# Fiscal Policy and the Coronavirus Crisis

PRESIDENCY WORKSHOP

16 April 2020

**MICHAEL SACHS**

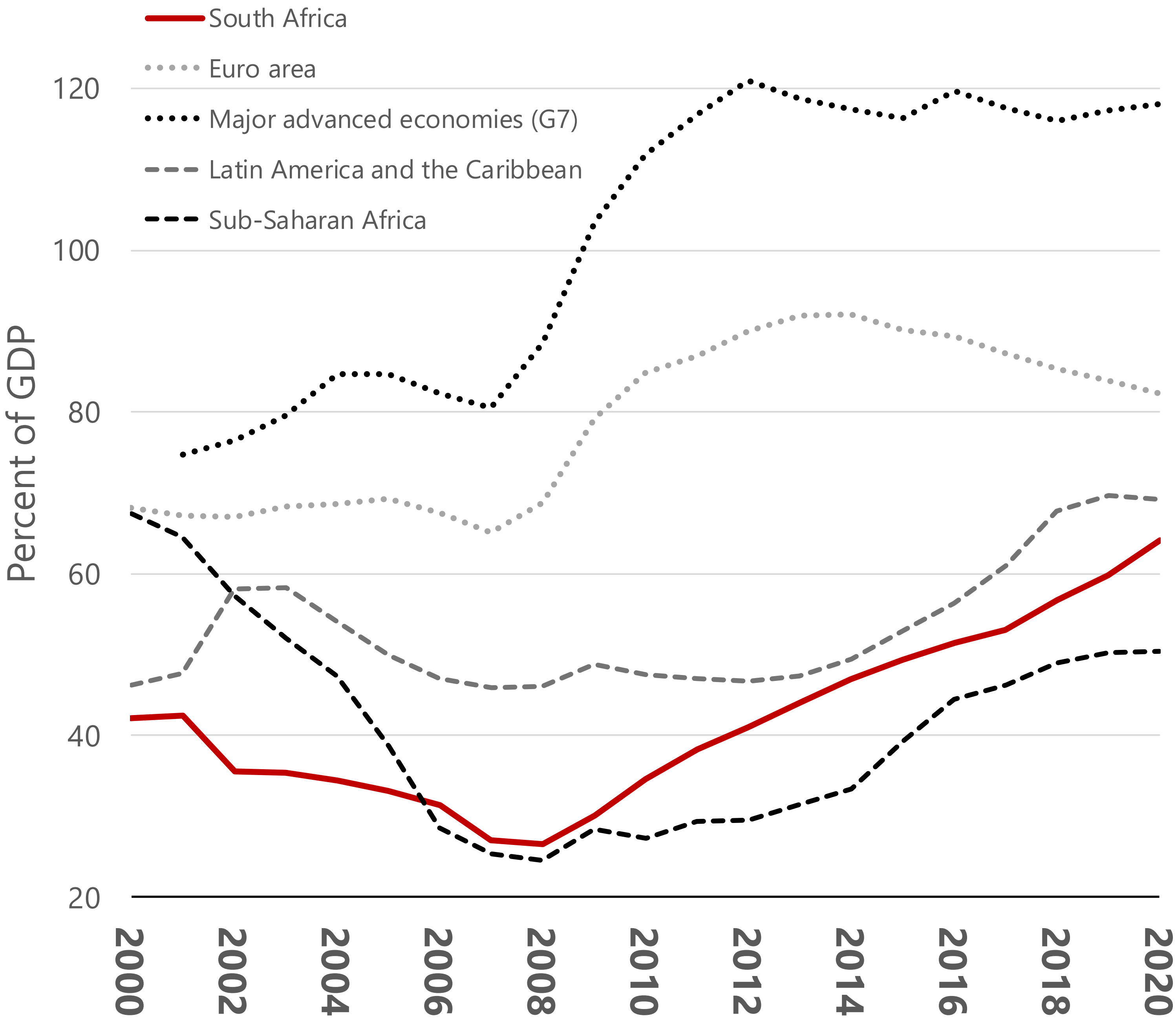
SOUTHERN CENTRE FOR INEQUALITY STUDIES

Adjunct Professor | Southern Centre for Inequality Studies
Faculty of Commerce, Law and Management
University of the Witwatersrand | Johannesburg
michael.sachs@wits.ac.za

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

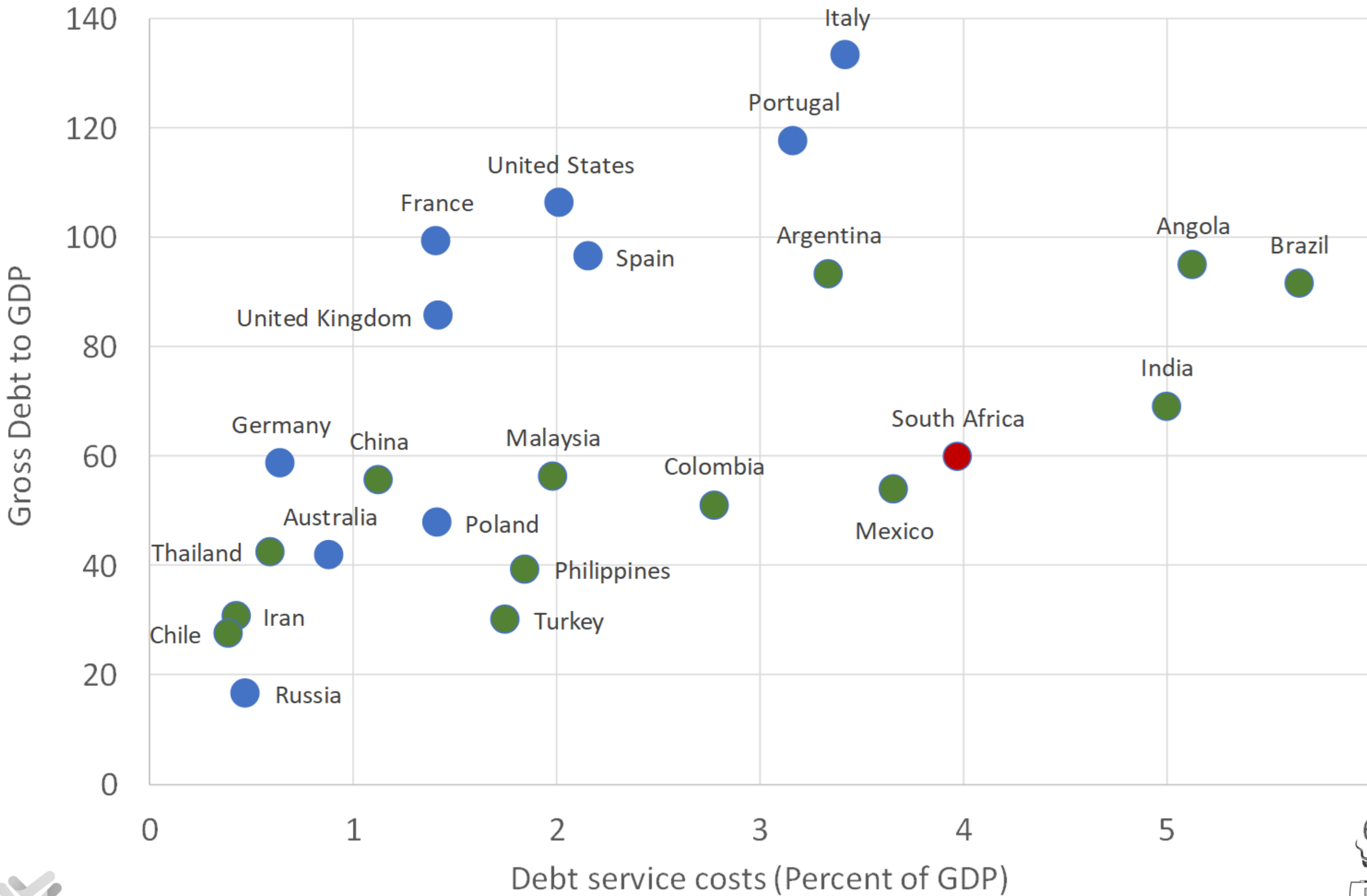
# Debt before coronavirus: Level vs Path





# Debt burden






*Source Data: Authors calculations based IMF fiscal monitor database*

# Factor related to sovereign borrowing



- It is not clear how South Africa will finance the budget deficit this year
- Before coronavirus South Africa's debt trajectory was unsustainable
- Government had no clear plan to close the deficit
- Most countries face a once-off debt shock
- South Africa faces a rapid acceleration of debt trajectory
- Advanced economies will come out with $r<g$
- There is very little chance of South Africa achieving $r<g$
- The burden of debt service will grow substantially and quickly
- South Africa will face debt distress in the years (and maybe months) ahead

# **Fiscal Response:** imperatives



- **Fight the virus**
  - Public health system
  - Public finance for private health providers
- **Relieve social distress**
  - Existing social grants: broad, rapid, simple
  - Special grant for informal workers?
- **Backstop wages**
  - Public "payroll of last resort"
  - Employed workforce
  - Unemployed workforce of insolvent firms
  - Public sector wages
- **Underwriting credit extension**
  - Solvent but illiquid firms
  - Insolvent firms

## **Initial fiscal response:** Design issues



- Initial response
  - Execute with speed
  - Scale over targeting
  - Then plan for the long haul
- Temporary
  - Unwinding monetary positions
  - Reversibility of fiscal positions
  - Delayed downward adjustment
- Quarantined finance for effective post-crisis resolution
  - Separate budget presentation
  - Separate funding strategy attached to budget

# **Initial fiscal response:** Package



<table>
<tr><th>Intervention</th><th>Resources</th><th>Funding</th><th>Agent</th><th>Constraints</th></tr>
<tr><td>Health response</td><td>R10 billion?<br>over 6 - 12 months</td><td rowspan="2">Multilateral development banks<br>Bilateral (e.g. China)<br>Budget redirection<br>Solidarity levy<br>Solidarity bond</td><td>Health sector<br>(public and private)</td><td>No financial constraint<br>Human resources<br>Organisational systems (especially procurement)</td></tr>
<tr><td>Social grants top-up</td><td>R60 billion<br>over 6 months</td><td>SASSA</td><td>Financing</td></tr>
<tr><td>Wage support</td><td>R100 billion<br>over 12 months</td><td>UIF<br>SDL/SETAs</td><td>SARS</td><td>Nedlac Constituencies<br>UIF administrative capability</td></tr>
<tr><td>Credit guarantee scheme</td><td>R200 billion (guarantee)</td><td>Contingent liability<br>R20 billion at risk over five years</td><td>SARB</td><td>Banks and risk sharing arrangements</td></tr>
</table>

# **Financing (1):** Budgets and revenues



- **Temporary budget reallocation**
  - Skills development levy
  - Capital grants (housing, municipal and provincial infrastructure)
  - Postponement of capital projects and other asset-forming spending till next year
  - Draw down on surpluses across consolidated government (Public entities, universities …)
  - Discuss contribution holidays (GEPF, GEMS, housing allowance)
- **Taxation**
  - **Solidarity levy**
  - Temporary and small
  - Surcharge on the back of an existing tax instrument
  - Target the most affluent
  - Ringfenced in Covid response

# **Financing (2):** Maintaining public access to borrowing



- Keeping bond markets open and liquid
- Nurturing and negotiating with the domestic asset base
- Avoid disorderly capital flight and domestic asset price collapses
- Build on SARB credibility to manage long term rates?
- Macro-prudential measures and capital account regulation (need for a responsible agenda)
- Risk benchmarks: short and foreign?
- Using cash balances (including sterilization deposits)
- Official foreign creditors essential
- **Solidarity bond** (concessionary instrument)

# Policy objectives during the lockdown



1. **Stabilize** income flows to prevent consumption shock
   - Circular flow of income
   - Decoupling the allocation for income from the production of output

2. “Bridging finance” to **protect** firms and households from bankruptcy and hunger
   - Uncertainty: inability to  locate on the spectrum from liquidity from solvency
   - Taking liabilities onto the public balance sheet in the expectation that these liabilities will be unwound at a future date.

3. “Breathing space” for **adjustment** to lower income
   - Flattening the income shock
   - Especially the consumption shock to the poorest
   - Which implies wage payments

4. **Distribute** the burden of adjustment equitably
   - Bottom 50% are already living below acceptable consumption levels
   - Top 10% are going to be flush with cash during the lockdown (some of this must be swept into the fiscus)

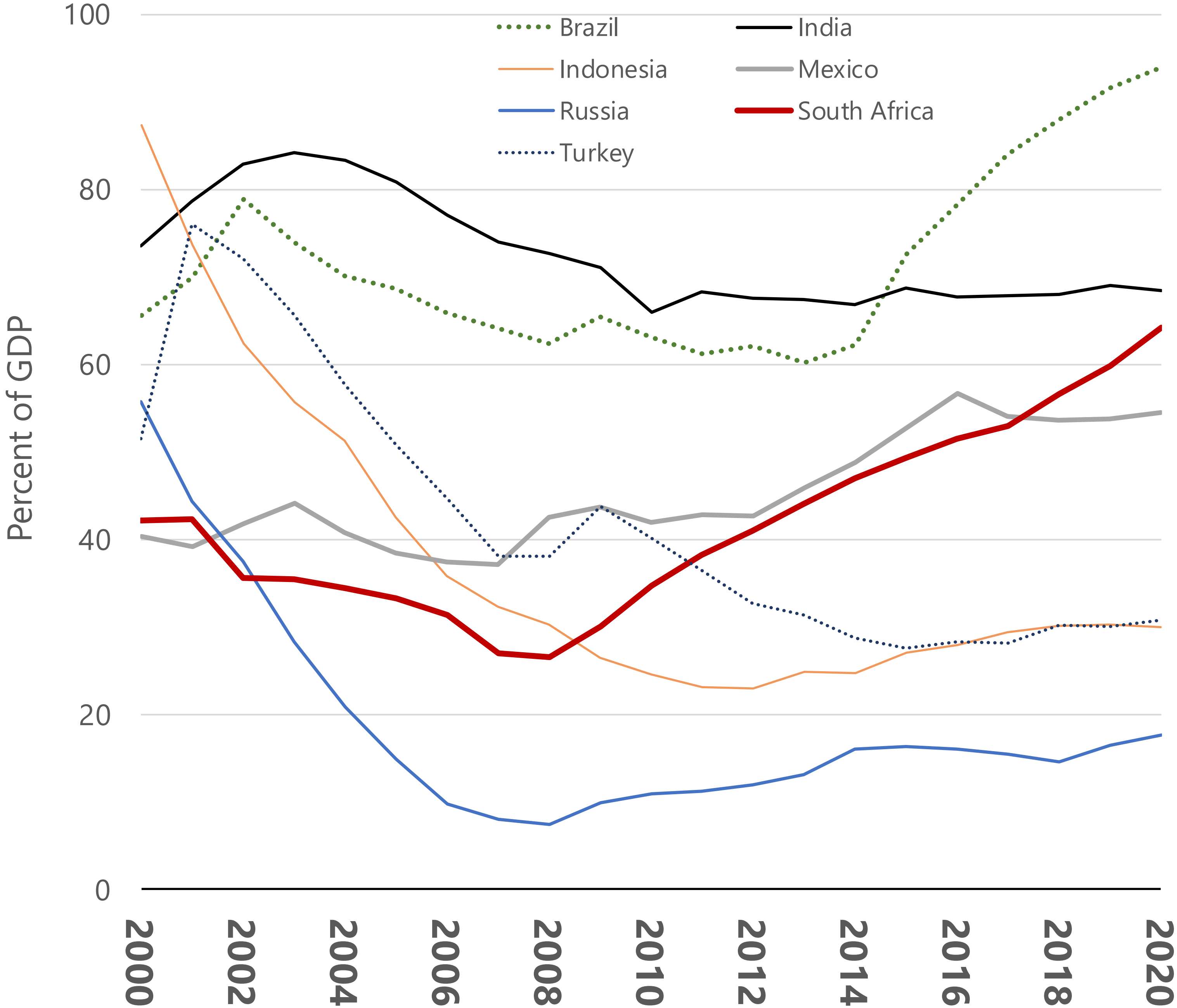
# Macro policy in an extra-ordinary crisis



- Normally macroeconomic intervention is about:
  - Fluctuations
  - Offset output gap
  - Dampen multiplier effects
  - Prevent *hysteresis*
- Coronavirus crisis implies a "normal" (but extreme) external shock (export prices and capital account crunch)
- Plus unique shock - a discretionary choice to:
  - Reduce potential output Restrain aggregate demand
  - No output gap, no stimulus
- Shape of the shock: Vs and Ls:
  - Both "shocks" will extend over a 5 – 18 months in various forms
  - Change the behaviour of economic agents
  - Economic structures will have changed fundamentally after the shock
  - Mega-hysteresis risk
- Requires an extra-ordinary policy response

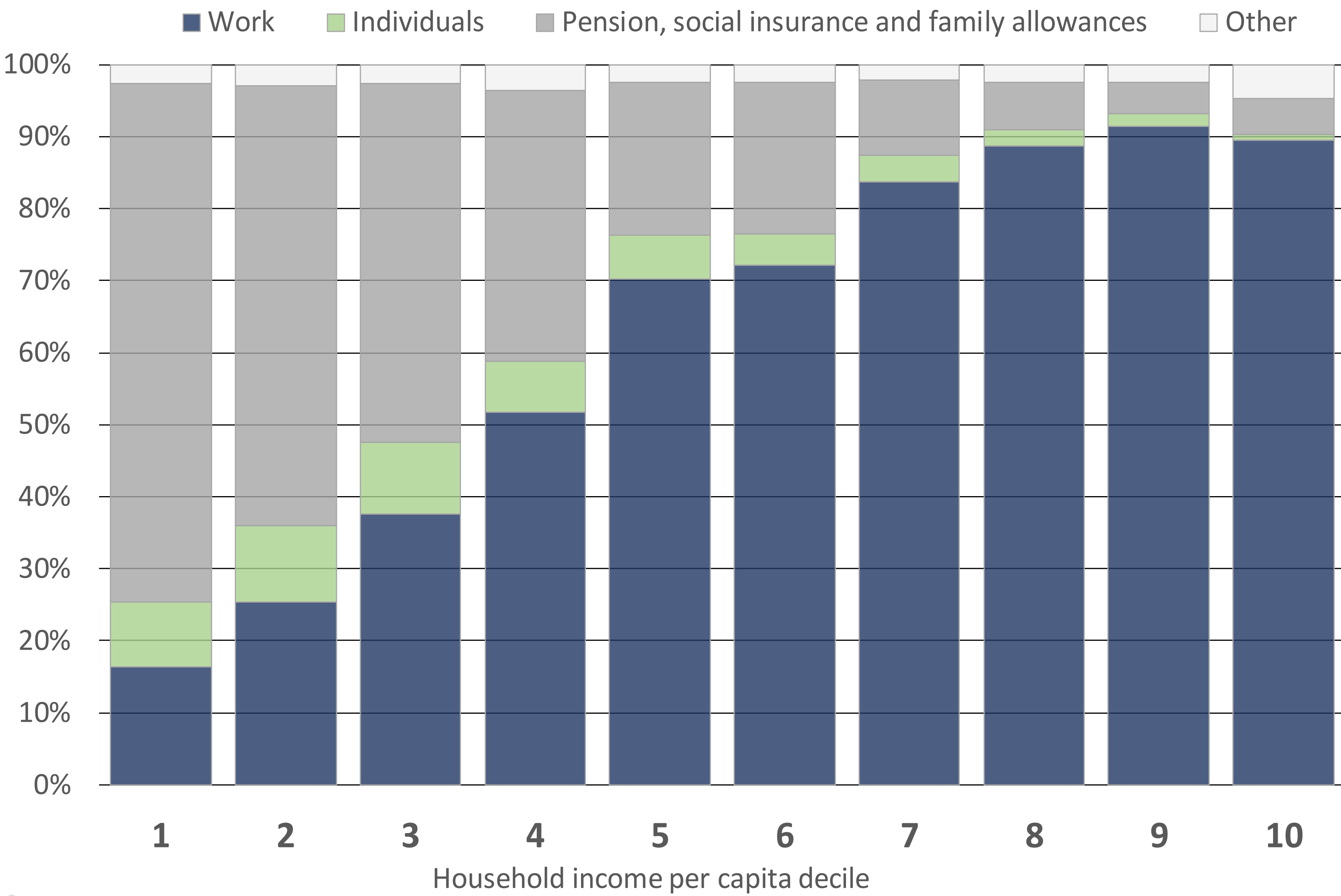
# Debt before coronavirus (2)





# Source of cash income





# Solidarity and the distribution of wealth



Table 9: The distribution of personal wealth in South Africa in 2017

| | Number of adults | Wealth threshold | Average (2018 R) | Average (2018 PPP $) | Wealth Share |
|---|---|---|---|---|---|
| Full population | 35,400,000 | | R 326,000 | $ 52,200 | 100% |
| Bottom 90% (p0p90) | 31,860,000 | | R 94,100 | $ 15,100 | 14.4% |
| Bottom 50% (p0p50) | 17,700,000 | | R -16,000 | $ -2,600 | -2.5% |
| Middle 40% (p50p90) | 14,160,000 | R 27,700 | R 138,000 | $ 22,000 | 16.9% |
| Top 10% (p90p100) | 3,540,000 | R 496,000 | R 2,790,000 | $ 447,000 | 85.6% |
| Top 1% (p99p100) | 354,000 | R 3,820,000 | R 17,830,000 | $ 2,860,000 | 54.7% |
| Top 0.1% (p99.9p100) | 35,400 | R 30,350,000 | R 96,970,000 | $ 15,540,000 | 29.8% |
| Top 0.01% (p99.99p100) | 3,540 | R 146,890,000 | R 486,200,000 | $ 77,920,000 | 14.9% |

Notes: The table shows the distribution of household wealth in South Africa in 2017. The unit of observation is the individual adult aged 20 or above. Wealth thresholds are in 2018 Rands.
Source: authors' computations based on data.

Table 10: Share of total assets held by wealth group by asset class, 2017

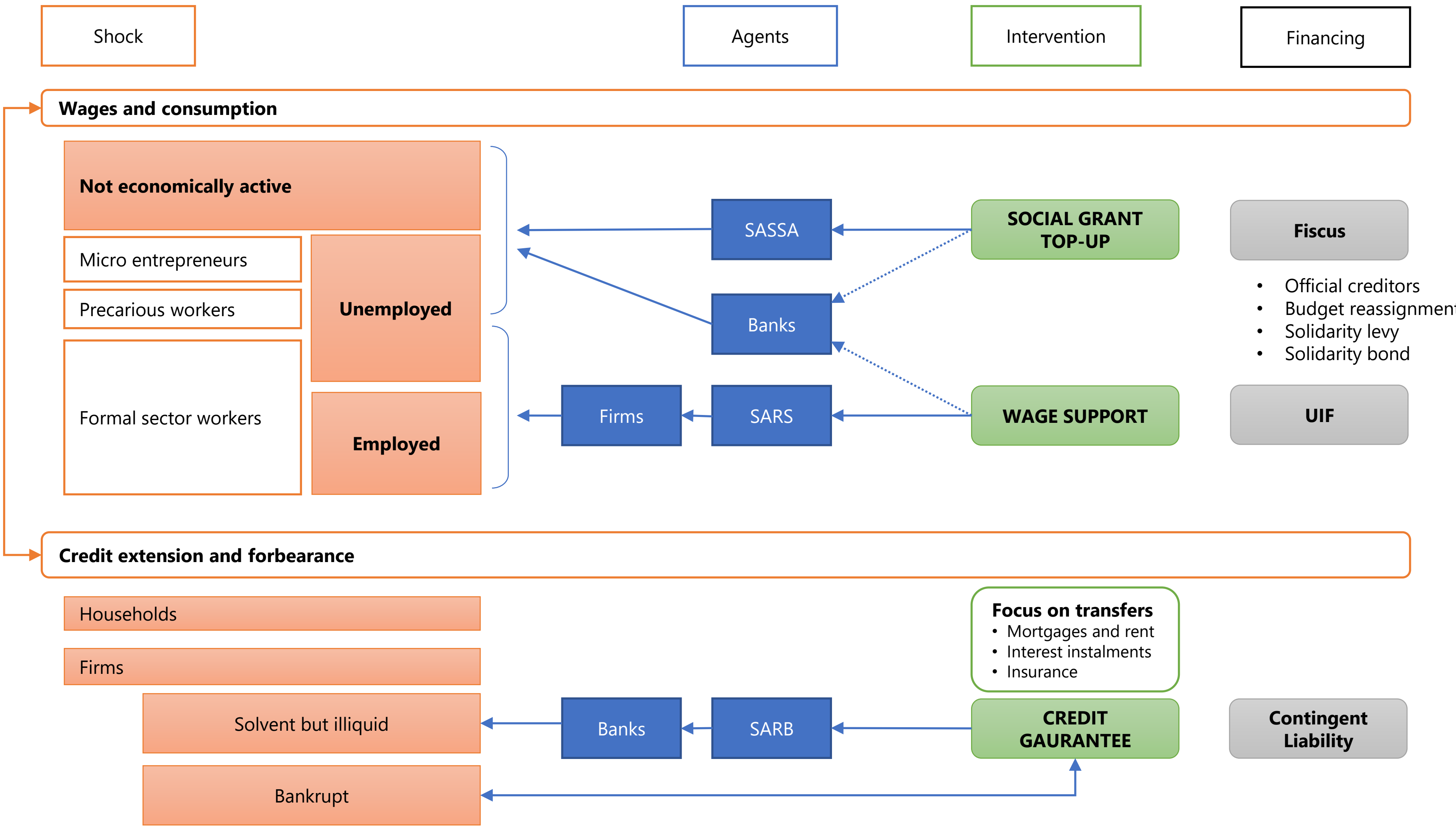
| | Currency | Business assets | Housing | Pensions / life insurance | Bonds & Stock |
|---|---|---|---|---|---|
| Bottom 90% (p0p90) | 37.3% | 40.4% | 41.2% | 36.2% | 0.2% |
| Bottom 50% (p0p50) | 9.7% | 1.4% | 14.0% | 5.3% | 0.0% |
| Middle 40% (p50p90) | 27.7% | 39.1% | 27.2% | 30.9% | 0.2% |
| Top 10% (p90p100) | 62.7% | 59.6% | 58.8% | 63.8% | 99.8% |
| Top 1% (p99p100) | 10.6% | 41.9% | 27.8% | 14.1% | 95.2% |
| Top 0.01% (p99.99p100) | 1.5% | 13.4% | 8.5% | 2.1% | 62.7% |
| % of total assets | 0.6% | 3.6% | 28.8% | 32.5% | 34.6% |

Notes: The table shows the shares of different types of assets held by specific wealth groups in 2017. The unit of observation is the individual adult aged 20 or above. In 2017, the top 1 per cent of South Africans in terms of net worth owned 95 per cent of the bonds and corporate shares in the economy. Bonds and shares represented 34.1 per cent of total household assets in the economy at this date. Figures may not add up due to rounding.
Source: authors' computations based on data.

*Source: Chatterjee, Czajka and Gethin (Forthcoming)*

# **Initial fiscal response:** Policy framework






*Source: Adapted from Van den Heever (2020)*