



**CENTRE FOR ECONOMIC
DEVELOPMENT AND
TRANSFORMATION**

**SUBMISSION FOR STIMULATING JOB CREATION IN SOUTH
AFRICA PRESENTED TO JOBS SUMMIT COLLOQUIUM**

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1. Problem Statement

South Africa has experienced sluggish economic growth - a lost decade - since the start of the global financial crisis (GFC) of 2007 to 2008. This has resulted in soaring levels and rates of unemployment. The country is now in its worst post-apartheid economic crisis. However, none of South Africa's political parties or social partners have come up with any plan or proposals to address the country's deep economic crisis in the short term. Some have proposed so-called structural reforms. But these reforms will not address the economic crisis in the short term. According to the International Monetary Fund: "Most reforms are likely to only make a small near-term contribution to the ongoing economic recovery, as it takes time for the gains to materialise." The IMF concedes that some of the reforms (those relating to the labour market) could have a short-term cost. They require complementary macroeconomic policies, including fiscal stimulus, to offset their contractionary impact. **The CEDT does not believe that any structural (or microeconomic) reforms or job creation projects will have any impact on GDP growth or employment in the short term. Therefore, this submission puts forward proposals for emergency measures to address South Africa's economic crisis in the short-term through expansionary monetary and fiscal policies.**

Between 2009 and 2017, South Africa's GDP grew by 1.6% a year. GDP per capita, the international benchmark of average living standards, grew by 0.3% a year. GDP per capita declined for three consecutive years during 2015 to 2017. As a result, GDP per capita has declined since 2013. According to Statistics South Africa's latest *Labour Force Survey*, the number of unemployed South Africans, using the more realistic expanded definition, soared by 3.6m to 9.5m in March 2018 from 5.9m in December 2008. Over the same period, the expanded unemployment rate increased to 36.7% from 28.7%. The expanded unemployment rate for black Africans is at a staggering 41%. In the Eastern Cape, the expanded unemployment rate is 46%. By comparison, 153 emerging and developing countries grew by 5.0% over the same period, according to the IMF. South Africa grew slower than all developing country regions. Their growth rates were: emerging and developing Asia (7.3%); Sub-Saharan Africa (4.2%); Emerging and Developing Europe (3.7%); Middle East, North Africa, Afghanistan and Pakistan (3.5%) and Latin America and the Caribbean (1.8%).

Therefore, South Africa's economic crisis has little to do with the global economy, which grew by 3.4% a year between 2009 and 2017. In the wake of the GFC, most developing countries implemented expansionary monetary and fiscal policies to counter the collapse of foreign demand from (or exports to) advanced economies, which contracted by 3.4% in 2009. For example, China announced a \$586bn fiscal stimulus on 9 November 2008, only two months after the collapse of Lehman Brothers. During 2009, new loans by state-owned banks doubled to \$1,4 trillion after they were ordered to back as many infrastructure projects as they could, according to the *Financial Times*. "China's rebound from the global crisis has been based on a massive stimulus programme. If new bank loans above what might be expected in a normal year are included, the fiscal stimulus was as large as 15% of GDP," the paper said.

However, In South Africa, the Reserve Bank increased its repo rate by 500 basis points to 12% between June 2006 and June 2008. While virtually every central bank in the world cut key policy rates in the wake of the GFC, half of rate increases (250 basis points) took place after the start of the crisis in June 2007. GDP dropped by 1.5% in 2009. Between December 2008 and March 2010, the economy shed almost one million jobs as employment fell to 13.8m from 14.8m. By comparison, 153 emerging and developing countries grew by 2.9% in 2009, according to the IMF. The Reserve Bank cut its repo rate by 700 basis points between December 2008 and July 2012. There was a modest recovery as the economy grew by an annual average of 2.8% between 2010 and 2013. However, tighter monetary and fiscal policies since the beginning of 2014 contributed to a slowdown in GDP growth to an annual average of 1.3% between 2014 and 2017. At the start of 2014, the bank started a new cycle of monetary policy tightening. This coincided with the implementation of austerity by National Treasury. Therefore, macroeconomic policy, including the mismanagement of monetary policy before and after start of the GFC, has been the major impediment to job creation.

2. Jobs Impact

This submission puts forward a package of emergency measures to get the economy growing again by implementing expansionary monetary and fiscal policies. It is difficult to model the impact of a cut in interest rates. At the end of 2017, the banking sector had extended credit of R3.5 trillion to the private sector, including households. A bold two percent cut in interest rates to kick-start the economy would provide relief of R70 billion, a portion of which could support consumption spending. The proposed R500 billion fiscal stimulus to be spent on infrastructure is equivalent to about R166 billion (about 3% of GDP) a year. According to National Treasury, the fiscal multiplier for constructing spending is 1.9 times, the highest of any sector of the economy. Therefore, additional expenditure of R166 billion on infrastructure could increase output by R315 billion and contribute towards job creation.

3. Theory of Change

This submission makes three proposals to kick-start the economy through expansionary monetary and fiscal policies.

Firstly, South Africa should suspend the inflation target and instruct the Reserve Bank to prioritise economic growth until the country has an acceptable rate of economic growth and job creation. During this period, we should work on changing the mandate of the Reserve Bank to also include growth and employment. (In March 2010, former finance minister Pravin Gordhan issued a similar instruction to former Reserve Bank governor Gill Marcus).

Secondly, South Africa should end its austerity policies and implement a R500 billion fiscal stimulus (or helicopter drop) over three years, funded equally by the government and the private sector led by the banking and life offices associations. At the end of March 2018, South Africa had gross loan debt of R2.5 trillion (52.7% of GDP) and net loan debt of R2.2 trillion (46.8% of GDP). according to the Reserve Bank. This is not high by international standards. Debt in advanced economies was 105% of GDP on average in 2016, according to the IMF. The figure for emerging and developing countries was 50%. There is fiscal space for expansionary policies. However, the proposal is structured to minimise the impact on national debt. There can be a fiscal expansion that is deficit neutral.

Thirdly, South Africa should have a once-off restructuring of its balance sheet. At the end of December 2017, the PIC had assets of about R2.1 trillion, according to the Reserve Bank. At the same time, net government debt was about R2.2 trillion. The level of funding in the PIC is obscene in a country with such high levels of poverty. This submission cannot go into a detailed analysis about the funding of public sector pensions. However, we can make two points. Firstly, the GEPF is a defined benefit (DB) fund. This means that its assets belong to the government and not the workers. The workers do not benefit or make losses if the value of the assets in the PIC (the GEPF's asset manager) increase or decrease. The GEPF is the government's means of financing its obligations to public sector employees.

As former finance minister Trevor Manuel has said: "Given that the GEPF is a defined benefit fund, it would be inappropriate to consider any returns accruing from such investments to be benefiting the beneficiaries. This is simply because the pension benefits are predetermined. In that regard, such investments are essential to the extent that the returns ensure that the employer is able to meet its obligations to its employees (who are the beneficiaries)." Secondly, the majority of government employee pension funds in developed countries are either unfunded - they operate on a pay-as-you-go (PAYG) basis - or partially funded, according to the Organisation for Economic Development and Cooperation (OECD).

The PIC's assets of R2.2 trillion at the end of December 2017, included: shares (R1.1 billion); government bonds (R451.8 billion); state-owned companies (SOC) debt (R187.5 billion); and cash (R95.3 billion). In March 2016, the GEPF had a funding level of 116% compared with a target set by the fund's trustees of 90%. During the year to end December 2017, it had income of R137.9 billion. This included contributions of R65.6 billion and investment income of R72.1 billion. The GEPF paid benefits of R90.7 billion. There are a number of options for restructuring the national balance sheet. A radical option could see the PIC writing off government and SOC debt (R640 billion) and releasing R250 billion to fund the state portion of the fiscal stimulus. Gross and net loan debt would drop to 48.6% and 41.9% of GDP respectively.

Less bold options could include: only writing of SOC debt and funding the stimulus; and only releasing the stimulus funds. Since investment income accounts for 80% of benefits, the GEPF could also have a contribution holiday for the employer and employees. Using 2017, figures and assuming a 65:35 ratio between employer and employee contributions, the government would save R42.6bn to partially fund its portion of the fiscal stimulus. Employees would save about R23bn, which would be equivalent to a tax cut that boosts consumption. A social compact would result in the private sector also committing R250bn over three years from financial institutions, members of the banking and life offices associations. They could

develop unique financial products - for example, infrastructure bonds with delayed payment terms to minimise the short-term impact on the fiscus.

4. Existing Initiatives/ Experience

South Africa's fiscal policies have been in austerity mode for most of the past 24 years. Real interest rates have been very high for most of the same period - an average of 9% until the start of the GFC. However, expansionary monetary and fiscal policies after 2003 contributed towards rapid economic growth and job creation. The repo rate dropped by 650 basis points to a low of 7% in April 2005 from a high of 13.5% in June 2003. This stimulated an economic recovery that was initially led by consumption spending. Government spending added impetus to the recovery. National Treasury's 2008 *Budget Review* said: "Consolidated government spending has increased by an average of 10 per cent in real terms over the past four years, allowing government to significantly grow expenditure on social services, increase transfers to households and accelerate infrastructure investment." There were double-digit increases in gross fixed capital formation (GFCF) between 2003 and 2008 as the government and state-owned companies (SOCs) made up for years of under-investment. As a result, GFCF increased to 23.5% of GDP in 2008 from 16% in 2003. Between 2004 and 2008, the economy grew by an annual average of 4.8%. GDP per capita grew by an annual average of 3.2%. As a result, 1.9m jobs were created between September 2003 and September 2008.

5. Constituency Participation in implementation

There are concerns about the capacity of the state to implement the fiscal stimulus within the shortest timeframe. Social partners at the National Economic Development and Labour Council (Nedlac) could set up a temporary agency (a public private partnership) to manage the process, decide on shovel-ready projects and award projects. Government entities (national, provincial and local) and the private sector could bid for projects. A similar process was implemented to build world cup stadiums.

6. Benefits

The proposal would initially benefit consumption spending due to interest rate cuts. The fiscal stimulus would benefit infrastructure sectors and stimulate job creation. Through multiplier effects, the benefits of additional consumption and infrastructure expenditure would extend to other sectors of the economy

7. Costs and Potential Sources of Funding

Group	Anticipated costs	Potential sources of funding to implement the project	Time frame for impact
Government	R250 billion over three years	Restructuring of the PIC and GEPF and/or increased levels of borrowing	One year
Private Sector	R250 billion over three years	Financial Institutions	One year

8. Risks

The major risks relate to the capacity of the state to implement the fiscal stimulus. There could be concerns about the impact of the fiscal stimulus on national debt

9. Risk Mitigation

Social partners could start a temporary agency to implement the fiscal stimulus. As outlined above, there are various ways of minimising the short-term impact on national debt. A social compact between Nedlac stakeholders - and local and international roadshows - would allay concerns about the fiscal stimulus.

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