Fiscal policy in the Coronavirus Crisis

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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

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)

Source of cash income

Work
Individuals
Pension, social insurance and family allowances
Other

100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%

1 2 3 4 5 6 7 8 9 10

Household income per capita decile

Factors 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

Debt before coronavirus: Level vs Path

South Africa
Euro area
Major advanced economies (G7)
Latin America and the Caribbean
Sub-Saharan Africa

Percent of GDP

120
100
80
60
40
20

2000 2002 2004 2006 2008 2010 2012 2014 2016 2018 2020

Debt burden

Gross Debt to GDP

140
120
100
80
60
40
20
0

Italy
Portugal
United States
France
Spain
Argentina
Angola
Brazil
United Kingdom
India
South Africa
Germany
China
Malaysia
Colombia
Mexico
Australia
Poland
Thailand
Philippines
Iran
Chile
Turkey
Russia

0
1
2
3
4
5
6

Debt service costs (Percent of GDP)

Source Data: Authors calculations based IMF fiscal monitor database

Fiscal Response: imperatives

1. **Fight the virus**
   - Public health system
   - Public finance for private health providers
2. **Relieve social distress**
   - Existing social grants: broad, rapid, simple
   - Special grant for informal workers?
3. **Backstop wages**
   - Public “payroll of last resort”
   - Employed workforce
   - Unemployed workforce of insolvent firms
   - Public sector wages
4. **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

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

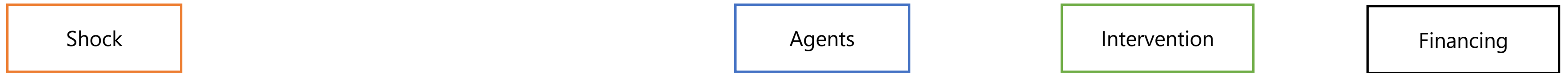
Financing (1): Budgets and revenues

- **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)

Initial fiscal response: Policy framework



Wages and consumption

Not economically active

Micro entrepreneurs

Precarious workers

Formal sector workers

Unemployed

Employed

SASSA

Banks

Firms

SARS

SOCIAL GRANT TOP-UP

WAGE SUPPORT

Fiscus

- Official creditors
- Budget reassignment
- Solidarity levy
- Solidarity bond

UIF

Credit extension and forbearance

Households

Firms

Solvent but illiquid

Bankrupt

Banks

SARB

Focus on transfers
- Mortgages and rent
- Interest instalments
- Insurance

CREDIT GAURANTEE

Contingent Liability

Source: Adapted from Van den Heever (2020)

Thank you