Mapungubwe Annual Lecture 2017

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Radical Economic Transformation – are fiscal and monetary authorities a help or a hindrance?

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In March MISTRA sent me a letter of invitation to give this fifth Mapungubwe Annual Lecture. I was honoured by this invitation and accepted it. A lot has changed since March and here we are.

It was suggested that the lecture be framed around the theme, "***Radical Economic Transformation – are fiscal and monetary authorities a help or a hindrance?***"

This is a difficult question, surely requiring a complicated answer, and truth be told, I was rather daunted by it.

But after reflection I decided to accept this challenging question, without any changes.

It is an excellent question and of central relevance, because it goes to the heart of present economic governance issues.

What could be more relevant than to ask: ***How can two of our core economic institutions – the one dealing with flows of public money, the other with private money - be better used to effect fundamental economic change?***

Let me up front invoke the words of Amartya Sen, who once apologized for '*dragging the central bankers down to my own level, as people who have to be committed to arguing. I am not, of course, arguing for central bankers to become obsessively "central talkers." But I would submit that they do have an important role in* **democratic public reasoning**, *in addition to their specialised tasks in monetary and financial affairs. Central banks are not only public agencies with special roles in financial leadership and monetary policies, they are also important parts of the general political landscape of a country…. If democracy is "***government by discussion***"[1] central banking may well involve more than banking.'*[2]

I have quoted Amartya Sen because he is relevant here to ourselves, and more broadly than just to the monetary authorities. His emphasis on 'democratic public reasoning' is something I will return to. But being a politician by nature, I would emphasise the need for 'democratic public action' as well as 'democratic public reasoning'.

My main argument here tonight is that there is scope for using our core economic institutions more boldly to drive fundamental economic change, especially through aligning fiscal and

[1] J. S. Mill
[2] See Sen (2006)

credit allocations to a more coherent strategy for inclusive growth. We must avoid the obvious temptations of populism, and recognise the various policy constraints within which our policy choices will be made. Short term political expediency can bring long term ruin, from which it might take upwards of a decade to recover. And any programme of radical economic transformation must be anchored in a much stronger democratic consensus among people and institutions.

The structure of the lecture is quite straightforward:

I will begin with a few general remarks about the state and economy.

Then I will review the fundamental features of our national political economy; the fundamental features that a strategy for 'radical economic transformation' would seek to change in a progressive and sustainable way.

Thirdly, I will try to answer the question of this lecture directly, giving particular attention to understanding the scope for new policy emphasis in light of the various constraints faced by the two institutions.

Finally, I will comment on the present politics of 'radical economic transformation', and what must be done to restore integrity to meaningful policy dialogue on the economic trajectory of the country.

1. Some conceptual thoughts on the state and economy

There is general consensus among all economic commentators and stakeholders that the South African economy is in dire need of a major overhaul. South Africa remains locked in a low growth, path dependent economic trajectory that is currently deepening social inequality and highly concentrated ownership patterns. There can be no denying that the economy needs to be radically transformed, which requires us to think afresh on the roles of institutions in economic governance and resource allocation.

Over the last twenty years, institutions have moved to the centre stage in debates concerning economic development. Poor-quality institutions have come to be seen as **the** root cause of poor economic performance. One of the better known recent perspectives on this matter is contained in a popular book by Acemoglu and Robinson called 'Why Nations Fail'[3]. The authors argue that failed nations have 'extractive' institutions, which serve the interest of narrow elites, while successful economies have 'inclusive' institutions which allow innovation and growth to flourish. According to Acemoglu and Robinson, countries characterised by extractive institutions, such as China, will not sustain innovation and growth (as they are currently experiencing) unless they transform to more inclusive institutions. Countries like South Korea, which commenced their economic upswing with extractive institutions, would not have been able to sustain levels of prosperity without transforming to more inclusive forms of economic governance.

While I think most of us could agree that institutions are critical for economic prosperity, at the same time I think we should be sceptical of 'grand theories' and general perspectives on this subject. Ruchir Sharma (2016) in his book 'Rise and Fall of Nations: Forces of Change in the Post-Crisis World' makes the important point that institutions themselves reflect the economic structure

[3] Acemoglu and Robinson (2012)

of the country. Where wealth is created primarily through innovation and productivity gains, societies tend to have strong and enduring institutions. Where wealth is created primarily through rent-seeking, institutions will always be under threat. This presents something of 'a chicken and the egg' paradox – inclusive institutions are required to restructure an economy towards more shared and sustained prosperity, but elite interests controlling rents actively prevent the necessary innovation and institutional change.

Also, very relevant to South Africa is a recent book by Francis Fukuyama called 'Political order and political decay'[4]. Fukuyama argues that modern and successful polities have a balance of three sets of institutions: the state executive bureaucracy, the rule of law and systems of democratic accountability. And he argues that all these institutions are subject to decay and corruption and require constant and vigilant renewal.

In South Africa's case, while our legal and democratic systems still display signs of life and functionality, our state executive institutions show strong signs of weakness and corrupt capture. Indeed, we continually observe the integrity of state institutions being compromised for short-term political expediency. Moreover, it seems that some in influential leadership positions seem to accept this institutional decay, even encouraging it, and do not understand the importance of healthy institutions for driving any sort of inclusive growth agenda.

So far, our key economic institutions of National Treasury and SARB have remained centres of excellence in a sea of institutional decay and mediocrity. But imagine the economic damage if this ceased to be the case. I will return to this point later in the lecture.

The problem with 'grand theories', and what I would call overly ideological policy prescripts, is that they do not do justice to the complexity of the relationship between institutions and economic development, which necessarily varies over time and particular circumstances. Similarly, as tempting as it may be, we cannot simply copy what has worked elsewhere in the world, without fully appreciating the enabling conditions which allowed institutions and economies in particular contexts to flourish.

Singapore – which is currently in our news following the visit of one of our provincial premiers – is a case in point. Singapore has a highly effective working model of state capitalism, which debunks the global standard view that fully privatised enterprises are more efficient than state-owned companies. Isabel Sim (2011), in her analysis of Singapore's Government-Linked Companies (GLCs), shows how Singapore's GLCs perform better and more efficiently than private companies. She attributes this to four success factors. Firstly, the GLCs operate with a very strong corporate governance culture, which limits short-term political interference. Secondly, the GLCs operate within a zero-tolerance corruption environment, with Transparency International ranking Singapore as one of the least corrupt economies globally. Thirdly, the GLCs are meritocratic and are characterised by high levels of technical capacity and professionalism. Fourthly, there is a primary focus on bottom-line performance and competitiveness.

I'm sure, all would agree, a very different context to what pertains back home. Nationalisation in a context of entrenched corruption, weak corporate governance, patronage rather than meritocratic appointments, and disdain for the bottom-line (if our existing state companies are anything to go by), will not deliver improved outcomes with respect to employment, poverty reduction and

[4] Fukuyama (2014)

reduced inequality. There are countless examples from Latin America and Asia which outline the economic dangers and consequences of wide-spread nationalisation without the requisite state capacity and integrity. Unfortunately, it is the poor who suffer most. Losses incurred by inefficient state companies always result in fewer resources available for other pro-poor and anti-inequality fiscal expenditure.

It would be a major failure of our political system (and tragic) if South Africa continues to follow a self-destructive path to radical economic ruin. The so-called Venezuelan option would not amount to 'creative destruction' as some advocates would have us believe, but would perhaps be more similar to the 19th Century cattle killings which greatly impoverished the mighty Xhosa nation for decades thereafter.

2. Fundamental features of South Africa's political economy

Two years ago, I wrote a piece on 'radical economic transformation'[5] (henceforth RET) which began by discussing the multiple interpretations of this concept. Since then there has not, quite honestly, been much progress in getting agreement on defining a clear, coherent and achievable strategy of RET, even within the ruling party, never mind broader society.

In this year's SONA President Zuma defined Radical Economic Transformation as '*fundamental change in the structure, systems, institutions and patterns of ownership, management and control of the economy in favour of all South Africans, especially the poor, the majority of whom are African and female.'*

While there is nothing fundamentally wrong with this definition, it is simply pitched at too general or abstract a level to be used to answer today's question.

Here I wish to define RET as a progressive structural change in the fundamental features of South Africa's political economy. And to make sense of **that** statement we need to have broad agreement on the 'fundamental features' that need to be progressively changed.

So, at the risk of boring repetition, let us identify the 'fundamental features'.

I am hoping that by now the following list of **eight features,** and the required changes to them, could be regarded as uncontroversial 'conventional wisdom', broadly agreed (or commanding 'sufficient consensus') both within the ruling party and in broader society:

1. South Africa has a seriously underperforming **mixed economy**, or 'really existing capitalist democracy'[6]. Property rights are protected by the constitution and the ruling party supports a mixed economy of the social democratic variety.[7]

2. As a result of the **colonial/apartheid** legacy South Africa suffers **extreme inequality**, particularly along racial lines. The statistics are quite well known, but remain **staggering, and bear repeating**.

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[5] See Jonas (2015)
[6] See Chomsky (2013)
[7] See ANC (2017)

South Africa is quite a rich country. In 2016, we had a GDP of R4.4 trillion[8] at current prices, and had 16.9 million households[9]. So, if our GDP were to be equally distributed among all households then each household would receive about R260,000 per year or R22,000 per month. Allowing 30% of GDP for fixed investment and 20% for the provision of public goods[10] would still leave each household with R11,000 per month.

About 20% of households earn less than 10% of this amount (R11000/month), and about two-thirds of all households earn less than half of this.

Only 8% of Black African households have monthly expenditure of more than R10,000, while 63% of white households do.[11] Also, the wealthiest 10% of the population own 90-95% of all wealth.[12] (With figures like these it is not surprising that many of our people cannot see beyond the 'skin thing').

All this needs to change, **but how (critical condition), without jeopardising increasing private and public fixed investment?**

3. South Africa is only **partially industrialised** and we have exceptionally high unemployment rates and low labour market participation rates by international standards. Essentially, we have accumulated insufficient capital to employ all our people. Present rates of private investment are not much larger than depreciation. This again points to the need to increase rates of real investment in our country, both public and private.

4. Our private sector is dominated by **large-scale capital** and capital-intensive industries. This reflects a global and historical tendency of capitalism towards the concentration and centralisation of capital. But by international standards we have unusually low contributions of SMEs to economic activity, and low new business start-up rates and entrepreneurship rates. We need to change this, while continuing to guard against the illegal collusive market behaviour of the dominant players.

5. The South African economy is completely integrated into the **global economy**, both through international trade, capital flows and ownership. We remain dependent on minerals-based exports. This must change. We must grow our export industries. As regards foreign capital, it is noted that for the first time ever in 2015 South African foreign assets exceeded foreign liabilities (R5.5 trillion liabilities compared to R6.2 trillion assets). Our foreign liabilities are mainly portfolio investment (R2.6 trillion) and direct investment (R2 trillion). Our total foreign liabilities are equal to 72% of our fixed capital stock (R7.6 trillion).[13] These are all stubborn facts. The large amount of foreign capital invested in this country means that we must continue to guard against capital flight and disinvestment. We need to increase FDI and progressively reduce our dependence on foreign funding of our national fiscus.

6. In terms of the **sector structure** our economy, it is now dominated by the services sector, which accounts for 69% of GDP. In particular, the finance, insurance, real estate and business services sector has seen rapid growth over the last twenty years. We need to ensure that this sector

[8] SARB figure
[9] StatsSA, Community Survey 2016.
[10] Both these figures are generously more than at present
[11] See General Household Survey, Tables 16.2 and 16.3.
[12] See Orthofer (2016)
[13] All figures are for 2015 (SARB)

becomes more responsive and relevant to increasing fixed investment in infrastructure, SMEs, new start-ups and new entrants. I will talk about this more later in the lecture

Employment in agriculture, mining and manufacturing has been in decline. This must be reversed, obstacles to new investment removed and new entrants better supported. New sectors need to be opened up to provide business opportunities to the new black business stratum.

7. Despite large fiscal allocations to the **education and training** sector, outcomes remain poor. A poorly educated and trained majority perpetuates inequality and is a binding constraint on all the facets of social development. There can be no RET unless we fix our broken education and training system.

8. Our **public sector** is generally weak. We need to transform our public sector to make it more effective and capable, less wasteful and much less corrupt. In particular we need political leadership that has the will, the 'wise courage' and truly focused dedication, to forcefully drive the implementation of any RET strategy.

Without this 'magical ingredient', brilliant national development plans and presidential nine-point plans will remain sterile pieces of paper.

The frightening thing is that most people in this country would probably actually agree with the general thrust of these eight fundamentals that must be changed (with obvious scope for quibbling over points of emphasis and particular wording), but yet we are not knuckling down and doing it! Why?

I am confident that our fiscal and monetary authorities are completely aware of these fundamental issues.

Before moving on to a more detailed response to tonight's question I want to make a few general points:

The first is that these eight fundamental issues are all pretty much mutually reinforcing. We can't address some while neglecting others. We must make progress with all eight.

In particular, I think it is now generally recognised that high inequality and low growth are mutually reinforcing. There is also evidence that corruption and poor education, for example, both accentuate inequality and reduce economic growth prospects.[14]

Second, we cannot ignore the stubborn fact that there are **constraints on policy**. We may all want more fiscal redistribution and higher public spending, but the macroeconomic consequences will be seriously negative, as the history of economic populism in Latin America, for example, makes abundantly clear.[15] In our case capital mobility cannot be ignored, given its large presence in our national economic life. More on all this later in the lecture.

Thirdly, we need to accept that both the public sector and the private sector are rather weak and moribund. In particular, the public sector (including SARB) needs to create more supportive conditions for increased domestic fixed investment by private capital, by existing 'big capital', existing SMEs, and new start-ups. I think it is relevant to point out that the two institutions under

[14] For more details see Jonas (2017)
[15] See Dornbusch and Edwards (1991)

focus today, the fiscal and monetary authorities, have an important role to play in all eight fundamental issues.

Fourthly, one of the most contested area of economic policy in South Africa today is how to deal with established wealth and big business. We must accept the inevitable truth that we need big capital, and require its mobilisation in support of industrial diversification to unlock the competitiveness of new industries where we have comparative advantage. The creation of this new wealth is critical to the successful de-racialisation of the economy. The large amounts of capital required for a successful economic restructuring programme do not magically appear from heaven, and we do not want more public debt that exacerbates fiscal risk. We need radically increased investment in fixed capital, and for this to happen we need policy certainty and more competitive costs of doing business. These include security of supply and costs of energy, costs of trade and logistics, supply and costs of skills etc. Some of our major corporates are now investing more in countries like China and Brazil, as well as elsewhere in Africa. This requires our urgent attention and a mind-set change in terms of the role we see for big capital in unlocking the necessary investment for growth and transformation.

We also need a mind-set change in how we go about de-racialising ownership of the economy. We must accept that efforts to date have had limited success, and we need new conversations with all economic role-players about how we radically increase the black share of assets and wealth. In doing this, we must be cognisant of historical reality which shows that crude and aggressive indigenisation programmes lead to capital flight, declining levels of investment, increased social tension, and most importantly negative impacts on poverty and employment. We must also accept that indigenisation programmes often serve as little more than thinly veiled attempts of politically-connected elites to capture rents (what the SACP has recently termed 'radical economic looting'). So, dealing with corruption and the integrity of the state becomes a prerequisite for effective black empowerment and racial transformation of the economy.

Now I move to a more detailed understanding of the functioning of these two institutions in relation to the RET project.

3. Mandates and functions of the two institutions

The fiscal and monetary authorities of any modern mixed economy are fundamental institutions of national economic governance, involving, as they do, the creation of the national money, the control of credit creation by the banks, the raising of taxes and the control of government spending, and so on.

It is therefore entirely appropriate that the two institutions get their own chapter in our 1996 Constitution: Chapter 13, titled simply 'Finance'. The chapter is ten pages long and is mostly concerned with fiscal matters. Only one page is devoted to the Central Bank.

In contrast to the Constitution, this lecture will have more to say on the monetary authority and the financial system.

3.1 The monetary authorities and RET

Since the Mapungubwe Institute is a place of strategic reflection I am hoping that the following ruminations will not be out of place. Before it becomes too obvious, I should also point out that I am not an expert on money, banking and finance: I am simply trying to understand the complicated world that we must negotiate and ultimately transform.

Imagine it is circa 1890 and we are sitting one evening with Oom Paul Kruger on his stoep in Pretoria, while he strokes his beard, smokes his pipe and sips a mampoer. He is talking about the new developments not too far away to the south: the gold rush and the emerging new city of Jo'burg. Then he remarks: 'Hierdie is waarig radical economic transformation!' (Most politicians talk like that!).

And Oom Paul would have been right: there truly was a fundamental reshaping of the South African economy, between say the establishment of the JSE in a few tents in 1887 and the creation of the SARB in 1921.

In 1920 the Bank of England invited Keynes to advise on the setting up of the SARB, but he was otherwise engaged, so a rich banker called Sir Henry Strakosch did the advising[16]. The SARB opened in 1921 and became the sole issuer of banknotes in the country and ensured that a gold refinery and Royal Mint were established.[17] SARB only took over the bank regulation function from Treasury in 1987.

At this point let me step even further back in time to reflect on the nature of this 'borrowed institution': a central bank.

Central banks were first established in Sweden and England in the 17th Century, spread and emerged strongly in the 19th Century as fundamental institutions of the new nation states: government's banker, sole creator of the national money and controller of bank credit. Central banks became key and complex institutions of the 'mixed economy', innovating and evolving up to the 21st Century's 'only game in town'[18] (referring to the dominant role of major central banks in today's globalised financial markets).

The Bank of England was established in 1694 as a private joint stock limited liability company, with 1,520 original shareholders, who came from the emerging commercial and professional social strata. It was a co-operative venture, not too dissimilar to a stokvel or a BEE consortium. 'The Company' raised a 1.2 million pound loan for the government and in return it received a Royal Charter and the privileged status of being able to issue its own banknotes[19] (no other limited liability company was allowed to do so). The Bank was nationalised in 1946.

For the first forty years of its existence (1921-61) SARB kept a one-to-one fixed exchange rate between the British pound and the South African pound, apart from 1931-32 when the UK abandoned the gold standard before South Africa. SARB dutifully followed a devaluation of the British pound in 1949.

The last South African gold pounds for circulation were minted in 1932, and thereafter the mineworkers (and everyone else who didn't have a bank account) were paid in reserve bank notes and non-gold coin.

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[16] See Gelb (1984).
[17] The Royal Mint in Pretoria became the SA Mint in 1941.
[18] See El-Erian (2016)
[19] See Bagehot (1873)

In 1961, shortly before the establishment of the RSA, SARB replaced the South African pound with SA Rands, initially fixed at R2 equal to one British pound. This exchange rate held firm until the collapse of the Bretton Woods system of fixed exchange rates in the early 1970s. Thereafter began the long-term depreciation of the Rand against the dollar and pound etc.

But SARB succeeded in building a fairly sound system of money, banking and finance that served white minority interests and, indeed, White Monopoly Capital.

And in 1996 SARB was mandated by the Constitution to 'protect the value of the currency' in the interest of economic growth, for **all** the people of South Africa (Section 224).

SARB was created by the Currency and Banking Act of 1920 and is governed by the SARB Act of 1989.

In preparing this lecture I took a look at this Act and found the second listed function of SARB to be:

'coin coins or cause coins to be coined'[20]

Don't you just love lawyers?

Functions of SARB include:

- Creation of the national money (Rands)
- Controlling credit creation by the banks
- Formulation and implementation of monetary policy (in consultation with the Minister of Finance)
- Regulating and supervising the banking system and acting as lender of last resort (provision of liquidity to the banks)
- Promotion of the stability of the financial system
- Ensuring the effective functioning of the national payments system
- Managing gold and foreign exchange reserves
- Acting as banker to the government
- Administering SA's remaining exchange controls; and
- The provision of economic and financial statistics.

The SARB is one of the few central banks globally (others include Belgium, Greece, Italy, Switzerland, Turkey and the USA) that is not wholly government-owned (hence the current attention on nationalisation). The SARB is owned by about 650 private shareholders.

When the SARB was established in 1921 most central banks were privately owned (BoE model; but BoE nationalised in 1946).

[20] See SARB Act 1989, Section 10 (1)(a)(ii)

The SARB shareholders have no real power. The only thing they do is vote for seven board members with knowledge of labour, agriculture, mining, industry, commerce and finance. The other eight board members are appointed by the President (including the Governor and three deputy governors).

The Governor meets periodically with members of the Parliamentary Portfolio and Select Committees on Finance.

The SARB has two million issued shares (each shareholder to have a maximum shareholding of 10,000 shares). The present share price is R3/share. The annual dividend/share is 10 cents.

I can't help but think that the current attention on nationalising SARB is a little bit of a red herring. I think the image that is presented is of an institution that is controlled by outside forces, rather than the Government of South Africa. The implication is that the SARB does not behave in the national interest. Let me upfront say that SARB is accountable through the Minister of Finance to Parliament, and so to the people of South Africa. SARB has an immutable constitutional mandate, and is governed in terms of the 1989 Reserve Bank Act (as amended, and in terms of regulations flowing from the Act), as well as other pieces of legislation, such as the Banks Act (1990). And while it is to be expected, in a constitutional democracy, that the institution's policies and practices are subjected to contestation and 'democratic public reasoning', it is imperative that the institution is politically protected and empowered so that it is able to achieve its constitutional mandate. I will return to this point in the conclusion of the lecture when I discuss the dangers of an emerging economic populism.

The South African monetary authorities perform a number of important functions in managing our national money, banks and the broad financial sector. These functions need to be preserved and reproduced, and may be regarded as pre-conditions for successful RET-type processes. They may therefore be regarded as 'helping' RET in terms of tonight's question.

These 'helpful functions' include the following:

1. **Protecting the value of the Rand**, in terms of the primary objective given to SARB by the Constitution. Historically, South Africa has never experienced any hyper-inflationary episode, in contrast to most countries in Latin America, and many elsewhere (again highlighting the dangers of economic populism and ill-conceived policy decisions). We must ensure that this always remains the case, because hyperinflation would surely further impoverish the majority of our people and surely jeopardise any RET project.

2. **Preserving an efficient national payments system** by SARB together with the banks. This electronic system (which was still paper-based 25 years ago) is crucial for the functioning of any monetised market economy such as ours and must be protected.

3. **Bank credit creation** is crucial to accelerating capital accumulation and the system must be preserved to support increasing private investment.

4. **Financial sector stability**. South Africa has been praised for the strength of its banking system and the quality of its oversight and supervision. We were one of the few countries in the world to avoid a significant financial sector crisis hit in 2008. South African banks have a leverage ratio[21] of

[21] Own capital in relation to credit advanced

about 8%, compared to ratios as low as 1% of some global banks prior to the 2008 crisis.[22] Our 'macro-prudential management' must remain in place. We are the financial centre of Africa and need to think better how we leverage this.

5. **The foreign exchange regulations** regarding pension funds and other institutional investors are that 75% of their assets must be invested in the domestic markets. This is useful to increase the supply of funds in the domestic capital market.

6. **Our country's foreign exchange reserves** have tripled over the last few years to over R700 billion. These assets must be protected.

Before looking at the various possible 'hindrances' of our monetary authorities to RET (and what to do about them) I want to take a closer look at the crucial issue of bank credit creation.

Capital, in the sense of 'money used to make money' is greatly assisted in its accumulation by, among other things, credit. The role of bank credit in accelerating capital accumulation is a recurring theme in all three volumes of Marx's 'Capital', and was later also emphasised by both Schumpeter and Keynes.

Joseph Schumpeter argued[23] that someone '*can only become an entrepreneur by previously becoming a debtor…What the entrepreneur first wants is credit. Before he requires any goods whatever, he requires purchasing power. He is the typical debtor in capitalist society'*. In this process, the banker is the key agent: '*The banker, therefore, is not so much the middleman in the commodity "purchasing power" as a producer of this commodity. He is the ephor (overseer) of the exchange economy'.*

In other words: banks are the arbiters of the expansion of the entrepreneurial social stratum (including start-ups and SMME expansions).

The development of a banking system whose assets (credit extensions) are counted as part of the effective supply of money is an important ingredient in the promotion of investment. This is reflected in Keynes' view that bank credit '*is the pavement along which production travels, and the bankers if they knew their duty, would provide the transport facilities to just the extent that is required in order that the productive powers of the community can be employed at their full capacity*'.[24]

Both Schumpeter and Keynes were aware that bank credit is created out of nothing (*ex nihilo*), subject of course to the capital adequacy and liquidity requirements of the central banks.

The recent history of 'quantitative easing' by the world's major central banks has revealed clearly, to everyone who cared to look, that central banks can create trillions of dollars, pounds, euros or yen at the click of a mouse. The US Fed and the Bank of England have only recently publicly admitted this.[25]

Total credit extension in South Africa is about R3 trillion, of which about 60% is to the household sector (mainly for mortgage loans) and 40% is corporate and investment banking. A very small

[22] See, for example, Norfield (2016)
[23] Schumpeter (1911)
[24] Keynes (1930)
[25] See:
http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q1prereleasemoneycreation.pdf

proportion of credit extension goes to small business and new start-ups. **High-earning households and corporates are the main recipients of bank credit.**

The credit creation activities of our banks help to keep the economic status quo functioning, but seems far from the progressive role of banks observed and written about by Marx, Schumpeter and Keynes.

There is an interesting literature on how the financial sector (private banks and DFIs), can be better engineered to support investment in infrastructure, agriculture, small business development, BEE and industrialisation etc. As a non-expert, I found the work of Professors Epstein (2015) and Dullien (2009, UNCTAD) of particular interest.

Of course, it is quite easy to see the possible problems in increasing (or diverting/subsidising) credit to the priority industries and credit recipients (such as employment-intensive exporters, innovative start-ups, the black entrepreneurial class etc.):

- A large **increase** in total credit creation could increase imports and induce capital flight, causing Rand depreciation, increased price inflation and the need for higher interest rates.
- A **diversion** of credit to priority industries and recipients could increase the risk exposure of banks and possibly reduce their profitability.
- SARB credit creation in favour of DFIs, and compensated by a regulated and equivalent reduction in present bank credit creation, may be a less risky alternative but also requires careful management.
- Also, it must be noted that credit availability (or its price) is probably not a constraint on the growth of corporate investment, given the large cash reserves of the non-financial corporations (reported to be of the order of R700 billion, or a similar figure to the annual gross fixed capital formation by private corporations).

But credit creation and extension (at a reasonable price) is absolutely critical to the emerging black entrepreneurial stratum.

The low level of SMME finance may not necessarily represent a market failure – as it is so often characterised. The price and quantum of SMME credit may reflect its riskiness in the context of alternative investment choices. This may be appropriate because of the dominant savings channel being contractional in nature (pension savings and therefore risk averse).

This is not to say that policymakers must accept this. In this regard government could opt to subsidise losses and/or reduce the expected loss (or riskiness). Government could incentivise SMME credit by subsidising this form of credit if it sees broader social benefits to doing so, as seems to be the consensus. The modalities of doing so however would be important.

Low levels of repayment of government provided credit (NSFAS, SEFA, NEF etc.) show that a subsidy could best be administered by the private sector. Indeed, delinquency rates within commercial banks are substantially lower than they are at state SMME finance providers.

The second option would be to reduce the expected loss (riskiness). Government could do so by providing a system of technical assistance to incubate aspiring business owners. These dynamics were patently evident during apartheid (1970's and 80's), where South African agriculture was characterised by a 'marathon' period of direct governmental intervention in which subsidised credit was reinforced through a range of non-financial business support (training, market access etc.).

South Africa has never embraced directed lending. Crude directed lending may have negative consequences. Brazil's excesses show that crude directed lending can reinforce the existing economic structures. However, both South Korea and India have some form of directed lending within a market-based economy. China has this too. Such directed credit can either be forced out of the private sector with transparent and sensible regulations or through DFIs which are supported by both fiscal and monetary authorities. But weak governance arrangements often result in this becoming 'loans to friends'. A prerequisite for any type of directed lending and subsidised credit schemes is a capable and accountable state. That condition remains the necessary indispensable condition.

A key hindrance of our financial system to radical economic transformation arises from our efforts to control price inflation in the context of a flexible exchange rate, internationally mobile capital, and current account and fiscal deficits.

Essentially, South Africa's interest rates are kept high to induce portfolio capital inflows that are necessary to prevent Rand depreciation and consequent price inflation. This now becomes even more important with the down-grade, and closes the space further for any creative remedies.

Also, it has been argued that the volatility of the currency has worked against a restructuring of the economy since it biases the allocation of resources towards non-tradables, and with mining benefiting sometimes. In general, both manufacturing and services that could be exported under-perform because of the currency's big swings (not daily volatility). These swings are too large and discourage investment in these sectors. While inflation targeting might be the least bad option, this unintended consequence prevents diversification.

So, the question I would want to leave here today with the real financial sector experts (of which I have already disclaimed that I am) is how we better achieve price stability combined with lower interest rates and a more competitive exchange rate? Or is this just a case of wanting the cake and eating it too?

And as we deliberate on this, there are a number of other possible hindrances related to the role of our financial system in supporting radical economic transformation.

The first relates to the phenomenon of 'financialisation' of the economy, which refers not only to the increasing share of the finance sector in GDP but also 'the increasing role of financial motives, financial markets, financial actors and institutions in the operation of domestic and international economies'[26]. As an IMF study[27] titled 'Too much finance?' concludes, finance is no longer a progressive force of capitalism, as it was (to repeat) in the days of Marx, Schumpeter and Keynes. The primary concern is that the sector, with its high returns, attracts capital away from productive investment. I know it could also be argued that the high costs of doing business and risks in the productive economy are a disincentive to investment, but I do think we need a conversation around this.

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[26] Epstein
[27] Arcand et al (2012)

Similarly, the financial sector, with its relatively high wages, attracts our best talent. Imagine the highly educated black business talent represented by, for example, the Association of Black Securities and Investment Professionals, ABSIP. And imagine the boost to inclusive growth if this stratum migrated to the RET-type priority sectors; innovative start-ups etc! And, in particular, new Black venture capital companies. I will return to this subject shortly. Again, of course I realise that the finance sector cannot be blamed for the failure of our education and skills system to develop sufficient talent, and obviously, talent will only move to priority sectors if it makes career sense to do so.

A second hindrance to RET relates to how our financial system has increased asset prices over the last twenty years. Both financial and fixed property values. This benefited existing asset owners, and was a counter-veiling force to inequality reduction through fiscal redistribution. It also now makes the acquisition of assets by 'new entrants' more difficult. Current calls for expropriation without compensation are unhelpful and will only serve to further starve the economy of much-needed investment (which in turn will increase poverty and unemployment). We instead need fresh conversations with banks, relevant state agencies (DFIs etc.), and existing asset owners about how we can collectively increase the asset share among the previously dispossessed. And as I have argued previously (see Jonas 2017), we also need to focus on how to create new assets and new wealth, in which black South Africans have the lion's share. This is something we haven't succeeded in, given that the benefits of growth continue to accrue primarily to those with existing capital, assets and skills.

Thirdly, and related to this last point, I find it quite remarkable that our private equity and venture capital 'industry' is so small, with funds invested only equal to about 5% of total bank credit extensions.[28] Moreover, most private equity deals in South Africa have been around BEE, rather than investment in innovative/entrepreneurial start-ups and expansions[29]. There are also very few Black venture capital companies.

It is this frustrating stubbornness of the status quo that explains the urgent need for the fundamental reshaping of our economy, which many people now believe, must be led by a strong growth of investment in the new Black entrepreneurial class.

A key component of any successful inclusive growth process must surely involve the emergence of a genuine Black 'class' of innovative and entrepreneurial business people (not just 'tenderpreneurs' and BEE wheelers and dealers). This new class formation process will require the development of a rich and 'networked ecology' involving financial corporations, non-financial corporations, DFIs, the Jobs Fund windows, universities and science councils, regional innovation systems, incubators etc. While we already have these ingredients in place, and many promising initiatives, the 'networked ecology' has not yet come together adequately.

While the NDP encourages entrepreneurship as well as R&D spending and commercialisation, it does not, I think, say enough about the crucial role of venture capital finance. Also, while the draft amended financial services BBBEE sector code has 'empowerment finance' among its tick-box scorecard, it only amounts to about 13% of the total scorecard, and could get 'lost'. In addition, the

[28] See KPMG and SAVCA (2015): "Venture Capital and Private Equity Performance Survey". R116 billion invested by the industry compared to total bank credit extensions of R2.6 trillion. About 40% of assets of industry are public sector (IDC, NEF etc)

[29] See Harris (2012) and De Beer and Nhleko (2009)

target for the banking sector under 'empowerment financing' is very modest, amounting to an extra amount of R80 billion spread over five years (2012-17). This is equal to just 3% of present bank credit extensions!

So, to build a new black entrepreneurial class we will need a new focused and energised approach that **goes far beyond** existing initiatives.

The role of the banks will be crucial to this. Whether this participation can be engineered by bank regulation, fiscal interventions, talking, or all three, I am not sure. We would wish SARB and others to advise.

Now that I have dealt with the creation and circulation of private money in our economy, let me now turn to the public purse.

3.2 The fiscal authorities and RET

Let me be briefer with the fiscal issues. I think they are simpler, better understood and less controversial than those relating to money, banking and finance. The politics of the fiscus are much more difficult than the economics, and I am sensing 'economics fatigue'!

The term 'fiscal authorities' would normally be taken to include National Treasury, SARS, provincial and municipal treasuries and numerous other specialised public finance entities.

National Treasury is mandated by the Constitution (section 216) to ensure transparency, accountability and sound financial controls in the management of public finances.

Specific functions of National Treasury include:

- The promotion of government's fiscal policy framework
- The co-ordination of macroeconomic policy (together with SARB)
- The management of budget preparation processes
- The facilitation of the Division of Revenue Act
- The optimal allocation and utilisation of financial resources in all spheres of government
- The raising of taxes (through SARS)
- The management of public debt
- The management of public procurements etc.

It must be emphasised that if the National Treasury is to achieve its mandate it needs the co-operation of the whole of Government, in terms of Chapter 3 of the Constitution (Co-operative Government). The political implications of this are still being learned.

In terms of tonight's question, I will focus my attention on the three main fiscal categories: taxation, spending and fiscal deficits/debt.

3.2.1 Taxation

The first 'help' that our fiscal authorities provide to the RET/inclusive growth process is the huge inflows of money into our national fiscus (the National Revenue Fund). Collected as various taxes by SARS these are budgeted to amount to R1.4 trillion in 2017-18.

This is equivalent to 30% of our GDP, and is potentially of great help to any RET-type process, since these taxes provide the purchasing power for all manner of progressive state interventions.

Moreover, we have a progressive tax system whereby richer people get taxed proportionally more than poorer people. This contributes to the reduction of inequality, which is a critical aspect of inclusive growth.

But we could imagine the tax system playing a larger role in the promotion of inclusive growth. Let me give a few examples:

1. We must consider wealth taxes to reduce inequality. But we must also recognise that wealth can easily be switched between asset classes, ownership structures and tax jurisdictions to avoid being subject to tax. The Panama papers and tax havens spring to mind. Also, effective wealth taxes would require the integration of several databases (PIT, dividends withholding, deeds register, trusts tax files, credit bureau etc.) and could be subject to constitutional privacy rights (section 14 of the Constitution).

2. Tax incentives for employee stock ownership plans (ESOPs) should be considered.

3. Tax incentives for corporate supplier development programmes could also be considered. So as to incentivise local content in targeted value chains.

4. Most importantly, we must focus on economic growth to increase the tax base. For example, if we could grow our economy by 5% a year we could expect to double the Government's income from taxes in 14 years, thereby allowing us to double the resources available for fiscal redistribution. This would have a massive impact both on poverty and inequality reduction.

The Davis Tax Committee, I am sure, is looking at these and other tax proposals to support the inclusive growth process.

Taxation could be a hindrance to inclusive growth if rates were set too high so as to stifle incentives to invest etc. Also and obviously, any loss of integrity or efficiency of SARS would be a very serious hindrance to RET. With any loss of legitimacy of SARS and possible tax revolts we could definitely kiss goodbye to RET.

3.2.2 Fiscal Spending

In the current financial year total spending from the National Revenue Fund is budgeted to be R1.56 trillion or 33% of GDP. Two thirds of the 2017 budget is allocated to functions dedicated to realising constitutionally mandated social rights, including education, healthcare, social security and housing.

According to a recent study[30], in 2010 South Africa's fiscal redistribution was greater than in Brazil, Chile, Columbia, Indonesia and Mexico.

[30] See Lustig (2015)

This fiscal redistribution effort is a great 'help' to RET/inclusive growth. But despite this major redistribution effort, South African inequality has not fallen. Why?

Essentially fiscal redistribution efforts were offset by several factors, such as:

- Financialisation (as already discussed)
- Continued very high unemployment rates, due to the absence of employment-intensive industrialisation, technological change and global competition
- Increasing remuneration of high skill workers as a result of skills-biased technological change
- The inherent tendency for inequality to worsen under capitalism (as outlined by Piketty)

But there is no doubt that our extensive fiscal redistribution efforts have eradicated extreme poverty, provided access to basic services for almost all citizens, and helped to make our economy more inclusive than it otherwise would have been. But we do need to go beyond fiscal redistribution and use the fiscus more deliberately to drive inclusive growth. Priorities going forward must include investing more in logistics, technology and skills.

National Treasury's professional control of fiscal spending is an essential condition for future RET/inclusive growth processes. In particular I would highlight the following:

- NT manages fiscal spending in an orderly and transparent manner. Notably South Africa is a global leader in budget transparency according to the Open Budget Index.
- NT manages fiscal budgeting as a democratic political process. Budget proposals are first approved by Cabinet and then Parliament.
- NT has succeeded so far in avoiding a gross misallocation of state resources (for example on nuclear energy)

And despite putting in place regulations such as the PFMA and the MFMA, as well as assurance capacity through the Auditor General, we still have significant challenges relating to waste and corruption in public spending, as well as deriving value for money. But this is not NT's and the AG's problem alone. What is required is a concerted politically-driven effort by the whole of government, and a more concerted effort to build a professional state bureaucracy based on the principles of meritocracy.

NT is also criticised as being a hindrance to inclusive growth by being too 'conservative' or 'austere' regarding fiscal spending. I think this is unfair because fiscal spending far above government's tax income would necessarily increase government debt. This could ultimately compromise our national sovereignty.

3.2.3 Fiscal deficit and debt

The budget deficit in 2017-18 is R148 billion. That is, government's spending is budgeted to be greater than its tax income by this amount, which is equal to 3.4% of GDP.

Government debt is about R2 trillion, or approaching 50% of GDP. This is much higher than it was before the global recession of 2009. Also, the foreign ownership of Rand-denominated South Afrivan government bonds has increased markedly since then, to about 36% now. Our debt service costs are budgeted to be R162 billion this year. This is set to increase with the downgrade, which will crowd out non-debt fiscal spending.

Since the 2009 global recession, and limited economic recovery since then, we engaged in a 'countercyclical' fiscal policy. That is, we purposefully ran a fiscal deficit to inject more demand into our economy, to compensate for the lower demand caused by the global economic downturn. Our massive infrastructure programme lay at the centre of this approach.

The low growth scenario has lasted much longer than anyone expected. We currently now find ourselves with higher government debt, higher debt service costs, higher dependency on foreigners for fiscal borrowing, and therefore more beholden to the ratings agencies than we were previously. Unfortunately, I'm not sure the gravity of this situation was appreciated by key players among our leadership. The result has been that the green shoots that were appearing as a result of rising global commodities prices and demand as well as improving emerging market sentiment have been momentarily destroyed by the downgrade.

So, while our countercyclical policy was a 'help' to the economy, and allowed us to escape recession, our foreign debt and debt service costs are a significant hindrance to RET. It is vital at this conjuncture that critical capabilities that exist within our fiscal authorities are retained.

Our debt would become even more of a severe hindrance to RET if there was ever to be any 'debt monetisation' whereby SARB was somehow directed to create money to purchase government debt. This is the well-trodden route to hyperinflation, as practiced by Weimar Germany, Zimbabwe and (in the present) Venezuela. Even a modest acceleration in the inflation rate presents a significant risk to fiscal sustainability given that close to 35% of government debt is either inflation linked or denominated in foreign currencies.

About a decade ago the so-called Harvard Panel recommended that South Africa should adopt tighter fiscal policy and looser monetary policy so as to achieve lower interest rates and a weaker or more competitive exchange rate. The essence of this approach is to limit the extent to which domestic demand grows above the sustainable rate of growth. When this occurs, the current account deficit widens and inflation rises. Achieving the goals of the NDP may well be incompatible with external balance unless there is a greater contribution to national savings by the fiscus. Fiscal policy – set in counter-cyclical fashion in times of economic upswings – would make a greater contribution to national savings in order to bring down the growth of domestic demand. In addition, this would provide the Reserve Bank with sufficient space to achieve the inflation target with a lower interest rate and hence with a more competitive exchange rate. However, it has only been during short and rare periods when this type of coordination could have been possible. In the current circumstances, the room for such macro-economic manoeuvre has closed because of the limited space for further fiscal consolidation that is not disruptive.

So, the real scope for fiscal and monetary support for RET is less at the macro-economic demand management level, but rather at the level of the micro-economic impact of taxation, public spending and credit extension.

Now I move on to reflect on the politics of RET.

4. Reflections on the present politics of RET and the dangers of economic populism

I have written previously on the various competing narratives of radical economic transformation (see Jonas 2015). I will not repeat what I have said previously, but will rather limit the few minutes left of the lecture to focus on what I see as a growing and extremely dangerous tendency that we need 'bold wisdom' to overcome.

Unfortunately, as we approach the December 2017 ANC National Conference, it is becoming ever more difficult to subject RET to what Amartya Sen calls 'democratic public reasoning'. Policy positions are seen as proxies for factions, which themselves are cast as representatives of competing elites. No wonder we are losing credibility day-by-day. The involvement of global spin-doctors such as Bell Pottinger has not helped.

And as trust, both within the ruling party and among economic stakeholders declines, economic populism takes root. Populism works best in low-trust societies, and encompasses a range of ideologies, left and right wing. In a real sense, it is more a way of doing than seeing, in which 'rationality is subordinated to expressiveness'[31]. The essence of populism is to define friends and enemies, and demand that the state takes sides and behaves in a partisan manner even if it breaks its own rules and bypasses the institutions established to uphold law. Populism denies complexity, denies constraint, and denies risk. It distracts attention from the real issues that must be addressed, and, as evident in the current context, closes down space for democratic dialogue and conversation. It offers 'absolute creative freedom to the bullshitter to come up with whatever the audience would enjoy hearing'. Hence its appeal to desperate politicians and the massive traction it enjoys among electorates. We need the wisdom and the courage to resist the bullshit, especially bullshit that divides us as South Africans.

We need to recast radical economic transformation as a genuine programme of inclusive growth around which society can be mobilised – embedded in a consensual vision – and alert to the complexities, constraints and opportunities of the current moment.

5. Conclusion

In conclusion, we must recognise that the ANC, as a multi-class party – the so-called broad church – continues to champion a diverse and sometimes even contradictory range of policy proposals. This translates into policy incoherence within the state, exacerbated by weak planning and co-ordinating capacity at all levels of the state.

Monetary and fiscal policies have been well designed and implemented to manage macro-economic demand and price stability. In the short term, we need to politically protect and empower the fiscal and monetary authorities to continue to fulfil their constitutional mandates. But there may be scope to make fiscal and monetary policies more supportive of inclusive growth, not at the macro-economic demand management level, but, for example, in terms of fiscal and credit allocations to support new black business, the development of new industries, expansion of employment-intensive export industries, logistics infrastructure etc. For this to happen, it is critical that these monetary and fiscal interventions are better co-ordinated within our overall economic development strategy, including our industrial policies, energy, skills and logistics programmes etc.

A useful mechanism to achieve such integration and coherence, not only within the state, but between the state and other economic stakeholders, will be an economic charter. At a minimum,

[31] Harrowell, 2017

this charter must achieve sufficient consensus (commitments and trade-offs) around a few key priorities for inclusive growth, including:

- Building a capable, professional and corrupt-free state;
- Increasing levels of employment and investment in fixed capital;
- Increasing the black share of wealth and income;
- Fixing the broken education and skills system.

This democratic consensual vision must drive a workable agenda, in a way that brings coherence to intra-governmental and societal co-operation. We must, as a matter of urgency, deal more decisively with vested interests, in terms of uprooting corruption and taking steps to get more value for money from public spending. We must protect our institutions from corrupt interference, and ensure that our state-owned companies, which should be the frontline forces of our developmental state, are re-geared to serve the national interest. We must find the collective will to arrest the emergence of a shadow state which, in dressing up corruption as indigenisation, threatens not only the economy but the fundamental principles of our constitutional democracy.

I thank you.

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