‘Don’t blame the goalie if the striker can’t score’ – Dep Governor of SARB

By Kuben Naidoo

Kuben Naidoo is the Deputy Governor of the South African Reserve Bank.

Monetary policy is largely defensive. It can provide a stable enough macroeconomic environment within which growth, development and social progress can take place. Without that stability it would be practically impossible to reduce poverty and inequality, but monetary policy on its own cannot secure development and growth. That is largely a function of the policy environment.

INTRODUCTION

If a football team is not winning, the jeering crowd can quickly see why it is not winning. Sometimes it is because the defence is weak, sometimes it is because the midfield is disjointed and sometimes it is because the strikers are not capable of scoring. A winning team requires all these elements of the team to be working well and working together. In South Africa, the debate around monetary policy is akin to shooting the goalkeeper because the team is not scoring more goals.

Economic growth is a team process. The South African Reserve Bank (SARB) and the National Treasury play a role in managing macroeconomic policy while several government departments and entities manage microeconomic policy and social programmes. Monetary policy is largely defensive in nature. It is akin to the goalkeeper in a football match. It can prevent the team from conceding too many goals but it cannot do much if the team is not scoring goals.

A cursory analysis of the South African economy will show that our key economic problem is the lack of growth and employment (scoring goals), underpinned by key structural weaknesses that perpetuate poverty and inequality (a disjointed midfield). In general, macroeconomic instability (conceding goals) has not been the key source of our concerns.

Attempting to change the framework for monetary policy because the team is not scoring goals is reflective of a misunderstanding of both economic policy-making and the role of the central bank.

THE POLITICAL ECONOMY OF MONETARY POLICY

The objective of all economic policy should be the attainment of full employment. What role does the SARB play in the achievement of higher employment and growth? What role should or could the SARB play in contributing to full employment? This article will explore the role of the SARB, its mandate and its policy stance in relation to growth, development and employment in South Africa. It aims to set out how monetary policy takes account of growth and development in the South African political economy context.

Debates around the role of the SARB in promoting (or some would argue stifling) growth and employment in the country have resurfaced recently. While the SARB’s policy stances are not above criticism, one requires an understanding of the architecture of economic policy in South Africa as well as an understanding of both history and context. In general, the SARB has

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played an immensely positive role in supporting growth and development given the constraints within which it operates. Some of these constraints are embedded in the legal and institutional framework of economic policy in South Africa whilst others emanate from the domestic and economic context in which it is found.

South Africa's growth performance of late has been dismal. In fact, at present, South Africa finds itself in one of its longest economic downturns in close to 60 years. How did we end up here and did monetary policy play a role in getting us here? Alternatively, what role does monetary policy play in getting us out of the mess we are in?

This article will not deal with issues around ownership of the bank, largely because the ownership issue is irrelevant to the substance of monetary policy or the role that the Reserve Bank plays in the economy in general.

HOW DID WE GET HERE AND DID MONETARY POLICY PLAY A ROLE?

South Africa is in its longest economic downturn since records began sometime in the 1960s. While it may not be the deepest economic downturn, it has been one of the longest in duration. Over the past five years, economic growth has averaged just above 1 percent, the unemployment rate has moved from a relatively stable 24 percent to a new normal of about 28 percent and per capita incomes have declined.

There are two main reasons for this poor performance. The first is the incomplete process of structural change to alter the drivers of the economy from its apartheid era and secondly, poor governance, in particular economic governance since the end of the financial crisis. Both failures are attenuated by the failure to understand and manage changes in the global economy, which created both opportunities and obstacles for our developmental aspirations.

The structural causes of racial inequality and an imbalanced economy are well-known and documented. In the late 1990s and early 2000s, several economic reforms were implemented to address some, but not all, of these structural weaknesses. South Africa had little choice but to move towards a high productivity–high wage economy. This required economic and social interventions aimed at boosting the economy's productivity and at the same time addressing the social causes of poor productivity; most critically the legacies of apartheid education and of spatial planning.

Partial success in one sphere, aimed at boosting productivity through opening the economy up to competition, combined with glaring failures in the other, that of reversing the legacies of apartheid education and spatial planning, produced islands of high productivity and high wages (which began to include a small but sizeable proportion of black people) but also a low employment economy.

At an international level, globalisation pushed up salaries of skilled workers and pushed down salaries of unskilled workers. Given South Africa's racial past, this factor, combined with our inability to turn the skills picture around, meant that the benefits of economic growth largely accrued to skilled workers.

While the economy is more inclusive from a racial point of view, it is still a highly unequal economy with few people working and almost 40 percent of households living in poverty. The main causes of this situation are, to repeat, incomplete economic reforms and failures in social policy, most particularly in education, to reverse the effects of apartheid. »

Illustration by Anastasya Eliseeva. New Agenda thanks New Frame for permitting the use of this graphic.

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Since 2011, South Africa has underperformed in the world economy and performed poorly relative to most emerging markets. The effect of poor governance over much of the past eight years has resulted in poor job growth, stagnant wages, insufficient wealth creation, inadequate resources for the public sector and rising social tension. Falling investment combined with rising fiscal stress makes driving growth and employment much harder.

In this context, monetary policy has played an important defensive role, preventing an even bigger economic disaster than the one we already have. Monetary policy has stuck to its knitting: it has kept inflation down, prevented largescale capital flight and ensured a reasonably stable and competitive currency, notwithstanding significant volatility from time to time.

Yes, perhaps with hindsight, one could argue that monetary policy could have done a bit more to support growth and development. But that argument would miss the bigger picture, that growth and development requires a capable state implementing complex economic and social reforms. At best monetary policy has provided a stable environment within which these developments could have taken place. The lack of progress in these areas of social and economic policy has led to the poor economic outcomes we see, and not because of an overly restrictive monetary policy.

SOME INTERNATIONAL EXAMPLES OF THINGS GONE WRONG

While it is always difficult to argue about what would have happened if alternative policies were pursued, we do have some timely and relevant case studies to observe. Brazil, Russia and Venezuela are all good examples to study. They all have high levels of inequality, are heavily reliant on commodity exports and all grew strongly during the 2000s before the financial crisis. During the growth phase, they all made meaningful inroads in tackling poverty through social programmes. As commodity prices fell and their economies were put under pressure, they all implemented populist macroeconomic policies. In parallel, there were also several lapses in governance, or put differently, political blunders combined with rising corruption.

The net effect was that all suffered deep recessions and declining living standards. In all three cases, inflation increased, eroding a substantial portion of the countries' savings. All experienced significant capital flight. Brazil's economic contraction was even larger than the contraction experienced during the great depression in the 1930s. Venezuela's collapse has been the most spectacular with inflation reaching 700 percent and four out of five Venezuelans showing signs of food deprivation. Russia suffered a deep depression but has recovered fairly quickly, at least in part through higher oil prices and widespread salary freezes, which cut over half of the buying power of workers, including public sector workers, (something that is neither possible nor desirable in South Africa).

South Africa has experienced many of the same things: a fall in growth following the commodity boom, poor governance, public debt growing from about 22 percent of GDP to almost 60 percent and a reversal in many of the social gains achieved in the early 2000s. We have not, however, had the kind of economic contraction that Brazil has had and we have not had the economic collapse of a country such as Venezuela. I would argue that the reason the wheels have not fallen off completely in South Africa (in an economic sense) is at least in part because we have a central bank that has been prudent. We have not had an erosion of the country's savings; we have not had capital flight; and we have not had the kind of erosion of living standards witnessed in any of the three countries mentioned. That is not to take anything away from our poor economic performance.

WHAT CAN MONETARY POLICY DO, AND WHAT CAN'T IT DO?

Monetary policy can provide a stable or at best a reasonably stable macroeconomic environment within which growth, development and social progress can occur. Without such an environment, reducing poverty and inequality would be practically impossible. Monetary policy, however, cannot guarantee or even contribute directly to growth and development on its own. Tackling poverty and inequality requires the successful implementation of social and economic policies that drive inclusivity, employment and investment.

Monetary policy is designed to, and is able to, support growth over the cycle through easing credit restrictions when the economy is performing below its potential growth level and tightening them when the economy is performing above its potential. It plays little role in actually determining this level of potential growth. Potential growth is largely a function of the policy environment.

Monetary policy does take account of growth and employment in its setting. When growth is performing below its potential, monetary policy can be more accommodative and has been more accommodative. Since the financial crisis, interest rates have been lower and more stable than they have been historically.

Part of the problem over the past six or seven years is that estimates of this so-called potential growth have fallen quite sharply. Prior to 2006, it was generally assumed that the economy can grow fairly robustly, above 4 percent, quite easily without too many imbalances occurring in the economy. In part because of weak growth and investment over the past decade, that estimate of potential growth is now closer to 1 percent.

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Similarly, monetary policy does take conditions in the labour market into account. South Africa's high unemployment rate is largely structural and not cyclical. A recent paper by Laurence Harris and Shannon Bold published in April 2018 indicates that monetary policy has been sensitive to both the unemployment rate and the labour force participation rate; and that this is particularly true since the adoption of inflation targeting.

While there is clearly a cyclical component to the unemployment rate, the bulk of our unemployment is due to the structure of the economy. The economy does not create jobs for the workers we have. It does create jobs for highly skilled people but that is not the composition of our unemployed. We need to create an environment in which we can generate low skill jobs and at the same time raise skill levels. Policy at present appears to do neither.

Under the present circumstances, monetary policy cannot raise the growth level of the economy from its present rate of around 1 percent to 3 or 4 percent on its own. It is simply incapable of doing this. Even if interest rates were to be cut to zero, it is not obvious that borrowing costs for most in the economy would fall, and even if they did fall and boosted growth, there is no evidence that this growth would be sustainable. In fact, in all probability, growth would return to the level of potential growth fairly quickly (in about four to six quarters).

Borrowing costs in an economy are not solely determined by a central bank. While the central bank does influence the policy rate at which most people borrow, this rate is also influenced by the shortage of savings in the economy, the fiscal deficit and investor perceptions. Whether we like it or not, these factors are not likely to become more accommodative simply because monetary policy is accommodative.

CONCLUSION

One can fiddle with monetary policy. It may well buy us some growth, at the margin. It is, however, not the major reason why our economic performance has been so dismal. Instead, sound policy has probably prevented an even worse economic outcome (the erosion of the countries' savings and capital stock). Our economic policy debates should focus on the source of the problem: incomplete reforms in the economic and social realms to raise productivity, investment and employment. By building a capable state able to implement sound policies efficiently, we can tackle our triple challenges of poverty, inequality and unemployment.

Don't shoot the goalkeeper every time the team loses. NA