulus is targeted and review every six months to see if it is achieving the desired aims.

- Nedlac constituencies to develop framework for UIF surplus as guidance to UIF Board.
- Communicate to workers and employers that rebates will only last for two years; do not eliminate UIF payments altogether, so that database remains in place; phase programme out over at least three months to avoid shocks to households and employers.
- Presidency to oversee implementation of CWP and make it a top priority.
- Review budgeting and procurement processes to internalise benefits of local procurement into account.

10 Additional comments

None.