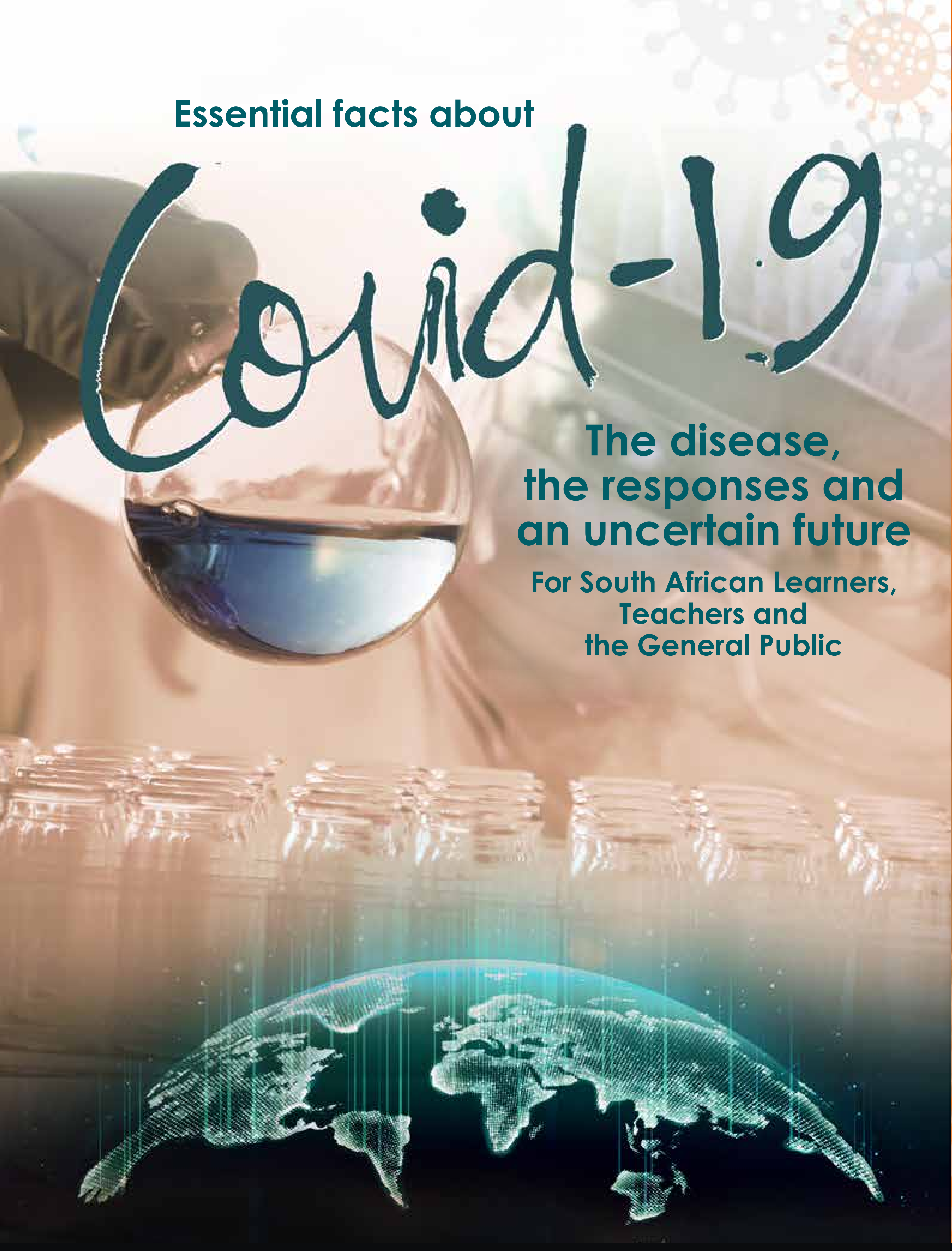


Essential facts about

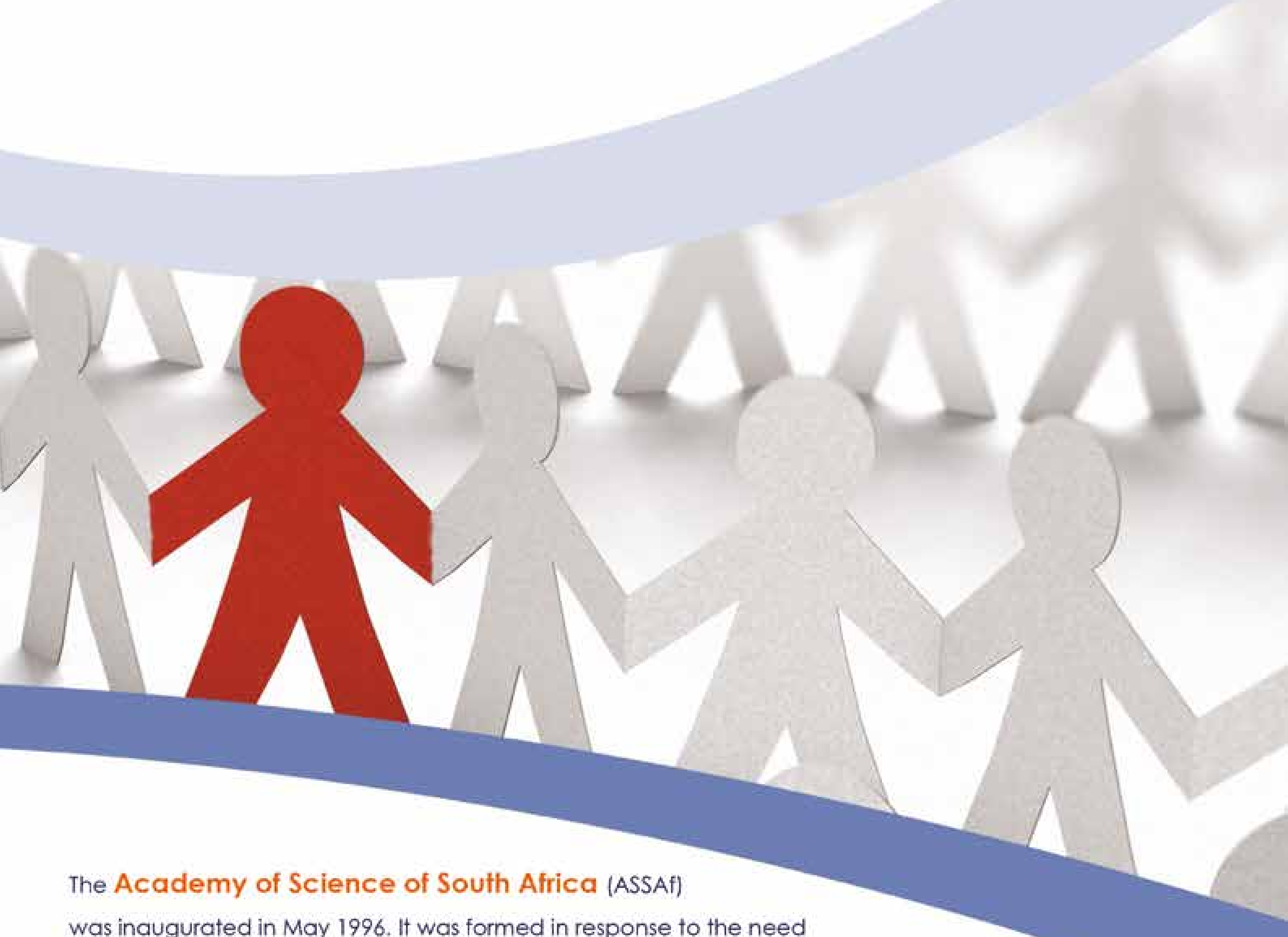
Covid-19

The disease, the responses and an uncertain future

For South African Learners, Teachers and the General Public

Commissioned by the Academy of Science of South Africa (ASSAf)

Applying scientific thinking
in the service of society



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CHAPTER **11**

Covid-19 and the Economy

The Covid-19 crisis has had a devastating effect on economies around the world and South Africa is no exception. The various lockdown measures have reduced economic activity, causing many to lose income and their jobs. Many businesses have struggled to remain solvent, and many have failed as a result of the pandemic. Governments have endeavoured to provide support to affected workers and businesses. However, the needs are enormous. Governments in less wealthy countries have found themselves limited in meeting these needs owing to their limited abilities to borrow on the international bond market. Governments around the world have struggled to find the right balance between preventing the spread of the disease through public health measures and avoiding an excessive negative impact on the economy. This chapter describes some of these issues with an emphasis on the South African situation.

Context

On 26 March 2020, South Africa initiated a severe lockdown as its primary intervention to interrupt the transmission of the SARS-CoV-2 virus. The period of the lockdown was initially set for 21 days but then extended until 31 April 2020. A rough estimate put the lost gross domestic product (GDP) at approximately R13 billion per day for what is now referred to as the Level 5 version of the lockdown. During this period both the supply (production of goods and services) and demand (consumption of goods and services) sides of the economy were largely closed down. The exceptions were producers of essential public goods and services.

Less restrictive lockdowns, beginning from 1 May 2020, involved a partial opening of the economy. However, major sectors remained closed until the shift to Level 2 from 17 August 2020. In total, a large part of the economy remained closed for a period of five months. Current estimates put the overall annualised loss in economic output or GDP expected for 2020 at around 8.2%. Current estimates also put lost employment at around 2-3 million, with some sectors likely to remain below their full potential for at least the medium-term (i.e., a period of around three years).

The consequences flowing from the decision to pursue a generalised lockdown will, in all likelihood, be with South Africa for many years to come.

Use of a generalised lockdown as the primary non-pharmaceutical intervention can largely be attributed to the absence of alternative public health measures that could be implemented at scale at sufficient strength in time to interrupt the spread of the local epidemic. Important amongst these alternative measures are testing, contact tracing and quarantining.

Countries slow to respond with adequate measures faced raging local Covid-19 epidemics that could not be contained using measures other than crude lockdowns. In contrast, South Africa was at a very early stage of the epidemic in March 2020 and could, arguably, have considered alternative measures but chose not to.

Social and economic implications

The consequences flowing from the decision to pursue a generalised lockdown will, in all likelihood, be with South Africa for many years to come, as the collateral effects are wide ranging. These effects are also likely to prove complex, with their social and economic features difficult to disentangle due to large-scale loss of livelihoods.

Three broad areas of impact can be identified.

Firstly, there are the social effects arising from immediate loss of employment and livelihoods. Those affected with limited savings and assets are the most vulnerable and would require immediate support of some form to survive the temporary period of hardship. However, where longer-term harm is done to livelihoods, deeper interventions are needed. The question is whether South Africa has the institutions that are able to address both the temporary and longer-term needs of society.

Secondly, there are the economic effects which can arise from two sources. The first results from the lockdown and the simultaneous closure of businesses, the interruption of supply chains and the loss of demand for products.

The second arises from reduced demand for service-related businesses, such as medical practices, hospitals, hotels and restaurants, where a fear of infection is presumed to be high.

Thirdly, there are severe consequences for public finances, which involve three main shocks.

The first is the immediate loss of tax revenue resulting primarily from the economic impact of the lockdown.

The second is the higher expenditure requirement to support vulnerable households and businesses during the period of the lockdown–and potentially beyond.

The third is that government's ability to finance the increased deficit is compromised by distressed financial markets, together with a loss of confidence in its ability to repay its fast-rising, accumulating debt.

Social effects

The social implications of the Covid-19 pandemic are complex and closely tied to the economic consequences. Prior to the pandemic, the socioeconomic context was already characterised by structural unemployment, inequality and poverty. The expanded unemployment rate[1], which stood at 39.7% in the first quarter of 2020, increased dramatically to 42.0% in the second quarter. The declines in employment affected both formal and informal sector settings.

As yet uncertain, however, are the implications for international and domestic economic growth arising from the substantial stimulation packages initiated in the more industrialised economies.

Given the dependency on employment to distribute incomes, the high levels of structural unemployment explain South Africa's extraordinary levels of income inequality, with South Africa at the bottom of all the international league tables. This unequal distribution of income also serves to skew domestic economic and industrial development, as economic demand is concentrated in the hands of a relatively small number of high-income households. What they choose to buy, consequently, shapes what we produce or don't produce. Through the employment losses, this underlying economic misalignment may, therefore, further embed the historical distortions in income distribution, unemployment and economic diversification.

Many countries institutionalise healthier distributions of income through well-developed systems of social security, which include social insurance (contributory social security), social assistance (cash grants), and free social services (healthcare; education; social work; care support for the elderly and disabled; social housing; adult skills development and efficient job placement). These systems diversify the sources of income for households beyond the reliance on incomes from work or assets (which only benefit very high income earners). In this way, many households are de-stressed while simultaneously shaping

1 This includes those aged 15 to 64 years not employed and actively seeking work, as well as discouraged workers (i.e., those who want to work but have given up hope). This is a better reflection of unemployment than the official definition which excludes discouraged workers.

a healthier distribution of consumption, with important implications for the richness and diversity of the domestic economy.

An enhanced social security system, however, cannot be implemented in the short-term, and even an accelerated programme of institutional and benefit reform could take well over 15 years. The ability of government to enhance the distribution of income has, however, also been compromised by the fiscal implications of the Covid-19 crisis, which has left public finances in a distressed state likely to last for at least the medium-term. Nevertheless, given the positive economic effects of improved distributions of income, incremental advances on this front appear to have merit and, given the acute nature of the social crisis, will need to be considered regardless of the fiscal position.

Economic effects

The simultaneous closure of both the supply and demand sides of the economy on the scale seen in the lockdown is unprecedented for South Africa, and the full implications are only likely to materialise over time.

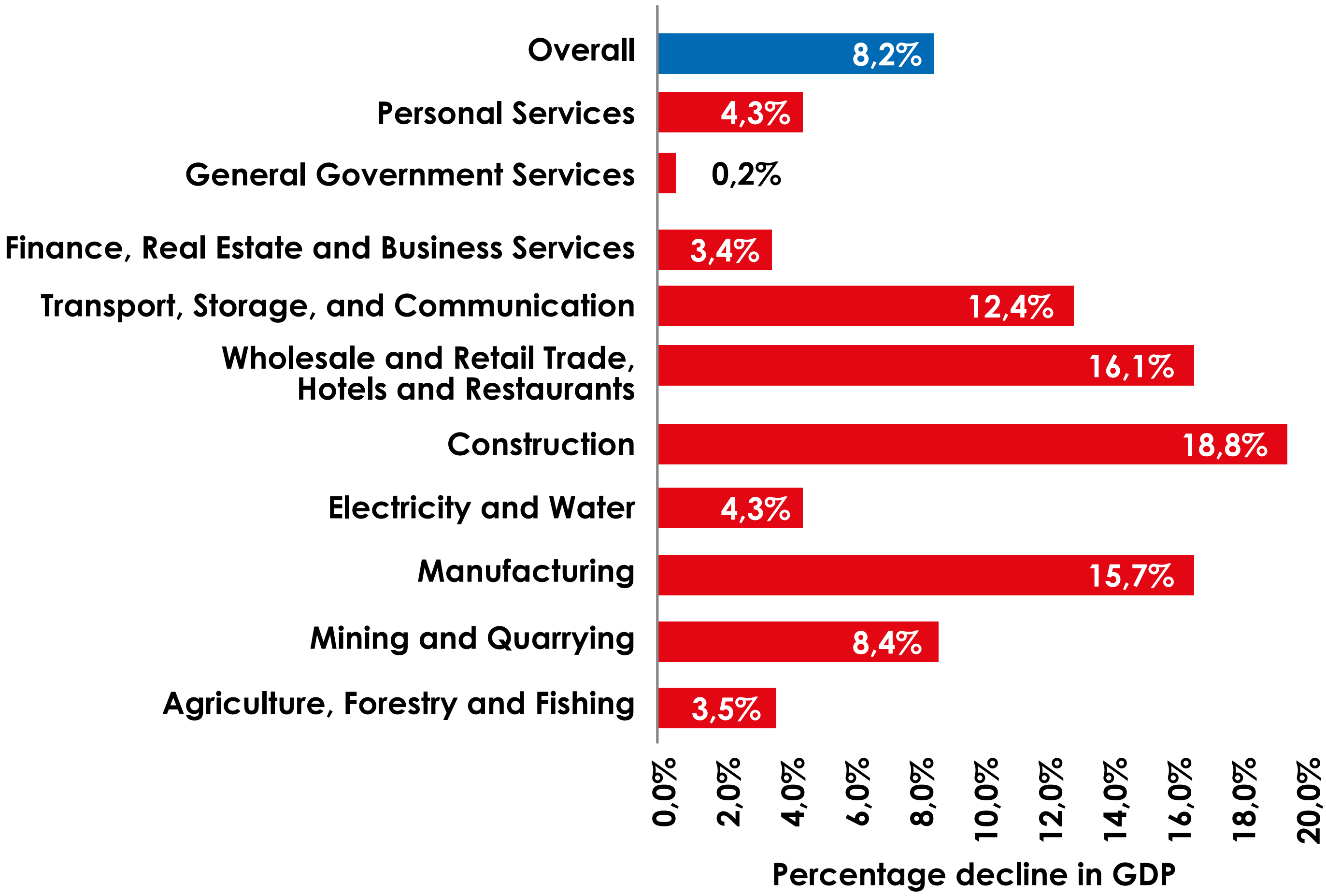

Figure 11.1: Estimated decline in GDP by sector of the economy

Credit: Alex van den Heever

Three effects have become clear by now. The first is the immediate stoppage of economic activity resulting in an immediate loss of output. The second is the long-term implications of the lockdown, such as permanent business closures, which will last for a protracted period after the reopening of the economy. The third is the medium-term implications arising from the decline in international economic activity resulting from the lockdowns and border closures.

The 2020 second quarter reduction in economic activity, which reflects the acute phase of lost output, is estimated to have declined by 51%. This is consistent with annualised projections for 2020, indicating a reduction of roughly 8.2% (Figure 11.1), which presumes some recovery of business activity. While this is unprecedented in South Africa's history, it is broadly consistent with the impact on many other economies that implemented generalised lockdowns.

As yet uncertain, however, are the implications for international and domestic economic growth arising from the substantial stimulation packages initiated in the more industrialised economies. These are likely to prove more important than South Africa's domestic stimulation package, which is compromised by South Africa's distressed public finances.

A combination of closed borders and the lockdown have necessitated that some businesses repurpose their output to serve new (domestic) markets.

While a 'bounce-back' has and will continue to occur, structural damage to the balance sheets of many established small businesses will take much longer to recover. Although a business may recover some of its pre-Covid-19 demand, the accumulation of debt will, in many instances, prove overwhelming, ending the life of a once viable business. In a number of cases, small businesses closed down immediately in March 2020 to avoid covering the overhead costs without incoming revenue and uncertainty about the ability of government to provide temporary relief.

While government initiated a number of loan support measures for small and medium-sized enterprises late in April 2020, most distressed businesses were unable to access the facilities due to restrictive criteria. For many, the relaxation of the criteria came too late in the day to survive the protracted lockdown.

Government also initiated the Temporary Employer-Employee Relief Scheme (TERS) through the Unemployment Insurance Fund (UIF) to support the incomes of workers remaining in employment to keep businesses viable. As the UIF does not have a member registry (it only has an employer registry), it needed to set up an application process to vet applicants for the support. A combination of weak systems and in-house corruption contributed to slow uptake and delivery failures. Government's failure to timeously initiate economic support programmes has, however, contributed to the severity of the economic downturn and to the possible protracted nature of a recovery.

Four of South Africa's most important sectors are now expected to see declines in excess of 10% (Figure 11.1), with the hardest hit being Construction with a decline of 18.8%; Wholesale, Retail trade, Hotels and Restaurants with a decline of 16.1%; Manufacturing with a decline of 15.7%; and the Transport, Storage and Communication sector with a decline of 12.4%. The Financial services sector, in contrast, faces a decline of only 3.4%, with Government showing virtually no decline.

There are entities crucial to the South African economy that need to be restructured and reconceptualised.

The financial sector has proven quite resilient in the face of the 'lockdown' and has in many ways contributed to supporting the viability of private industry in general. This was made possible through bank-initiated loan restructuring arrangements and even strategic interventions during the lockdown to mitigate the epidemic. Given the pivotal position of the financial services industry, any failure by them to take mitigating action will invariably have far reaching collateral implications for many industries.

An instance of poor conduct by the financial sector has seen the short-term insurance industry act in unison to avoid paying out business interruption policies taken out by the hospitality industry. In this way, they contributed to failures in particularly vulnerable sectors, despite contractual obligations to provide support. Pre-Covid-19, the hospitality industry contributed around 8.5% to GDP and was the second-most important export sector (inbound tourism). Instead of paying out on policies, insurers opted to follow court processes to decide on liability, despite apparently clear policy wording that required they pay out

when business interruptions resulted from notifiable infectious and contagious disease outbreaks within a 50 kilometre radius of the business. As a consequence, hundreds of small businesses in the hospitality industry are having to await the outcome of protracted court decisions before being paid out. This has significant direct and indirect implications for the economy. The former involve the affected businesses directly. The latter arise from the knock-on effects of downstream businesses and their employees and dependent families.

On the positive side, a combination of closed borders and the lockdown have necessitated that some businesses repurpose their output to serve new (domestic) markets. Many retail outlets and restaurants developed online ordering arrangements and direct-to-household deliveries. It is likely that much of this restructuring will be permanent and create employment opportunities, albeit at the precarious end of the job spectrum. Many of these changes could aid the localisation of manufacturing in South Africa and stimulate new industrial development. Were this to be combined with a smoothing of demand across all income groups, resulting from a progressively improving social security system, the effects could be permanent and support economic diversification. However, many of these gains are likely to occur only over the medium-term and are far from certain at present.

Public finances

Planned government expenditure has remained virtually unchanged for 2020, with stimulus plans stated as worth R500 billion, mostly funded through budget restructuring rather than new financial commitments. This weak fiscal response is largely due to the substantial loss of tax revenue arising from the lockdown and the protracted closure of the tobacco and alcohol industries. It is projected that the deficit will rise to around 15.7% of GDP with reduced revenue of around R300 billion.

A solid scientific approach is required to deal with this pandemic.

Whereas more industrialised countries are in a position to finance increased deficits through additional borrowing at low interest rates, South Africa went into the Covid-19 crisis with its debt downgraded to junk status. This influences the rate of interest government pays on new debt as well as the take up of any new bonds issued in the primary lending market (i.e., where government auctions off treasury bills to finance its deficit).

The South African Reserve Bank (SARB) was sufficiently concerned about liquidity in the South African capital markets during April 2020 to intervene by both lowering the benchmark interest rates and purchasing government bonds in the secondary bond markets. This was done to increase the capacity for private investors to take up government bonds in the primary market, so that government would have the funds to continue spending. Without this intervention, it was increasingly possible that government would not be able to raise the funds needed to finance its liabilities. Given the downgrades by international ratings agencies, a concern arises concerning South Africa's ability to service the deficit, which has cumulatively increased to over R2 trillion (or around 65% of GDP and steadily rising), as well as finance important public programmes, especially those central to revitalising the economy post-Covid-19.

It is for this reason that consideration has been given to the issuing of a special Covid bond at a special interest rate (which appears to have fallen through) as well as accessing some loan facilities at the International Monetary Fund (IMF) ($4.3 billion on the government balance sheet. On the other hand, there are entities crucial to the South African economy that need to be restructured and reconceptualised. Their failures, arguably, derive from the governance arrangements permitting political appointments that encourage the entry of private interests into strategic public organisations.

Whereas employment in the public sector has not been impacted by the Covid-19 pandemic, the sectors from which it derives its funding have been badly diminished. What this implies is that productive industries have been severely depleted, while an inefficient public sector competes for the country's limited resources.

The fiscal position of the country is integrally tied to the performance of the economy. The economy will need to be reconstituted as a priority going forward. The success of such an outcome, however, depends on South Africa progressively improving its productivity.

Conclusion

The Covid-19 pandemic has already impacted heavily on South Africa's social and economic systems, increasing its fragility. Prior to Covid-19, South Africa's social and economic outcomes were already experiencing difficulties. The pandemic has rendered the situation more acute. The next three years will prove to be a decisive time in the history of South Africa.

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The Parliament of South Africa passed the Academy of Science of South Africa Act (No 67 of 2001), which came into force on 15 May 2002. This made ASSAf the only academy of science in South Africa officially recognised by government and representing the country in the international community of science academies and elsewhere.

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