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MACROECONOMY

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IEJ Collaborator: Gilad Isaacs, Duma Gqubule and Redge Nkosi

Institute for Economic Justice, Centre for Economic Development and Transformation, and First Source Money (respectively)

1. WHY MACROECONOMIC POLICY MUST BE PART OF THE JOBS SUMMIT DISCUSSION

The traditional South African approach by economists, business and government to solving the country's unemployment challenge revolves around addressing issues like skills, labour laws, labour brokers, strikes, wages, equity, and related microeconomic aspects. While these issues do matter, this approach does not fully address the nature of the problem. It is precisely because of this approach that past efforts to curb unemployment have failed to yield desired outcomes.

Firstly, unemployment or employment is a macroeconomic phenomenon. As such, attempting to solve a macroeconomic challenge using microeconomic doctrines disregards the role that macroeconomic variables have on shaping employment levels. The impact of variables such as deficits, debt, inflation, finance/savings, etc. on unemployment is critical.

Secondly, South Africa's experience shows that attempting to solve this stubborn macroeconomic problem with microeconomic interventions – as has dominated policy making to date – have failed to address this intractable problem.

Thirdly, microeconomic reforms are unlikely to have an immediate and direct impact on the economy, and unless immediate bold intervention is taken, the economy will continue to stagnate.

In recognition of the centrality of both fiscal and monetary policies to (un)employment, JM Keynes (1980: 267) stated that the principal objective of fiscal policy was to solve "the real problem, fundamental yet simple… (namely) to provide employment for everyone". Keynes (1930: 220) was equally categorical on monetary policy as providing the "pavement… in order that the productive powers of the community can be employed at their full capacity".

It is thus clear that any serious deliberations about solving the unemployment crisis in South Africa without bringing in an employment-centric macroeconomic policy approach will be futile. In this instance, even targeting the output gap instead of the labour gap will not help clear the unemployment problem we face.

2. NATURE OF THE PROBLEM

Macroeconomic policy in South Africa has not been geared towards developmental ends. This is a long-standing problem as discussed below. From both a monetary and fiscal perspective, South African policies would generally be described as contractionary. The phrase contractionary is derived from the way such policies contract the economy. Contractionary fiscal policy mostly involves the cut in fiscal spend or increase in taxes, whereas contractionary monetary policy is about raising interest rates. Recently, the risks posed by the prevailing macroeconomic policy approach have been accentuated. This has occurred because of the growing imposition of fiscal austerity and the on-going contractionary nature of monetary policy in the face of persistently sluggish economic growth. In the

three years between 2016/17 and 2018/2019 (see Table 1 in the Appendix), average annual growth in government expenditure (in real terms) excluding interest payments was 0.3%, population growth was 1.6% This shows that per capita expenditure is actually falling.

In 2017/18, economic affairs, housing and community amenities, agriculture and public order and defence all saw falls in their expenditure (of -3%, -2%, -3.6% and -0.4% respectively). In 2018/19, the health budget will fall by -0.1%. Given the scale of the crises faced in sectors across the economy, such a situation poses significant risks.

Austerity has proven extremely harmful internationally. In the wake of the global financial crisis (GFC) numerous countries imposed austerity in order to reduce debt burdens (or so their governments claimed). In all cases austerity has led to a contraction in the economy and an undermining of social services. As David Stuckler and Sanjay Basu show in their book The Body Economic: Why Austerity Kills, this is not a new result. When comparing states in the United States during the great depression, countries after the collapse of the Berlin Wall and economies in the wake of the GFC, those that instituted austerity saw far worse outcomes than comparable countries who pursued a stimulatory route. Further, austerity has failed to reduce debt relative debt burdens, as GDP shrinks the debt-to-GDP ratio rises even if gross debt is reduced.

Contractionary monetary policy – through raising of interest rates in an attempt to reduce the money supply and depress demand in order to control inflation – can be equally as harmful. Between June 2006 and June 2008, the South African Reserve Bank (SARB) raised its repo rate by 500 basis points while virtually every central bank in the world cut rates in the wake of the GFC. The SARB did cut its rate between December 2008 and July 2012 but by much less than most other developing countries. The South African economy faired far worse than many of its peers during this period, although there was a modest recovery between 2010 and 2013. However, tighter fiscal and monetary policies after 2014 contributed towards putting on the economic brakes, and at the start of 2014, the SARB began another cycle of tightening.

While these contractionary fiscal and monetary stances have intuitive appeal, they often lead to reduced output, increase in unemployment and expansion of deficits and thus debt.

In environments of both monetary and fiscal contractions, prospects for job creation are reduced. Often, these positions lead to an increase in unemployment, which in turn impacts on aggregate demand and thus poor growth. With both monetary and fiscal policies tightened, the economy is unlikely to recover quickly without an active hand from government.

The most plausible way to revitalise the economy is therefore through either a fiscal or monetary stimulus. A coordinated approach to raising aggregate demand and or increasing lending to the productive sectors of the economy is known to be the most effective way of spurring growth.

However, since 1996, South Africa has adopted an "orthodox" macroeconomic policy framework – reducing tax rates, limiting borrowing, moderate increases in fiscal expenditure, widespread trade and financial liberalisation, financial sector deregulation and containing inflation through short-term interest rate manipulation (inflation targeting) together with an "independent" central bank. The state has largely been cast in the role of a "market enabler", attempting to ensure "business confidence", rather than an interventionist state that should strongly steer the course of development in the country. In the first decade of democracy, industrial policy was weak and public sector spending and borrowing was perceived to "crowd-out" private sector investment. The focus throughout has been on creating a "stable environment" in which it was presumed the private sector would invest, including through significant foreign direct investment (FDI).

Large-scale, job-creating investment has not been the result of this macroeconomic framework. Rather, short-term money flows dominate the capital account, moderate spending has left South Africa with a massive housing backlog, failing schools, and a looming health crisis, to mention but a few sectors, and investment has been contained by high interest rates, a lack of domestic demand, and poor industrial policy. Instead of investment, private sector funds have been channelled into speculative finance or remain idle. The growth path of the economy has shifted somewhat with de-industrialisation and financialisation coming to the fore. However, the underlying political economy of an economy dominated by mining, mining-linked manufacturing, finance and now services, with weak manufacturing sectors, all supported by low wages for the majority, has remained in place. This has fuelled high levels of joblessness, poverty

and inequality.

3. PREVIOUS AGREEMENTS BY SOCIAL PARTNERS TO ADDRESS THE ISSUE

Macroeconomic policy has largely been a "no go area" within Nedlac since GEAR was imposed unilaterally in 1996, undermining Nedlac and the concept of social partner engagement. The trade union movement has a long history of pushing for a macroeconomic policy framework that supports growth and development.

Labour positions on monetary policy:

- As early as 1998, COSATU raised questions about Government's approach to monetary policy in its submission to the standing committee on Finance on the role of the South Africa Reserve Bank (SARB) and Monetary Policy, and numerous COSATU Policy documents and Congress Resolutions raised concerns that the SARB's approach to maintaining high interest rates was stifling the economy.
- COSATU made a comprehensive input on this issue to the 2008 Alliance Summit.
- A series of policies were proposed by COSATU in the wake of the global financial crisis.
- COSATU's 2010 Growth Path Towards Full Employment notes: "Employment will be the primary target of monetary policy, whilst price stability plays a subordinate role; Monetary policy will support industrial development; Foreign exchange control measures will be an essential part of monetary policy; Exchange rate management will be one of the pillars of the monetary policy framework; Reserve Bank asset and liability management will have to be aligned to our development mandate, in order to strengthen the capacity of the state and the economy to deal with the balance of payments problem; Monetary policy must support an expansionary developmental fiscal policy; A broader and more sophisticated framework of fiscal monetary co-ordination (is required)."

Important recent milestones upon which Labour could build include:

- Inclusion in the ANC 2009 Elections Manifesto that: "Fiscal and monetary policy mandates including management of interest rates and exchange rates, need to actively promote creation of decent employment, economic growth, broad-based industrialisation, reduced income inequality and other developmental imperatives."
- The Government's 2009 Medium Term Strategic Framework notes the importance of: "Promoting the creation of decent employment, economic growth, broad-based industrialisation, reduced income inequality and other developmental imperatives and maintaining a stable pro-employment macroeconomic environment… Maintaining countercyclical monetary and fiscal policies and ensuring an optimal policy mix between the two policy instruments in dealing with both the short- and long-term management of macro balances and imbalances."
- The precedent of the Minister of Finance Pravin Gordhan writing to the SARB in 2010, saying: "The recession, and its negative impact on the lives of ordinary people, has taught us many lessons about the importance of pursuing policies that promote sustainable and balanced growth. It has also heightened the urgency for South Africa to chart a new growth path that allows the economy to achieve faster growth with more job creation."
- The National Development Plan notes: "The mandate of the Reserve Bank gives it the license to take factors such as the exchange rate and employment into account in conducting monetary policy".
- The ANC 2012 conference resolved that: "South Africa requires a flexible monetary policy regime, aligned with the objectives of the second phase of transition. Without sacrificing price stability, monetary policy should also take account of other objectives such as employment creation and economic growth. In this regard, government should engage with the new wisdom developing on macroeconomic policy around the world in response to past failures and the global crisis."
- The 2014 ANC manifesto reads: "Our job creating an inclusive growth path will require macroeconomic policies that address unemployment, poverty and inequality; promotion of investment in the productive economy; addressing the poor lending practices and excessive charges in the financial sector; and making the financial sector more inclusive and accessible."
- The agreement that the NDP is a "living document" and that the economic chapter is not cast in stone is the outcome of opposition to the orthodox framework proposed therein.

4. PROPOSED APPROACH

As already argued, South Africa cannot pursue job creation without moving away from contractionary fiscal and monetary policies. It is critical that we boost demand in the economy and allow for ease of access to credit for productive sectors in order to grow supply. Neither of

these can be solved by microeconomic interventions alone. In addition to the need for a fiscal stimulus and monetary policy that supports expanding investment, South Africa also requires monetary policy that ensures forms of financial stability and global integration that encourage investment in the productive sectors of the economy. Principally this requires containing short-term speculative capital flows and short-term speculative trading of rand assets, curbing capital flight and stabilising the exchange rate, while concurrently encouraging greenfield foreign direct investment in the productive sectors of the economy (i.e. FDI to establish new industries). This requires the judicious use of capital controls, reducing interest rates, and steering funds away from speculative investment.

5. SPECIFIC POLICIES

5.1. FISCAL STIMULUS

We propose a R500bn fiscal stimulus over three years; this is approximately 3% of GDP. This is below the fiscal stimuli that a number of countries successfully implemented in the wake of the GFC. The stimulus could be spent in a number of ways: economic and social infrastructure, service delivery role out, social transfers or directly expand public sector employment. We suggest that at least a large part is earmarked for economic infrastructure expenditure. According the National Treasury, the fiscal multiplier for such spending is 1.9, the highest in the economy. Therefore additional spending of R166 billion of infrastructure (one third of the R500 billion) could increase output by R315 billion.

There are six avenues through which the necessary funds can be sourced:

1. Taxation: The majority of government expenditure is sourced from tax revenue. As argued in a separate policy brief (2.3: Tax) there is room to increase personal and corporate income tax rates, and significant scope to increase or impose new taxes on wealth. There is also room to reduce tax breaks given to wealthy households. This said, taxation cannot raise R500bn on its own over such a short period. Up to R100 billion (in total) towards a three year fiscal stimulus could come from increased taxation, but these funds could also go towards existing budget line items with the fiscal stimulus funds sourced elsewhere.

2. Borrowing: Despite public rhetoric, South Africa has, by international standards, moderate government debt levels. The speed and gusto with which National Treasury aims to reduce debt levels – given the dire need for fiscal stimulus – is therefore concerning, although unchecked borrowing is not the solution either. Figure 1 shows government debt at 53%, projected to rise to 56% of GDP over the medium term. Debt in advanced countries was, on average, 105% of GDP in 2016. Notable, in the South African case, is that the 2018 Budget shows a far more ambitious debt-reduction plan than the 2017 Medium Term Budget Policy Statement (MTBPS) indicating accelerating austerity.

Allowing debt to rise by another 5 percentage points to 60% of GDP in 2019/2020 would raise approximately an additional R250 billion. Provided borrowing is invested in growth enhancing activities, increased borrowing would not lead to unsustainable debt-to-GDP ratios, as increased economic growth would reduce the relative debt burden. Similarly, with economic growth and increased wages comes increased tax revenue and the debt service costs could be contained through this. The real danger regarding debt lies in government's debt guarantee exposure to state owned enterprises, Eskom in particular (with an exposure to Eskom of R221 billion, 74% of government's public institutions' exposure). It is likely that Eskom's debt levels are unsustainable and an urgent social partner compact on rescuing the power utility is needed.

3. A solidarity contribution from the Public Investment Fund / Government Employees Pension Fund (GEPF):

The PIC has assets over R2.1 trillion. The GEPF is a defined benefit scheme meaning that pensioners are entitled to a particular payout irrespective of the size of investments held. So long as investments and investment returns are sufficient the GEPF will be able to pay out pensioners.

The PIC is currently over-capitalised. The PIC has a funding level of 116% of its obligations, well above the target of 90% set by its trustees. The fund is therefore over-capitalised in the region of R470 billion.

Funds from the PIC could be used to:

a. Write off a share of government debt

b. Write off a share of SOE debt, in particular Eskom

c. Take an equity stake in Eskom, the funds from which can be used to reduce its debt burden

d. Channelled into a ring-fenced fiscal stimulus fund

The historic opposition by Labour towards using GEPF funds for such a purpose is regressive. The PIC should not simply be maximising returns for its shareholders. The massive PIC funds should be leveraged in a manner that is fiscally responsible and does not put the pensions of government employees at risk, but which helps to address the urgent challenges of the day. Without a fiscal stimulus, workers will see far more harm than is conceivable from using over-capitalised pension funds.

4. Private sector: The private sector could be required to contribute towards any stimulus in a measure equal to government and the GEPF. This can take place through mechanisms such as compulsory lending to government from the local financial sector or prescribed assets (see policy brief 1.6). South Africa has massive private sector institutional investors which sit on trillions worth of investments. There is no reason why such savings should not be channelled towards developmental ends more forcefully.

5. Monetise debt: The monetisation of debt by the SARB is the direct purchase of government bonds (gilts) by the reserve bank. This can be purchased at below market rates thus reducing the associated debt service costs (see policy brief 2.4 a: Monetary).

6. Overt Monetary Financing / monetary transfer: This is a different process where the reserve bank transfers money to the fiscal authorities as demanded by national development needs, including public works, without creating any debt on the books of the fiscal authority. China is a primary user of this approach. It has helped lift people out of poverty by creating millions of jobs. The demand arising from the massive employment projects have ended up creating supply of its own, and thus growth and development. As a government banker, the reserve bank can execute such a transfer. Unlike the monetisation of debt by the Reserve Bank, this does not incur a cost to the fiscus (see policy brief 2.4a: Monetary policy brief).

5.2. MONETARY POLICY

Monetary policy can be altered in a number of ways that would allow it to support the expansion rather than the contraction of the economy.

1. The goal of monetary policy: The goal of monetary policy to support sustainable and stable growth, the expansion of productive sectors of the economy and employment creation, as well as related support to the broader economy. This requires changing the mandate of the SARB. This can be done via a letter of instruction from the Minister of Finance to the National Treasury or by a change in the legal mandate. The former should be pursued immediately and the latter initiated. Nationalising the SARB will not necessarily change its mandate but a medium-term process to do so can be initiated in order to bring South Africa in line with international norms.

2. Emergency rates cut: An emergency rates cut of at least 2 percentage points is needed in order to stimulate investment in the economy.

3. Direct credit provision (see policy brief 2.4a: Monetary): The SARB can provide credit directly to the productive sectors of the economy in a number of ways. It is important to understand that the primary tool of monetary policy is not control over monetary aggregates (the amount of money in the economy), nor the price of money (interest rates), but the volume and type of credit available.

This has recently been recognized (in part due to the recent financial crisis). For example, the reserve bank of the UK (BoE) and Her Majesty's Treasury initiated and designed credit policies (Funding for Lending etc) to their SMMEs (Churm, et al, 2012). Similar policies were also initiated by the reserve banks of Europe (ECB, 2014); Japan (BoJ, 2014) and many other nations. Post-war Japan, whose economic model was adopted from Germany, was a prolific user of directed credit to the economy.

In this regard, the Reserve Bank balance sheet is the primary and most important monetary policy tool.

Credit provision can be done through:

a. Quantitative Monetary Easing (QME): QME for South Africa would entail reserve bank credit being given directly to productive economic agents in the economy. Credit would be given out both to the reserve bank counterparties and non-counterparties, i.e. to non-customers of the Reserve Bank (ordinary SMMEs). Credit easing in this context refers to DIRECT interventions in what would be described as "unconventional" market segments – the economic agents on the ground. The sectors would have been pre-determined by the Department of Trade and Industry (DTI) for maximum effects on jobs and growth. Given the credit supply shocks to the economy, this form of lending would be the most ideal to quickly energise SMMEs (in productive sectors only). The security demanded by the reserve bank would be unlike the normal ones counterparties would supply.

b. The other QME targeted lending is the reserve bank boosting commercial bank lending by offering explicit incentives to commercial banks to lend to the non-financial private sector. The nature of this lending to the private sector would be stipulated by the reserve bank. There are numerous international cases of such interventions. The ECB and the BoE launched the above lending schemes in support of their economies in 2014 and 2012 respectively. And so did Japan in 2014. Many other nations frequently use their reserve banks in this manner. During their developmental phase, these operations were routine in Asia and in Europe.

c. Quantitative easing through reserve expansion: One dominant modality of quantitative easing (QE)

has been reserve expansion. This entails the central bank purchasing assets as part of a QE programme. This reduces the supply of these assets in the market but does so by issuing new central bank reserves. This passes on capital to those who previously held the asset. Where the need to flatten the yield curve becomes necessary for whatever monetary considerations, the reserve bank can engage in this form of balance sheet operation. This is the form that has been most used recently by reserve banks. While they call it QE, it is in fact not QE as the model that gave rise to the phrase QE only applies to QME above and not to this form of QE.

4. Renegotiate South Africa's global financial integration: Monetary policy also pertains to South Africa's global integration. The scope and type of financial liberalisation has brought significant instability to the South Africa economy. Most pertinently: a. money coming into the economy has been short-term and not channelled into long-term investment; b. this has led to appreciation in asset markets (e.g. the stock market and housing prices) unrelated to the conditions in the economy; c. asset price movements, most notably the exchange rate, have become disconnected from any "real economic indicators" and move based on the trading of these assets, this is particularly damaging when it results in exchange rate volatility as it has.

Capital control measures can include[1]:

- Straightforward taxes or withholding taxes on transactions, foreign borrowing, and foreign investment in local bonds (for example, Brazil in 2009–12 and Thailand in 2010) – taxes on targeted types of capital flows.
- One important tax is a "Tobin tax" – a tax imposed on financial transactions.
- Controls on swap and forward-cover transactions (for example, Indonesia, Malaysia, and the Philippines in the early 1990s) – limits speculative trading of rand assets.
- Minimum offshore borrowing or holding periods (for example, Indonesia in 2010 and Thailand in 1996) – limit short-term offshoring borrowing by banks that is often channelled into asset markets.
- Unremunerated reserve requirements (URR) on investments of less than a minimum holding period, and higher reserve requirements for foreign currency liabilities (for example, Chile in 1991–98 and Peru recently) – compulsory non-interest-bearing deposit in foreign currency to be lodged with the Central Bank for a set period (e.g. one year) in an amount proportional to the size of the inflow so that the additional cost discourages external financing entering through identified channels covered by the mechanism.

The following additional measures:

- Limit use of "sterilisation" of capital flows as this bears significant fiscal costs and further encourages short-term capital inflows.

5.3. FISCAL AND MONETARY POLICY WORKING TOGETHER

A conventional approach to macroeconomic policy sees a separation between fiscal and monetary authorities. This naïve approach to macroeconomic policy management has been costly. Changes to this have already happened in the UK with a view to minimising risks inherent in compartmentalised macroeconomic operations.

The one fundamental link and necessity for close working relations between monetary and fiscal authorities lies not only in the Overt Monetary Financing (OMF) as suggested above but in monetisation of fiscal operations. Unmonetised fiscal policy is what makes fiscal policy highly ineffective in South Africa and elsewhere. In South Africa, fiscal policy is unmonetised, that is funds must be borrowed on open markets, and this leads to unnecessary increases in debt, which in turn impacts on what traditional economists call "fiscal space" with all its negative effects on employment creation, structural transformation and macroeconomic stabilisation. It also means a drain on the fiscus through the need to service that debt, i.e. to pay interest on the debt and repay the capital.

Monetisation of fiscal operations means the direct provision of funds from the SARB to the Treasury. Close cooperation between the SARB and Treasury on the monetisation of fiscal operations is extremely important.

A second and equally important cooperation relates to stimulus. A successful quantitative monetary easing requires both the SARB and the Treasury working together to align sequencing, targets and even delivery of the QME as a whole. This is besides the operations of the OMF scheme, which on its own calls for calibrations that both institutions must be confortable with.

The cooperation envisaged in delivering both the stimulus and related credit easing operations is similar to the one undertaken by the nationalised Bank of England and her Majesty's Treasury (HMT), where policy formulation to support national agendas are taken together. This was more apparent in the "Funding for Lending Scheme" and similar credit easing programmes.

As a consequence of having close policy relations between

the BoE and HTM, the UK was able to raise employment levels considerably in the recent past.

6. WHY THIS WILL HAVE A POSITIVE IMPACT ON JOBS

An appropriate fiscal stimulus would have a positive jobs impact through a number of channels:

- Direct employment in the public sector, e.g. through growing the Expanded Public Works Programme
- Direct employment in the private sector, e.g. through large scale infrastructure projects
- Expansion of private sector employment through economic infrastructure supporting private sector investment and economic growth
- Supporting human capital development through improving social services such as health and education

More appropriate monetary policy could lead to economic expansion through improving conditions needed for long-term investment in the productive sectors, including via:

- Reducing borrowing costs
- Reducing government financing costs
- Stabilising the exchange rate
- Funnelling capital flows and idle domestic funds towards long-term investment rather than short-term speculative investment

7. ROLE OF STATE INSTITUTIONS AND SOCIAL PARTNERS

Regarding the fiscal stimulus, government would need to lead on the raising and spending of funds. However, a social compact agreement in this regard is essential as it is a major endeavour which all parties must support. Various financing methods discussed above involve contributions by different sectors.

A special body could be established to oversee the stimulus with representation from all sectors.

Regarding monetary policy, this is largely a policy issue and would require government action. An inter-ministerial team should be established to undertake this action as National Treasury has opposed such measures previously.

8. SEQUENCING AND TIMEFRAMES

Macroeconomic reforms envisaged in this submission require a nation-wide approach. However, the main starting blocks would be the Treasury and the Reserve Bank. The fiscal stimulus could begin in the 2018/2019 financial year if the social partners acted swiftly.

Within a period of 18 to 24 months, a new monetary architecture could be constructed, depending on availability of resources and in the absence of opposition.

APPENDICES: MACROECONOMY POLICY BRIEF

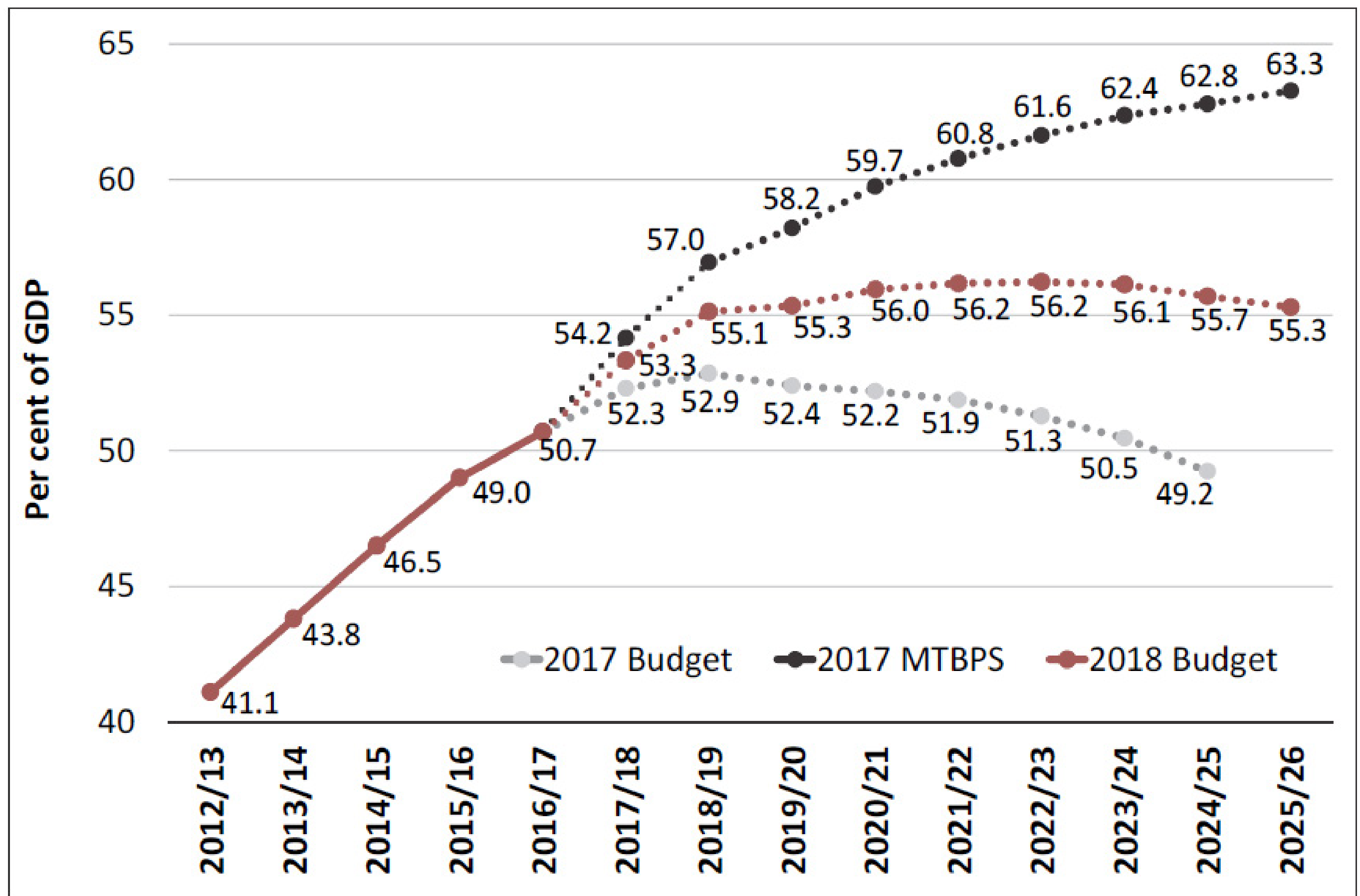
Table 1: Average annual growth in government expenditure (in real terms), between 2016/17 and 2018/2019

R billions	Audited Outcomes	Revised Estimate	Medium–term estimate

(2018/19 Rands)	2015/16	2016/17	2017/18	2018/19	2019/20
Expenditure					
Expenditure less interest payments	5.1%	-1.4%	1.0%	1.4%	2.1%
Social security and protection	4.3%	3.7%	2.3%	5.2%	2.9%
Basic education	2.1%	0.9%	0.4%	1.6%	1.1%
Health	4.5%	2.9%	4.5%	-0.1%	2.5%
Public order and defence	0.3%	0.1%	-0.4%	-1.6%	0.8%
Debt service costs	6.2%	8.1%	4.7%	5.2%	4.0%
Economic affairs	13.5%	-14.4%	-3.0%	1.2%	1.6%
Housing and community amenities	7.3%	-2.4%	-2.0%	5.1%	-1.3%
Post–school education and training	7.3%	2.2%	10.7%	10.0%	12.3%
General public services	2.5%	6.0%	3.4%	-14.7%	1.4%
Agriculture	-5.1%	0.7%	-3.6%	8.1%	-7.7%
Arts, culture, sport and recreation	3.4%	10.8%	2.9%	-1.7%	-0.9%
Environmental protection	4.8%	-16.5%	9.8%	-0.6%	2.1%

Source: 2018 Budget Review

Figure 1 Debt-to-GDP levels (2012/13 - 2025/26)



Source: National Treasury, 2018 Budget Review

1. http://growthdialogue.org/growthdialog/wp-content/uploads/2017/09/Policy-Brief-Resurgent-Capital.pdf