

Reopening the economy: Obstacles, opportunities and risks

INTRODUCTION

Both South Africa and the world face an economic crash as a result of the COVID-19 pandemic. The downturn, which threatens to rival the Great Depression, results from the need to take extraordinary efforts to limit the contagion. Internationally, the result has been plummeting demand, especially in the global North, with falling export prices except for gold, as well as disrupted supply chains for most producers. In South Africa, the lockdown has brought a sharp decline in domestic production, combined with a rapid increase in joblessness, falling household and business incomes, and shrinking government revenues. This brief looks at the impacts of the pandemic on the global economy, and especially South Africa's main trading partners. It then analyses the blockages to reopening the economy, which in turn lays the basis for more effective and strategic measures.

AIMS AND APPROACH

This analysis draws largely on an informal survey of businesses and well as more in-depth interviews with stakeholders in auto, steel, plastics and furniture manufacturing.¹

The analysis points to five main obstacles to restarting economic activity.

First, expanding production increases interpersonal contact both at work and on public transport, raising the risk of a renewed outbreak. Managing the risk requires changes in work organisation and commuting practices. It also necessitates ongoing monitoring of the contagion and isolation of hotspots, a task made harder by the global lack of testing materials. It is likely that the process will entail a gradual rebooting of production, with the least risky and most competitive opening first and riskier production processes, notably services and retail that require direct contact with customers, to come last.

Second, South African producers have largely exhausted their liquid resources. During the lockdown they had to meet fixed costs (salaries, rent, rates) despite an extraordinary decline in sales. Both large and small businesses will need financial support, including deferred payments, to reopen, especially while demand remains weak.

Third, reopening will have to apply to value

chains, not just enterprises. For producers to reopen, their suppliers and sales agents or retailers must also start up again. During the lockdown, both imports and exports faced hindrances due to limitations on international procurement and sales as well as the partial closure of Transnet. Auto production must sync with the reopening of the international economy.

Fourth, both global and domestic demand are depressed by lockdowns, with widely divergent forecasts of when growth will bounce back. Recovery will be slowed by the fragile state of the international and South African economies even before the pandemic. Stagnant commodity prices and the escalating climate crisis from 2012 meant South Africa needed to find alternatives to its historic growth model of exporting mining products with an unusually heavy reliance on coal for energy.

Fifth, because achieving safe conditions is particularly difficult in services and retail, both overall employment and small business are likely to lag in the recovery. By extension, redistributive programmes will have to be maintained and stepped up, with appropriate financing mechanisms. While some programmes have been established formally, they have been very slow in actually providing resources to those in need.

The final section of the brief discusses options for addressing these blockages, identifying the often very difficult choices as well as key next steps required to restart economic activities.

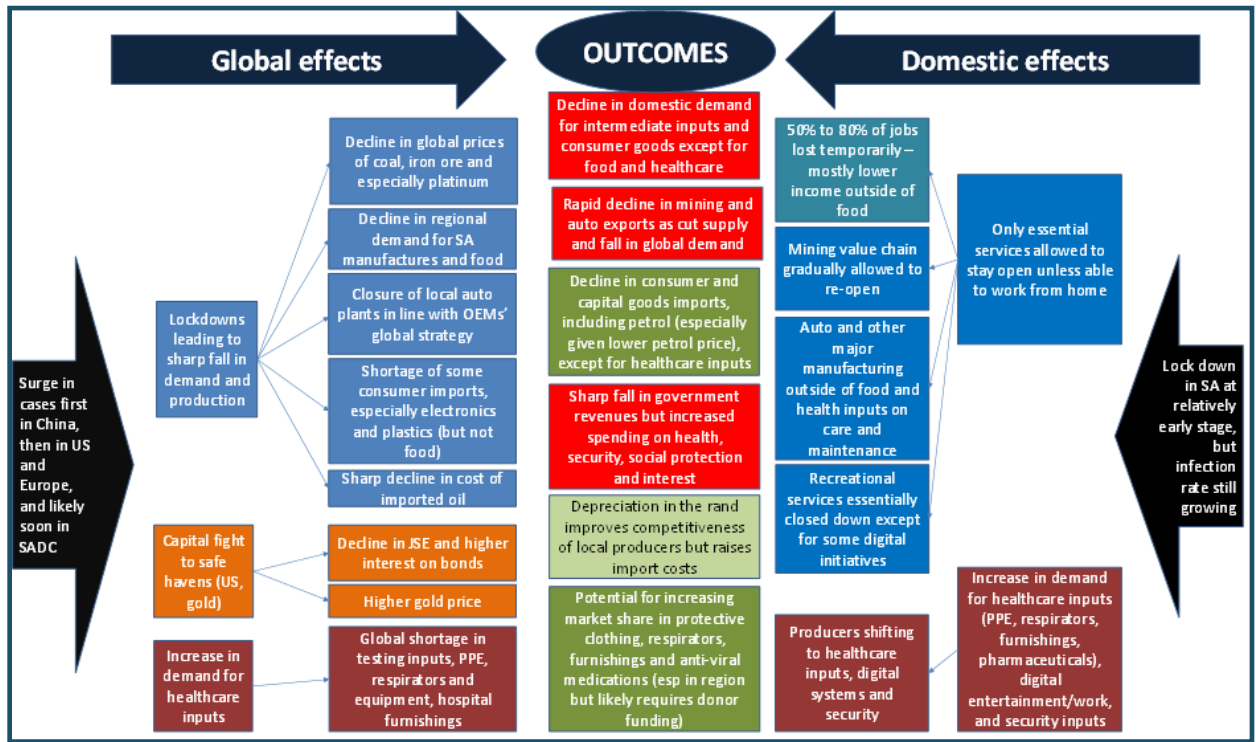
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¹ We wish to thank Annie Neo Parsons for her advice on public health policy. Any errors in this regard are, however, our own."

Figure 1. The impacts of the global and South African lockdowns on the economy



EXTENT AND IMPACTS OF THE DOWNTURN

In mid-April 2020, the COVID-19 pandemic was on track to cause the deepest fall in the global GDP since the Great Depression, surpassing the global financial crisis a decade ago. As Figure 1 shows, the South African economy was first affected by the global lockdown, and a few weeks later by local action to prevent a surge in infections. The global slowdown affected South Africa primarily through lower export prices, closure of local auto assembly, capital flight, and the growing global scarcity of healthcare inputs. On the domestic side, the lockdown was associated with the closure of most economic activities except for food, healthcare inputs, security services and mining.

Data on the overall economic impacts of the pandemic are not yet available. Still, forecasts and transactional data show the depth of the crisis. In mid-April, the IMF forecast that the world economy would shrink by 3%, with an 8% drop in the global North. For comparison, during the global financial crisis in 2009, the global GDP contracted by less than 0.1%.

China, where the outbreak started in December 2019, reported a 6.8% decline in its first quarter 2020 GDP compared to first quarter 2019. The decline marked an abrupt reversal, since China had claimed 20 years of growth at over 6% a year. That rapid expansion had transformed it into the world's second-largest economy and a key market for South Africa's mining products.

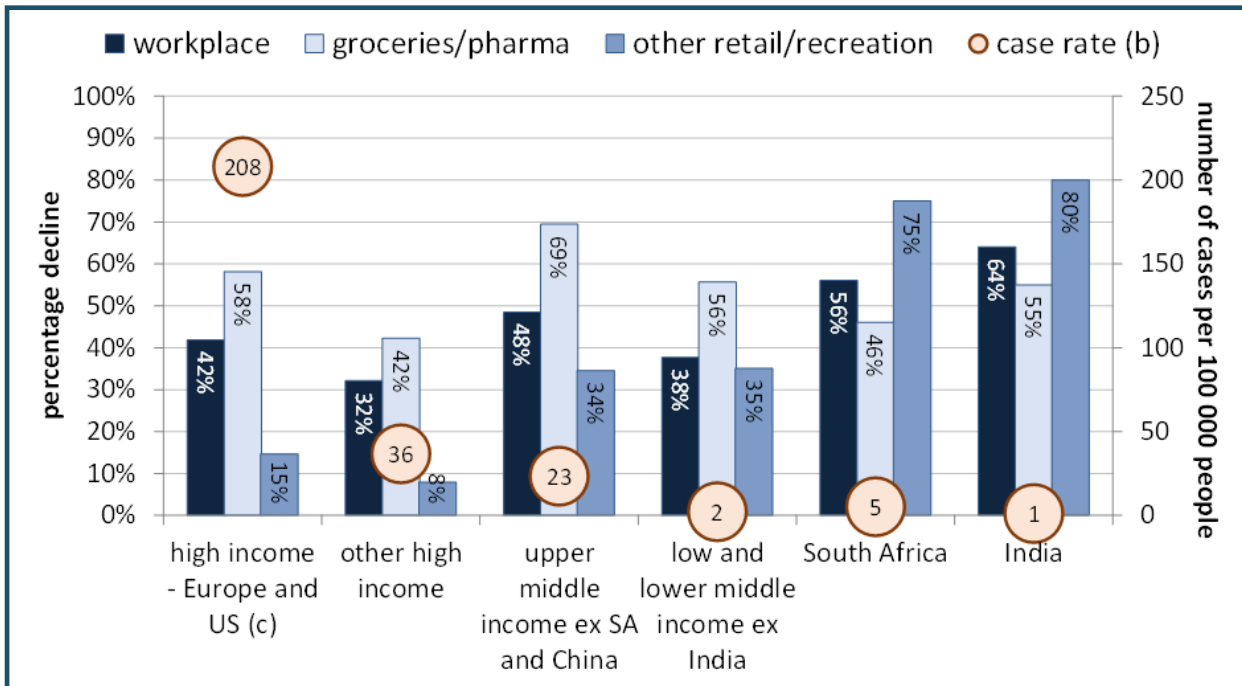
The countries of Europe and North America, which account for over half of the global GDP, had the

highest rates of known COVID-19 infections in April 2020, averaging over 200 per 100 000 people (for comparison, in South Africa the figure was just seven per 100 000 as of 22 April). They began lockdowns in March, when the incidence of infection was already high. The first quarter data will not reflect the full economic cost of the pandemic, but projections and transactional data indicate the impact. For instance, cellphone analysis indicates a 40% decline in travel to work in Europe and the US in mid-April compared to January (see Graph 1 on page 3). In the US, from mid-March to the first week of April, new claims for unemployment insurance totalled 22 million. That was over 10% of employment and equal to all job creation over the previous decade.

In South Africa, the lockdown was imposed in late March, when the known infection rate was around one per 100 000 but growing well over 20% a day. The economic impact was severe. As of mid-April, the Reserve Bank forecast a 6% decline in the GDP over 2020, followed by 2% growth in 2021.

Three figures underscore the extent of the economic slowdown. First, travel to work fell over 50% after the lockdown; for food and pharmaceutical shopping, it fell almost as much; and for recreation and other retail, it plummeted by 75%. The decline in travel for work was somewhat higher than the average for upper-middle-income countries. Second, electricity sales dropped by over half during the lockdown. The main cause was sharp cuts in industrial production, especially the metals refineries. Third, applications for the UIF's special Temporary Employer/Employee Relief Scheme (TERS) for the pandemic covered 1.6 million formal workers – a tenth of all employed people and a seventh of all formal wage earners.

Graph 1. Percentage decline in travel to work and for other purposes and number of cases per 100 000 people, South Africa and other countries by region and income group, mid-April compared to January 2020 (a)



Notes: (a) Figures are for 11 April as percentage of average for 3 January to 5 February. Country groups are weighted by size of GDP. (b) Number of cases per 100 000 people. (c) New York had 1217 cases per 100 000, with work travel down by 48%, recreation and non-essential shopping by 62%, and food and pharmaceuticals by 4%. Source: Travel data from Google LLC. Google COVID-19 Community Mobility Reports. Accessed at <https://www.google.com/covid19/mobility/> on 19 April 2020. Incidence from The New York Times. Coronavirus Map. Accessed at www.nytimes.com on 20 April 2020.

The effects of the lockdown varied substantially by sector. Designated essential services were allowed to continue production and sales, mostly in the food, healthcare, security, utilities (including coal suppliers), personal and freight transport value chains. The mining value chain (which includes smelters and refineries) was permitted to re-enter production gradually but could only use half the normal labour force. Estimates suggested its output would remain around 25% below re-lockdown level.

In contrast, non-essential businesses were expected to end production and sales altogether unless they could work from home. That meant that most producers of goods and personal services as well as non-food retailers effectively shut down.

In a snowball survey² conducted in early to mid-April, nine out of 10 respondents said they had reduced production as a result of the lockdown. Half had closed down entirely, while another third had reduced output by over 50%. The share of companies

reporting at least some downsizing ranged from two fifths in private healthcare to almost all in non-food manufacturing, business services and construction.

Part of the problem was that production from home was not possible for most goods and many services. Managers in formal businesses and most professional services outside of healthcare could function under these conditions, supplying digital products and endless Zoom meetings. But these workers represented only 15% of the private labour force. In contrast, making it possible for manual workers to produce at home would typically require a complete overhaul of equipment, work organisation and logistics. Moreover, personal services, retail and restaurants generally require direct contact with customers. Lockdown regulations meant that retailers and restaurants could not use the alternative of delivery services. In theory, entertainment could be delivered through the internet. In practice, however, demand was constrained because only a tenth of households had broadband. The lockdown also narrowed access to production equipment and technical support.

Even essential service providers often downsized during the lockdown. The main reason was falling demand from both households and businesses; in some cases, inputs were not available. For instance, one large food company said that a quarter of its sites had reduced or ended operations during the lockdown; banks closed up to half their branches;

² The sample was based on the circulation of a questionnaire by Business Unity South Africa (BUSA) and its affiliates, as well as the Manufacturing Circle and some other business organisations. Over 190 companies of all sizes responded. We are grateful for the assistance of BUSA and the other organisations that distributed the questionnaire. Nokwanda Maseko consolidated the answers and undertook an initial analysis.

the Natref refinery shut down; and Eskom declared force majeure on two coal and all wind-base electricity suppliers. Imports of inputs as well as exports were hampered by new and sometimes unclear infection-control procedures at the ports.

In the case of food, plummeting demand from restaurants and institutions was not fully offset by higher household demand. In any case, differences in packaging and different delivery systems often ruled out a simple transition to retail sales. Furthermore, private healthcare has seen even fairly ill people avoid clinics if they don't have COVID-19 symptoms. One company saw the number of cardio procedures it supported fall from 12 to 15 a week before the lockdown to two or three a week during it.

Some producers were able to shift capacity into essential goods, for instance personal protective equipment (PPE), mattresses and lab coats, as well as packaging for food and healthcare products. A number of initiatives aimed to produce ventilators. In the snowball survey, half of large companies, with over 2 000 employees, were able to shift into essential products. In contrast, only one in seven companies with fewer than 50 workers were able to take this route.

Even companies that increased production of essentials saw a substantial reduction in output, however. Moreover, government procurement procedures remained slow and hard to predict, which meant that producing healthcare products did not guarantee sales. In clothing, businesses often said that production of PPE alone would not stave off closure in the medium term. Similarly, most plastics producers had to shut down the bulk of their production even if they continued to supply the food and healthcare industries.

SECTOR CASE STUDIES

TIPS commissioned case studies of the impact of the lockdown on the auto, steel and plastics value chains. The findings are summarised here. The auto and steel reports have been issued as policy briefs (see online at [auto industry](#) and [steel industry](#)).

1. The auto industry³

The state of the South African auto industry – South Africa's largest export of manufactures, which employs around 100 000 people – is affected by both the global and the national lockdowns. Except for production of inputs for essential services, mostly replacement parts, and critical factory maintenance activities, the entire value chain has effectively ceased all operations. This is in line with the closure of virtually all auto centres outside of China, where production restarted in March. Interviews suggest the permit system for critical operations works well.

³ Our thanks to Justin Barnes, Charles Dednam and Annabe Pretoria for researching the case studies.

The lockdown has imposed huge financial losses and liquidity pressures on the industry. Smaller, second tier automotive component manufacturers appear most affected, largely because they have lower operating margins and limited access to credit.

To date, no major South African vehicle assemblers or automotive component manufacturers have formally initiated retrenchment programmes, but they agree that some downsizing is inevitable. The extent will depend on the effectiveness of government support as well as trends in domestic and international demand when the lockdown ends. Smaller firms fear they may not be able to restart operations if the industry is locked down for much longer. That in turn would affect the competitiveness of the larger assembly operations.

2. The steel industry

The first three weeks of the lockdown were already devastating for every phase of the steel industry, with an estimated cash cost of around R1 billion inclusive of labour and fixed costs. Downstream steel users and information on global markets suggest that demand for steel in the second quarter of 2020 will be half the level before the pandemic, and only recover by 20% to 30% for the rest of the year. Domestic capacity utilisation could fall to around 50% for long steel. Even before the lockdown, global demand was weak and shrinking. Globally, however, steel mills have not cut production fast enough, leading to high inventories and continued downward pressure on prices.

In South Africa, a core problem for the steel manufacturers is that downstream industries such as construction, manufacturing and mining are not paying for steel. As a result, steel producers that are integral to the South African supply chain may not recover, with a longer-term impact on broader industrialisation and competitiveness.

The main essential products in the industry are steel drums for Sasol to transport alcohol for hand sanitisers. The producers were able to buy enough steel from Arcelor Mittal to keep production running during the lockdown. The companies also export containers. Some manufacturers are also looking into the potential for supplying hospital beds and ventilators as well light building frames for fast-tracking hospitals and clinics. These projects will only succeed, however, if there is alignment with national plans and fast-tracked procurement.

3. Plastics

The plastics industry employs around 50 000 workers, many of them in small businesses. From the start, some plastic products were deemed "essential" inputs for healthcare and food, mostly for packaging. Production of face shields and masks as well as other PPE has scaled up, with some lines running at full

capacity. Medical products such as IV lines, blood bags and breathalysers have also expanded, sometimes to the point where it proved difficult to get packaging. Some products and also medicines are being exported to Europe. In addition, the industry supplied 41 000 water tanks at the onset of the lockdown.

Expansion in essential products did not offset the sharp decline in packaging for takeaways, alcohol, personal care, textile and clothing and electronic goods. On net, production and sales have declined. Producers have seen job losses outside of essential products, and their future is now uncertain. There are no reports of layoffs as yet, but retrenchments could occur if the lockdown persists or demand remains depressed after it ends.

MANAGING COVID-19

Reopening the economy has to manage the risks of reigniting the infection through increased social contact at work and during commutes. This section therefore briefly reviews the factors that led to the lockdown, and the public health considerations that will shape its relaxation.

1. The reasons for the lockdown

In early 2020, the COVID-19 pandemic posed a crisis both because the virus is highly infectious and because there was no acquired immunity, vaccines or treatments.

The number of confirmed cases worldwide climbed from zero in early December 2019 to 150 000 on 3 March 2020, one million on 2 April, and 2.5 million three weeks later. Known deaths exceeded 160 000 in late April. These figures are underestimates because many cases are undiagnosed, including when people die at home. Death typically occurs only two to three weeks after symptoms begin, so the death rate will

continue to rise for several weeks after the number of new cases starts to fall.

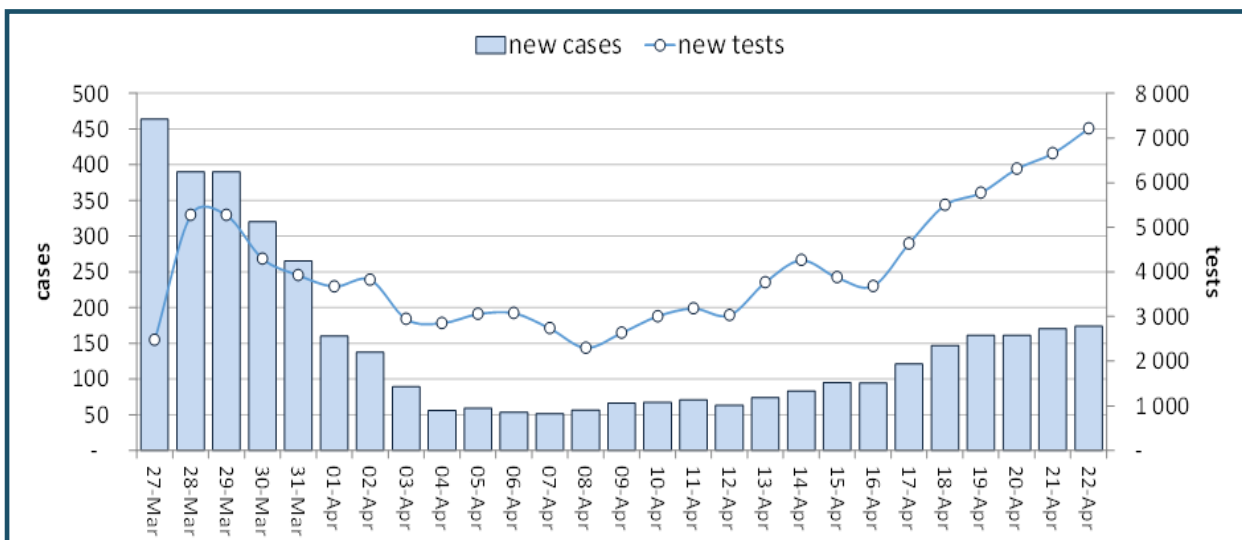
Lockdowns are an extreme measure designed to slow down a fast-spreading pandemic when no alternatives exist. They aim, not to eradicate all new infections, but to buy time for four purposes:

- To establish systems to identify and isolate cases, essentially by ramping up screening, testing and when necessary the isolation of individuals, businesses, other institutions and localities;
- To prepare the health system for a surge in patients;
- To begin to develop more effective treatments and vaccines, although the lockdown period in itself rarely lasts for the months required to test treatments or the years needed for most vaccines; and
- To reorganise work, public transport, schools, retail and recreation to reduce contact through distancing, physical barriers (plexiglass shields, protect clothing) and disinfection.

COVID-19 spreads particularly rapidly in the absence of control measures (physical distancing, use of masks and regular cleaning of hands and shared surfaces) because people are contagious before they have any symptoms, which some never develop at all. Estimates suggest that in Wuhan in China, before the lockdown, each individual case infected five more. To slow down the spread requires reducing that number significantly; to reduce the number infected, it has to fall below one.

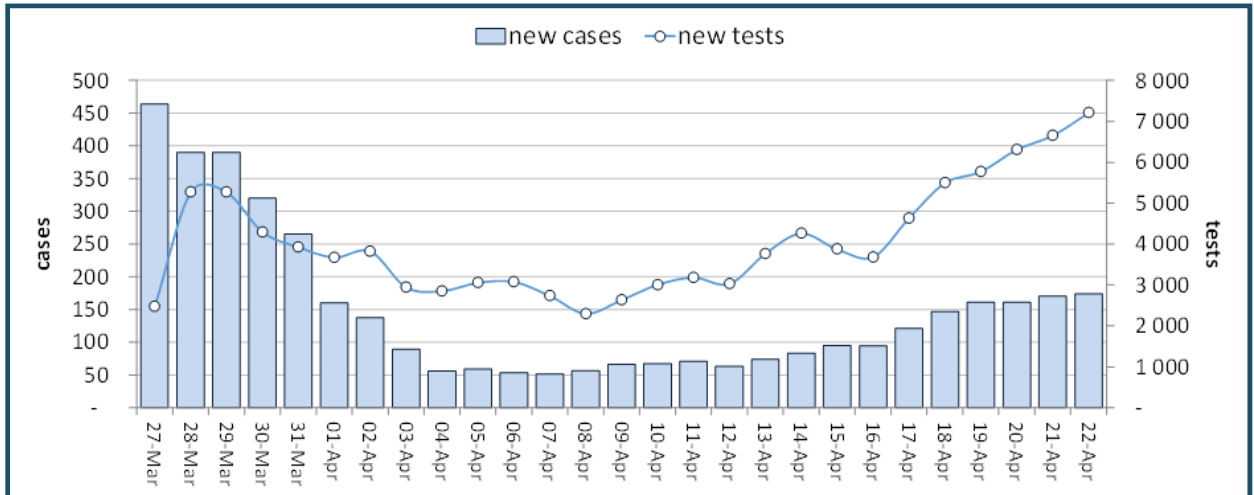
Efforts to manage COVID-19 were complicated by weak responses in much of Europe and the US from February through late March 2020. As a result, as Graph 1 shows, by mid-April the number of cases in these regions was 10 times the average for the rest of the world. In New York alone, the figure was over 1 200 per 100 000. Since Europe and the US are the

Graph 2. Seven-day rolling average (a) of new cases and tests, and number of known cases per million, in South Africa from 27 March to 22 April 2020



Note: (a) From 27 March to 31 March, the average is from 25 March. Source: Calculated from NICD. COVID-19 Statistics in RSA. Relevant dates. Accessed at www.nicd.ac.za.

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epicentres of globalisation, their contagion led to a rapid spread to upper-middle-income economies, like South Africa, that rely heavily on foreign travel for both business and recreation.

Because initial cases arose from foreign visits, the rate of infection in South Africa slowed rapidly in mid-March after restrictions were placed on overseas travellers. (See Graph 2). This origin story also affected how the virus developed in South Africa. Foreign travellers generally belong to the richest 10% of households. They had access to testing and most could isolate themselves in spacious homes. In effect, apartheid entrenched extreme physical distancing on class lines. As a result, the virus did not immediately spread into denser and poorer communities where controlling it proved far more difficult.

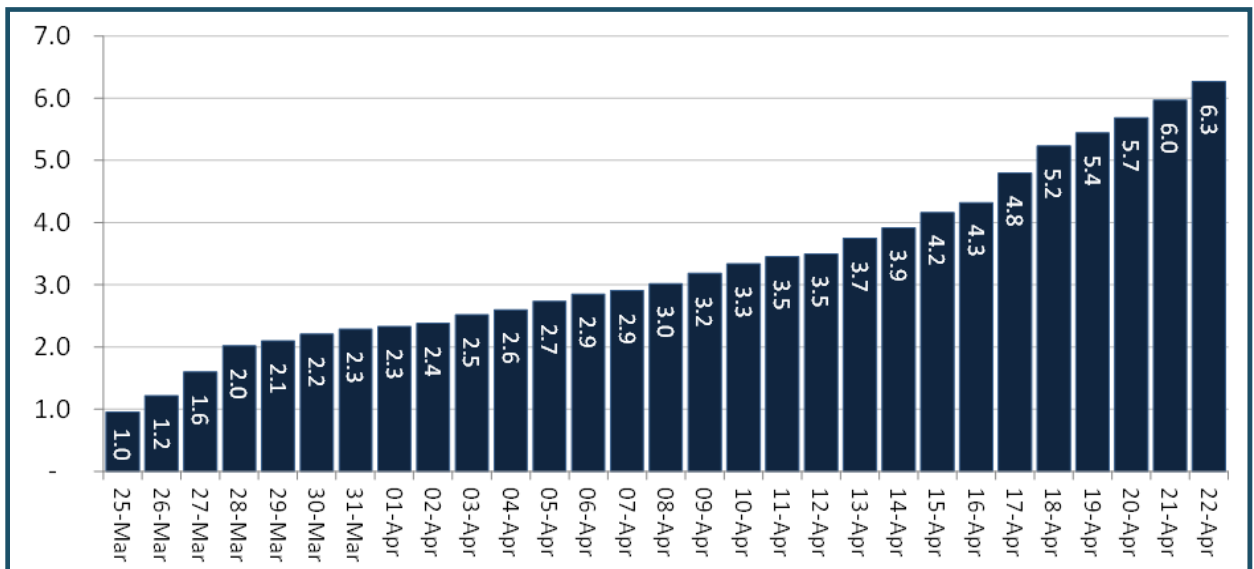
The lockdown did not, however, fully stop new infections inside the country. After the initial sharp fall, the case rate climbed gradually, although it remained far behind the US and Europe.

From 4 to 22 April, the number of known new infections increased around 4.5% a day. They often centred on known clusters, increasingly outside the rich suburbs, arising among others from church services, poor controls in private hospitals, and crowding in jails.

The continued increase in case numbers under the lockdown meant that the infection was delayed, not stopped. The number of known cases per 100 000 people climbed from one on 25 March to six on 22 April (see Graph 3).

At that growth rate, the cumulative number of cases would double every two weeks, and reach 150 000 in three months. Most of the accumulated total would no longer be ill, but there would still be around 130 active cases per 100 000 South Africans. Other countries with that level of cases experienced significant difficulties in hospitals and communities, with the attendant risk of higher death rates.

Graph 3. Number of known cases per 100 000 people, 25 March to 22 April 2020



Source: Calculated from NICD. COVID-19 Statistics in RSA. Relevant dates. Accessed at www.nicd.ac.za

Until a vaccine or effective treatment is developed, measures to control the spread of COVID-19 will have to remain in place. Ideally, however, the spreading infection will be managed increasingly through more targeted measures both to monitor and contain the spread of the virus, and to maintain physical distance in a wider range of activities.

2. Managing the risks of restarting economic activities

Until a vaccine or effective treatment is developed, measures to control the spread of COVID-19 will have to remain in place. Ideally, however, the spreading infection will be managed increasingly through more targeted measures both to monitor and contain the spread of the virus, and to maintain physical distance in a wider range of activities. In particular, that means the following.

- Government would have to scale up measures to identify and quarantine individual cases and clusters through screening, testing, contact tracing and isolation. Localities with higher levels of infection – which could be suburbs or entire municipalities or metros – could see more generalised restrictions. Compared to a lockdown, these targeted monitoring and control measures place more visible burdens on the public health system and the government budget, but they are far cheaper for society.
- Individuals and collectives of all kinds would have to reorganise activities outside of the home to make them safer. Typically, that means reorganising work and public transport to maintain space, using masks, providing sanitiser, restricting the numbers using facilities, and sometimes regular temperature tests. The process of opening generally starts with activities that are seen as more important and easier to undertake safely.

This phase in controlling epidemics has been called a dance, as measures to limit and identify infections are tried and refined, and sometimes reversed, in contrast to the brute-force hammer of a national lockdown.⁴ It is dancelike because the measures to permit new activities and behaviours do not follow a set path. Moreover, they are unpredictable, since an unexpected outbreak may lead to a reversal, with restrictions reinstated.

South Africa has an advantage in terms of screening, testing and tracing because efforts to control the spread of HIV and TB have left it with strengths

around expertise, equipment and systems. The public health authorities used the lockdown period to expand screening for COVID-19 symptoms as well as tracing. By 20 April, they had deployed many of the almost 30 000 community health workers and screened over a million individuals. That was a high level of screening by international standards. The number of tests climbed from around 2 500 a day at the end of March to an average of 6 500 between 18 and 22 April, with around half at public facilities.

As discussed in the Annexure, the economic discourse in recent weeks has tended to highlight mass testing to ensure the most accurate monitoring of infections. This approach has been particularly attractive in the US, where mass screening and tracing capacity barely exist. Given the global shortage of test materials, however, many countries have found it hard to achieve their targets for testing. Moreover, the level of testing required in countries with a high level of infection and virtually no screening or tracing is likely administratively impossible. For this reason, making efforts to reopen the economy dependent on testing will cause additional delays. At the current rate, for instance, testing 0.5% of the population will require over three weeks.

If mass testing is not viable, then efforts to manage the risks of reopening the economy will require that some limits on in-person social and economic engagements persist. From this standpoint, activities that require interactions, posing a risk of infection, fall on a continuum from basic essentials to frivolous. Restrictions will remain longer when policymakers or consumers see an activity both as higher risk and as less necessary. That means recreational activities are likely to be permitted after other forms of production, and to experience a slower recovery in demand.

Views of what is essential vary substantially between stakeholders. In South Africa, for instance, government deemed parts of the mining value chain as essential, but not food or wine exports. In the US, states have decreed variously that bicycle shops, gun stores and professional wrestling constitute essential services. A more explicit and coherent discussion on what activities are important for the economy, for equality and for households would help in setting an agenda for reopening the economy.

⁴ Thomas Pueyo. 2020. *Coronavirus: The Hammer and the Dance*. 19 March. Accessed at www.medium.com on 20 April 2020.

Table 1. Illustration of choices in evaluating the importance and risk of value chains

Note: For each set of criteria, the value is averaged with the risk, on a scale of 1 to 5. The value for the economy is only in terms of production, which understates for instance the enabling role of PPE and telecommunications. The value for society is necessarily subjective. Opportunities for women reflect the share of women in the labour force for the value chain.

	Economic impact	Social cohesion	Women's work	Ability to manage risk	Share in GDP/ exports	Labour intensity/ SMEs	Social importance	Opportunities for women
	1 + 2	1+3+4	1 + 5	1	2	3	4	5
Auto	5	3.0	3.0	5	5	1	3	1
metals	5	2.3	3.0	5	5	1	1	1
mining	4.5	2.3	2.5	4	5	2	1	1
machinery	4	2.3	2.5	4	4	2	1	1
food for SA	4	4.0	3.5	4	4	3	5	3
food and wine exports	3.5	3.0	3.5	4	3	4	1	3
healthcare	3.5	4.3	4.0	3	4	5	5	5
freight transport	3	2.3	2.0	3	3	3	1	1
fashion	3.5	4.0	4.5	4	3	3	5	5
telecommunications	3	3.3	3.5	4	2	1	5	3
security	3	4.3	3.0	4	2	5	4	2
cleaning	3	4.3	4.5	4	2	5	4	5
PPE	2.5	4.0	4.5	4	1	3	5	5
education	2.5	4.0	3.5	2	3	5	5	5
concerts and theatre	2	3.3	2.5	1	3	5	4	4
restaurants	1.5	3.0	3.0	1	2	5	3	5
public transport	1.5	3.0	1.0	1	2	3	5	1
personal services (e.g. hair dressing)	1.5	3.3	3.0	1	2	5	4	5
church services and family gatherings	1	3.7	2.5	1	1	5	5	4

Table 1 illustrates some of the trade-offs. For instance, many socially important and labour-intensive activities, such as church and family gatherings as well as personal services, are high risk and do not contribute much to the GDP or exports.

Heavy industry dominates South African exports, but provides few opportunities for women. Companies that were able to produce during the lockdown introduced substantial changes in their practices to reduce the risks, in part on the basis of government regulations. Businesses mentioned the following measures:

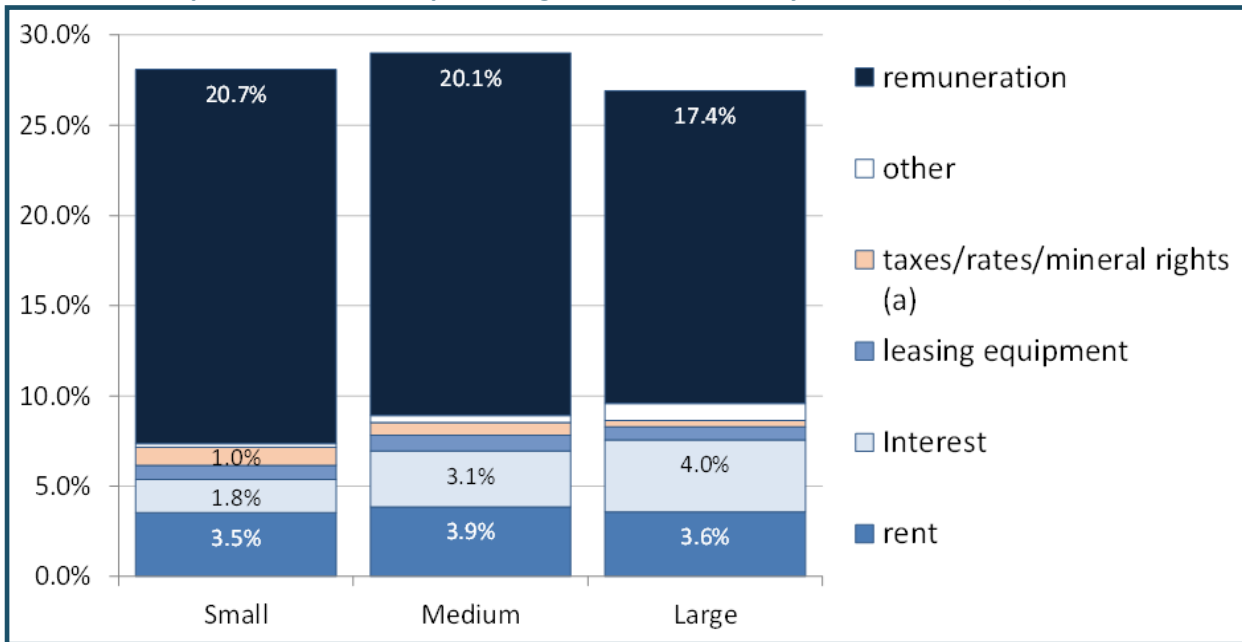
- Services and management started working from home;
- On-site producers instituted sanitising and protective clothing, often at a significant cost, and reorganised work to maintain physical distancing where possible;
- A few larger employers conducted regular temperature screening or even testing; and

- Some staggered shifts to reduce crowding on transport for employees.

Several noted that while they could reduce risks in the workplace, they could not do much to influence public transport. Virtually none said they provided their own transport for workers, although in some cases they encouraged car-pooling.

In sum, the lockdown will likely end, not with a bang, but a whimper. Risk management requires that it be gradual, unpredictable and uneven both geographically and by industry over the coming months. It will depend on a combination of identifying, tracking and isolating COVID-19 infections, and the adoption of new practices especially in production and during commutes to minimise the risk of infection. Businesses that require more contact, such as retail and events management, will likely only be able to re-open later, as discussed in the subsection *Sectoral limits* in the following section. Restrictions will also linger longer for recreational activities that involve group interactions.

Graph 4. Fixed costs as percentage of cash on hand by size of business (a), 2018



Notes: (a) Fixed costs are defined for the period of the lockdown, so they include employment, rent and equipment leases, since the contracts usually extend beyond a month. Cash on hand is cash and cash equivalents. Company size is based on dti legislation. (b) Company income taxes, VAT and mineral royalties should decline with sales, so the figures here are overstated. Source: Calculated from Statistics South Africa. Annual Financial Statistics. Excel spreadsheet. Downloaded from www.statssa.gov.za in April 2020.

ECONOMIC CHALLENGES TO RECOVERY

In addition to the risks arising from the pandemic, a number of economic obstacles will likely make it more difficult to return to growth.

Above all, most businesses are facing a liquidity crisis, since they have had little or no income for over a month but have had to pay some costs; restrictions have affected value chains from raw materials and inputs to sales, not just individual producers; both international and domestic demand are depressed due to the lockdowns, and the economy was slowing even before the pandemic hit; and the industries that present the greatest difficulties for physical distancing – many services plus retail – are also the largest employers.

These economic difficulties vary significantly by sector. Critical factors included whether industries were able to remain open during the lockdown; the nature of demand for their products; and their economic position before the crisis.

1. The liquidity crisis

The lockdown stopped or substantially reduced sales for most businesses, including some in essential services. Many had limited reserves going into the lockdown because of the 2019 recession. But they still faced fixed costs, above all wages but also rent, interest and taxes. As a result, a number said they would find it difficult to reopen and in any case would likely still retrench some workers after the lockdown ended. Virtually all said that the longer restrictions on production and sales lasted, the more likely they would be to go out of business.

Graph 4 shows fixed costs as a percentage of cash on hand for formal enterprises by size in 2018. The 2019 recession likely reduced the cash reserves for most producers, and the averages hide substantial variations between businesses in the same size range.

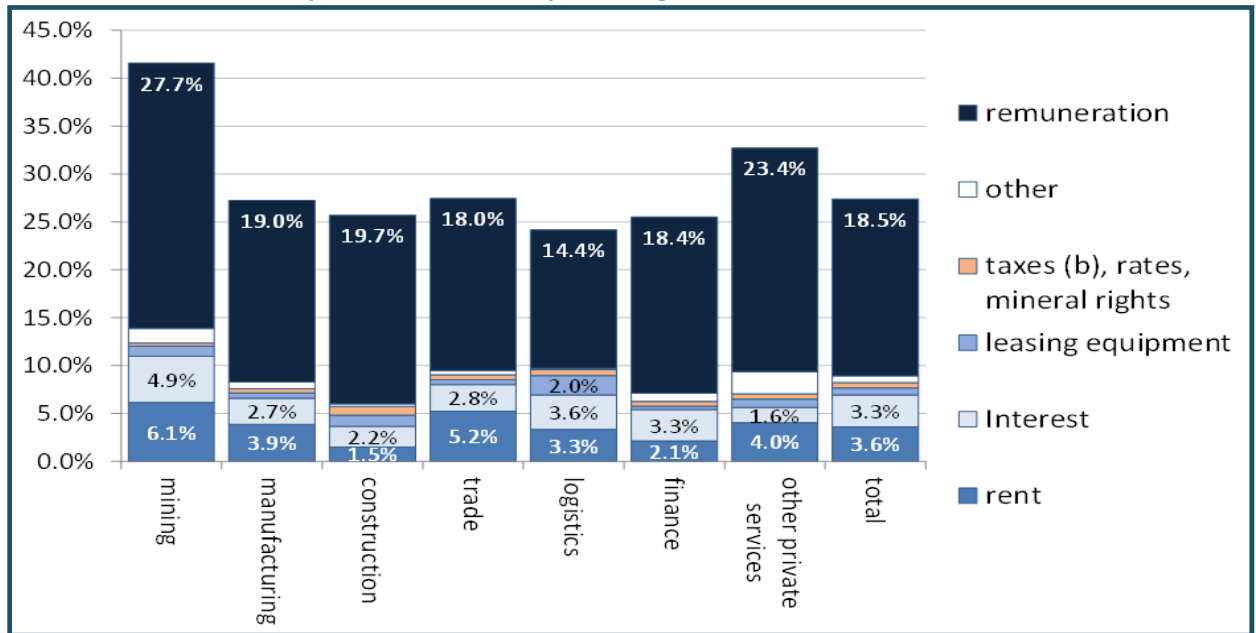
Irrespective of business size, remuneration accounted for the bulk of fixed costs. The share was higher for smaller companies, which mostly operated in more labour intensive sectors, largely in services and retail. The majority of respondents to the snowball survey said they were still paying their workers even if they were not working. Several required employees to use annual leave time, but that did not relieve the immediate strain on liquidity. A few said they had applied the “no work, no pay” principle.

The largest costs after remuneration, on average, were rent, followed by interest payments. Payments to government as a share of cash reserves were highest for small businesses, at 1%. For medium-sized enterprises, the figure was 0.7%, and it was 0.4% for large businesses.

As Graph 5 shows, fixed costs varied by industry, but remuneration dominated across the board, followed by rent and interest payments. Transport and telecommunications (labelled as logistics in the graph) also faced substantial charges for equipment rentals. Payments to government in the form of taxes, rates and mineral leases averaged 0.6% of cash on hand across all industries, but ranged from 0.3% for mining to 0.9% in construction.

In the auto industry, major producers see their ability to survive the lockdown as almost entirely dependent on credit relief and support in meeting payroll.

Graph 5. Fixed costs as percentage of cash on hand (a), 2018



Notes: (a) Fixed costs are defined for the period of the lockdown, so they include employment, rent and equipment leases, since the contracts usually extend beyond a month. Cash on hand is cash and cash equivalents. (b) Company income taxes, VAT and mineral royalties should decline with sales, so the figures here are overstated. Source: Calculated from Statistics South Africa. Annual Financial Statistics. Excel spreadsheet. Downloaded from www.statssa.gov.za in April 2020.

The OEMs do not see the lockdown as an existential crisis but are losing large amounts of money. Smaller producers face a greater threat from the liquidity crisis.

Many businesses were in trouble before the lockdown as a result of the recession and loadshedding. For instance, one plastic company had to cut its production in half in February and March due to loadshedding. Construction has been in a five-year decline, so many enterprises had very limited reserves even before the lockdown

Government has sought to help companies manage fixed costs through payments from the UIF; a reduction in taxes for workers earning under R6 750; and by deferring income tax and VAT payments, and speeding up refunds where due. It has also instituted various schemes to extend credit especially to small-scale producers. In addition, it encouraged private donors, who have set up funds worth R2 billion to provide soft loans to small formal businesses.

The main weakness to date has been the failure of the UIF to get up to scale. It committed R37 billion to meet claims arising from the pandemic, including R10 billion for TERS. As of 20 April, however, it had paid out only R1.1 billion, and still had to process 60% of claims. For companies facing a cashflow crisis, however, delays could mean help comes too late to save jobs or even the enterprise.

The tax relief on payroll, provided under the Employee Tax Incentive, reduced payments by just R500 per worker per month. That equalled only about a tenth of median pay in the formal sector, which seemed unlikely to reduce the cash crunch substantially. The deferral of national taxes would

provide real relief, but did not affect municipal rates and basic service costs.

Finally, the credit schemes are important but risky for companies to take on before the economy has restarted.

As noted, some sectors may face considerable time before they can reopen at all. Moreover, demand is likely to remain soft as a result of lower incomes both in South Africa and internationally. In any case, as of April 22 it was not clear when the public credit schemes will start to provide loans or how difficult it will be to get them. Support for spaza shops, for instance, would require the purchase of goods on an approved list of small local suppliers, which experience shows can often lead to significant delays and logistical issues.

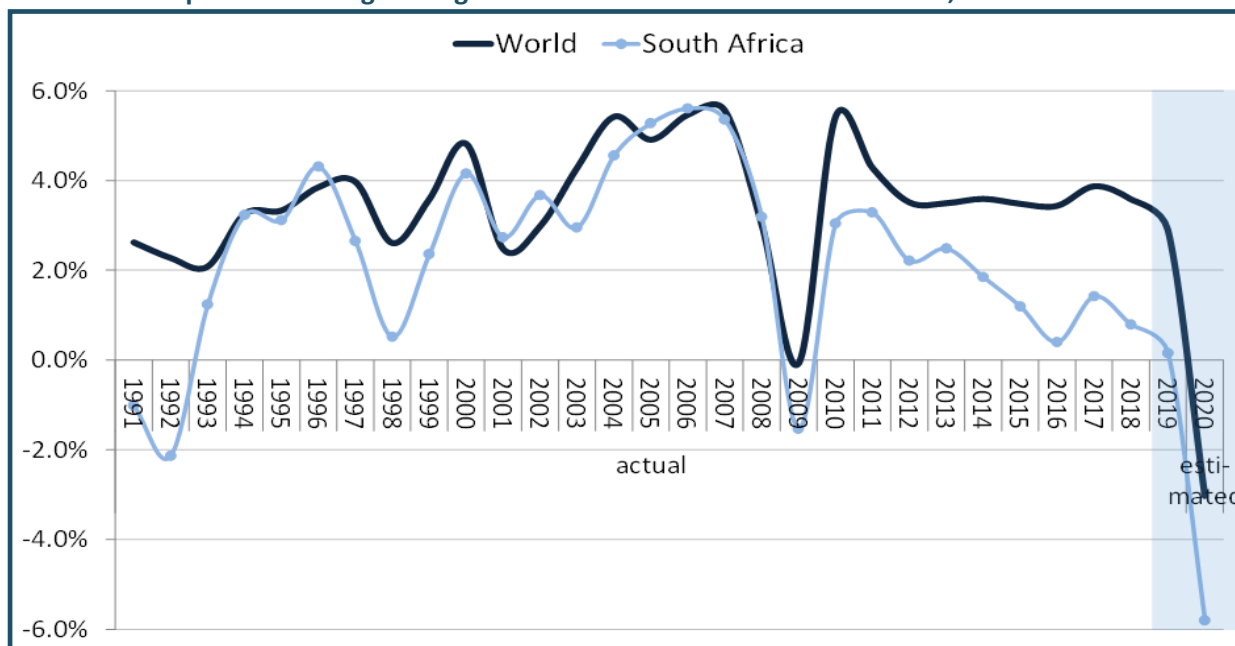
The application of preferences for black empowerment also imposes some trade-offs, since 40% of small formal businesses are owned by white families. They would not qualify if black ownership were required but might benefit if broad-based empowerment criteria were used. Similarly, support for spaza shops was limited to South African citizens, which excludes many outlets in both urban and rural areas.

2. Restoring value chains

Measures to reopen the economy will not work if they relate to industries rather than value chains. To restart production, businesses must be able to get their goods to customers or obtain key inputs.

On the demand side, the challenge emerges sharply for consumer goods. It seems likely that clothing and

Graph 6. Percentage change in GDP for the world and South Africa, 1991 to 2020



Source: IMF. *World Economic Outlook*. April 2020. Interactive dataset. Accessed at www.imf.org in April 2020.

other retailers outside of food, pharmacies and hardware will remain restricted. Some proposals would continue to limit delivery services outside of food as well. That in turn means that producers of non-essential fashion, appliances, plastic products and other consumer goods would not be able to sell their output.

In terms of inputs, most production processes in South Africa rely at least in part on imported machinery and equipment. Capital goods and auto manufacturers generally import the bulk of advanced components. These inputs are produced in Asia, Europe and the US. Their availability will depend in part on when production starts up there. Most of China's manufacturing has reopened, although often still not at full capacity. In contrast, supply from the US and Europe remained limited as of late April. Even after supply recovers, the depreciation of the currency, mostly due to capital flight but also to declining prices for metals (except gold) and coal, will continue to put pressure on import-dependent industries.

A challenge for the auto industry is that, absent effective government support, smaller local suppliers may not survive the lockdown. That would in turn put the assembly operations at risk.

In plastics, depreciation has increased the cost of imported inputs, largely cancelling the benefits of increased demand for essential goods. China re-entered production just in time to avoid shortages of inputs. The industry initially experienced hiccups in obtaining maintenance, electrical and fitting services, but the suppliers have now been deemed essential.

Finally, before the lockdown loadshedding and the high cost of electricity dragged heavily on production across the economy. They followed from fundamental

problems with the Eskom business model. The main measure to address the challenge was to permit increased supply to the grid by small private producers, which in turn would let Eskom undertake planned maintenance and rehabilitation. Failing to drive this strategy, including both the regulatory reforms and the upgrading of Eskom generation capacity, will impede any economic recovery.

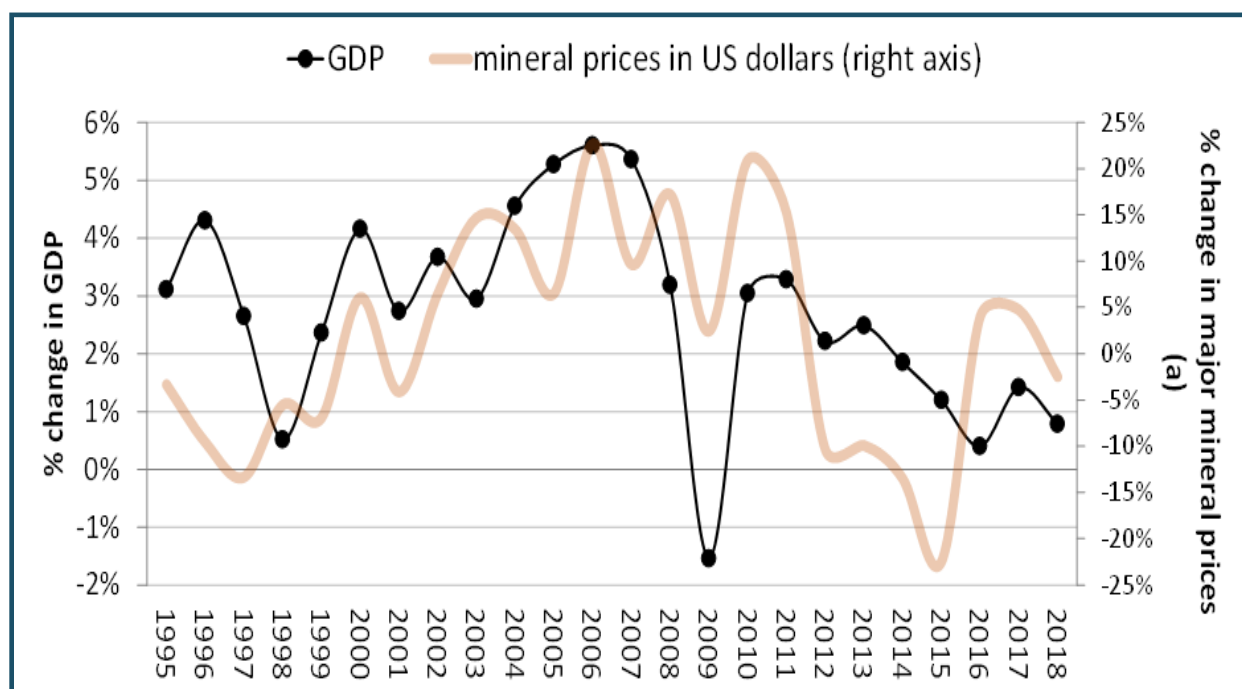
3. Depressed demand

The lockdown has reduced incomes and consequently demand from both households and along value chains in South Africa. Lockdowns in China, Europe and the US have had a similar impact, which depressed demand for South African exports. The sharp fall in demand as a result of the pandemic has a harsher impact because growth was slow globally even before the pandemic. As Graph 6 shows, growth internationally and in South Africa has generally slowed from the end of the commodity boom in 2011, with a particularly sharp decline from 2018.

The US and much of Europe have responded to the downturn with massive stimulus packages, geared mostly to meeting at least part of the wage bill for affected workers as well as providing loans to small business. In addition, spending on healthcare has increased sharply. China has had less of an explicit fiscal stimulus, but it has made some moves toward easing access to loans. Despite the stimulus packages, it is not clear how quickly global markets will recover. Even before the lockdown, significant fragilities had emerged internationally and in South Africa, as shown by the declining growth rates from 2017. In particular:

- Chinese dependency on demand from Europe and the US means its recovery may be slow as long as demand and production are affected by the pandemic.

Graph 7. Annual percentage change in GDP compared to annual percentage change in international price of exported metals, ores and coal



Note: (a) Trade-weighted index of prices for coal, iron ore, platinum and gold. Source: For GDP, Statistics South Africa; for prices, Index Mundi/IMF commodity prices.

- Very low interest rates from 2008 led to the accumulation of debt by large companies, which may lead to depressed demand even after the lockdown.
- The recovery from the global financial crisis in 2008/9 saw deepening inequalities in the US and Europe. That in turn fuelled the rise of populist and national governments, which arguably underpinned the weak response to the crisis, notably in the US, the UK and Italy.

Even before the downturn, South Africa was in a recession. It resulted mostly from persistently low export prices, as demonstrated by Graph 7. It was, however, aggravated by the failures at Eskom; the after-effects of state capture; and pro-cyclical fiscal and monetary policies.

It is unlikely that household demand will recover immediately after the lockdown. In key industries, production and employment will remain limited for some months. Depending on the effectiveness of government measures to deal with liquidity challenges, bankruptcies and job losses may persist through the end of the year. In addition, the sharp fall in the stock market means that the top 10% of households, which account for well over half of non-food consumption, will likely hold back on consumption.

Government has adopted a fiscal recovery package valued at R500 billion, combined with a somewhat more relaxed monetary stance. A core challenge will be to disburse the funds, which has historically been

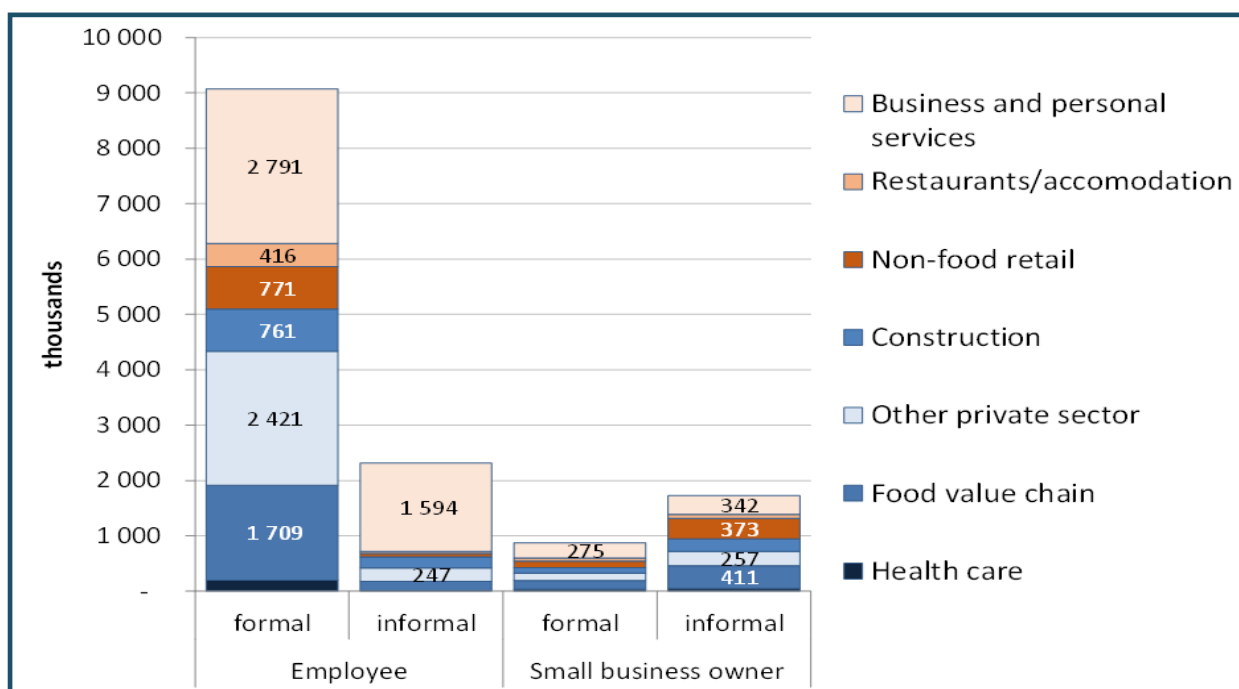
an obstacle especially for programmes that aim at meeting the needs of low-income communities or promoting economic diversification.

In addition, timing will be a challenge. In the short run, while economic activity is heavily restricted, stimulating demand will not have much impact. In this period, the stimulus package is geared mostly to upgrading the health system and to maintaining incomes for the poorest 60% of households through a modest increase in social grants and the UIF. In the longer run, government demand will likely be critical. A central question will be how it divides the resources between the core developmental needs of community infrastructure, economic infrastructure, support for diversification and regional development, agrarian reform and township economies, and improving access to quality education and skills development. Experience shows that it is easier to expand infrastructure than to implement programmes to restructure production and ownership in order to create a more equitable, inclusive and dynamic economy.

3. Economic reopening and employment

As noted in the subsection *Managing the risks of restarting economic activities* (page 7), the services and retail are likely to be among the last sectors to reopen fully. These sectors are critical for employment and for small and informal businesses. By extension, it is likely that job creation will lag the reopening of the economy. That raises the risk that measures to address the pandemic lose public support and consequently become unsustainable.

Graph 8. Employment in private-sector services and non food retail compared to other private industries, in thousands, 2017



Source: Calculated from Statistics South Africa. Labour Markets Dynamics 2017. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za in December 2018.

As Graph 8 shows, two fifths of formal and three quarters of informal waged employment was in services and non-food retail. Around half of small businesses in both the formal and informal sector were in these industries.

If the reopening of the economy proves easier for capital-intensive, export-oriented industries dominated by large-scale producers, redistribution will have to form part of any recovery package. Current proposals for household income support are expected to last for six months, but the full return to normal operations for services and retail may take longer, depending on the progress of the pandemic, treatments and vaccines. In that case, government might have to facilitate a just transition to other kinds of production for affected workers and small businesses.

CONCLUSIONS

Reopening the economy will take time and provide opportunities unevenly by industry and region. The regulation of economic activity will depend in part on the extent of infections, in part on the relative priority given to different value chains, and in part on the risk associated with the production of specific goods and services. But the recovery will also be affected by economic factors, in part rooted in the shutdown period and in part reflecting long-standing economic challenges nationally and internationally.

Government has announced a range of short-run measures to assist households faced with lower incomes and to cushion businesses faced with a disastrous decline in sales. In the medium to long run,

however, it will need to develop more coherent plans to support key value chains pro-actively. Those plans will have to overcome the immediate liquidity crisis, ensure adequate and affordable electricity, and coordinate opening along the value chain. A particular challenge will be to find ways to enable sales of consumer goods other than food and medicines if retail remains restricted. In addition, it is critical that the strategy to fix the electricity system be implemented vigorously despite the sharp fall in demand during the lockdown.

In the short run, the obvious priorities for reopening are the lead export industries in the mining value chain as well as auto, food and the production of healthcare inputs. In the longer run, however, a core question will be how to drive structural changes to diversify more strongly away from dependence on mining exports, which since the end of the international commodity boom has been unable to support dynamic growth or job creation. That in turn requires a stronger degree of consensus around what value chains as well as investments in education and infrastructure can both succeed and do more to generate employment and support more equitable incomes and wealth.

Finally, the economic recovery seems likely to generate limited employment in the short run, as measures to manage the risk of the pandemic inherently militate against restarting the labour-intensive retail and services sectors. By extension, the redistributive measures established to deal with the relatively short-run effects of the lockdown may need to be extended for at least a year.



APPENDIX: ALTERNATIVES TO MASS TESTING

Economists have argued that mass testing is the best way to manage the risks of infection from restarting economic activity because it can in theory rapidly pinpoint new cases. But as this pandemic is global, most countries cannot get the necessary inputs, especially reagents and specialised swabs, even if, like South Africa, they have systems in place to administer them and to follow up with contact tracing. If opening the economy depends on mass testing, it will be delayed for weeks or even months.

The focus on testing has become extreme in the US, largely as a way to compensate for its near-absence of capacity for tracing contacts. The US had about 2 200 contact tracers in late April.⁵

For comparison, South Africa had a fifth the population but 30 000 community health workers, who were able to undertake contact tracing on a mass scale. To reach the level of staffing for tracing in South Africa, the US would need to increase its capacity over tenfold. Given the near-absence of contact tracing capacity, the economist Paul Romer argued that reopening the US economy without an attendant spike in cases would require at least 20 million tests daily – enough to test every citizen once every two weeks.⁶

⁵ Jessie Hellman. 2020. *Why Contact Tracers are Key to Unlocking the Economy*. In *The Hill*. 18 April. Accessed at www.thehill.com in April 2020.

⁶ Cited in Umair Irfan. 2020. *The Case for Ending the COVID-19 Pandemic with Mass Testing*. From *Vox*. 13 April. Accessed at www.vox.com in April 2020.

⁷ Danielle Allen et al. 2020. *Roadmap to Pandemic Resilience*. Edmond J. Safra Center for Ethics at Harvard University. Cambridge, Massachusetts. Page 6.

⁸ Robinson Meyer and Alexis Madrigal. 2020. *A New Statistic Reveals Why America's COVID-19 Numbers are Flat*. In *The Atlantic*. 16 April. Accessed at www.theatlantic.com on 20 April 2020.

A study published by the Safra Centre at Harvard called for five million tests a day in June to permit partial economic reopening, ramping up to 20 million a day to return to full production.⁷ Under this approach, restarting the US economy would require that the daily number of tests climb from five per 10 000 people in late April to between 150 and 600 per 10 000 over the next two months.

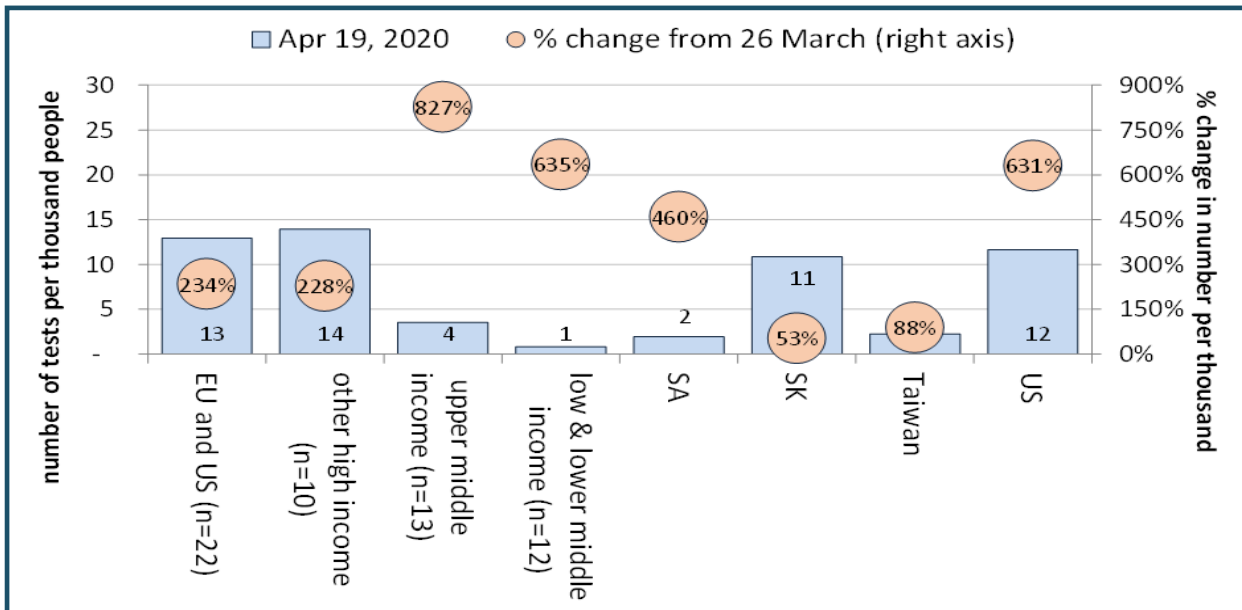
For comparison, South Korea successfully contained the pandemic through late April through extensive screening, testing and contact tracing plus social distancing. It tested around two people per 10 000 residents a day from February. On 20 April, South Africa tested 1.2 people for each 10 000 residents, up from just over 0.5 people per 10 000 a month earlier.

In theory, the advantage of vastly scaling up testing to manage the risks of reopening the economy are inarguable because it would minimise disruption to work organisation and daily life. The aim is to manage the risk of infection by increasing monitoring to a near-comprehensive level, reducing the need for contact tracing, quarantine of suspected cases, physical distancing and sanitation. Countries like South Korea that have contained the virus to date did not adopt this approach, but they also started before the virus was widespread. They linked testing to screening for symptomatic individuals and tracing contacts, and maintained a high degree of physical distancing, although not always a full lockdown.

The practical obstacles to testing on a mass scale are daunting.

To start with, production of testing materials, especially the chemicals and specialised swabs, fell far behind demand from February 2020. Not coincidentally, the two countries that ramped up testing early on, South Korea and Germany, both had substantial and well-established capacity to manufacture tests. For other countries, procuring the necessary inputs became increasingly expensive and subject to delays.

Graph 9. Cumulative tests per 1 000 people by country income level as of 20 April 2020, and percentage growth in testing from March 31 (sample based on available data) (a)



Note: (a) The sample of countries providing information is only around a quarter of the total, and proportionately smaller for lower income economies. The numbers for each group are given in brackets. For the change in tests, the sample is even smaller, as many countries did not report any figures for March. The total sample for tests per thousand is 57; for the change in numbers, it is 44 countries. Figures for country groups are unweighted averages. Source: Calculated from Roser, M. et al. 2020. total tests for COVID-19 per 1000 people. Excel spreadsheet. Oxford University. Downloaded from www.ourworldindata.com in April 2020.

As Graph 9 shows, as of 19 April the high-income countries had tested over 10 people per 1 000 of population, compared to four in upper-middle-income economies and one in low and lower-middle-income countries.

The high-income countries had doubled total tests from late March. Upper-middle-income countries had increased testing eight-fold on average; in South Africa, the number was up five-fold. Nonetheless, they still lagged far behind the rate of testing in high-income economies.

Mass testing also imposes substantial organisational burdens. The proposals for the US effectively require daily tests for one in every 150 citizens. Currently there is no home-testing, so the public health system would have to identify millions of individuals every day to test, and then match them up with someone to take the sample. Even at the much lower levels of late

April, procuring the protective equipment needed for people administering the tests had become a blockage to scaling them up.

Finally, tracking the pandemic in the US and Europe required a high testing rate in part because of the extent of infection. That made it difficult even to estimate the prevalence of the disease or to identify hotspots without extensive random tests. In contrast, in countries that started tracing cases earlier, like South Africa, the contagion is largely limited to localities and institutions. In these circumstances, mass screening combined with targeted testing is more efficient than testing on a huge scale. In the US, the share of tests that came back positive in mid-April was 20% (and 40% in New York); it was between 5% and 10% in Europe; and in South Korea, it was 2%.⁸ In South Africa, between 4 and 20 April the figure fluctuated around 3%.

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