Key Challenges in Ensuring Economic Development
8 June 2021

Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

The Parliamentary Budget Office

- The Parliamentary Budget Office (PBO) was established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act no. 9 of 2009)
- The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills
- The PBO supports the implementation of the Act by undertaking research and analysis for the finance and appropriations committees
- This presentation focuses on providing the Committee with the context and analysis in relation to economic growth-
  - the role of Government in promoting economic growth
  - recent international rethinking of the role of the state in economy

Outline

- Introduction
- Human Development Indicators
- Economic restructuring and industrial transformation
- Prerequisites for growth and development
- Changing views on the role government
- Conclusion

Introduction

- Two aspects of economic development that act as important constraints to well-being and ultimately the ability of the economy to achieve sustainable economic growth are discussed:
  - Human development
  - Economic development and the need for industrial structural transformation
- These aspects of economic development are interrelated because human and industrial development impact on one another through employment and income
- The ability of an economy to create adequate levels of employment and income will affect levels of poverty and human development
- Food and energy security and infrastructure are also discussed as they are crucial for human and economic development
- The adequacy and quality of food, energy and infrastructure affect the quality of life and productive capacity of the economy
- Overall, we find that there are large constraints on economic development and growth due to the inadequacy of human development, economic and industrial transformation and food and energy security and infrastructure

Introduction

- The context for this discussion is that evidence shows that inequality is negatively correlated with growth and development
- The Washington Consensus forged during the 1980s advocated economic and financial liberalization, a larger role for the market and smaller role for the state
- However, the outcome of this approach has been large increases in inequality within and between countries, financial instability and crises, growing unemployment and a climate crisis
- There is also concern about the rise of network industries, data collection and privacy as well as global market dominance of a few corporations. These problems raise important questions about the capacity of individual states and the need for more international coordination
- There is an emerging consensus that these problems cannot be solved without a much larger role for the state and some reversal of the widespread economic and financial deregulation that occurred since the 1980s
- The measures taken by the state to address poverty and inequality and redressing historic injustices will affect human and economic development
- Expenditure on state social support and infrastructure investment is necessary for economic and industrial development and will affect the size and performance of the economy
- In turn, the size and performance of the economy affects the well-being and capabilities available for increased productivity and economic growth

Human Development indicators (HDI)

Long and healthy life

Access to education

Poverty levels

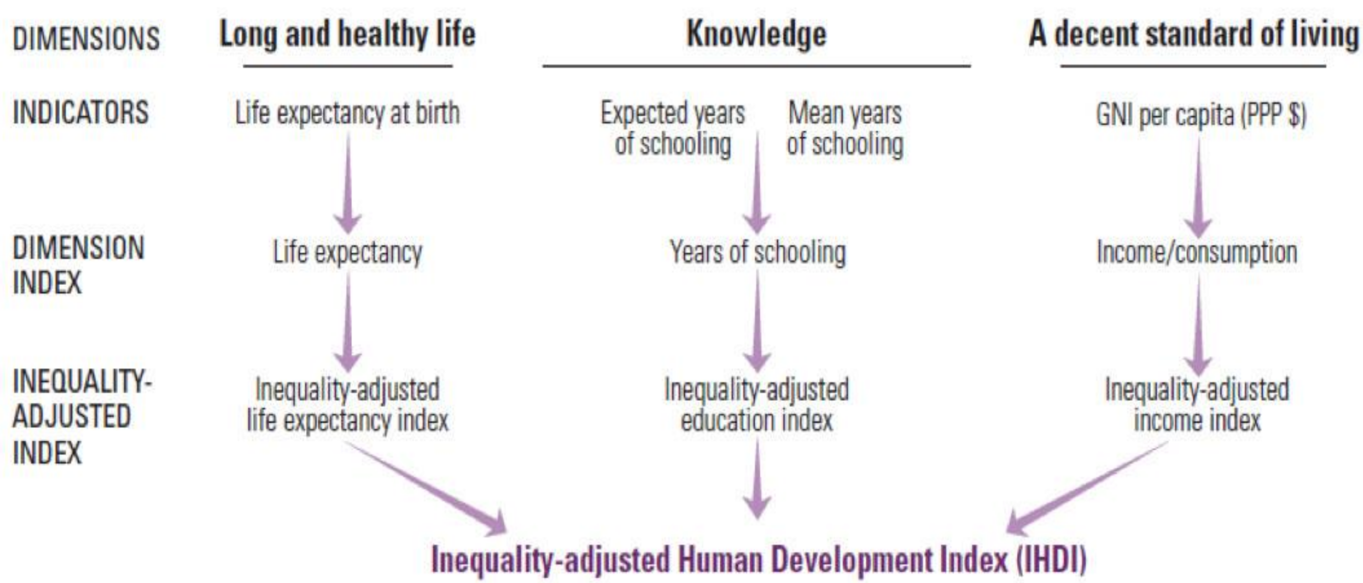
Inequality level

Basic Services delivery

Standard of Living

The Human Development Index (HDI)

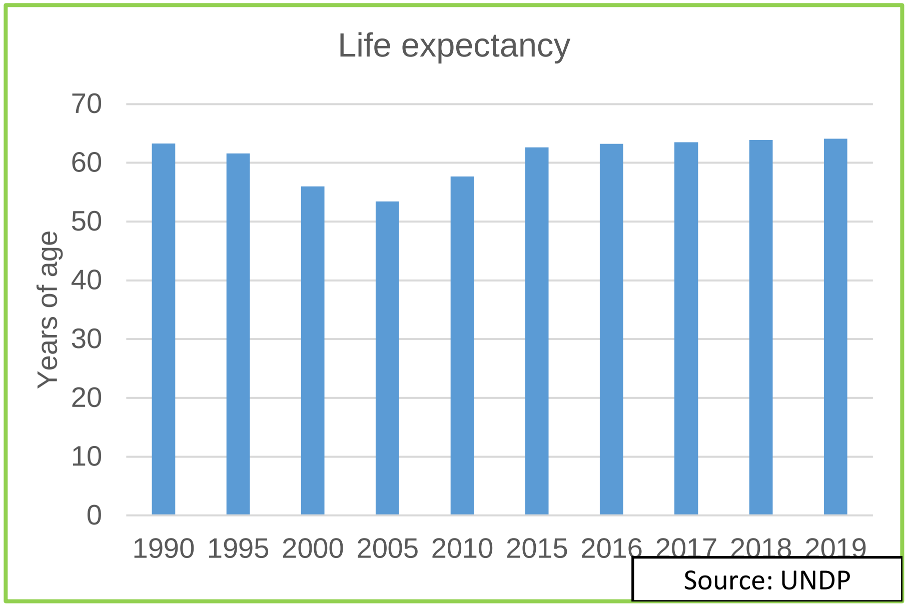
Inequality-adjusted Human Development Index (IHDI)

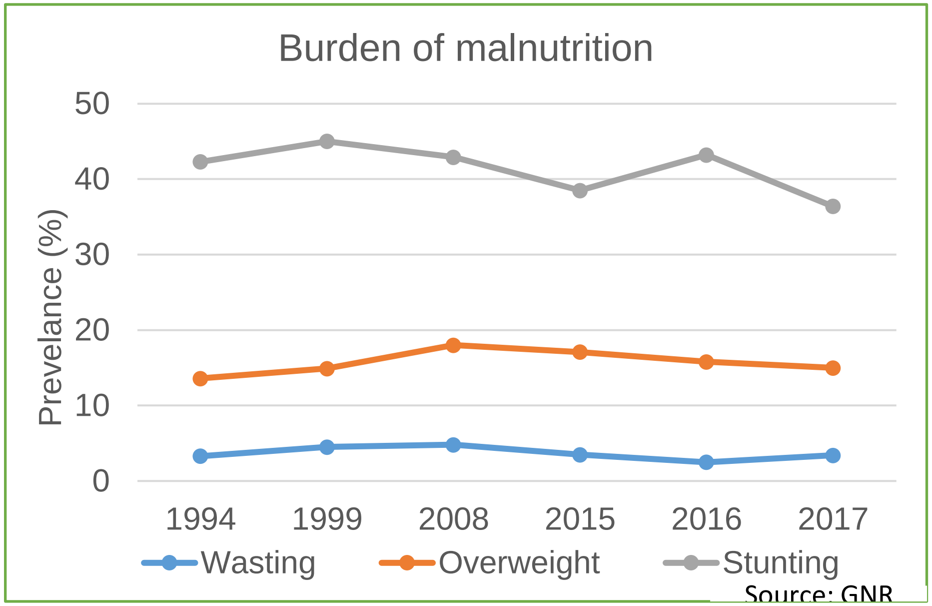


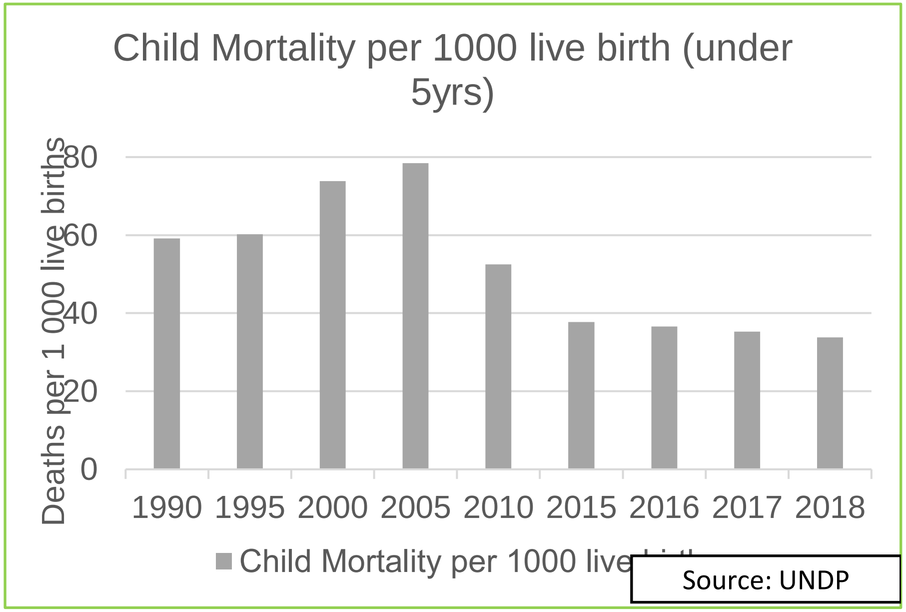
As of 2019

- South Africa’s HDI was 0.709
- The IHDI was 0.468
- SA HDI was ranked 114 out of 189 countries
- Between 1990 and 2019:
  - South Africa’s HDI value increased from 0.627 to 0.709
  - Life expectancy at birth increased from 63,3 to 64,1 years
  - Expected years of schooling increased from 11,4 to 13,4
  - Mean years of schooling increased from 6,5 to 10,2
  - GNI per capita (2017 PPP$) increased $9,975 to $12,129

Long and healthy life



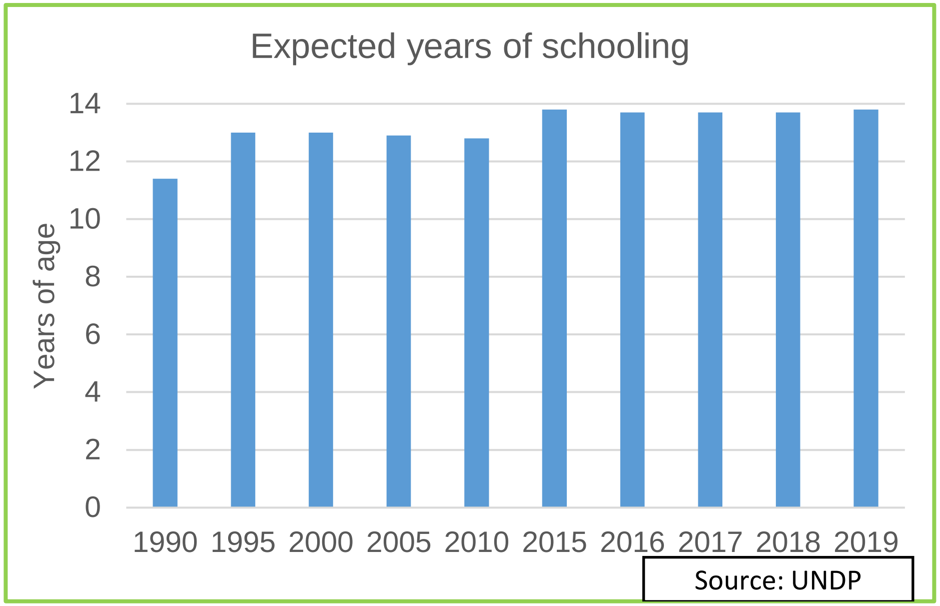


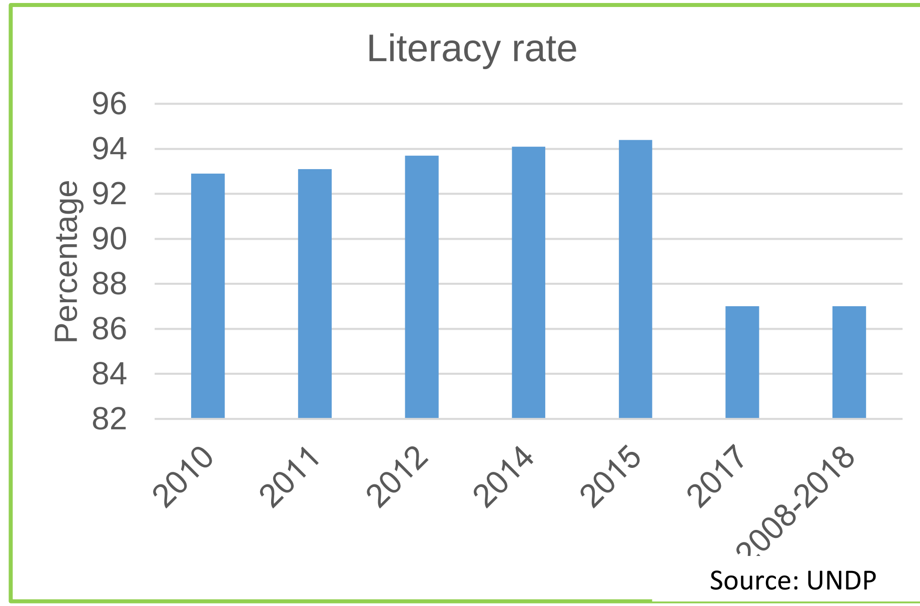


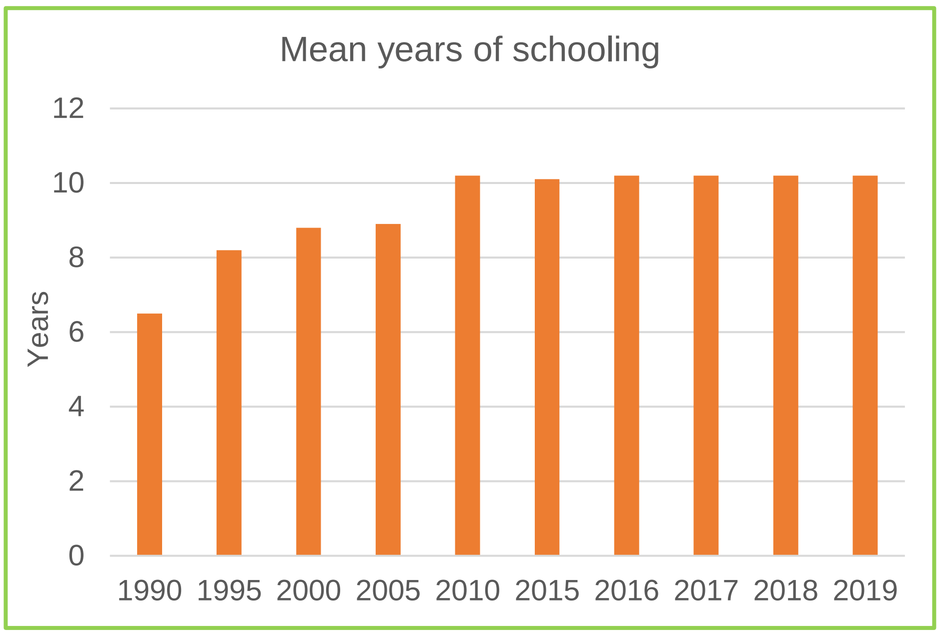
Health indicators between 1990 - 2019

- Child mortality rate, under five declined from 59,2 to 33,8 per 1 000 live births
- Burden of malnutrition 1994 - 2017
  - Stunting rate improved to 21,4%
  - Wasting rate worsened to 3,4%
  - Overweight worsened to 11,5%

Access to education

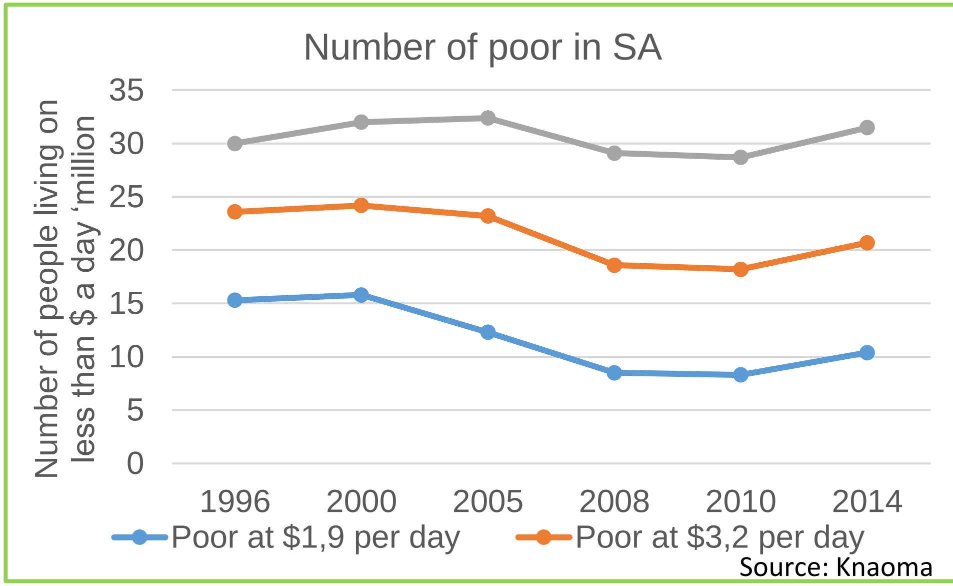


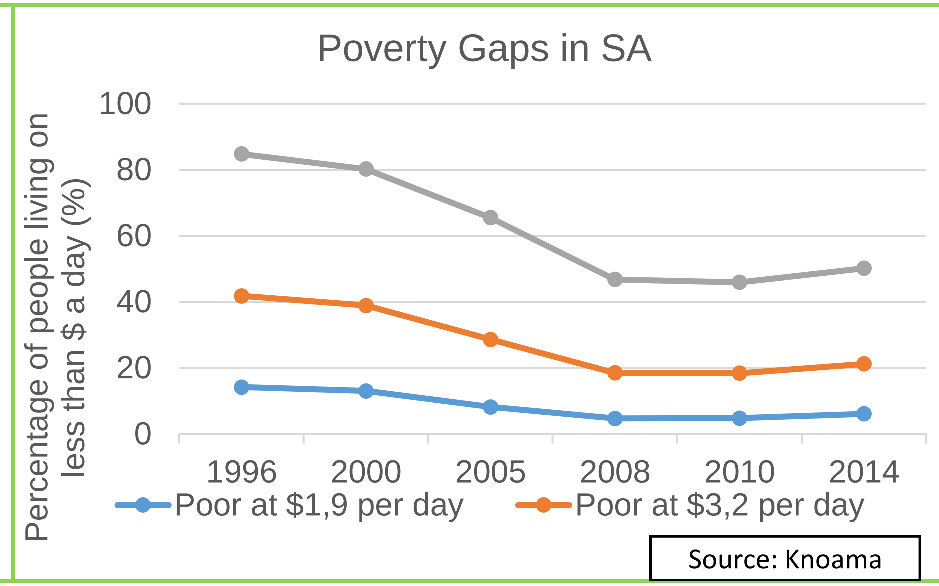


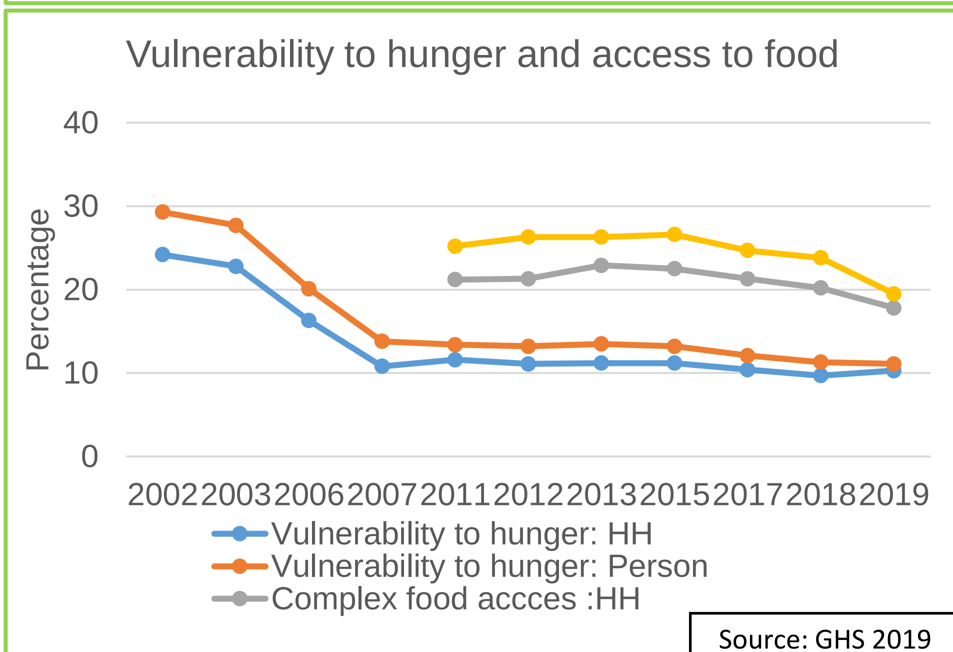


- Like many countries, SA set targets for each of the 17 SDGs. Goal 4 (SDG4) deals with quality educn
- South Africa has made large strides in education. E.g., participation among five-year-olds increased from about 40% in 2002 to 85% in 2018
- However, the education system faces large challenges
- In February 2020, an Amnesty International report concluded that SA's education system is characterized by crumbling; Infrastructure, overcrowded classrooms and relatively poor educational outcomes that perpetuate inequality.

Poverty levels in SA

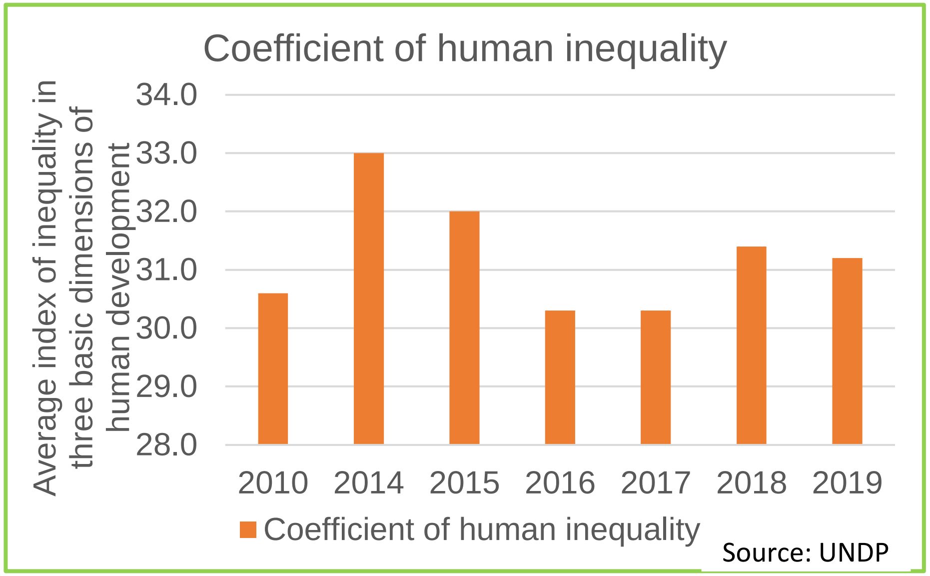


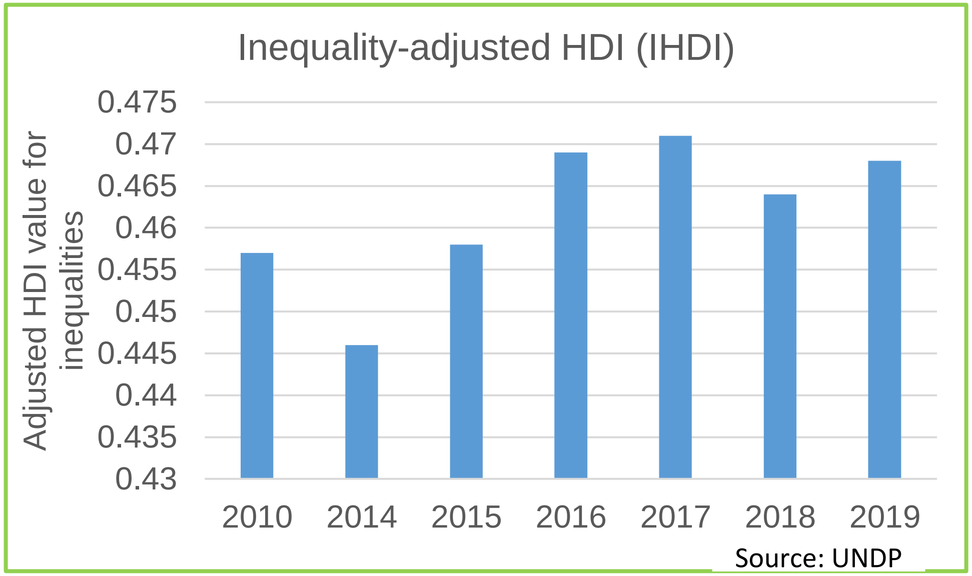


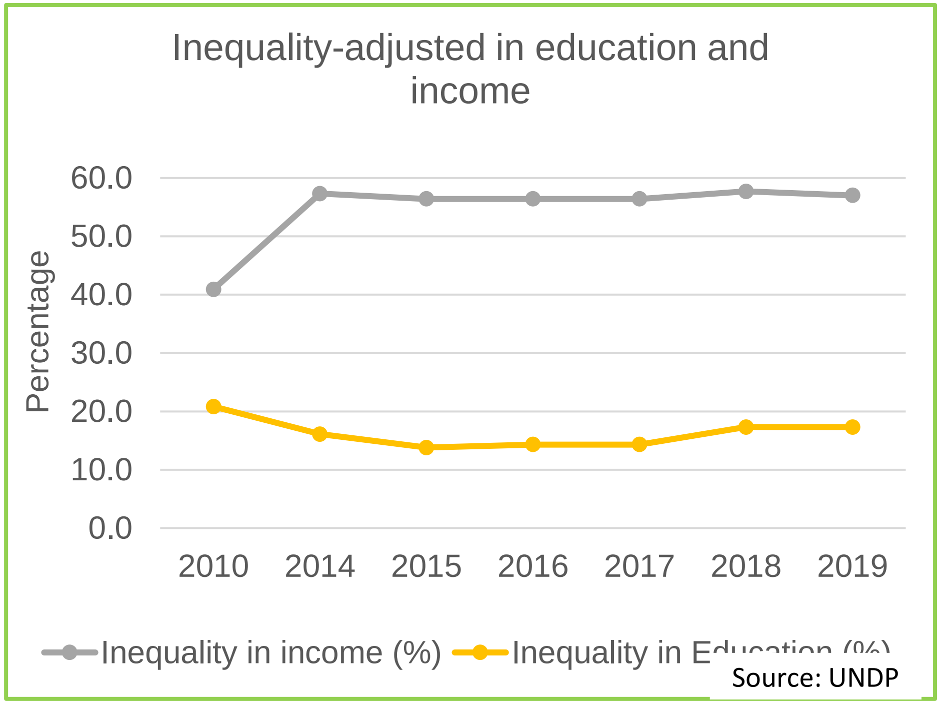


- Multidimensional poverty index (MPI) - 0.025
- Population in multidimensional poverty (MPI), headcount: 6.3%
- Contribution of deprivation in education to the MPI: -13.1
- Contribution of deprivation in health to the MPI: - 39.5
- Contribution of deprivation in standard of living to the MPI: - 47.4

Inequality levels and indicators in SA

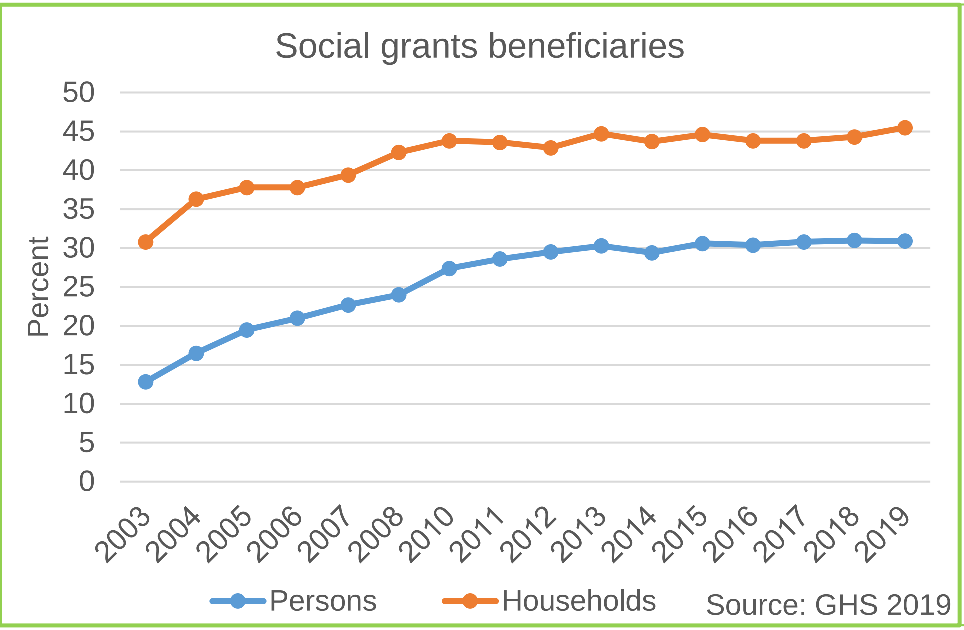


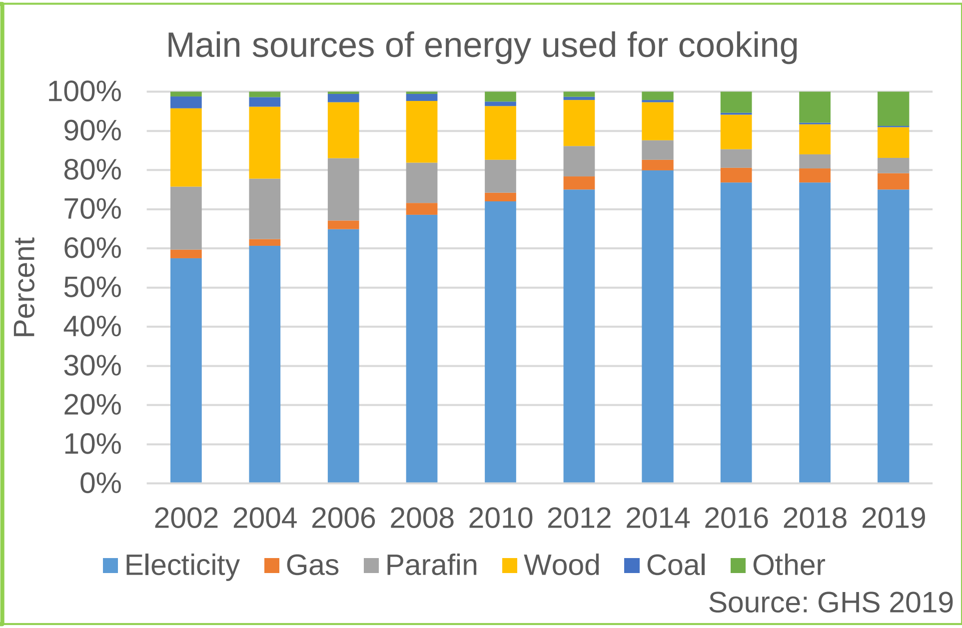




- StatsSA's inequality report showed that SA is one of the most unequal countries in the world.
- The per-capita expenditure Gini coefficient was 0,67 in 2006 and dropped to 0,65 in 2015
- The Palma ratio shows that the top 10% by income spent 8,6 times more than the whole of the bottom 40% in 2006; this ratio reduced to 7,9 in 2015.
- The IDHI increased from 0,457 in 2010 to 0,468 in 2019
- The coefficient of human inequality decreased from 33 in 2014 to 31,2 in 2019
- Inequality-adjusted in education decreased from 20,8 in 2010 to 17,3 in 2019
- Inequality-adjusted in income. increased from 40,9 in 2010 to 57 in 2019

Service delivery in SA





- The percentage of individuals that received social grants steadily increased from 12,8% in 2003 to 30,9% in 2019.
- Eight in ten (81,9%) South African households lived in formal dwellings in 2019, followed by 12,7% in informal dwellings, and 5,1% in traditional dwellings.
- Households that received some form of government housing subsidy increased from 5,6% in 2002 to 18,7% in 2019
- The percentage of South African households that were connected to the mains electricity supply increased from 76,7% in 2002 to 85,0% in 2019.

Economic restructuring and industrial transformation

Growth and economic development

Employment, value-added, investment and trade

Concentration

Finance and financial flows

The fourth industrial revolution

Economic growth is not necessarily development

- Gross Domestic Product(GDP), which is presented as an objective measure, is actually socially constructed and indicates certain views on what is productive & should be classified as the economy
  - Economic growth is anything that causes a positive change to a country's GDP
  - However, the cause of this change may not be good for the economy, e.g., activities measured in GDP that are harmful to people or nature
  - Often, harm caused is not measured (called externalities)
- Many activities that have positive economic impacts on society are not measured in GDP and therefore undervalued. (Women carry a disproportional load):
  - Unpaid housework, including cooking and cleaning
  - Care for the young, sick and aged
  - Community building and support
  - Aspects of public and charitable health and education and other services

Econ. growth is not necessarily development

- The System of National accounts (SNA) included finance, which previously was deemed unproductive and in many cases a cost to production, in GDP
  - 1930s banking fee revenue reclassified and so finance included in GDP
  - 1953 SNA saw most finance contribution as negligible and even negative
  - 1968 SNA interest payments were reclassified from unproductive to productive, even though, financial fees and costs reduce incomes available for purchase of productive, value-adding goods
- Predatory finance and activities that increase systemic risk are negative for GDP and economic development
  - For e.g. proliferation of subprime loans and their securitization in the USA
- South Africa's economic growth from 2003 to 2008 was relatively high but not sustainable because it was driven by increased commodity prices, growth in finance, debt driven consumption and a real estate bubble
- Growth was also increased by public infrastructure investments for the 2010 World Cup and to deal with backlogs
- Growth could not return to pre-crisis (2003-08) levels after the crisis

The need for structural transformation

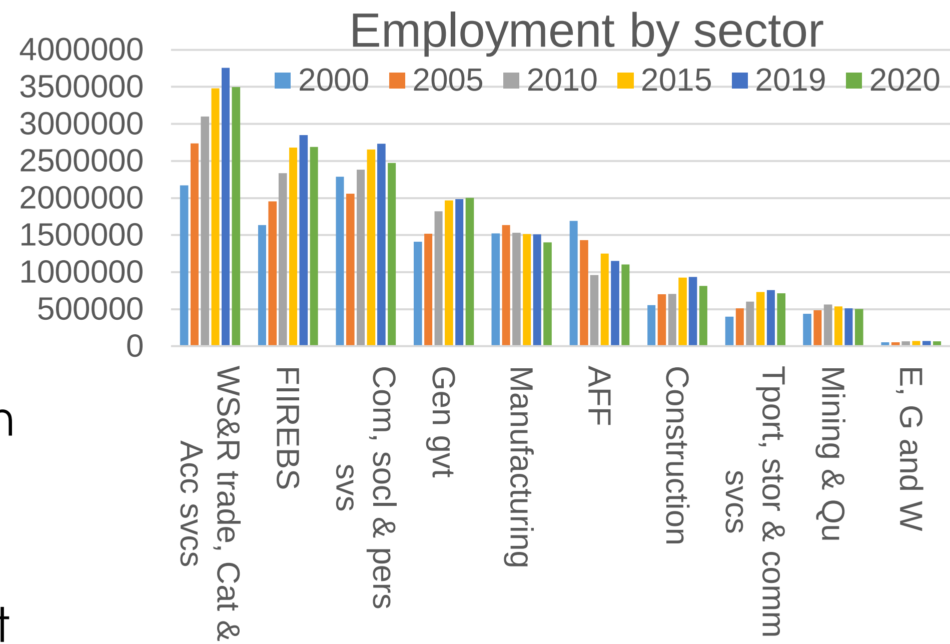
- Structural transformation of an economy requires industrial change that:
  - Builds and increases economic activity from sectors of low to high productivity and complexity, and
  - Deepens industrialisation though upgrading from low to high productivity activities within economic sectors
  - For example, transforming an economy with most value-added in primary sectors such as mining and agriculture towards increasing value added from manufacturing and then on to advanced industries that combine high value services, increased research and development and manufacturing
- Evidence shows that economic development is associated with increasing the size of the economy
- GDP growth leads to a larger tax base that in turn could support increased provision and quality of social services
- It is also associated with increased employment and incentives that promote higher levels of education and skills development

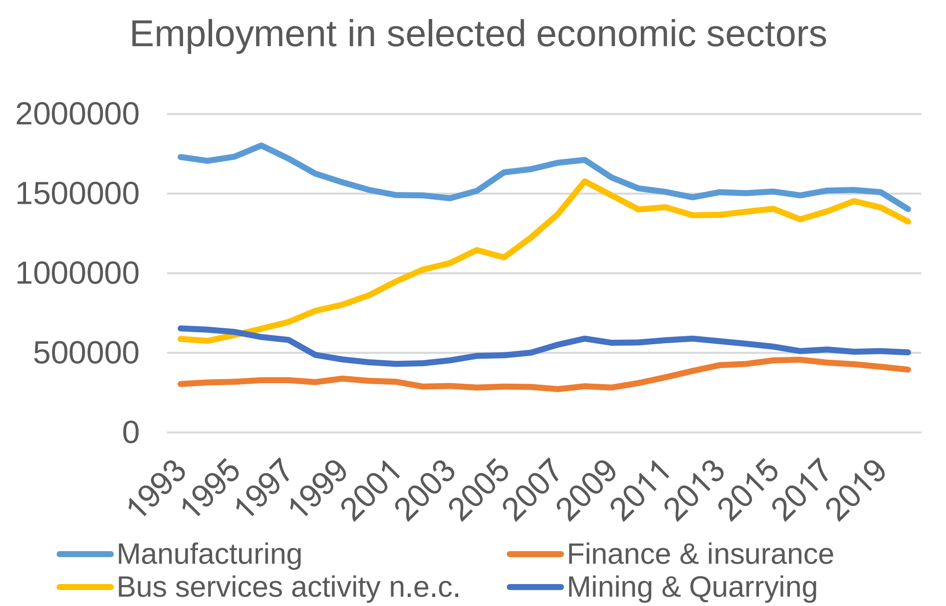
The need for structural transformation

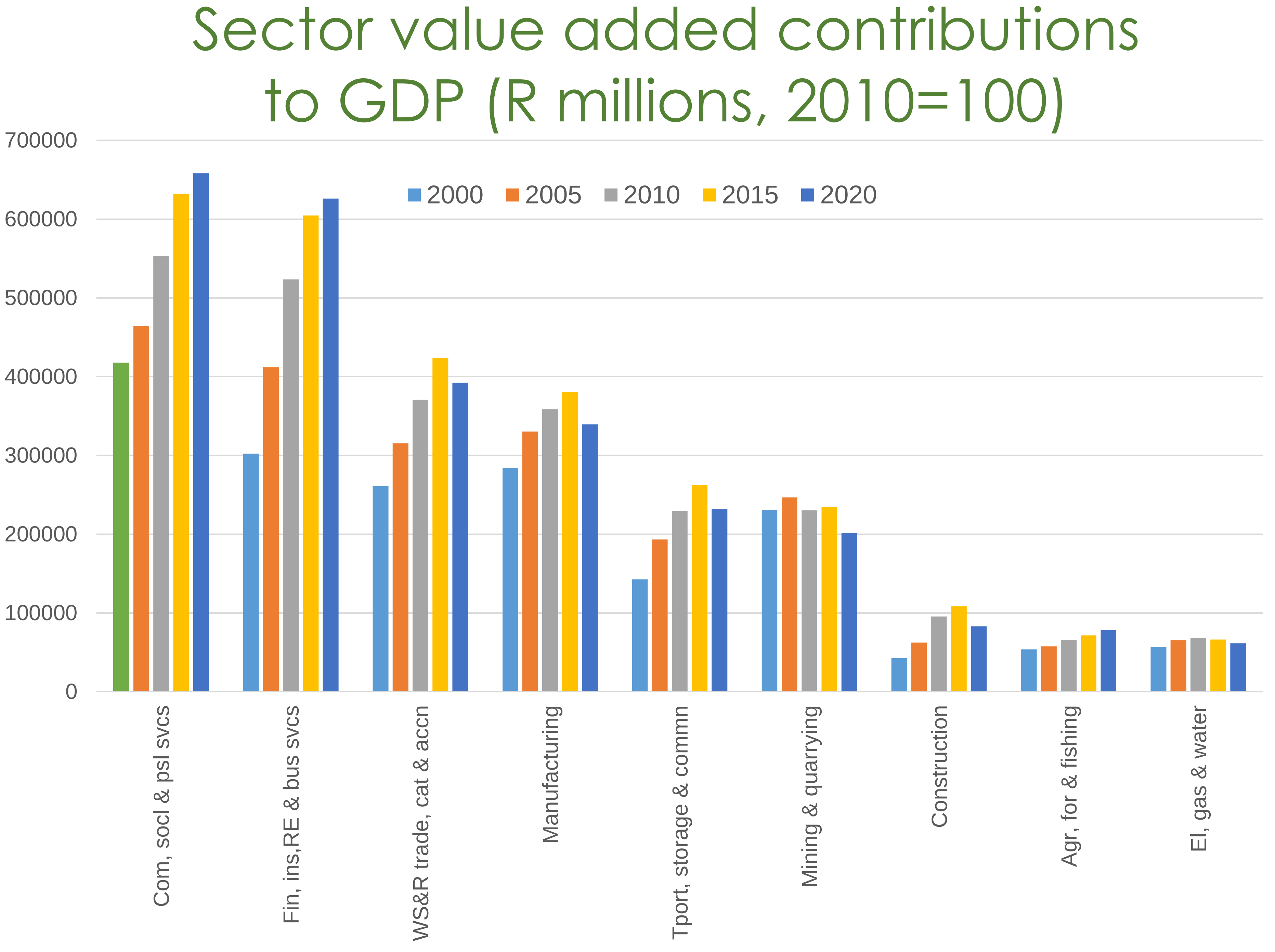
- Manufacturing is considered key to structural economic transformation because it has strong linkages across entire value chains from primary sectors such as mining and agriculture through to advanced services like engineering and design.
- Historical evidence shows that development of manufacturing has the ability to drive technology dependent productivity of other economic sectors within value chains
  - For e.g., productivity has increased in agriculture with advances in manufacturing of agricultural machinery, chemical fertilisers and even genetic engineering
- South Africa has not achieved significant transformation and has in fact prematurely deindustrialised
- There have been large losses of employment in manufacturing, particularly due to declining diversity in sectors that would support faster employment growth directly and in associated services sectors
- While certain services sectors, particularly finance, have grown, South Africa’s role in global value chains has generally remained that of providing low value-added primary products and raw materials
- South Africa continues to remain dependent on mining and minerals for much of its export earnings

Employment in low value added services

- There have been job losses in productive sectors such as manufacturing, mining and quarrying and agriculture, forestry and fishing
- A disaggregation of the finance, insurance, real estate and business services shows that the growth in jobs in this sector was not in finance and insurance
- There has been increased employment in services but much of this employment has been in low value added services such as wholesale and retail trade and in business services such as private security and cleaning services
- The outsourcing of cleaning services from manufacturing and mining accounts for some of the increase in business services

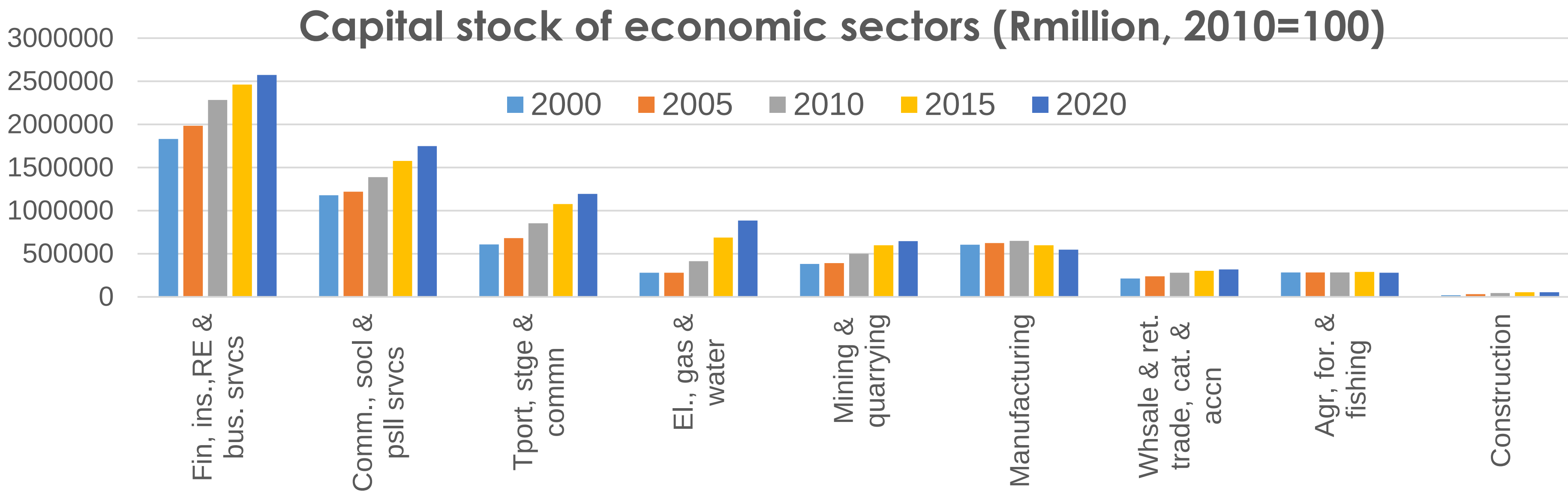


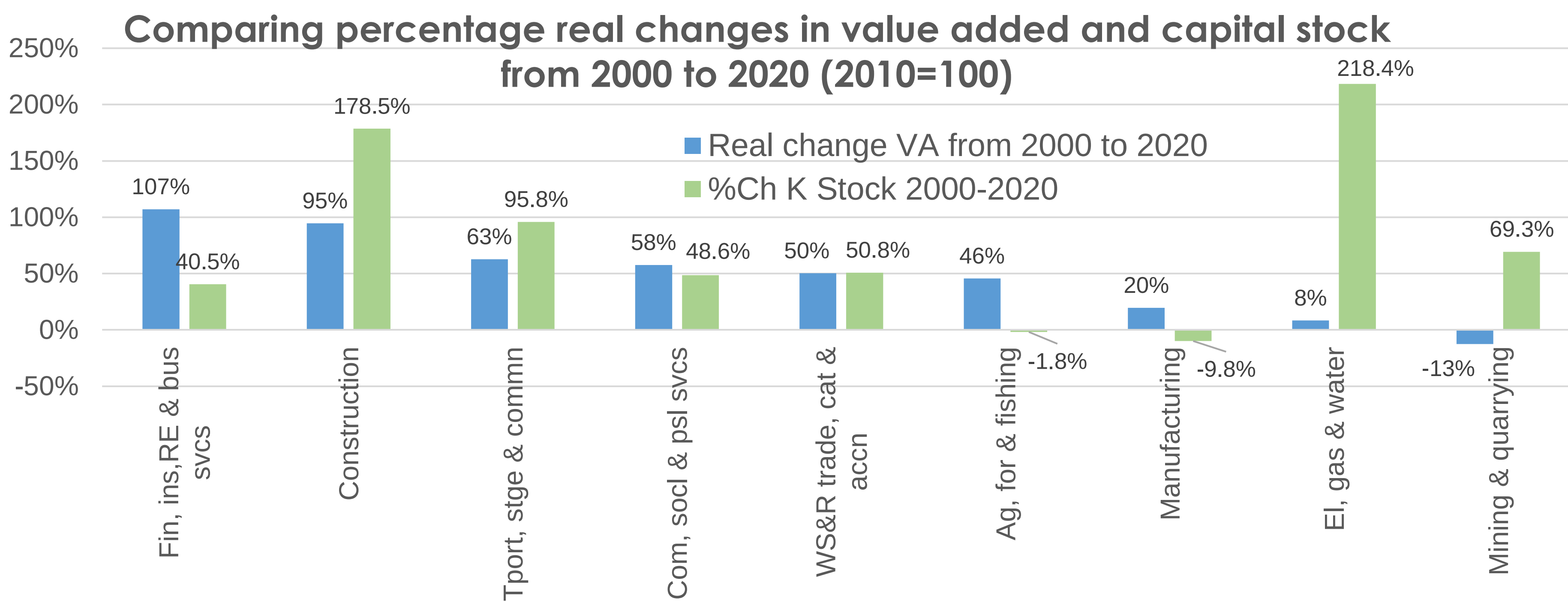




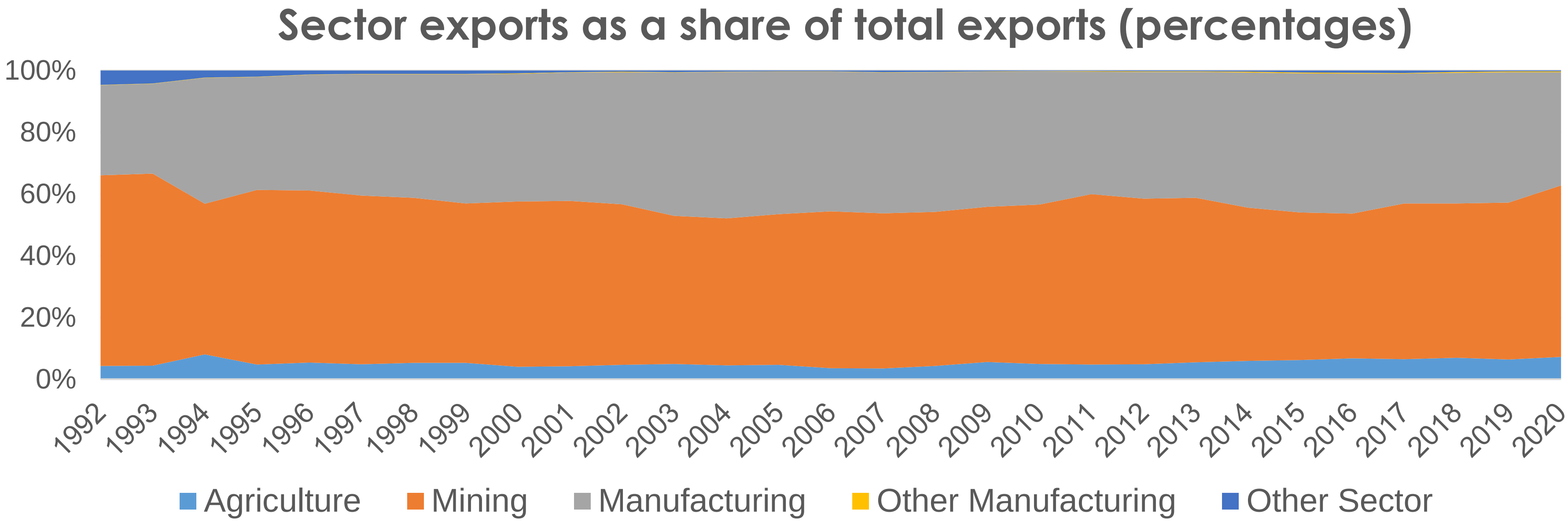
Sector value added contributions to GDP (R millions, 2010=100)
700000
600000
500000
400000
300000
200000
100000
0
2000
2005
2010
2015
2020
Com, socl & psl svcs
Fin, ins,RE & bus svcs
WS&R trade, cat & accn
Manufacturing
Tport, storage & commn
Mining & quarrying
Construction
Agr, for & fishing
El, gas & water

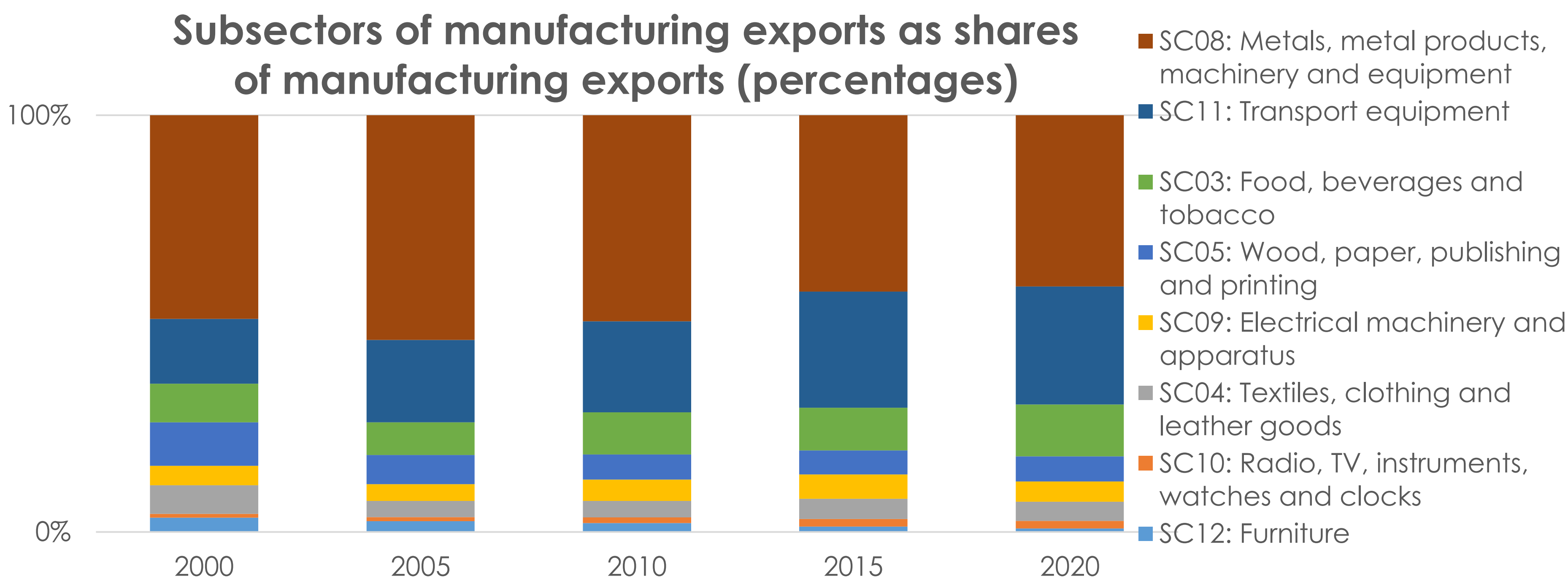
Capital stock and capacity across the economy





South Africa's exports





Concentration, profits and low levels of investment

- Concentration of markets and the role and actions of large corporations are critical to understanding the poor levels of fixed investment in South Africa
- The roots of the very high level of concentration of the South Africa economy lie in the development and growth of the mining and minerals sector in South Africa and the formation of mining-finance houses
- South African big businesses followed the trend in the 1980s in the US and some other developed countries to build large diversified conglomerates
- However, further concentration occurred in a smaller South African economy
- The liberalisation of finance during the 1980s supported conglomeration, which was aided by the large life assurers and other institutional investors
- Large corporations also bought up the subsidiaries of companies that divested due to pressure from the anti-apartheid movement
- The result of this extreme market power was that the conglomerates could behave in a predatory manner to buy out or squeeze out competition
- The conglomerates also colluded and divided up markets and the economy amongst themselves
- Extreme concentration remains one of SA’s greatest challenges

Profitability of top 50 companies

2017	ROA	ROE
Consumer services	20%	35%
Telecommunications	17%	38%
Banks and insurance	2%	18%
Mining	11%	23%

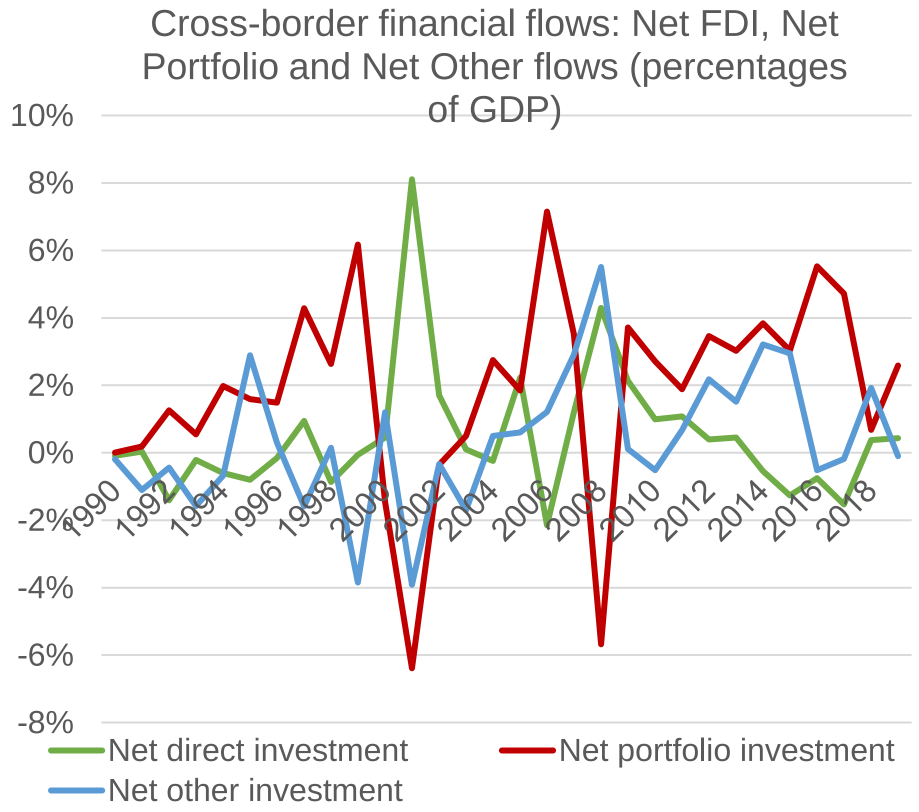
- Profitability is linked to market power
- Woods et al (2018) identified dominant firms in 294 distinct product markets.
- Sectors highly concentrated in terms of the Hirschmann-Herfindahl Index (HHI), :
  - Communication Technologies;
  - Energy;
  - Financial Services;
  - Food and agro-processing;
  - Infrastructure and construction;
  - Intermediate industrial products;
  - Mining;
  - Pharmaceuticals;
  - Transport.
- Concentration and vertical integration within sectors has increased since 1994, reinforced by high barriers to entry

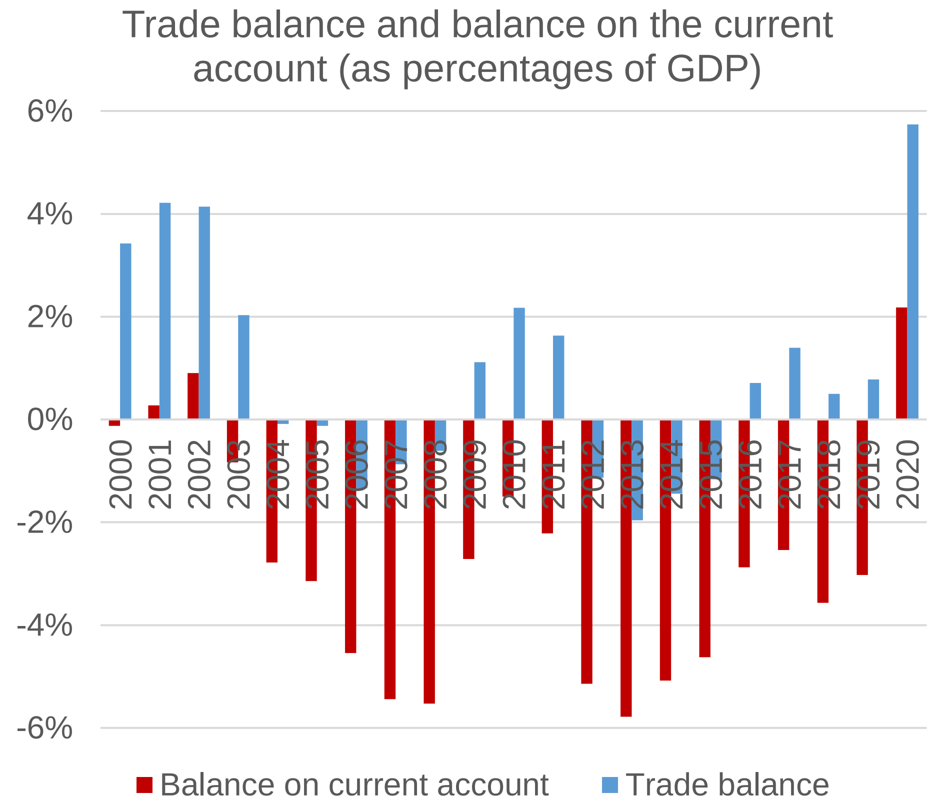
Concentration, profits and low levels of investment

- The concentrated non-financial and financial markets means that investment financing is allocated towards the existing dominant firms
- The large firms use their market power to earn good profits but investment remains weak, for e.g., the decline in manufacturing capital stock
- The post-apartheid government thought that financial liberalisation would attract foreign direct investment (FDI) to compete against SA's dominant large firms but this FDI did not materialise at close to anticipated levels
- Foreign ownership of shares of SA firms have increased
- Instead, many of the largest SA corporations, such as Anglo American and SA Breweries restructured, moved their primary listings abroad or cross-listed
- Today a large share of their operations are outside of South Africa
- The application of competition laws to reduce market power has also not worked as required and in the current context is clearly not enough
- Industrial policy aimed at economic transformation and diversification combined with much higher levels of development finance directed towards higher value-adding productive activities is required

Impact of capital flows on SA

- The large but grudging shifts in mainstream views on efficacy of capital controls seem to have had little impact on SA policy
- SA continued to liberalise financial flows and offered a second amnesty to residents with money outside of the country illegally.
- Even if this policy led to more inflows of capital it was not associated with more and better investment – most net inflows have been short-term and net FDI relatively small
- South Africa economic growth path has been affected by financial liberalization and the type of financial flows crossing the country's border.





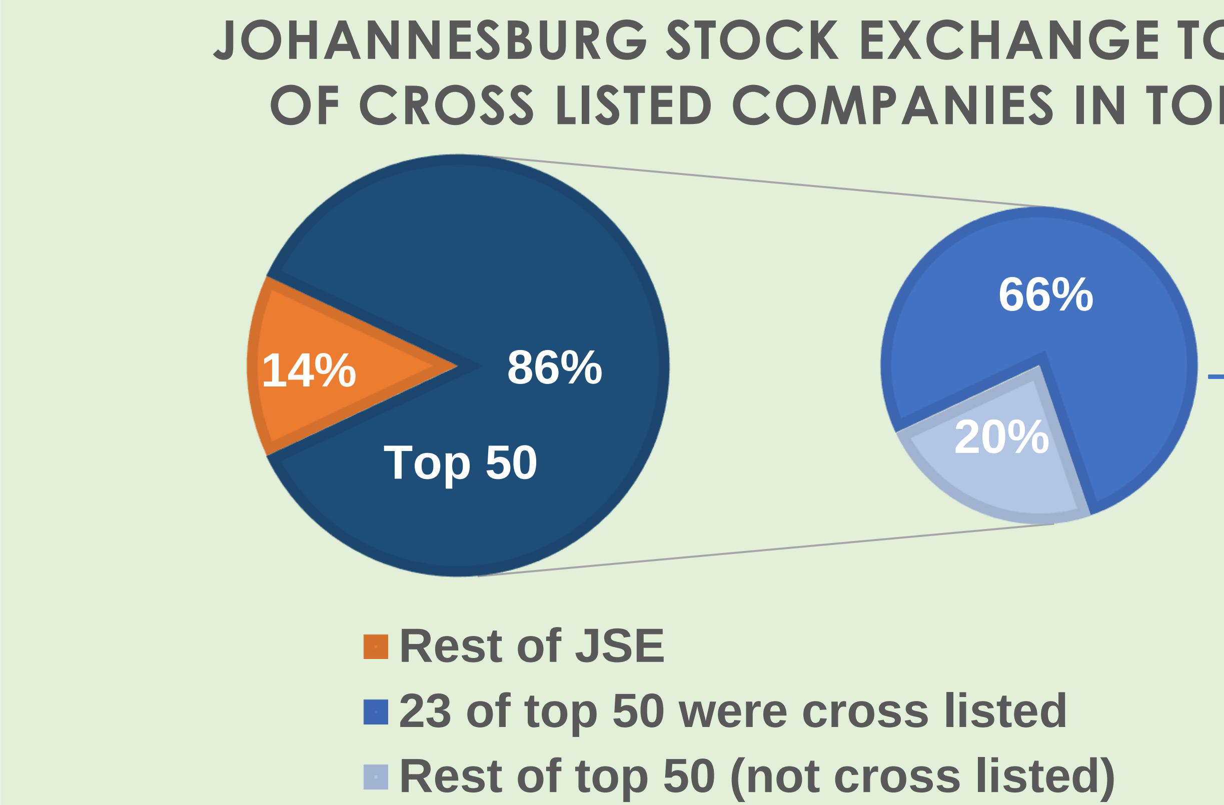
Institutional investors and foreign ownership

The very high percentage of institutional investors, including foreign investors, reinforces power of the shareholder value movement and focus of large firms on high short-term returns rather than longer-term productive investment

Type of owner	% of JSE market capitalization in 2016
Foreign investors	38%
Ownership through South African institutional investors	48%
• Retirement funds	24%
• Long-term insurance companies	5%
• Collective investment scheme companies	5%
• Investment managers	14%
South African: Other investors	14%
Additional item: Cross-holdings of JSE-listed co.s[1]	9%

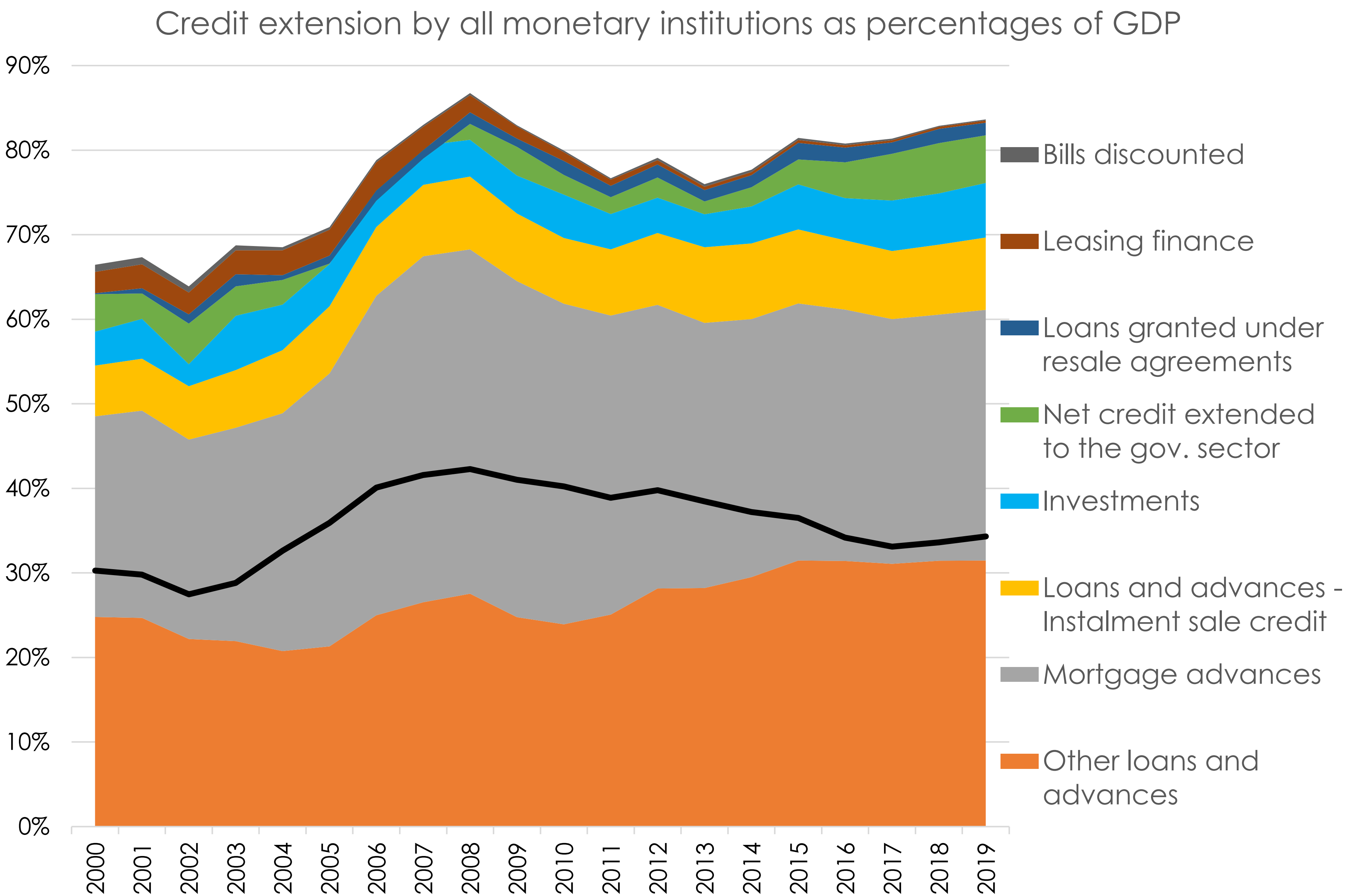
Note 1: Estimate of the cross-holdings of JSE-listed companies, i.e., where one listed company holds the shares of another listed company. Based on an analysis of the major shareholdings in the Top 25 South African companies, representing around two-thirds of the total market capitalization of South African listed companies at the end of 2016.

Most of the operations of many of the largest corporations by JSE market capitalisation are outside of South Africa



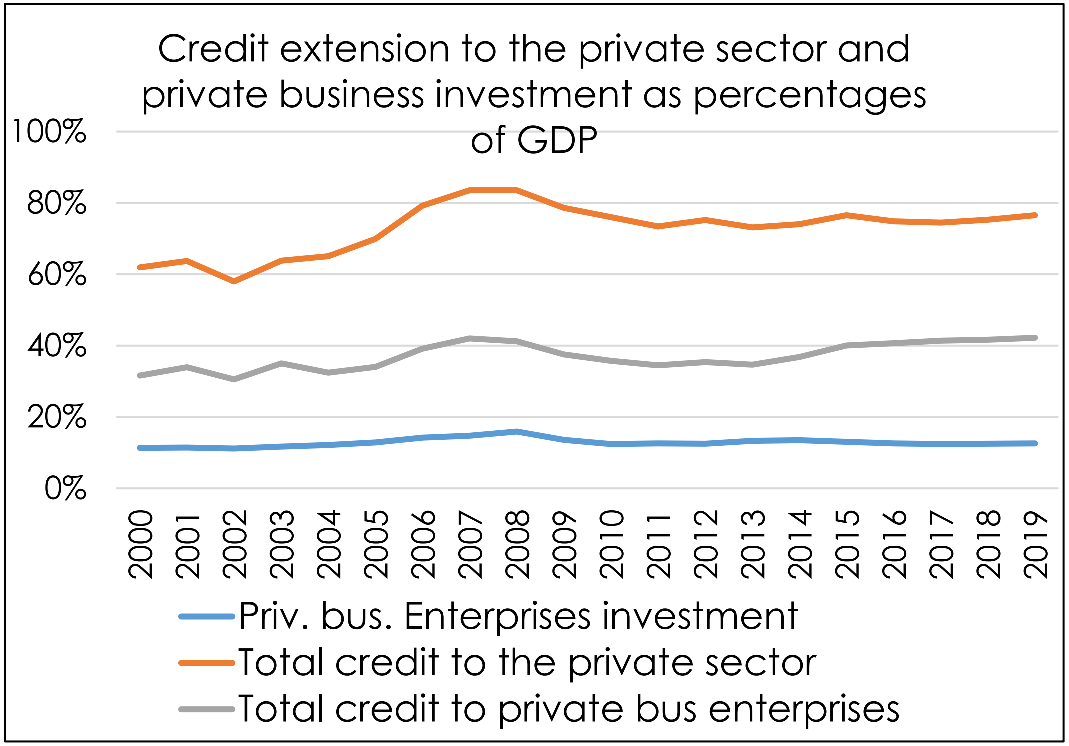
SA operations small part of global operations, 2017	
Naspers	5,5%
Richemont	8,0%
BAT	18,0%
South32	10,0%
Anglo American PLC	7,0%

Credit extension (percentage of GDP)



Own calculations using SARB data

Private investment and credit



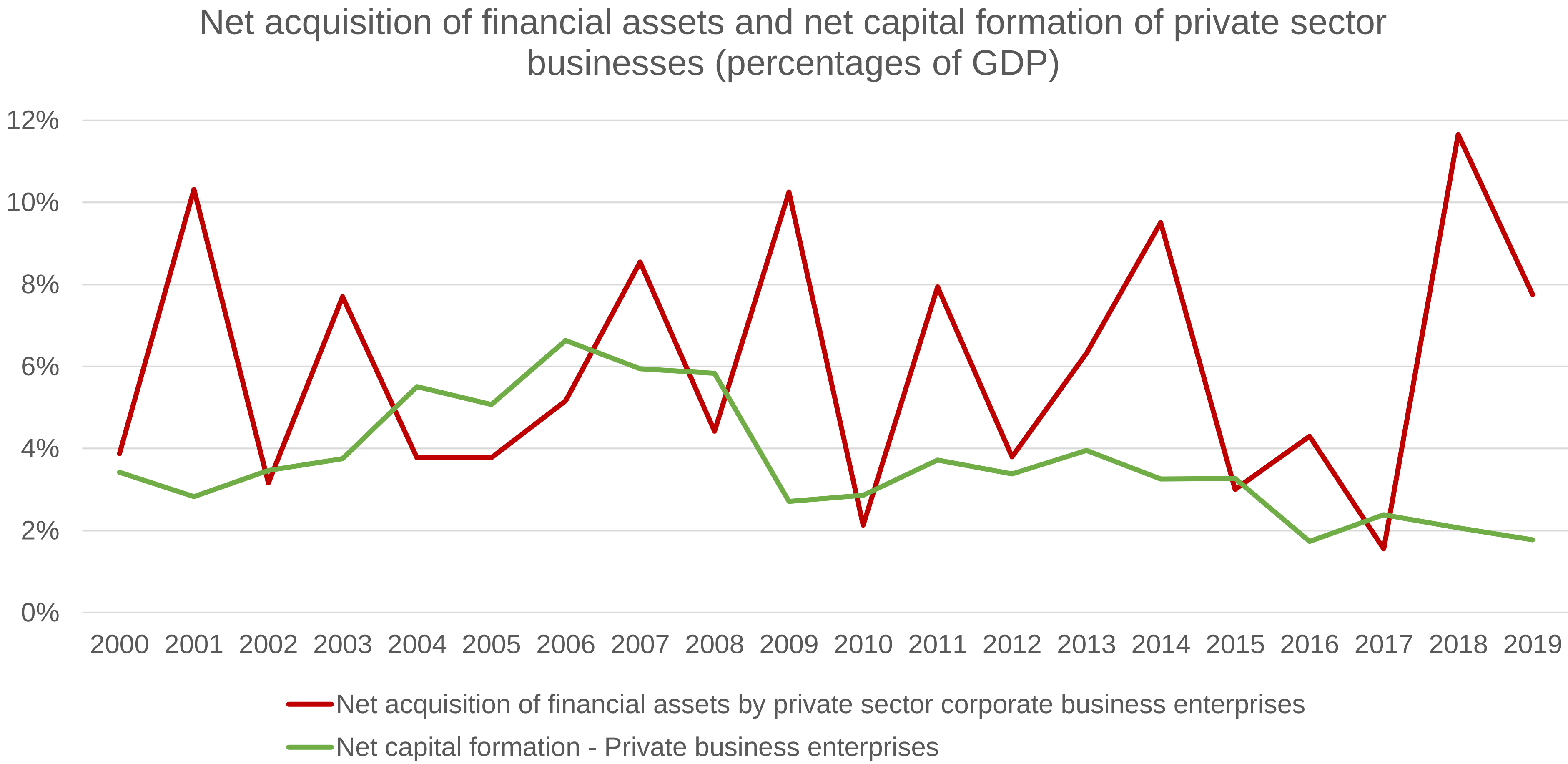
	2003 to 2008	2008 to 2013	2013 to 2019
Priv. business Enterprises investment	4.2%	-2.6%	-0.7%
Total credit to the private sector	19.7%	-10.4%	3.4%
Credit to private bus. enterprises	6.2%	-6.6%	7.6%

Own calculations using SARB data

- 2000-04 average credit to priv. bus. was 32.7% of GDP and investment was 11.5%
- 2015-19 average credit to priv. bus. was 41.2% of GDP and investment was 12.6%
  - Average Cred. extension increased 8% of GDP but investment only 1% of GDP
- Total credit extended to the priv. sector increased 2.4% of GDP from 2013-19
- Total credit extended to private businesses increased 7.6% of GDP from 2013-19
- In that period, gross fixed capital formation by private businesses decreased by 0.7%
- Gvt debt is not crowding out private borrowing for investment (nor is household debt)

Private sector corporations net acquisition of financial assets has been higher than their net capital formation

- Aver. annual net acquisition of fin. assets by priv. bus. from 2000 to 2019 was 5.9% of GDP
- Average annual net capital formation by priv. bus. from 2000 to 2019 was 3.7% of GDP
- This relatively large choice of acquisition of financial assets over net capital formation may indicate pressure from institutional investors and the shareholder value movement for higher short-term returns over long-term productive investment



The fourth industrial revolution (4IR)and inadequate structural transformation

- Structural regression linked to inadequate industrial transformation is likely to mean that technology and innovation required for South Africa's leap into 4IR will be severely constrained
- South Africa has had declining investment in manufacturing causing capital stock to age and decline
- The technology for 4IR is introduced as manufacturing and productive services grow through investment and addition of new capital stock
- Learning and innovation for 4IR occurs cumulatively though applying labour to new technologies embedded in new capital stock
- The new investments for 4IR platforms across sectors have to occur within value chains and throughout economic infrastructure

Prerequisites for growth and development

Food

Energy security

Infrastructure

Food security

Defining food security

- Food security exists in a society/country when all people at all times have enough food for an active, healthy life.
- Food security includes:
  - The availability of food that is nutritious and safe
  - An assured ability to procure and acquire food of good quality in a socially acceptable way (e.g. without resorting to emergency food supplies, scavenging, stealing or similar coping strategies)
- Food insecurity exists when food is not easily accessible and households have difficulty securing adequate food.

Measuring food security

- Food access - can be measured both in terms of the hunger experienced by individuals within a household or of the household's dietary diversity
- Food utilization - can be measured using anthropometric parameters (height and weight), dietary intake or blood nutrient levels)
- food availability - can be measured using household food inventory and/or food procurement data

Food security policy

Policy

- South Africa's food system is capable of supplying enough food either through production or trade
- Primary challenge is the majority of people cannot afford to purchase the food they need
- Primary normative policy (should be) to improve food security through increasing incomes, either through welfare (such as social grants), or through increasing employment or entrepreneurship.

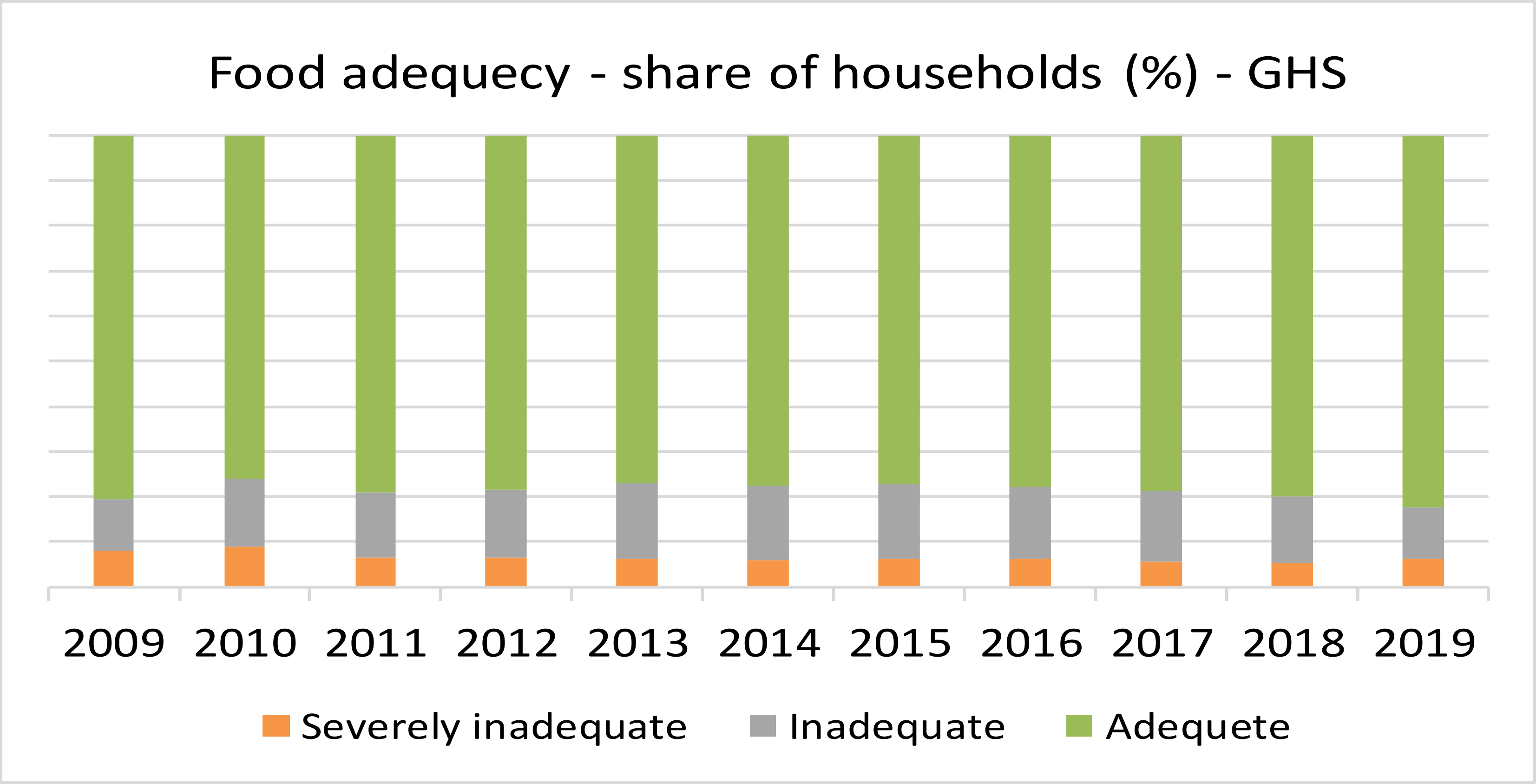
SA's current food security approach

- Increasing incomes through welfare (social grants) and supporting labour intensive growth to increase incomes
- Supporting food production from small-scale farmers
- The Agricultural Policy Action Plan (APAP) - is linked to the National Development Plan (NDP) that aims to create 1 million additional jobs in the food and agricultural sector by 2030

Food security in SA

Food security in SA

- The general household survey (GHS) estimates that food adequacy in about 20% of households is either severely inadequate or inadequate
- Food adequacy has only improved marginally over the last 10 years

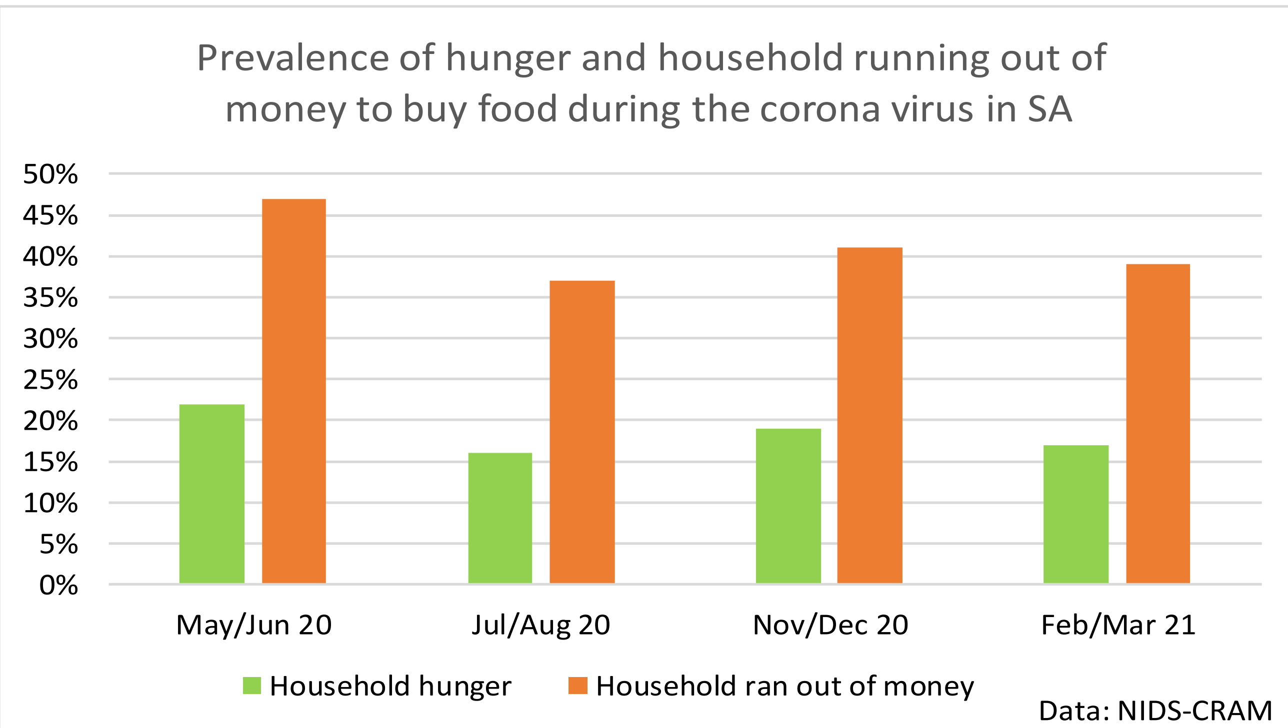


Covid-19 and food security

The covid-19 pandemic combined with lock-down measures, interruption of global trade, has worsened food security in SA and most other countries, through:

- Loss of incomes
- Declining purchasing power (higher food inflation)
- Inadequacy and imperfect coverage of food relief and social relief from government, NGOs and civil society.

- Exacerbating already high levels of poverty, inequality and hunger



NIDS- CRAM survey estimates about 20% of HHs experienced hunger since the beginning of lock down across all 4 waves of the survey

Energy security

Definition of energy security

- Energy security was historically defined as the adequate supply of energy across the electricity, gas and liquid fuel sectors
- Emphasis has also been placed on resilience of energy supply to different forms of shocks (political, technical, climate etc.)
- The World Energy Council define energy security according to:
  - Accessibility - minimum level of commercial energy services (in the form of electricity, stationary uses, and transport) is available at prices that are both affordable and sustainable
  - Availability - long-term continuity of supply as well as to the short-term quality of service
  - Acceptability - public and environmental considerations

Energy security and economic growth

- An adequate and affordable (to households and business) energy supply is a necessary condition for economic growth
- Energy-intensity of growth general reduces as countries reach higher levels of economic development and services share of the economy increases relative to primary and secondary sector

Energy security in SA

Overall, SA's energy security has deteriorated over the last 15 years

Electricity

- SA's most severe and long-running energy challenge (since 2008)
- Particularly costly to the South African economy, growth, exports, job creation and contributor to energy poverty
- Primary contributing factors to electricity crisis:
  - Due to poor planning pre-2009
  - Non – cost reflective tariffs
  - Poor procurement & construction of new coal power stations
  - Mismanagement of national power utility
  - Reluctance on DOE to allow more independent producers
- Increasing cost of electricity served to business and households has made SA less competitive, made electricity less unaffordable
- Some mitigation in security of electricity supply with the REIPP
- Oil and liquid fuels
  - Under-investment in processing infrastructure
  - Inadequacy of crude oil reserves

Energy security policy in SA

DMRE – 2020-2025 strategic plan:

"South Africa needs to grow its energy supply to support economic expansion and, in so doing, alleviate supply bottlenecks and supply/ demand deficits in energy-dependent industries"

- Despite this, energy security policy in SA is characterised by:
- Policy uncertainty
  - About turn- on previously mooted Regional Energy Distributors (REDS)
  - Status of Eskom unbundling
  - Continued delays with IPPs after successful first three rounds, and delays and restriction on non – renewables IPPs and own-generation licencing
- Policy Incoherence and Vested interests and capture of energy planning
  - Drastic changes in updates of the Integrated Resources Plan (latest 2019)
  - IRP does not promote lowest cost option for SA energy mix, despite demonstrable risks and unaffordability, or even consider public finance implications
  - IRP and DMRE budget still gestures as nuclear option for SA

Energy security policy in SA's Economic Reconstruction and Recovery Plan

- ERRP strongly prioritises energy security
- Creating a transmission company from a restructured Eskom and facilitating electricity trading
- Securing and additional 550MW procured by Eskom that will be connected
- Connection of additional 128MW of IPP capacity
- Connection of Bid Window 4 IPP capacity, and procurement of additional capacity
- Prepare for the nuclear programme at affordable pace and rate
- Finalise model and partnership for the LNG Import architecture and
- Finalisation of the Petroleum Resources Development Bill
- Finalise the Bioenergy regulations
- Implementing price and market regulatory changes to increase usage of LPG as an alternative energy source for heating and cooking
- RFQ for gas to power programme
- Enabling generation for own use

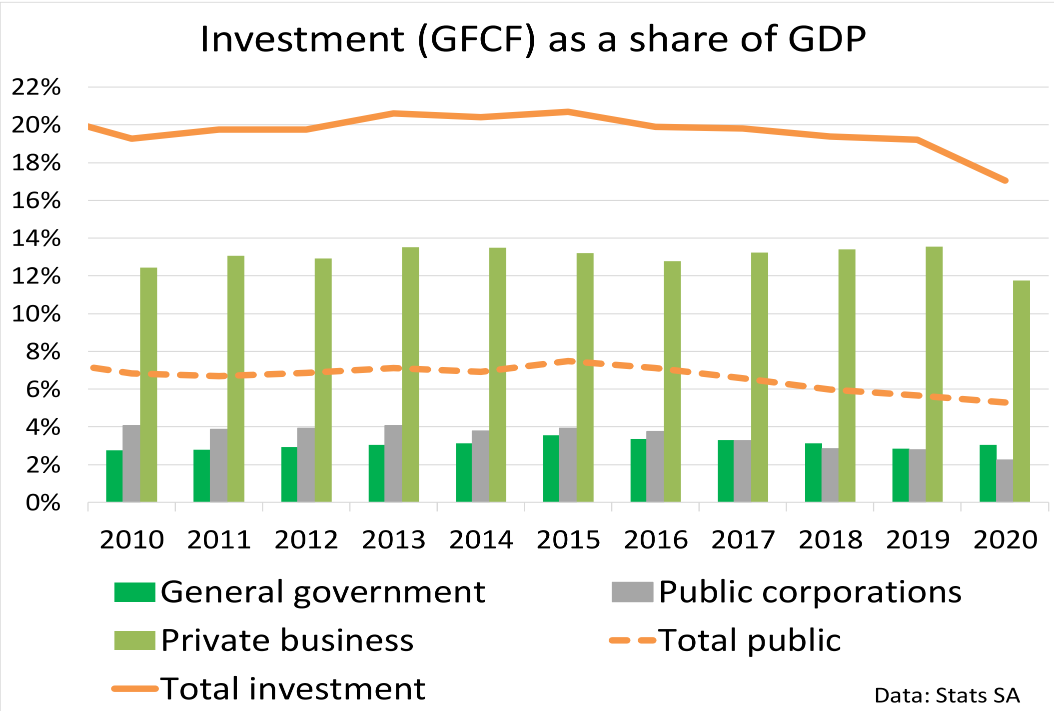
Infrastructure

- Economic and social infrastructure is critical for growth and development
- Infrastructure is essential for faster economic growth, higher employment and development
- Also promotes inclusive growth, providing the means to improve their own lives and boost their incomes

NDP views Infrastructure as a central policy priority

- Infrastructure to facilitate economic activity that is conducive to growth and job creation
- Essential to lower the cost of living for poor households
- Identifies the need to increase public infrastructure spending, especially investment in roads, rail, ports, electricity, water, sanitation, public transport and housing.
- Role for both public and private sector in building infrastructure
- Identifies the need for shifting public spending towards more investment
- Need for balance over funding of public infrastructure
- Requires a clear vision for the role of SOEs, within a robust framework for financial and operational management

Infrastructure investment in SA



The NDP Identifies the need for gross fixed capital formation to reach about 30 per cent of GDP by 2030, with public sector investment reaching 10 percent of GDP, to realise a sustained impact on growth and household services

- Infrastructure investment has been poor, and declining as a share of GDP
- Poor financial health, management and corruption of SOEs has slowed public corporation investment
- Composition of general gvt spending has shifted away from infrastructure
- Policy delays have also affected investment (i.e. spectrum)
- SA's Economic Reconstruction and Recovery Plan prioritises infrastructure led-growth (energy, telecoms, transport etc.)

Changing views on the role of Government

The role of the state

The role of the state and monetary policy

The role of the state and fiscal policy

Expansionary fiscal policy to support recovery and development in South Africa

The role of the state

- The Covid-19 pandemic has been one of several global events that has led to widespread consensus within governments of developed and developing countries, international agencies and business that the state should play a leading role in guiding the economy
- Contrary to the rise of the ideological perspectives in favour of a greater role for markets and private businesses favoured during the 1980s, there is a consensus that private businesses and individual cannot and should not be expected to adequately respond to a pandemic or climate related crises or even instability in financial markets
- The neoliberal ideology in favour of a larger role for the markets and a smaller role for the state was influential in shaping increased globalization, particularly greater integration of trade and financial markets
- This ideology also promoted a smaller role for the state, which advocated privatisation of state businesses, outsourcing of economic and service provision activities of the state and more control and discipline over governments' abilities to spend and increase debt
- The goal of macroeconomic policy of most governments since the Great Depression of the 1930s and the Post-WW2 to eliminate unemployment was replaced with the goal of price stability and keeping inflation low

The role of the state and monetary policy

- Monetary policy gained dominance over fiscal policy to curb the growth of the state and its spending and to curb that spending from putting upward pressure on inflation
- There was a monetarist revolution that shifted mainstream macroeconomics away from Keynesian influences towards viewing fiscal policy as ineffective and fiscal stimulus as incapable of sustaining reduced levels of unemployment and higher levels of economic growth
- The rise of rational expectations theory further supported a reduced role for the state and argued even more strongly that fiscal policy is ineffective
- For example, they say that rational economic agents will foresee and undermine the effectiveness of fiscal stimuli of governments because they will expect tax increases and instead of spending more will save
- However, Keynesian ideas of stimulating the economy repeatedly reemerged during recessions and particularly during economic crises

The role of the state and fiscal policy

- In the aftermath of the global financial crisis (GFC) and great recession of 2008 a new mainstream macroeconomic consensus took form
- The immediate response to the GFC was to focus on monetary policy and to use strategies such as quantitative easing to help the financial sector recover
- The main instrument to support post-GFC recovery was to resuscitate financial markets with liquidity
- There was a short period where fiscal measures were used but there is agreement in countries such as the US and those in Europe that the stimuli were too small and ended too soon
- The fear of rising government debt escalated with the European sovereign debt crisis and countries switched to fiscal consolidation and even austerity
- Mainstream economists and governments accepted the arguments by Alberto Alesina and his coauthors that fiscal contraction would be expansionary because it would promote budget and debt stability and so increase business confidence
- Carmen Reinhart and Kenneth Rogoff's empirical work showed that debt to GDP over 90% would have a negative impact on GDP growth also influenced fiscal policymakers

The role of the state and fiscal policy

- The empirical studies of Alesina and Reinhart and Rogoff were shown to be flawed and incorrect
- Alesina's glaring mistakes were corrected to show that fiscal contraction hurt economic growth prospects
- Empirical work that corrected Reinhart and Rogoff's mistakes showed that debt to GDP levels higher than 90% were associated with positive GDP growth not contraction
- However, most mainstream macroeconomists and policymakers seemed to feel comfortable relegating fiscal policy to the backburner.
- They continued to support the use of monetary policy and fiscal contraction
- The absence of recoveries in the decade after the crisis raised hard questions about the efficacy of monetary policy, particularly where central bankers had implemented zero and negative interest rates and continued with quantitative easing.
- A new consensus about the efficacy of fiscal policy developed amongst mainstream economists.
- They did not argue for reestablishing the dominance of fiscal policy over monetary policy but drew on mainstream economists work that showed that monetarist and rational expectations arguments about the efficacy of fiscal policy were incorrect.
- They showed that government stimulus worked and economic agents would spend when governments increased spending or cut taxes
- They also showed that fiscal stimulus and increased government borrowing did not crowd out private sector investors but could instead crowd-in private sector investors when the spending stimulated economic activity and improved infrastructure

The role of the state and fiscal policy

- They also showed that fiscal expansion and stimulus would improve economic performance and in this way could pay for themselves.
- They advocated long-term use of fiscal stimulus, particularly where it promoted economic activity and productivity gains
- The role of the state in supporting economic recovery and reconstruction has also been boosted by experiences notably in Japan over the past 2 decades, and more recently other developed economies such as the US and the European Union, that reduced the fear of debt in their governments
- Central banks have played an important role in financing government debt and this role has increased dramatically to support responses to the economic crisis caused by the Covid-19 pandemic
- There was also acceptance by mainstream macroeconomics of Lawrence Summer's notion of secular stagnation, which said that economies would not revert back to their previous equilibrium and grow at the level they had been growing but instead there is a long-term period of low economic growth
- Empirical work also showed similarly that interest rates did not revert to some higher equilibrium level over time but that they had significantly reduced and were expected to stay low
- The reduction in fear over debt, the increased financing of debt by central banks and the low interest rates have led to much larger use of fiscal stimulus in developed countries since the GFC

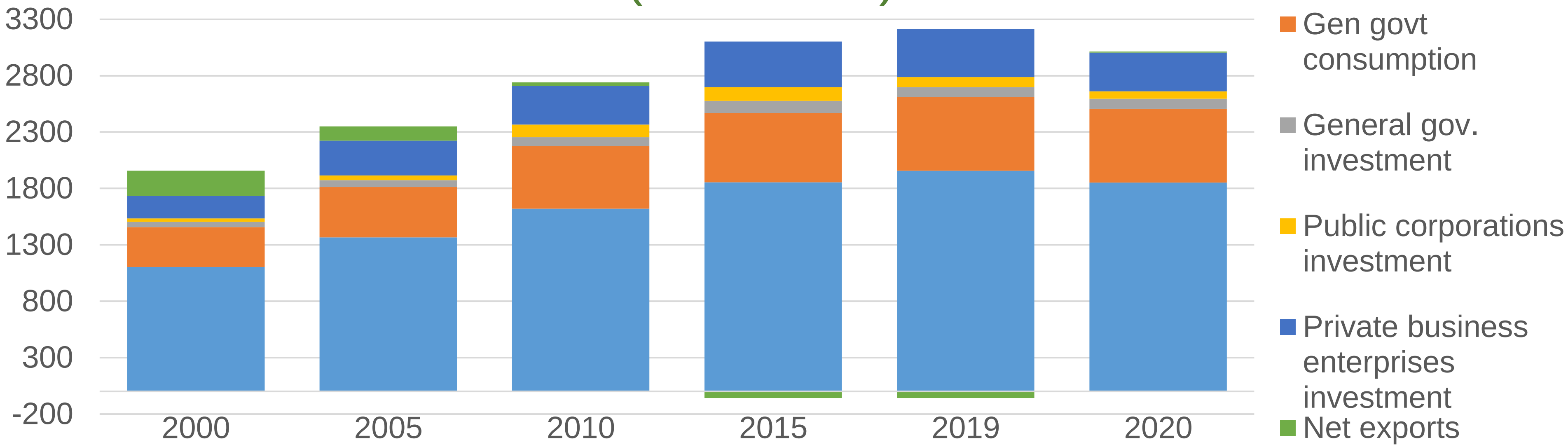
The role of the state and fiscal policy

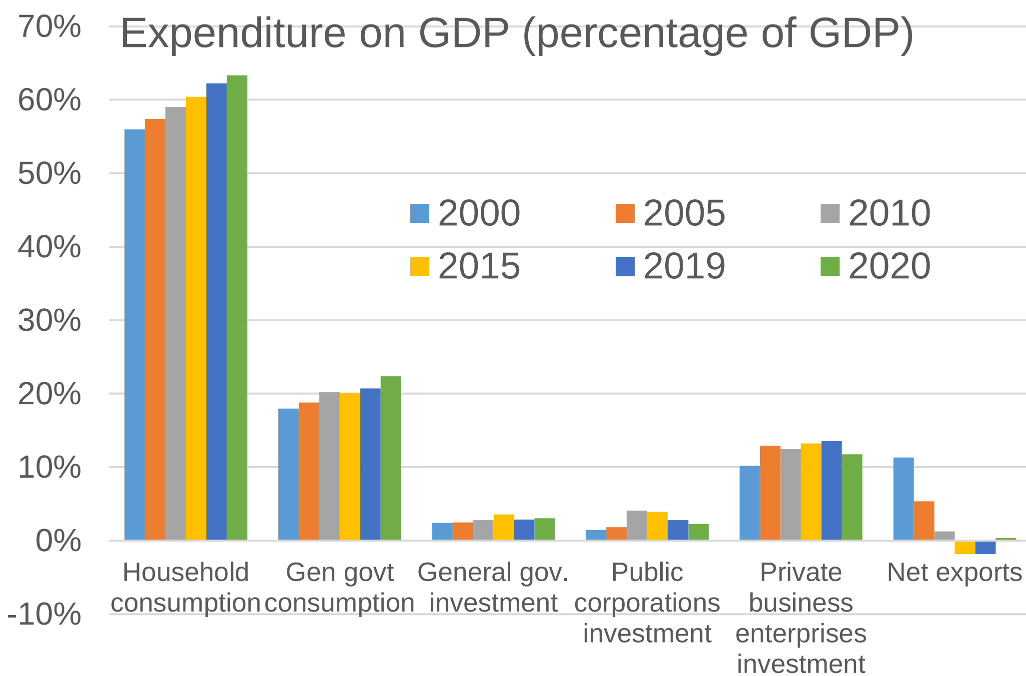
- The broader background for the large shift in thinking about the use and efficacy of fiscal policy is related to longer term concerns
- The widespread shift towards contractionary fiscal policy from the 1980s had the effect of lowering not only GDP growth in individual countries but also global GDP growth
- The shift in monetary policy focused on fighting inflation had a similar effect by causing widespread use of interest rates to respond to price changes that were not necessarily due to actions by economic agents within a country
- These macroeconomic shifts led to long-term neglect of public infrastructure and in some cases undermined long-standing state social programmes
- The liberalization of finance and the large growth of the financial sector was supported by these macroeconomic policies while central bankers and policymakers made efforts to support larger financial markets
- The deregulation of financial markets did not support growth or reduce the role of the state in the economy
- The instability caused by financial liberalisation and the increased integration of global financial markets meant that states instead of regulating to prevent financial crises played a larger role cleaning up and bailing out finance during and after crises
- The increased financial instability and crises had a negative effect on economic growth and development
- The growth of finance and the macroeconomic policies to support and stabilize finance also contributed to growing inequality within countries and across the globe

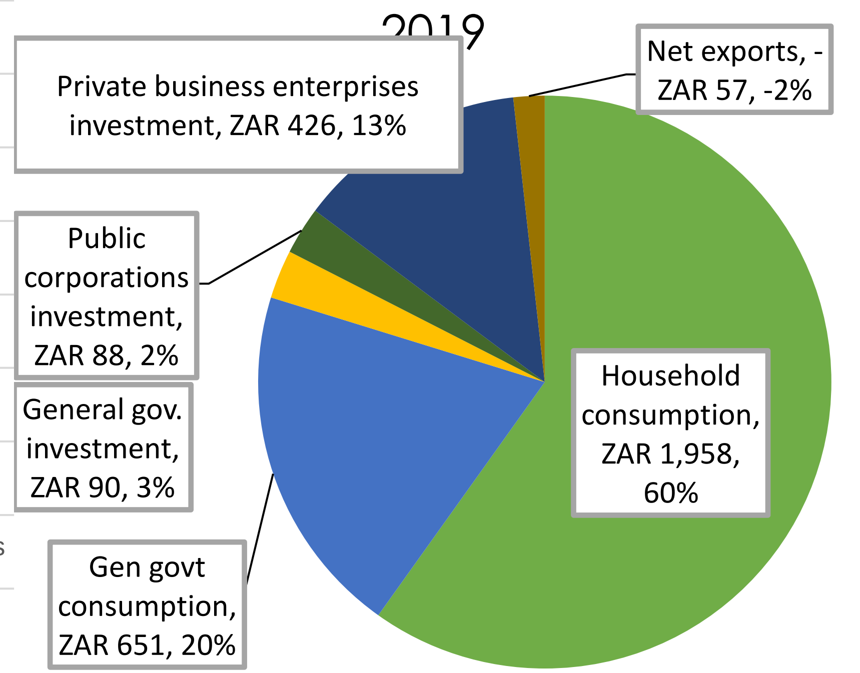
The role of the state and fiscal policy and the pandemic

- With the pandemic, developed to ease the suffering of the poor and unemplcountries have realized that expansionary fiscal policy should be used oyed while boosting economic recovery and growth
- They are also using expansionary fiscal policy to support infrastructure investment while looking toward supporting a transition away from fossil fuels
- The central role of the state in the transition to a green economy, to resuscitate infrastructure, improve levels of employment, provide improved and even free healthcare and other efforts to reduce inequality and to support increased localisation of production is now broadly accepted by policymakers and economists in developed economies
- The role of expansionary fiscal policy to achieve these goals in addition to providing relief and recovery from the pandemic seems to be taken for granted in developed economies

South Africa, expenditure components of GDP in Rbillions (2010=100)







Expansionary fiscal policy to support recovery and development in South Africa

- After household consumption, general government consumption has been the most important contributor to GDP
- General government consumption and public sector investment are important components of annual GDP
- Government should plan for increased expenditure and borrowing because of the increasing risk of future crises and contagion related to the possibility of future pandemics, climate change related events, financial instability and political turmoil reinforces the case for fiscal flexibility
- Government expenditure is required not only to respond to crises when they happen but also to mitigate risks and their socio-economic costs
- Government expenditure can promote stability and economic growth and development in a world prone to instability (and not the assumed stable equilibria)
- Fiscal expansion can lead to GDP growth and so lower debt to GDP levels while fiscal constraints can cause GDP growth to decline and so cause debt to GDP levels to increase
- Government fiscal stimulus is required particularly in recessions and crises where private sector household consumption and business investment is likely to remain low and constrained

Expansionary fiscal policy to support recovery and development in South Africa

- Government expenditure and fiscal expansion could support GDP growth:
  - Directly through injection of money into the economy
  - Indirectly through increasing the social wage through grants and provision of services
  - Households could benefit from more aggregate disposable income to spend and invest thus supporting GDP growth
  - Government investment in infrastructure and expenditure that increases household consumption could "crowd-in" investment
  - Increased government expenditure on poverty reduction and expansion of services could pay for themselves because they can increase GDP growth and tax revenues
  - Sustained government investment that is well targeted could support the supply side of the economy and curtail inflation and increase localisation
  - Increased government expenditure