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First Source Money

1. NATURE OF THE PROBLEM

The almost permanent contractionary tendency of South Africa's "monetary policy" is in large measure a consequence of the economic development model[2], which misguidedly relies on imported capital for growth and development, and a certain type of "monetary policy" instruments employed to fight or stabilise prices. Though pervasive to monetary and the macroeconomic policy frameworks, the theoretical foundations of the model are not considered in detail here given space considerations.

Both the goals and instruments of "monetary policy" in South Africa do not reflect the South African developmental objectives they are supposed to serve. There is a strong lack of congruence between "monetary policy" goals and instruments on one hand, and the developmental tone of the national policy imperatives on the other. With such a gulf between these two, the monetary policy analytic equipment necessary to confront developmental challenges that South Africa faces would, as a matter of reality, be at odds with those that are applied for mere "economic stabilisation purposes" within advanced nations. However, South Africa (monetary authority) has opted to employ tools whose primary purpose is to "stabilize" not grow or develop an economy. Indeed, as Prof Masato Shizume (2018) forcefully asserts, monetary policy for a developing Japan were different from those of a mature and industrialised Japan. "Once Japan had achieved industrialisation and become a leading economic power, the primary goal (monetary) shifted from development to stability. Instruments of monetary policy have also shifted over time". "The goals of monetary policy have been defined based on the goals of the nation as a whole", Shizume adds. The consequences of the disjuncture between macroeconomic policies and developmental objectives in South Africa have led to de-industrialisation, financialisation, chronic unemployment and other developmentally retarding outcomes. Unfortunately, the national discourse among economists has reduced "monetary policy" to the achievement of price stability and the tools available to interest rates and monetary aggregates.

This has not only impoverished our understanding of the subject matter, but has undermined the capacity of monetary authorities to understand how monetary policy can support tackling the developmental challenges the country faces, unemployment being one key challenge.

The framework of inflation targeting and the objective of keeping inflation low in an economy where much of the inflation is not entirely demand generated is clearly inappropriate.

The use of interest rates as the sole tool to achieve this is completely inappropriate given both its ineffectiveness (with inflationary pressures not due to "excessive" domestic demand) and its contractionary consequences. The resulting high interest rates lead to not just sluggish growth but also discouraged investment, and thus spur unemployment. This brief departs from this conventional understanding of monetary policy and approach. The conduct of "monetary policy" in South Africa is not only

wholly anti-developmental, but is also incompatible with the ideals and efforts of creating an egalitarian society. In fact, monetary policy in South Africa has contributed to the de-industrialisation and financialisation of the economy, while simultaneously increasing poverty, inequality and unemployment, and raising the price structure of the economy.

Indeed, as the Reserve Bank itself shamelessly asserts, "It is acknowledged that monetary policy cannot contribute the economic growth and employment creation". Yet monetary policies were at the centre of sustainable growth, industrialisation and employment in Germany, Canada, Japan, the East Asian Tigers and more recently China. The assertion by the South African Reserve Bank is, therefore, both unfortunate and misleading.

Given the stated problem and the absolute shocking failure by both the monetary authorities and monetary policy to even appropriately intervene, respond and support the economy during and after the global financial crisis of 2007/8, whose deleterious effects remain real and raw today, there can therefore be no better opportunity for social partners to ensure that the goal, instruments and institutional alignment of monetary policy accord with the nation's social and economic priorities. Failing to do so calls into question the constitutional muster of our policies.

2. PREVIOUS AGREEMENTS BY SOCIAL PARTNERS TO ADDRESS THE ISSUE

Monetary policy deliberations and more specifically inflation targeting has formed part of the on-going debates between social partners for a while. However, such policy has been tightly controlled by the National Treasury with little interest in publically debating amendments.

3. PROPOSED APPROACH AND CONCRETE PROPOSALS TO ADDRESS THIS CHALLENGE, AND HOW IT COULD GENERATE JOBS

As the historic role of developmental reserve banks of France, Canada, Germany, Japan, Asian Tigers and now China have proved, monetary policy goals, as well as the instruments employed for developing nations cannot be expected to operate in the same way as for advanced economies (ILO, 2017; Epstein, 2015).

The goal of monetary policy to support sustainable and stable growth, employment creation and related support to the broader economy must be clearly stated.

Following this we must 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.

Depending on the sector and/or needs of a nation, interventions to support its domestic economy are not limited to the above, and can take all manner of forms including differentiated interest rates, or reserve requirements for targeted sectors (Galli, 2017). The SARB should be able to implement this easily.

APPROACH

Monetary policy is not intended to work on its own nor be operationalized independently of other macroeconomic policies, especially fiscal policy. It is for this reason that the compartmentalisation so very much encouraged by the Bretton Woods institutions is unhelpful for the proper management of an economy. This is costly, especially for developing nations. Similarly, the appropriate mix of sub policies within monetary policy and across other macro policies cannot be determined a priori.

Factors to take into account when proposing an approach would include: the nature and severity of the economic shock South Africa is faced with; the distinctive regional and national circumstances at play at any one time; the nature or structure of the labour 'market' including measures to accelerate employment recovery; and the institutional layout of our policy making. In this regard, the Reserve Bank balance sheet is the primary and most important monetary policy tool. However, this does not refer to the reserve bank manipulation of reserves to the banking system for purposes of daily liquidity management. This is done using the interest rate as a monetary policy instrument. In this case the size and composition of the balance sheet signals no meaningful policy stance. I only consider active or influential balance sheet policies.

DIRECT LENDING TO THE ECONOMY

1. Real Quantitative Monetary Easing (QME):

This does not refer to the popular understanding of central bank quantitative easing (QE), which will be considered below. This real quantitative monetary easing (QME) spans a range of reserve bank interventions, largely dependent on the structure and character of the impairment and idiosyncratic nature of the targeted market. In some literature this QME may be referred to as Credit Easing.

The first and most crucial 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.

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. The composition of the reserve bank balance sheet would in all cases of QME change according to the nature of intervention decided. Note that the reserve bank can choose to eliminate any debt at no cost that may be a hindrance to the private sector requiring credit, including for State Owned Enterprises (SOEs). 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.

For such QME operations to occur, it is neither necessary nor is it a sufficient condition for interest rates to have reached a zero lower bound as is often said. Such credit is not inflationary either. The effect of this monetary policy stance on both jobs and growth are empirically found to be fast and real without any inflationary pressures.

2. Reserve Expansion (QE):

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.

3. Monetisation of Debt, Overt Monetary Financing (OMF) & Contingent Balance Sheet Policy:

The task of job creation by the State should be the ultimate goal of both fiscal and monetary policies, undertaken through a close working relationship between monetary and fiscal authorities.

Commitment to full employment demands the deployment of many tools including the monetisation of debt by reserve banks, that is the direct purchase of government bonds (gilts) by the reserve bank. Overt Monetary Financing is a different process where the reserve bank merely 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.

Contingent balance sheet policy is simply a communication approach where the reserve bank will signal to market agents that it will deploy any form of balance sheet support should national priorities like unemployment and other imbalances threaten the economic interest of government and the people. This is akin to a statement made by Mario Draghi, Governor of the ECB, who declared that the ECB will do everything in its power to save the EU economy and the Euro, thereby boosting confidence in EU economies and in the Euro.

SARB and The Fiscal Link

A conventional approach to monetary policy sees a separation or total gulf 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.

De-Financialisation of the Economy

Financialisation of the South African economy has reached alarming levels. At about 21% of the GDP and growing, the financial services sector is now sucking the economic air necessary for the real sector to survive. Normally, less than 10% would be ideal. The capacity for this sector to absorb jobs is known to be low. Therefore measures to constrain continued liberalisation would be appropriate.

Inherently, the South African monetary policy approach breeds financialisation of the sector. Unbounded by any form of macro-prudential rules, the bonds of shared citizenry are unpicked by the resultant inequality and unemployment caused by the unmitigated financialisation of South Africa, creating long-lasting harm. A reform of the monetary policy regime contemplated in this research brief contains a macroeconomic model that helps monetary authorities deal with financialisation of the economy by directing credit to the productive sectors of the economy.

Beyond this, the reorientation of finance must be supported through the creation of public banks across the nation. As monetary policy transmission belts, public banks mandated to lend for productive purposes would be a permanent macro prudential tool in the absence of a reserve bank that is supposed to be goal- and instrument-oriented in this direction.

For the first time in as many generations, serious Western Reserve banks have recognised the folly of unmitigated credit flows to the economy and have imposed (macro-prudentially) restrictions on the direction and type of credit to the economy. Japan, East Asia and later China have always had such restrictions. The BoE followed this approach in June 2014.

The proposal for the SARB, as detailed above, is to monitor and restrict flows of credit, through the banking system, to sectors of the economy that deepen financialisation. This restriction will have the effects of directing credit to productive sectors and thus job creation, but will also promote financial stability, and help induce industrialisation while de-financialising the economy. All non-GDP asset/financial transactions should be curbed as they are highly inflationary. In this way the SARB will be fulfilling the price stability mandate without the use of the misguided interest rate policy (labelled as monetary policy in South Africa) and the failed inflation targeting practice. In the model that undergirds this proposal, inflation targeting is rendered useless.

Due to space, a mathematical model that cuts across fiscal and monetary policy is available elsewhere. In the model, both the role of banks and the definition of money as traditionally understood by most economists are dispensed with.

4. POLICY CHANGE

For a sustainable and successful implementation of this change in monetary policy, a concomitant change in the fiscal and exchange rate policies, including capital account based policies are required. The entire macroeconomic policy framework as currently practiced requires change as it is based on a flawed economic model.

More specifically, it is recommended that:

1. The mandate of the SARB is changed to include growth and employment and the provision of credit to productive sectors of the economy.
2. Controlling monetary aggregates and price stability is made a secondary target of the SARB.
3. Interest rate manipulation is dropped as the primary monetary policy tool.
4. Interest rates are immediately lowered.
5. Quantitative Monetary Easing (QME) (direct credit provision by the SARB) is undertaken, directing credit to specific sectors of the economy, e.g. SMMEs or certain productive sectors, inline with broader industrial policy objectives. This can be undertaken directly by the SARB, or via industrial financing institutions like the IDC, or through government departments like the DTI.
6. One or both of monetisation of debt (the SARB purchasing government debt) and Overt Monetary Financing (OMF) (the SARB directly financing government projects) be used to ensure that government has the necessary funds to undertake fiscal stimulus (see Macroeconomic brief) and financial necessary social and economic infrastructure and social services. This brief supports OMF as the most effective and least costly of the two options.
7. The National Treasury and SARB work closely together in order to achieve the above and other objectives specified.
8. Public banks are established with a mandate to lend in a manner that encourages productive investment, equitable access to credit at affordable rates and sustainable levels, growth, and employment.
9. The de-financialisation of the economy is prioritised and made an objective of monetary policy. This is congruent with other recommendations made, e.g. by lowering interest rates will assist in this regard. Other dimensions of de-financialisation, e.g. capital controls, are discussed in the brief on Macroeconomic policy and Financial-sector reform.

5. IMPACT ON JOBS

The recommendations made would have a profound impact on job creation. Directly, by allowing for fiscal expansion, jobs would be created in the public sector (either in the formal public sector or through public works programmes). At the same time, government spending on social and economic infrastructure as well as a service delivery would expand demand and employment in the economy. Beyond this, the direct provision of credit to productive sectors of the economy and the reduction of interest rates would allow for investment, growth and job creation. Jobs cannot be created in South Africa without a supportive macroeconomic framework.

6. FINANCING REQUIREMENTS

The reorganisation of policy will only require non-financial capital. The funding envisaged in this segment does not apply.

7. ROLE OF STATE INSTITUTIONS AND SOCIAL PARTNERS

All partners are required in helping implement the changes but the role of State Institutions is more robustly required.

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. Within a period of 18 to 24 months, a new architecture would have been constructed, depending on availability of resources and in the absence of opposition.

1. Note: changes were made to the contribution by the collaborator by the IEJ.

2. The implications of the economic development model on the design and institutional structure of our macroeconomic policy is profound yet highly unrecognised by most economists and key policy players on this matter.