by GORDON SMITH

THE CURRENT MACROECONOMIC CRISIS

Reflections on some of its causes

Introduction

This paper seeks to critically analyse the specific policy response of the South African state to a debt-imposed macroeconomic constraint on the rate of growth of Gross Domestic Product (GDP). However, this type of appraisal is necessarily tentative because of a current lack of systematic empirical research. Hence, the reflective nature of this paper. The paper also seeks to broaden an understanding of economic issues in South African social studies. It seems to me – although I may be wrong – that non-economists perceive that there is a barrier in the way of engaging economists. While this is not the fault of non-economists – the well known political economist Ezra Mishan has written about the 'methodological techno-mania" of economists – there **is** an intellectual gap between economics and the other humanities. I hope this will gradually be overcome through more frequent and serious multi-disciplinary exchange. This paper is explicitly written with this hope in mind.

The first section of the paper briefly outlines the current macroeconomic policy context in South Africa. The second section critically analyses current fiscal, exchange rate and monetary policies at two levels. Firstly, at the level of each policy and secondly, at the level of macroeconomic policy harmonisation. The third section concludes the paper with a suggestion for future research.

The current South African Macroeconomic Policy Context.

It is widely accepted in capitalist economies that macroeconomic policy makers are faced with the task of prescribing a package of policies to solve one or more of the recurrent symptoms of economic instability in the form of unemployment, inflation and balance of payments (BOP) disequilibria. In the present South African economy, all three of these crisis manifestations are apparent. Notwithstanding the problems with the definition of unemployment, reliable estimates put this rate at between 20-30% of the labour force; the reported rate of inflation for this year is expected to be 16-17%; the exchange rate is weak and foreign currency reserves are very low. These conditions are hardly unique to South Africa and, indeed, by way of comparison to Latin American countries, South Africa's macroeconomic indices are not unimpressive. While there is undoubted academic value in comparative research, the extent of the current macroeconomic malaise in South Africa is either indirectly or directly linked to state policies.

It is instructive to analyse the annual budget at the beginning of the fiscal year to identify macroeconomic policy priorities. Since the debt-moratorium of August 1985, the most crucial economic policy concern has been the BOP and linked to it the rate of inflation. The BOP is under pressure primarily because large foreign exchange reserves are needed to pay back the economy's substantial short term foreign debt. This has crucial implications for the growth capacity of the economy. A typical means of preventing cyclical disturbances in a capitalist economy is to stimulate economic growth either through aggregate demand-management or through supply-side, usually tax, incentives. In South Africa an excess over the level of domestic savings and taxes has been historically required to sustain an upswing or avoid a downswing in the economy. This means that investment expenditure in the economy is typically partly financed by foreign investment and borrowing. As long as this condition exists, there is a strong positive relationship between both expansionary fiscal policy and GDP growth and a positive net capital inflow on the BOP and GDP growth. However since 1986, several constraints have imposed themselves scotching a growth orientated macroeconomic policy.

Current Fiscal, Exchange Rate and Monetary Policies in South Africa.

1. Fiscal Policy

Regarding raising state spending, any mildly expansionary fiscal policy is expected to increase the level of national income. Fiscal policy is defined by the size of the budget as a proportion of GDP. Since not all state expenditure is met out of taxation revenue, fiscal policy incorporates a deficit before borrowing. This is simply the borrowing requirement to cover the deficit between current expenditure and current revenue. However, for both consumption and investment aggregates in the national income accounts, there exists a strong positive relationship between GDP growth and local import demand. Thus, as the economy grows, the demand for imports rises. This causes a deterioration on the trade account of the BOP as foreign exchange reserves dwindle to pay for the imports. Yet policy makers are intent on engineering the economy to generate a recurrent surplus on the trade account to pay for the deficit on the capital account. This deficit is largely caused by the amount of the country's external debt and the appalling extent of foreign and local corporate capital flight from the economy. By way of illustration, since August 1985, the US dollar value of net foreign and local capital flight is estimated at 25 billion while the US dollar value of the debt stands at just over 20 billion. Thus, a BOP equilibrium requires a near static rate of growth of aggregate output and employment creation. Indeed, economists put this constraint at a mere 2-3% of the value of GDP. Thus, as

economic expansion puts pressure on the BOP by way of falling foreign currency reserves, the economy's ability to pay back its external debt is jeopardized.

Specifically, there exists an inverse relationship between rising state expenditure and the BOP. It is for this reason that fiscal policy for the 1989/90 fiscal year has been described as "neutral" or even "contractionary". While the latter probably overstates the point, there are pressures on the state fiscus **not** to increase expenditure in real terms. This is reflected in the slightly reduced value of the deficit before borrowing and the intention, over the next 5 years, to reduce the ratio to 3% of the value of GDP. However, there is an international trend for the size of state expenditure as a proportion of GDP to increase over time and South Africa is no exception to this trend. Thus, there remains much scepticism on the part of the private sector that the state will cut back on its rate of growth of expenditure.

TAXATION

It is for this reason that organized business is advocating a reduction in the level of direct and indirect taxation. This is, broadly speaking, the supply-side private sector's alternative to expanding fiscal policy. However, with the current BOP constraint, an increase in private sector spending is likely to have a similar negative impact on the trade balance as an expansionary fiscal policy. While the state has used this argument not to change the tax structure, there are more immediate issues which cause it to hedge against a reduction in the level and rate of taxation. These emerge directly from the co-optatative basis of the political system. This view is well established in the relevant literature but it suffices to say that the internal logic of reformed or neo-apartheid is that vast public funds are required to pay for existing (repressive) state structures as well as any social infrastructural upgrading programmes that aim to extend the costly incorporation of urban blacks. While the undemocratic nature of infrastructural provision is generally considered to be politically unacceptable the physical provision of it is not. Under a tight fiscal policy stance, such social wage redistribution provision is under threat of being rationalized. This is especially the case where an incumbent state is highly unlikely to compromise on direct security related expenditure. It is in this sense that there is a direct tension or even contradiction between the state's political reform agenda and macroeconomic policy. Thus, given this strategic stalemate, one needs to look more closely at the reasons for the state accepting the primacy of open economy considerations in its currently chartered macroeconomic strategy

LOCAL CONDITIONS

While the existence of the foreign debt burden is not a uniquely South African phenomenon, the adverse conditions of debt repayment can be related to local conditions. At the time of the 1985 moratorium, the structure of the national debt in short term maturities was typical of many countries' external debt portfolios. This switch reflected a rising risk associated with Less Developed Country (LDC) borrowing and was typically accompanied by rising interest rates in lender economies. For South Africa, not only had the economic risk and cost of indebtedness increased generally but the political risk of association with apartheid had a ratchet effect on the access of the South African state and, to a lesser extent, private sector to overseas borrowing facilities. When the crunch came in the form of a refusal by the country's foreign commercial bank creditors to rollover outstanding debt, a staggering 35% of the value of GDP was bunched in short term debt. When that debt soon matured, the economy, predictably, defaulted. Unlike Latin American countries, where there exists a debtor cartel to attempt to countervail the multinational creditor cartel led by the International Monetary Fund (IMF), and having already defaulted, South Africa was not in a strong bargaining position.

Even if the economy did not have the current BOP constraint to GDP growth, a denied access to foreign credit, in terms of its historic cyclical significance, would be worse than no access at all. For precisely this reason the state has been politically pressured into a macroeconomically onerous repayment schedule in order to preserve its survival. This point is equally understood by the anti-apartheid opposition both inside and outside South Africa and, as a strategic opportunity, explains their specific pressure for financial sanctions. While it remains to be seen how this pressure influences further debt-repayment negotiations, the politicization of the South African debt issue does reinforce the degree of risk associated with the country. It is in this environment of creditor imposed austerity that an exchange rate policy is being linked to the tight fiscal policy stance.

EXCHANGE RATE POLICY

Under a (managed) floating exchange rate system, a trade deficit would lead to a depreciation of the rand. A low rand is argued to be necessary and indeed, the logic of the exchange rate policy is self-perpetuating – at least until the economy has met its negotiated foreign debt obligations. A depreciating rand encourages the sale of exports and this would, under less indebted circumstances, lead to an expansion of the level of economic activity and national income. But the economy is currently not able to absorb all of this foreign exchange since the South African Reserve Bank (SARB) must hoard a substantial part of it to meet creditor obligations in their currency units. This necessity has the effect of suppressing an import bill that would otherwise be financed out of earnings from exports. Since South Africa is a developing country, the economy, and particularly the manufacturing sector, requires access to imported capital or investment goods to produce consumer goods. This is another way in which economic growth is being constrained by the BOP constraint.

The low rate of economic growth has a reinforcing effect on the exchange rate. If the economy is not growing, then it is not an attractive investment prospect for foreign investors. This pressure on the exchange rate cannot be compounded by a rising import demand. As long as macroeconomic policy remains committed to servicing and repaying external debt obligations, the exchange rate is not likely to improve. However, if there is a recurrent net export surplus with which to meet foreign debt requirements, the exchange rate is expected to be relatively stable. This is important for at least two reasons; firstly, to anticipate a stable rate of cost inflation in the relatively import dependent sectors of the economy by

knowing an approximate value of the exchange rate and secondly, since the external debt is denominated in foreign exchange, if the rate worsens, the cost of the debt burden is made more onerous. Thus, the earlier conclusion of the inverse relationship between the level of national income and the BOP is qualified if the basis of GDP growth is export-generated. This is a very significant qualification because it adds macroeconomic weight to the insistence of organized business and the state that South Africa must follow the development path of the high export-performing East Asian Newly Industrialised Countries (NIC's). It is not insignificant that such a strategy forms the backbone of a typical IMF "structural adjustment programme" (SAP) for indebted LDC's. Indeed, the IMF is not only one of South Africa's major creditors but, through access to the Special Drawing Rights (SDR) facility, it is the country's current source of bridging finance. This source of finance appears necessary for the economy to meet current short term debt obligations. Infact, the macroeconomic constraints defined by both South Africa and its creditors could be seen as facilitating the export drive route as a strategy to overcome **both** the macroeconomic and structural crisis in the economy.

POLITICALLY ABSURD

While a full appreciation of this structural policy falls outside the ambit of this paper, it is worth mentioning that this strategy seems politically absurd in the context of a sanctions hostile international economic environment. To date, there is insufficient evidence on the "success" of the trade sanctions campaign. Indeed, to the extent that it has not realised the objective of isolating South Africa economically, this may indicate that there is a high foreign demand for South African exports at their relatively low prices. Again, while the exchange rate contributes to this, the nature of South Africa's foreign trade is highly unequal in value added terms. As the terms of trade have moved against LDC's, particularly in the 1980's, this has contributed to depressed exchange rates and a situation where an increased volume of exports can purchase the same value of imports. In fact, manufactured goods, as a proportion of South Africa's exports, have increased substantially. However, as semi-processed raw materials, the increase in value-added and thus export price is hardly significant, especially against a background of a depreciated exchange rate.

As a result, the export performance of the economy remains contingent on the dollar price of gold. Any fall in this pivotal price has immediate exchange rate and foreign currency reserve implications for the economy. Thus, a sustained fall in the world price of gold, principly because of an absence of inflationary expectations in the Developed Countries (DC) and an excess world supply of gold, is reflected in a rising dollar and falling rand exchange rate. That is, a fall in the price of gold leads to an increase in the economy's foreign debt burden through its impact on foreign reserves. Again, by way of illustration, it is estimated that the fall in the dollar price of gold to 370 US dollars per fine ounce has reduced foreign exchange earnings by 1.2 billion US dollars. While the SARB has permitted gold-debt swops, this runs the risk of creating an excess supply in the world gold market should the debt-settlement supply be resold. This principle may be extended to include debt-equity swops. This essentially involves giving local private sector or public sector assets to foreign commercial bank creditors in exchange for external debt redemption. Again, while this is yet to happen, this is a structural policy quite consistent with the rest of a SAP package. In spite of these problems, a stable if weak exchange rate and a tight fiscal policy are also being accommodated by a strict monetary policy.

MONETARY POLICY

A restrictive monetary policy seeks to reduce the rate of growth of the money supply below the current inflation rate. For monetarists, this is a possible policy intervention because, subject to certain behavioural assumptions about market participants' responses, the money supply is considered to be controlled by the SARB. Particularly if a strong transmission mechanism is evident, as monetarists would argue, a fall in the rate of real growth of the money supply would lead to an increase in real interest rates. The typical effect of a restrictive transmission mechanism is as follows. A fall in the rate of real money growth would create an excess demand for money at the established market interest rates. This would allow interest rates to rise to clear the money market. A rise in interest rates would induce a shift into financial assets as institutional investors take advantage of the relatively higher rates of return on stocks and bonds. On the other hand, the cost of borrowing investment capital and consumer credit rises; investment in productive capacity falls and aggregate output and employment also contract. Once again, the intended effect is to dampen economic growth.

It is particularly in this sense that monetarists associate a strict monetary policy with controlling the rate of inflation. Typically, if the rate of growth of the real money supply is growing less slowly than the rate of growth of real expenditure, there will not be enough money in circulation to purchase the available aggregate output. The resulting excess demand for money will increase the opportunity cost of spending as market interest rates rise. As far as the BOP is concerned, it is necessary to control inflation because of its undermining effect on the exchange rate. Simply, if the local inflation rate is higher than those in other countries, the price competitiveness of South African exports can only be compensated for by a further depreciation of the exchange rate. The macroeconomic imperative to prevent this, in the current policy context, is by now self-evident.

Furthermore, a rise in interest rates can also have the effect of priming the exchange rate through attracting financial inflows on the capital account of the BOP. This in itself would reduce the rand value of the present capital account deficit but the primed exchange rate would also have the effect of cheapening the foreign exchange value of the external debt as explained earlier. This was the major reason for the re-introduction of the dual exchange rate system where the financial rand is explicitly designed to attract large foreign capital inflows for investment purposes by being cheaper than the commercial rand.

PROBLEMS

There are, however, a number of problems that can emerge from rising interest rates. The low level of business confidence in the economy only allows for short term prospects. This accounts for the excessive speculation in the financial market and a propensity for volatility

on the stock exchange. In this sense, rising interest rates tend to support speculative rather than productive activity. In the capital market, short term loans maturing earlier typically carry higher interest rates, while some firms, especially those without access to own capital funds, and those who have been negatively affected by the cost implications of a low exchange rate, including the mining houses, have sought bridging finance to meet committed capital outlay costs. Far more noticeably has been the soaring demand for credit as consumers hedge against inflation; as households compensate for higher taxation to maintain a particular standard of living; because of expected high lifetime income earnings or because many home buyers have committed themselves to service and repay mortgage bonds. This also means that the personal savings rate of the economy is declining at a time when high interest rates should be facilitating a rise in this rate. This fact coupled with almost no access to foreign borrowing and, indeed, where the economy is likely to remain a net exporter of capital for some time, has negative implications for long term productive investment and employment creation prospects. Clearly, what this means is that monetary policy does not seem to be able to control inflation.

Indeed, a fusion of money and capital markets seems to be emerging. Specifically, any excess supply of loanable funds in the financial sector will be made available if the demand exists. Indeed, given the high interest rates, it is in the commercial interests of the large banks to lend at these rates irrespective of the intentions of current monetary policy. Since this demand does exist, especially from consumers, the monetary targeting of the SARB is consistently out of line with the actual rate of real growth of the money supply. Thus, some proportion of the money supply can be argued to be non-responsive to a monetary transmission mechanism.

DEMANDS

This continually higher than expected rate of real monetary growth has also been laid at the door of the SARB itself. While the state intends to maintain its deficit before borrowing at an annually declining proportion of GDP, the demands on the state fiscus identified earlier create a tension that could forfeit austerity. To the extent that the size of the deficit before borrowing has become an important index of expected future inflation, any increase in its relative size leads to resistance from an inflation-sensitive private sector. In particular, a market sensitivity to the size of the deficit before borrowing makes the marketing of public debt in the economy more difficult. This expectation is given weight by the seeming incapacity of the state to redeem any of its recent past loans on time. Coupled with the current cost of foreign debt servicing, this accounts for the large slice of the fiscal budget that must now be allocated to interest payments. The opportunity cost of this lost revenue is, again, self evident. If the state wants and is able to deficit finance by borrowing on the local capital markets, the high interest rates, which it has partly engineered, would simply add to the current cost of the debt burden. In the context of fiscal restraint, this strategy would be contradictory. The crucial point now is that in the absence of access to foreign borrowing, a declining domestic personal savings rate and a market sensitivity to the size of the deficit before borrowing means that the state may resort to the printing press if it cannot maintain its fiscal discipline. The immediate effect of this is inflation. There are suggestions that the state benefits from inflation via the effects of fiscal drag or bracket creep. While there is a popular resonance in this argument, it is structurally weak in terms of the imperative of a capitalist state to attempt to maintain the relative stability of the economy. This is especially the case where the degree of openness of the economy makes the country highly sensitive to changes in the global economy. Hence the political acquiesence of so many LDC economies to managed intervention by the IMF and other external institutions in the 1980's.

While the state is hedging against a reduction in the rate and level of taxation in the economy, it is neither politically or structurally expedient for it to increase the level of taxation. It has already been identified that a possible cause for the high demand for credit is to hedge against the decline in real disposable income. Indeed, the average per capita real disposable income is now at the same level as in 1970. Indeed, to the extent that higher tax revenues are sought, this can only really occur through indirect means. Not surprisingly, the proportion of indirect taxes, and thus the proportion of taxes falling on poorer income groups, has increased substantially over the past decade. The perceived high corporate tax rates have obviously also contributed to what some economists see as a capital strike. The state has effectively abrogated responsibility for job creation and, from the point of view of organized business, it must appear that macroeconomic policy is facilitating the structural conditions for the private sector to be able to do this. This is the broader context of the deregulation and privatisation initiative as the state envisages a retreat from the economy. That is, as this retreat occurs, the taxation burden can be relieved. Again, like the export initiative, this is a logical structural spin-off of a monetarist policy project. Thus, the state realises that if this strategy is going to succeed, any further increases in taxation would be a macroeconomic contradiction of structural policy.

CONCLUSION

This paper has reflected on the macoreconomic policy response of the state to an externally imposed GDP growth constraint. The sensitivity of the BOP and the requisite need to control inflation has induced the state to opt for a "neutral" fiscal policy being tied to a strict monetary policy and stable exchange rate. In addition, some reference has been made to the links between this strategy and structural policy. However, as this paper has contended, the degree of policy harmonisation is somewhat tenuous. This is because of a lack of control of the SARB over monetary growth; the fiscal requirements of current political policy and the potential volatility of the exchange rate. That this policy has been imposed by external agents and carried through by an undemocratic state is a political problem in itself. Even the country's top economic managers have publicly stated that a political solution is a precondition to restore both domestic and international confidence in the economy. By implication, this would mean a relaxation of debt repayment conditions by foreign creditors. The long term effects of the current constraint on economic growth are not encouraging. For this economy to sustain a broad based prosperity, it has been estimated that an average GDP growth rate of 7.5% over the next decade is needed. By contrast, the

GDP growth rate for 1989 so far has been less than 1%. While the current policy package is under stress, this is also a reflection of the extreme pressure on the South African state. For the progressive opposition, this cannot of itself allow political solace because of its real effect on masses of people. Therefore, the research agenda beyond these reflections is that there is a need to investigate alternative macroeconomic intervention based on national and democratic prioritisation.

Note: This paper is a revised version of a paper presented to the Critical Studies Group Seminar Series at the University of Natal, Pietermaritzburg, 3 October 1989. I would like to thank Norman Bromberger for helpful comments on the economics and Prakash Naidoo for help on minimising the jargon. All remaining errors remain solely my responsibility.

Primary references:
"Budget '89", Supplement to the **Cape Times**, 15 March 1989.

Cobham, D. (1988) *Macroeconomic Analysis.* Harlow: Longman.

Hirsch, A. (1989) The Origins and Implications of South Africa's continuing Financial Crisis, *Transformation*, No. 9, 31-50.

Holden, M. (1989) Changes in the World Economy and their Importance to South Africa, *Paper presented at the biennial Economics Society of South Africa Conference in Johannesburg, 6-7 September.*

Lapper, R. (1989) Apartheid heads for a harsh reckoning, *South*, no. 108, 26-27.

Lipton, M. (1989) The Challenge of Sanctions, **Paper presented to the biennial Economics Society of South Africa Conference in Johannesburg, 6-7 September.**

Mittermaier, K. and Torr, C. (1989) The Appropriate Role of Government in the Future Economic Development of South Africa, *Paper presented at the biennial Economics Society of South Africa Conference in Johannesburg, 6-7 September.*

Standard Bank Economic Review, January, April, May, July, August and September 1989.

by MARTIN PROZESKY

CAN THE TRUE EXODUS STOP AT DAMASCUS?

Review of THE ROAD TO DAMASCUS : KAIROS AND CONVERSION. Johannesburg : Skotaville Publishers, 1989. 36 pages.

The most important development in modern Christianity has nothing to do with Darwin, obdurate popes, wayward evangelists or what has become known as "the secular challenge". It is the discovery that large and influential sections of the Christian church, especially in first-world countries, are not only a serious distortion of the central message and example of Jesus of Nazareth and the Exodus tradition of faith which he inherited and helped broaden and spread, but also fall well short of universal goodness.

The Road to Damascus, despite its modest size and generally unpretentious style, belongs in the ranks of and is a means of furthering that great discovery, which is its main significance, along with the novel phenomenon of being a joint statement by Christians in seven conflict-ridden countries stretching in a broad sweep from South Korea through South Africa to Central America. The local edition includes ten pages of Southern African signatories from most denominations at the end. Many of them are prominent church and academic figures, an endorsement which will doubtless help the message of the book make an impact among the lay people it is evidently intended to guide, encourage and convince.

What wse are given in this document is an analysis of the scandal of Christians on both sides of the bitter conflict in these countries; a condemnation of all right-wing Christians as heretical and concluding call on them to undergo conversion, Saul-like, from being persecutors of Christ to being supporters of the Christianity represented by the standpoint of this little book. That kind of Christianity is portrayed as an active faith which sides with and stands by the poor and oppressed, drawing on what is seen as the central biblical heritage going back to the Exodus faith. Nothing could be more alien to it than the kind of church that aids and abets imperialist-typoe domination of the world's marginalized people.

This amounts to the recognition that ruthless exploitative forces have succeeded in appropriating important sections of Christianity into their service. So successful has this tactic been that many whose values haven't much in common with Jesus of Nazareth sincerely think they are his true followers, for example by striving to keep the world safe from communists and their like. Naturally enough, such a travesty of the gospel, thus understood, must be unmasked and denounced, so that a key section of **The Road to Damascus** is the critique of right-wing society and its attendant form of Christianity in the chapter called "Our Prophetic Mission." This is done in terms of five traditional theological evils – idolatry, heresy, apostacy, hypocrisy and blasphemy – whose relevance to present-day political, economic and military forces is interestingly but briefly indicated.

Critics of the now-famous Kairos Document made much of its alleged lack of theological finesse. They could doubtless do the same to this successor. So far as I am concerned, that kind of objection is irrelevant for documents which are designed for a mass readership. It is much more appropriate to perceive that an important and justified ethic of compassion governs **The Road to Damascus,** and then to concentrate on main themes, not doctrinal niceties. If we do that, we can then move to the question whether there is anything substantially new