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Re-orienting Monetary and Financial Policy towards Job Creation and the Interests of the Poor

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INTRODUCTION

South Africa's recent poor job creation performance and worsening inequality underscore the need to implement monetary and financial policies that promote employment and development while serving the interests of the poor. A sterile monetary framework that focuses narrowly on controlling inflation fails to address the pressing socio-economic problems aggravated by unduly restrictive credit policies, particularly high interest rates. The failure of commercial banks to provide adequate financial services for low-income individuals results from a market failure that requires government intervention. This report recommends four policy reforms:

- The reorientation of monetary policy towards balancing growth and development objectives with the imperatives of financial stability;
- The targeting of subsidised credit towards key industries and enterprises;
- The implementation of community reinvestment legislation that induces commercial banks to provide financial services to the poor; and
- The revitalisation of the postal bank and the restructuring of postal bank resources towards poor communities.

These four recommendations provide initial steps in transforming monetary and financial policy to support job creation and socio-economic development, with a particular focus on the poor. This report is structured in two major parts. The first part provides an appraisal of monetary and financial policy in South Africa over the past ten years, with a particular focus on the availability of financial services to the poor. The second part of the report develops the policy recommendations listed above, utilising economic theory, cross-country evidence, case studies, and South Africa's historical experience to analyse the appropriateness of the proposed reforms and to identify concrete steps in implementing them.

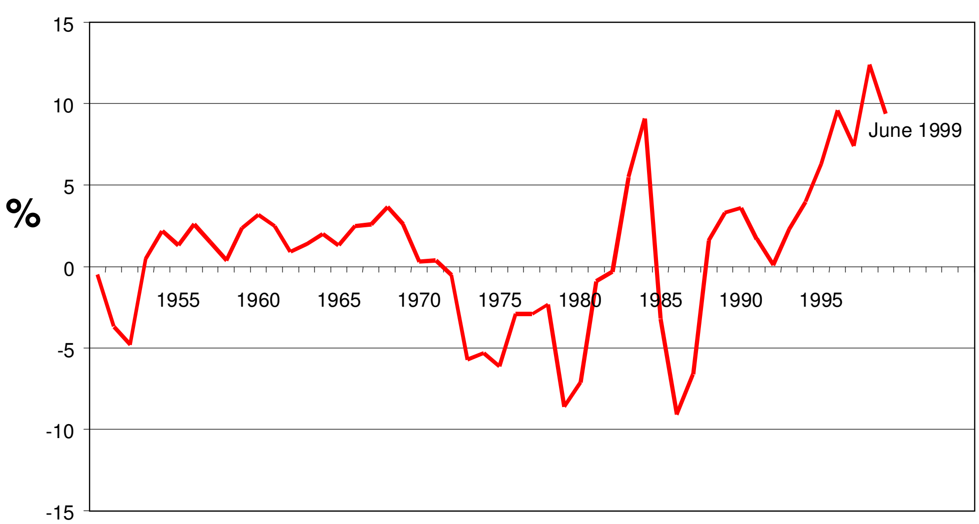
PART I) AN APPRAISAL OF MONETARY AND FINANCIAL POLIC

I.1) MONETARY POLICY

The Reserve Bank has aimed monetary policy since 1989 at the objective of reducing the rate of price inflation. To achieve this, extraordinarily high interest rates have depressed consumer and business demand and inflated the interest costs of servicing the government's debt.[1] The high interest rates have also propped up the external value of the rand, leading to exchange rates in the short run which are probably stronger than they would otherwise be. Stronger exchange rates lead to lower costs for imported capital goods (as well as capital complements such as imported energy products). Thus, high interest rates have increased the cost of credit for domestic investment, suppressing job creation, yet also tended to some bias towards capital-intensive production.

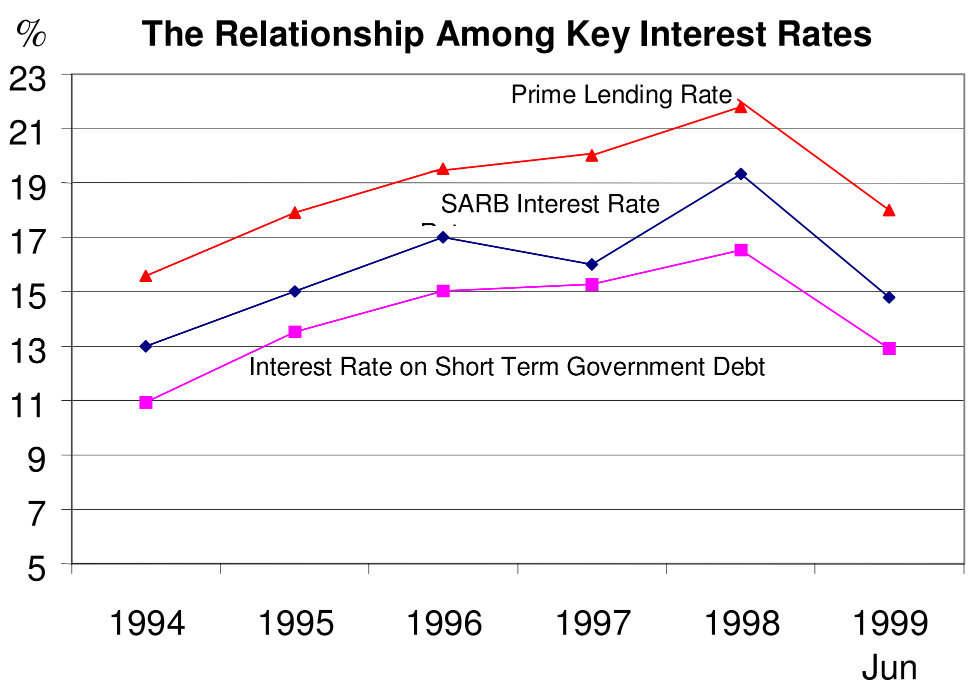
The Reserve Bank's policy of disinflation has reduced the rate of inflation from an average of 15% during the 1980s to 5% in June 1999. The graph below shows that over the past several years the Reserve Bank has raised the key interest rate it

The South African Reserve Bank Interest Rate (Inflation-adjusted)



controls to the highest levels (in real terms) in the history of South Africa. The cost of this programme in terms of higher unemployment, reduced economic growth, and lower national income has been extraordinarily high. One study estimated that the disinflation from 1989 to 1996 cost the country forty percent of a year's national income—about twice the relative cost of the disinflationary programme in the Unit States in the early 1980s.[2] These high interest rates have deterred investment and undermined prospects for small businesses to survive. They also have increased the cost of servicing the public debt, and created a personal debt burden for many consumers who rely on credit.

The increasing real interest rates observed since 1994 followed systematic increases in the key interest rate controlled by the Reserve Bank, even as the rate of inflation fell. Increasing nominal interest rates and falling inflation together propelled real interest rates higher. There is a strong link between the Reserve Bank's interest rate and other interest rates in the economy, including the interest rates paid by firms to invest in job creation as well as the interest rates the government pays on the public debt.[3] The graph below demonstrates the strong link between the



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[1]Samson, Michael. 1996. "Evaluating the Costs of South Africa's Monetary Policy Alternatives". *A Consultancy Report to COSATU Commissioned by the National Institute for Economic Policy*. Johannesburg: NIEP.
[2] Ibid.
[3] The Reserve Bank recognises this link. For instance, after the September 1994 increase in the "Bank" rate of one percentage point, the Reserve Bank's December 1994 Quarterly Bulletin noted: "Both short-term and longer-term interest rates and yields reacted immediately to this rise in discount rate and moved sharply upwards" (page 2). For more detail on how the Reserve Bank uses this policy instrument to influence interest rates, see: Nel, H. 1996. "The Term Structure of Interest Rates and Economic Activity in South Africa" in the *South African Journal of Economics*. 64(3).

Reserve Bank's interest rate and two key interest rates—the prime lending rate a[nd] the interest rate on short term government debt.

I.2) FINANCIAL POLICY

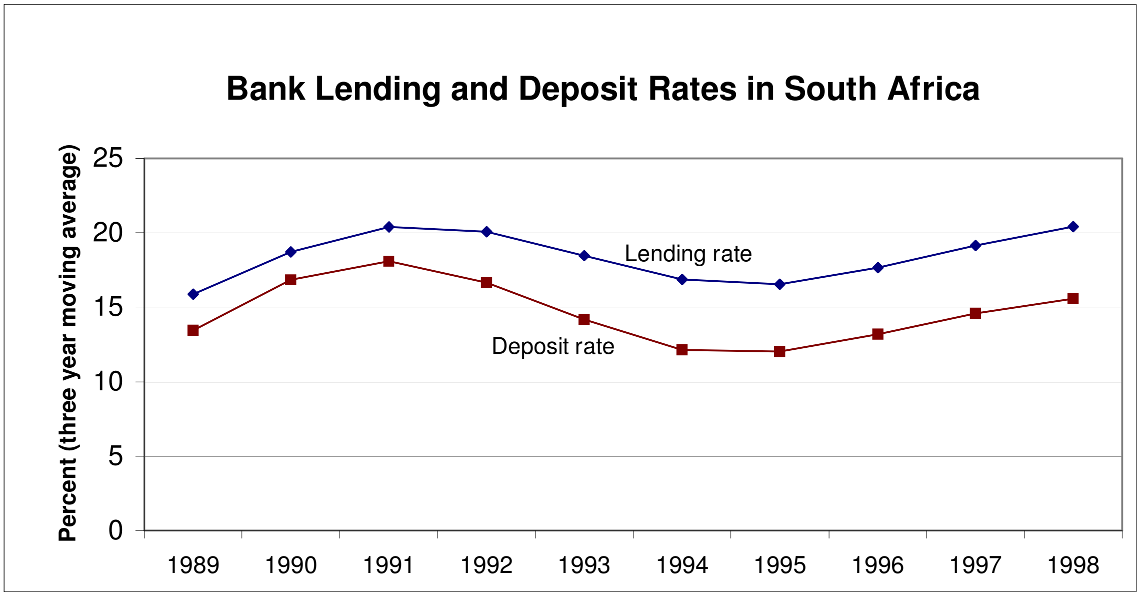
Financial policy over the past five years has focused on deregulation and financial liberalisation, with insufficient emphasis on the promotion of competition and the protection of consumers. Even an ABSA bank publication characterises South Africa's financial system as "lagging behind in consumer protection legislation…compared with international 'best practice'",[4] articulating "a general feeling among regulators and government…that the Competition Board needs more teeth."[5]

The move toward deregulation of financial services since the early 1980s has enabled commercial banks to adjust their interest rates independently of the Reserve Bank.[6] Apparently collusive behaviour by banks has resulted in unfair price setting, leading to increases in the interest rates charged on loans. The absence of an effective competition board hinders effective action against this anti-competitive behaviour. This was illustrated in South Africa on 17 May 1996 when the banks unilaterally raised their interest rates by one percent even though the Reserve Bank had not raised the cost of funds. The competition board ruled that the increase by the commercial banks should be considered an act of price leadership (lawful) and not a case of price collusion (unlawful) and that the banks had sound *economic reasons* for increasing their interest rates.[7] This finding of the competition board demonstrated a lack of resolve to promote competition in the interests of the development objectives of the country. The finding was inconsistent with a 1997 study that found that the four largest commercial banks in South Africa (ABSA, Standard Bank, FNB, and NEDCOR) enjoyed very high profit margins. The average margin between lending and deposit interest rates was 4.5% compared to a

[4] ABSA Group, 1999. "Financial Reform in South Africa", *Economic Spotlight No. 26*. Johannesburg: ABSA Group Limited. Page 22.
[5] Ibid. Page 13.
[6] COSATU Submission to Combined Parliamentary Sub-Committee Hearing On the Alleged Collusion of Banks On Interest Rates, July 1996.
[7] Ibid., pp41

comparable margin of 3% in the United States, and a 15-year average of 3.8% in South Africa.[8]

An analysis of recent trends in the spread between lending and deposit interest rates suggests that this problem has worsened. An analysis of International Monetary Fund data on South Africa demonstrates that the interest rate spread over the past five years (1994 to 1998) has been about twice the spread in the previous five year period (1989 to 1994), and the gap has increased further in early 1999. The graph below documents this widening interest rate margin over the past ten years. Since the deposit rate is a key determinant of the cost of funds for commercial banks, and the lending rate represents revenue, the gap between these two rates is an important indicator of bank profitability. This highlights an important problem to be addressed by the newly operational Competition Commission.

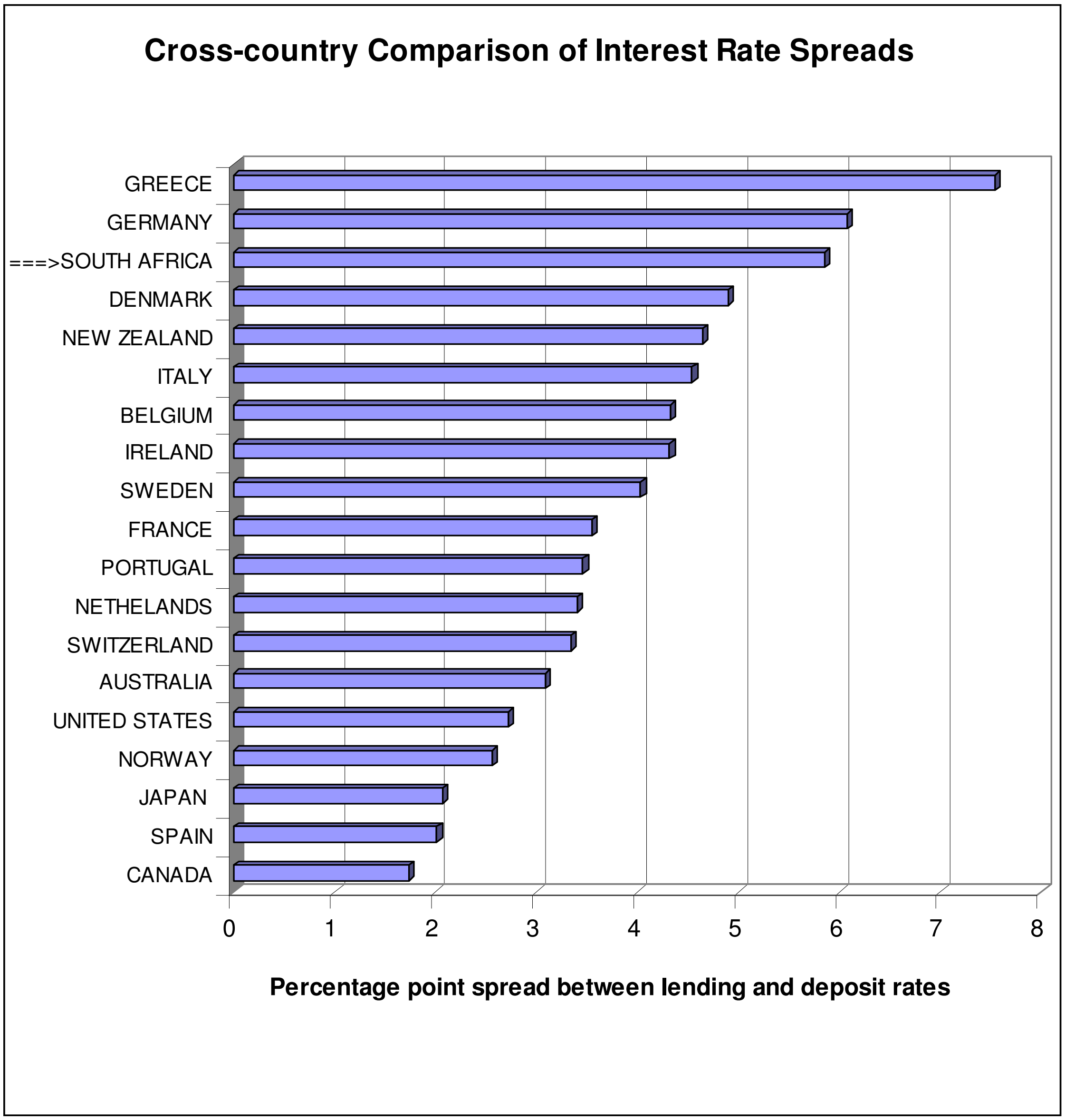


SOURCE: IMF

International comparisons confirm the relatively high spreads between South Africa's lending and deposit rates. Comparing countries with comparable levels of financial system development demonstrates the relatively non-competitive nature of financial intermediation in South Africa. IMF data documents that South Africa's spread in 1998 was 5.9 percentage points compared to an average of 3.8 percentage points for other countries in the sample. South Africa's spread was more

[8] Ryan, E. Assessing the Risks of Lending. *Enterprise*. December 1997.

than fifty percent larger. Canada had the lowest spread overall, while only Germany and Greece had larger spreads than South Africa. The graph below depicts the difference between lending and deposit rates for the countries in the sample, indicating that South Africa ranks 3rd highest (most profitable) out of 19 countries.



I.3) BANKING SERVICES FOR THE POOR

South Africa's banking system has failed to serve the financial needs of the poor. A survey carried out by the Economic Policy Research Institute found most commercial banks requiring at least a two thousand rand minimum deposit to open a checking account.[9] Fees on electronic accounts consume a high proportion transactions for low income-individuals. As a result, most South Africans do not use the commercial banking system.[10] The unavailability of credit that is linked with the lack of formal financial intermediaries in poorer areas ensures that the poor are under-served or in many cases served by unscrupulous informal moneylenders.

One strategy to ensure sustainable access to financial services for micro-entrepreneurs is for formal sector banks to create specialised divisions or programmes aimed exclusively at serving the this section of the market.[11] A recent study of commercial banking in South Africa identifies several important issues. Lack of access to financial services seriously constrains micro-enterprises. Yet South African banks have focused their transformation strategies on low-income salaried blacks, but with little success. "The fact that a client of a formal bank with stable employment in the formal sector of the economy has to approach micro money-lenders for a loan does not reflect favourably on the commitment of banks to serve this section of the community."[12] This can be attributed to:

- The excessive service charges, which consume disproportionate amounts of the salaries of low paid workers,
- The fact that less expensive alternatives such as electronic services are usually available to the rich rather than the poor.[13]

This situation is exacerbated by the fact that the postal banking system in South Africa has failed to provide a viable alternative for the poor. Low interest rates and withdrawal restrictions deter low-income individuals from opening accounts. Interest rates are as low as one percent, and customers frequently must wait as long as week after giving notice of intent to withdraw funds. The postal bank is slowly introducing electronic banking, but electronic facilities are skewed toward post offices serving wealthier areas.[14]

[9] Economic Policy Research Institute, 1999. "A Survey of Commercial Bank Financial Services".
[10] Wiese, C.F. 1996. *The Changing Role of Banks in South Africa*. Address at the Banking Seminar, South African Reserve Bank Training Institute. Pretoria.
[11] Schoombee, A. 1998. "The Financial System Approach to Development Finance : Origin, Evolution and Prospects ". *Development South Africa*. Vol. 15. No 3, Spring 1998. Pages 381-391.
[12] Schoombee, A. 1998. "Commercial Banking Services for Micro-enterprises in South Africa". *South African Journal of Economics*. Vol. 66:3. September. Pages 337-363.
[13] COSATU, 1999. "*Parliamentary Submission on Bank Charges, Micro-lending and the Usury Act Presented to the Portfolio Committee on Trade and Industry", 2 March 1999.* COSATU Parliamentary Submission on the Postal Services Bill [B97-98]. 17 September 1998. Page 23.

PART II) POLICY RECOMMENDATIONS AND ANALYSIS

II.1) RE-ORIENTATION OF MONETARY POLICY

POLICY RECOMMENDATION

The Reserve Bank and government should re-orient monetary policy to balance the imperatives of job creation and socio-economic development with the objectives of price stability and a stable currency. An analysis of the Reserve Bank's policies over the past ten years documents extremely high costs imposed by the country's disinflationary monetary policies, and demonstrates that either further disinflation or inflation targeting at low levels are likely to impose even higher social costs. Nominal income targeting provides a better balance between financial stability and development objectives. A fundamental result of monetary policy reform that balances financial and social objectives is the lowering of interest rates and a likely depreciation of the rand exchange rate. These two results will lower the cost of investment and shift relative prices towards more labour-intensive production.

POLICY ANALYSIS

The introduction of a disinflation policy in a country that does not have a history of unstable inflation is negatively related to economic development if such a policy crowds out employment creation and growth. According to Stiglitz[15] evidence suggests that while high inflation is costly, there is little evidence that inflation below *forty percent* undermines socio-economic objectives. He concludes from his research that controlling high and medium inflation should be a priority but that pushing low inflation even lower is not likely to significantly improve economic performance. He goes on to state that the single-minded focus on inflation may not only distort economic policies – preventing the economy from living up to its full growth and output potential – but also lead to institutional arrangements that reduce economic flexibility without gaining important growth objectives.

The East Asian experience shows that central banks were not independent in terms of formulating their monetary policy but were often instrumental in pursuing the development objectives of their countries.

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[14] Economic Policy Research Institute, 1999. "A Survey of Postal Bank Financial Services".

[15] Stiglitz, Joseph E., 1998. WIDER Annual lectures 2.More instruments and Broader Goals: Moving Toward the Post-Washington Consensus. World Institute for Development Economic Research: United Nations University. pp 7

- In Taiwan, "the CBC [Central Bank of China] was put under the jurisdiction of the Executive Juan (the cabinet) to better co-ordinate with the cabinet on economic policies, despite strong warnings from the scholars … that this move would create the danger of monetary policies being determined largely by popular clamour rather by more dispassionate opinion…. As a result, promoting economic and export growth supplanted financial stability as the CBC's primary policy goal."[16]
- In Korea the government undertook a series of measures in the early 1960s to strengthen the state's control over finance. It nationalised commercial banks and amended the central bank act to subordinate the Bank of Korea to the government.[17]
- In Thailand the central bank (Bank of Thailand) also focused on the development objectives of the country by providing selective credit in the form of "packaging credits" for exporters.[18]

A comparison of Latin American experiences with these Asian examples supports the imperative of balancing price stability against broader socio-economic objectives, and lends insight into the dangers of unbridle financial liberalisation. "High positive real interest rates are as disequilibrating as the heavily repressed negative real interest rates… Domestic investment tends to become a hostage to high interest rates."[19] In Chile's case, financial reform after 1974 led to extraordinarily high real interest rates, a persistent oligopolistic banking system, widespread bankruptcies and financial collapse. Argentina and Uruguay experienced similarly negative consequences as a result of financial liberalisation.[20] Other studies have assessed the financial deregulation experience in the Southern Cone of Latin America and found similar results.[21] More recently, the financial crisis

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16 Shea, Jia-Dong. Taiwan: Development and Structural Change of the Financial System." In Patrick Hugh's and Yung Chul Parks, eds., *Financial Development – Japan, Korea and Taiwan*. New York: Oxford University Press. pp 226.
17 Vittas, Dimitri and Yoon, Je Cho. *Credit Policies: Lessons from East Asia.* Policy Research Working Paper 1458, Financial Sector Development Department The World Bank (May 1995) Page 18.
18 Christensen, Scott R. Dollar, D. Siamwalla, A and Vichyanond, P.1993. *Thailand: The Institutional and Political Underpinnings of Growth*: The World Bank.
19 Cho, Yoon-Je and Deena Khatkhate, 1989. *Lessons of Financial Liberalisation in Asia: A Comparative Study*. World Bank Discussion Paper #50. Washington, DC: The World Bank. Page 103.
20 Ibid. Pages 89-91.
21 Schoombee, A. 1998. "The Financial System Approach to Development Finance : Origin, Evolution and Prospects ". *Development South Africa*. Vol. 15. No 3, Spring 1998. Pages 385.

in East Asia has been linked to excessive deregulation and injudicious financ liberalisation.

Spain and France also provide examples of countries that subordinated the central bank's objective of price stability to the more important objectives of economic development.[22] After the Second World War, France rejected Germany's export-led growth strategy and focused on stimulating aggregate demand through monetary expansion and inexpensive credit. Adverse macro-economic consequences were avoided by channelling inexpensive credit to domestic enterprises that rapidly increased employment and production, thereby satisfying the increased demand. Likewise, an abundant supply of inexpensive credit fueled Spain's "economic miracle" in the 1960s, at the expense of the central bank prioritising price stability.

The South African Constitution guarantees the independence of the central bank, but provides a potentially broad mandate to the Reserve Bank "to protect the value of the currency in the interest of balanced and sustainable economic growth." The Reserve Bank's current stance holds that "a monetary policy that maintains financial stability in a credible and lasting way will accordingly make the best overall contribution to improving economic growth, employment, and living standards."[23] This position sees financial stability as the transmission mechanism by which monetary policy promotes job creation and development. Monetary policy, however, has a more powerful potential to directly stimulate job creation and promote development objectives, but this requires directly balancing financial stability aims with development objectives. Formal inflation targeting may have the effect of moving the Reserve Bank even further from considering socio-economic objectives. Evidence suggests that inflation targeting is not appropriate for South Africa's conditions.

A recent research paper analyses how South Africa's volatile exchange rate creates a situation whereby inflation targeting unduly ties the hands of the Reserve Bank. This increases the country's vulnerability to external shocks, such as dramatic

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[22] Perez, Sofia A. 1997. Banking on Privilege: The Politics of Spanish Financial Reform. Ithaca: Cornell University Press. Pages 65-89. For more detail, also see: Michael Loriaux, 1991. *France after Hegemony: International Change and Financial Reform*. Ithaca: Cornell University Press. The role of directed credit in France is discussed in: Pierre Patat and Michel Lutfalla, 1990. *A Monetary History of France in the Twentieth Century*. New York: St. Martin's Press.

[23] Mboweni, T.T. 1999. "Address by Mr T. T. Mboweni, Governor of the South African Reserve Bank, at the seventy-ninth ordinary general meeting of the shareholders on 24 August 1999."

increases in the prices of imported capital goods or drops in foreign demand South African goods. The switch to an inflation target would undermine the exchange rate's ability to support economic stability and to reduce job losses associated with shocks to the economy. At a minimum, escape clauses should be built into an inflation-targeting strategy; or else the measure of the inflation rate to target should reflect prices of domestically produced goods. Nevertheless, "the problem of instrument instability will be a major handicap to any inflation target." The volatile exchange rate and the relatively weak link between monetary policy instruments and the inflation target contribute to "instrument instability", whereby costly shifts in monetary policy instruments are necessary to maintain the inflation targets.[24] This can be offset to some extent by establishing a wide band around the inflation target, providing policy-makers with some discretion in employing monetary policy instruments. A wide band acts as a shock absorber, allowing some accommodation of external shocks to the economy before contractionary monetary policy must be imposed.

Empirical analysis documents that industrialised countries that have implemented inflation targeting actually have more volatile inflation rates and income growth rates as well as higher unemployment rates than industrialised countries that have not implemented inflation targeting.[25] An IMF study of the appropriateness of inflation targeting for South Africa identified seven industrialised countries that have adopted inflation targeting, as well as a set of other industrialised countries that have not adopted inflation targeting and hence serve as a control group.[26] IMF data demonstrates that these countries that have adopted inflation targeting have more variable annual inflation rates as well as more variable real Gross Domestic Product (GDP) annual growth rates than those industrialised countries which have not adopted inflation targeting. In addition, currently, the unemployment rates of industrialised countries employing inflation targeting are higher than those industrialised countries that have not adopted inflation targeting.

[24] Woglom, G. 1999. "*An Inflation Target for South Africa*?". University of the Western Cape: Mimeo.
[25] See the appendix for details.
[26] Jonsson, G. 1999. "*The Relative Merits and Implications of Inflation Targeting for South Africa*". International Monetary Fund African Department. Draft version of forthcoming working paper. May. Washington, D.C.: IMF.

POLICY SCENARIO

An alternative to inflation targeting is nominal income targeting. Rather than focusing simply on prices, nominal income targeting promotes real economic growth. An appropriate long-term growth rate for nominal income is identified. This growth target includes a component for real growth as well as a component for inflation—together these two components add up to the nominal growth target. In any period during which real economic growth failed to meet expectations, the inflation component of the target is automatically adjusted in a transparent manner. The higher inflation target supports lower interest rates and expansion of credit, thus stimulating economic growth. The nominal income target provides a policy rule for the Reserve Bank that supports transparency and predictability while fostering economic stabilisation.

II.2) DIRECTING CREDIT FOR JOB CREATION AND DEVELOPMENT

POLICY RECOMMENDATION

Affordable credit must be directed to priority sectors to ensure more rapid rates of labour-absorbing investment and to promote employment. A general fall in interest rates is insufficient to achieve this objective--lending rates do not always respond rapidly to reductions in the cost of funds, and commercial loan policies frequently fail to serve industries that provide the best opportunities for job creation. Targeting credit towards job creation can be achieved in two ways: (1) by charging one or more public financial institutions (SARB, DBSA, or a new institution) with responsibility for lending to enterprises that meet social criteria, or (2) by regulating or creating incentives for commercial banks to restructure their loan portfolios towards sectors that foster job creation and social investment, utilising prescribed asset requirements and/or favourable loan rediscounting.

POLICY ANALYSIS

Financial policies should target priority sectors through the use of directed credit. Directed credit can be an effective tool in promoting job creation and socio-economic development. The funds for directed credit policies can be made available through commercial banks or specialised government banks that are specifically established for the promotion of targeted sectors. Priority sectors could include the activities of small and medium enterprises, critical industries that provide high levels of employment, housing programmes, and other socially desirable sectors. The ultimate aim of the directed credit policies should be socio-economic development and employment creation. Thus the role of the directed credit program must be subordinate to the development objectives of the country.

"A government role in allocating credit can be justified on two grounds. First, directed credit programmes can be a preferred or superior industrial policy instrument for reaping positive externalities. Second, the government has a comparative advantage in directing the allocation of credit. Government agencies may have better information on sectoral prospects than do individual private firms. They may therefore have an advantage in screening projects, as well as in monitoring behaviour and outcomes- although that will depend partly on the relative efficiency of the government agencies and the financial intermediaries. In addition, government costs of enforcing contracts, through taxation and police powers, are likely to be lower than costs for private intermediaries. The power to tax moreover may make it possible for the government to internalise the benefits from specific lending policies that private intermediaries cannot capture. This advantage increases if there are technological spill-over effects that neither the firm nor its intermediary can capture but that the government can claim through future taxes" [27]

CASE STUDY: JAPAN

The Japanese government made extensive use of directed credit programmes to promote economic growth and development after World War II. Policy based finance directed financial resources to the government as well as the private sector into areas consistent with national socio-economic objectives. Credit was directed to industrial as well as social objectives. The development policy earmarked four objectives:

(1) to pick and support winning industries, especially in markets in which Japan could enjoy a comparative advantage;
(2) to phase out industries in which Japan was no longer internationally competitive,
(3) to support small industries, and

[27] Vittas, D. and Cho, Y.J. 1996.Credit Policies: Lessons from Japan and Korea. *The World Bank Research Observer*. The International Bank for Reconstruction and Development. The World Bank. pp.279-280

(4) to provide the industrial infrastructure necessary for growth.[28]

After the four objectives were identified policy based financial institutions were instructed to provide finance. To function effectively these policy based financial institutions in most cases provided loan conditions that were more favourable than those of private finance did. The most favourable interest rate offered by policy based financial institutions at the beginning of the 1950s was lower than the private sector long term prime rate by 3.5%: the least favourable was the same as the prime rate.[29] This financial support was also provided for social policy objectives, for example housing.[30] It was the long-term credit at affordable prices that made it profitable and viable for the targeted industries to grow and to expand and which also allowed Japan to realise its development objectives. Credit policy was not just haphazardly instituted but was carefully monitored and regulated for it to have been effective. For example:

- Credit policy in Japan evolved in response to the changing needs and structure of the Japanese economy.
- There was high quality loan appraisal and project oversight, which involved a detailed review of the projects financed and evaluations of the history and character of the firms involved. Close co-operation between development and commercial banks ensured continuous monitoring of the performance of borrowers and allowed development banks to take early action if loan repayments were in arrears.
- Another important characteristic of the Japanese credit policy was that the close relationship between policy based finance and the government's economic plans. The development banks provided credit to targeted sectors. These banks thus promoted the government's development objectives. The relationship between the development banks can be summarised as follows:
  1. Provision of assistance from the state to priority sectors, especially in the initial years;
  2. The government enabled development banks to obtain cheap credit, through postal savings and annuities networks.

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[28] Ibid., pp 282

[29] Vittas, Dimitri and Yoon, Je Cho. Credit Policies: Lessons from East Asia. *Policy Research Working Paper 1458*, Financial Sector Development Department. The World Bank (May 1995). pp 10

[30] Ibid.,10

3. The government clearly identified targeted sectors, as was the case industrial policy.

This close relationship enabled the development banks to effectively respond to the development objectives and plans of the government.

Two recent empirical studies lend support to the argument that policy-based finance in Japan was effective in stimulating initial growth and encouraging private investment to growing firms in priority industries. Horiushi and Sui[31] compared the investment behaviour of medium-size firms receiving development bank assistance for the 1964-1988 period with firms of similar sizes not receiving funding. Their study found that the year of initial lending was associated with increased private investment and that within three years firms began to move away from dependence on development bank lending to rely more on private banks. Calomiris and Himmelberg[32] also found that government funds had not been captured at either the industry or the firm level. Directed credit was usually offered to a firm once and for a brief period and that it was usually provided to large, growing capital intensive firms with high investment rates. The authors also found that government credit was positively correlated not only with private credit but also with reinvestment by the firms themselves. For the nearly thirty year sample period studied by Calomiris and Himmelberg, a government loan of a 100 yen produced an average investment of 60 yen. The effect of credit from the Japan Development Bank was even stronger. A 100-yen loan produced a 150-yen investment as well as 44 yen in long term loans from private sources.[33]

CASE STUDY: SOUTH KOREA

Credit policy in South Korea was more coercive and extensive than it was in Japan. The Korean program made extensive use of commercial as well as

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[31] Horiuchi, Akiyoshi and Qing-yuan Sui. 1993. "The Influence of Japan Development Bank Loans on Corporate Investment Behavior." *Journal of the Japanese and International Economies*. Volume 7, December. Pages 441-465.

[32] Calomiris, Charles.W. and Himmelberg, Charles, P. 1994. *Government Credit Policy and Industrial Performance: Japanese Machine Tool Producers. 1963-1991*. The World Bank. Financial Sector Development Department, September, mimeo. Also, Charles W. Calomiris and Charles P. Himmelberg, 1994. "Directed Credit Programs for Agriculture and Industry: Arguments from Theory and Fact." *Proceedings of the Annual Bank Conference on Development Economics*. 1993. The World Bank.

development banks to channel loans to priority sectors. From the 1960s onwa credit policies were also more closely related to policy measures and exports. In the 1960s the government strengthened its control over finance. It nationalised the commercial banks and amended the central bank act to subordinate the Bank of Korea to the government. The government of South Korea consulted with industrialists and was able to adjust directed credit programs to the needs of the business sector. At the time of the economic take-off period in South Korea (1960s), credit policies were structured toward providing export support and they were better linked with other policy measures. In the 1980s the structure of directed programs changed giving greater emphasis to social programs and the redistribution of income. According to Vittas credit policy was effective in reducing the cost of funds and enhancing access to funds by priority sectors. He argues that exports were the main engine of growth in Korea in the 1960s and 1970s and that credit policies supported such growth.[34] Before financial policy was implemented a regulatory and institutional framework mechanism was first put in place to ensure that the directed credit programmes could be effective. Some of these mechanisms are noted below:

- The Korean government developed special deliberation councils. These councils were set up between businesses and the state. The deliberation councils met frequently to discuss problems faced by financially supported firms as well as the progress that supported firms had made in achieving targeted goals.
- Careful monitoring of the performance of supported firms was also undertaken.
- The government was a partner with industry and banks in an implicit coinsurance scheme. Without this partnership South Korea might not have been able to established large, internationally competitive industrial firms so quickly.

Directed credit policy was thus not haphazardly implemented, rather it was part of a larger development plan of government to promote business.

[33]Vittas, D. and Cho, Y.J. 1996.Credit Policies: Lessons from Japan and Korea. *The World Bank Research Observer*. The International Bank for Reconstruction and Development. The World Bank. pp 287

[34] Vittas, Dimitri and Yoon, Je Cho. Credit Policies: Lessons from East Asia. *Policy Research Working Paper 1458,* Financial Sector Development Department. The World Bank (May 1995) pp 17-22

CASE STUDY: TAIWAN

In the 1950s and 1960s, the Taiwanese government was short of investment funds, the private sector lacked experienced entrepreneurs and was largely undeveloped. During the 1980s the Taiwanese economy was regarded as one of the East Asian miracles with spectacularly high growth rates, high human capital development and a highly equitable distribution of income. Financial policies were one of the key instruments that contributed to Taiwan's success.

The government tried to influence the allocation of the available investment funds and to create additional funds for specific industries and activities through selective credit control policies.[35] These policies include export financing, strategic industry financing and the establishment of specialised banks. Export financing was financed by the commercial banks from their own loanable funds.

TABLE 1) INTEREST RATE SUBSIDIES AND EXPORT LOANS

YEAR	EXPORT RATE	MARKET RATE	SUBSIDY
1972	7.50	11.63	***4.13***
1973	8.17	11.81	***3.64***
1974	10.99	15.89	***4.90***
1975	7.80	13.48	***5.68***
1976	7.00	12.83	***5.83***
1977	6.62	10.91	***4.29***

SOURCE: CBD, Financial Statistics Monthly, various issues.

Table 1 documents Taiwan's use of directed credit policies to promote the targeted sectors in the economy. This specific example illustrates the degree of subsidisation of the export sector. Designated commercial banks were given low discount rates from the central bank for export purposes. These banks then made the financing available to the targeted groups at one percentage point higher than the rediscount rate. So the commercial banks in conjunction with the central banks subsidised the targeted industries. The degree of subsidisation can be illustrated above in the table. The subsidised interest rate for exports is given in the column

[29] Shea, Jia-Dong. Taiwan: Development and Structural Change of the Financial System." In Patrick Hugh's and Yung Chul Parks, eds., *Financial Development – Japan, Korea and Taiwan*. New York: Oxford University Press.

labelled "EXPORT RATE". The minimum interest rate on loans determined by the market is given in the column labelled "MARKET RATE". The difference in the rates—representing a measure of the subsidy—can be seen in the last column. This example provides evidence of how commercial banks can be regulated to promote targeted sectors in the economy.

OTHER COUNTRIES

Japan, South Korea, and Taiwan are the most frequently cited success stories exemplifying the value of directed credit. Todaro points out: "The early success of South Korea and Taiwan (and, before them, Japan) with financial systems…demonstrates that judicious and selective government intervention can be a stimulus to industrial development."[36] Yet favourable international experience with directed credit is not limited to East Asia. The World Bank's *World Development Report* focusing on finance and development highlighted the directed credit policies of only two Latin American countries—Costa Rica and Ecuador.[37] The most recent United Nations Development Programme (UNDP) *Human Development Report* documented only two Latin American countries for which the per capita income of the poor rose faster than the countries overall economic growth rates—again Costa Rica and Ecuador.[38] This is not coincidental. The UNDP report cites "access of poor people to productive resources, including credit" as one of the key instruments for promoting pro-poor economic growth. The World Bank report describes the impact of the directed credit policies employed. Costa Rica, a primarily agricultural country, subsidised credit to small farmers through four government-owned banks, utilising a network of about a hundred rural branches. Ecuador established an autonomous development fund to support small enterprises. The fund worked by refinancing loans from local banks and other financial institutions.

The World Bank report also cited the experience of European and African countries. Turkey, for instance, directed most of its productive credit to priority sectors in the 1970s and early 1980s, achieving economic growth rates exceeding 5% in a difficult global environment. Operationally, the Central Bank in Turkey

[36] Todaro, Michael P. 2000. *Economic Development*, Seventh Edition (forthcoming). Reading, Massachusetts: Addison-Wesley. Page 667.
[37] World Bank, 1989. *World Development Report 1989: Financial Systems and Development*. New York: Oxford University Press. Pages 58-59.
[38] United Nations Development Programme, 1999. *Human Development Report 1999*. New York: Oxford University Press. Page 94.

directly provided credits, acting in a dual capacity—both as a development bank well as a central bank. After 1987, as Turkey phased out directed credit as part of an international trend towards financial liberalisation, the commercial banking system was unable to make up the shortfall. Credit contracted, with adverse consequences for growth and employment.[39] Botswana provides an example of continuing success. The government of Botswana established the Botswana Development Corporation in 1970. Within twenty years it had supported over sixty companies with loan arrears of less than one percent.[40]

IMPLICATIONS FOR SOUTH AFRICA

Directed credit programs can effectively mobilise resources to promote growth and development through the targeting of priority sectors. These policies can be successfully implemented if they are well managed and directed to the sectors that promote job creation and socio-economic development. The experience of the East Asian countries analysed above show that these countries made use of development banks, central banks as well as commercial banks to aid in the implementation of directed credit policies.

Current government policy stresses the role of exports in promoting growth and economic development. Yet export policy does not make allowances for the implementation of adequate financial sector policies to support this goal. In the East Asian economies the use of directed credit policies was essential in the promotion of exports. In the case of Taiwan commercial banks assisted in the provision of credit to the export sector. The use of directed credit programmes was also essential for the promotion of exports in Korea as well as in Japan. Yet directed credit policies were not limited to the promotion of exports but encompassed socio-economic objectives as illustrated in the case of Korea and Japan.

The example of Taiwan also has implications for the regulation of commercial banks in South Africa as well as for the re-evaluation of the role of the development banks and the Reserve Bank in South Africa. Commercial banks, the Reserve Bank and development banks are not effectively drawn into the process of economic

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[39] Atiyas, Izak, and Hasan Ersel. 1994. “The impact of financial reform: the Turkish experience.” In *Financial Reform: Theory and Experience*. Edited by Gerard Caprio, Jr., Izak Atiyas, and James A. Hanson. Cambridge: Cambridge University Press. Pages 117-119.

[40] United Nations Development Programme, 1989. *Human Development Report 1989: Financial Systems and Development*. New York: Oxford University Press. Page 60.

growth and development in South Africa. Banks need to be regulated and poli needs to be co-ordinated so that banks can effectively supply credit to priority sectors of the economy.

The following points provide some insights that can be drawn from East Asia's experience relating to the design of financial policy regulation for South Africa:

- Commercial banks can be regulated to provide directed credit to priority sectors through a network of branches throughout the country.
- Government institutions like the Reserve Bank, as well as development banks, should be regulated in such a manner that their policies do not conflict with the government's development policies. Currently the Reserve Bank is pursuing a policy of disinflation that undermines government growth and development objectives. The DBSA (Development Bank of South Africa) also formulates its policy independently of government.
- Government flexibility is very important. When programmes fail they must be replaced and as economies change so should the role of government.
- Good management of credit programmes is essential for the success of such programmes. Good management requires the establishment of an effective incentive scheme to motivate behaviour that is beneficial to the economy and a supportive institutional environment, an arrangement for close consultation and co-ordination between the government and the business sector, and effective mechanisms for monitoring and enforcing performance. Proper information and incentives can eliminate many of the problems other countries have experienced with directed credit.[41]
- In the early stages of economic development, when many markets are missing, when those that exist are highly imperfect, and when private institutions are poorly developed, there is a particularly strong need for government intervention to help stimulate healthy economic growth.[42]

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[41] Vittas, D. and Cho, Y.J. 1996.Credit Policies: Lessons from Japan and Korea. *The World Bank Research Observer*. The International Bank for Reconstruction and Development. The World Bank. pp 281

[42] Ibid., pp 281

POLICY SCENARIO

The government establishes a framework for directing credit to targeted sectors. NEDLAC is commissioned with responsibility for formalising the criteria used to identify priority recipients of subsidised credit. The government and the Reserve Bank employ a two-pronged approach in channelling credit. First, the Reserve Bank uses prescribed asset requirements and favourable discount rates to induce commercial bank lending to targeted enterprises. Second, a public development bank provides credit to exceptionally high priority projects that have no access to private finance.

II. 3) BANKING SERVICES FOR THE POOR

POLICY RECOMMENDATION: COMMUNITY REINVESTMENT

A regulatory framework must be promulgated that will induce commercial banks to effectively serve historically disadvantaged communities, focusing on ensuring that the composition of commercial bank loan assets are broadly representative of the larger society. This regulatory framework must include practical mechanisms for civil society to enforce compliance, serving as an effective check on regulatory authorities. In order to effectively meet asset composition requirements, commercial banks will find it necessary to deepen their commitment to providing other financial services in poor communities.

POLICY ANALYSIS

The commercial banking sector in South Africa is failing to provide adequate service to most South Africans. It is under-servicing poorer communities and in so doing it is limiting access to savings, transmission and credit facilities. A direct effect of this is the mushrooming of the kind of formal and informal micro lending practices.[43] Banks should therefore be drawn into the development process through regulation. Stiglitz states that one of the purposes of regulation of financial markets is that under-served groups gain access to credit reinforces this point. He reinforces this by stating "that in many cases the pursuit of social objectives –such as ensuring that minorities and poor communities receive funds as the United States Community

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[43] COSATU, 1999. "Parliamentary Submission on Bank charges*, Micro-lending and the Usury Act Presented to the Portfolio Committee on Trade and Industry", 2 March 1999.* COSATU Parliamentary Submission on the Postal services bill [B97-98] 17 September 1998. pp 23

Reinvestment Act does, or ensuring funds for mortgages, the essential mission of the government–created Federal National Mortgage Association – can, if done well, reinforce economic objectives.[44] Necessary objectives of regulation of commercial banks in South Africa include:

- Banks must be regulated in a such a manner that they comply with fair lending requirements;
- Banks must satisfy disclosure requirements so that the public has access to information regarding the demographic profile of bank loans;
- Affordable bank charges and lending rates as well as positive real deposit rates should be made available to the poor
- Regulation should protect consumers
- Regulation should not only be restricted to the formal banking sector but should also extend to the informal financial sector.

CASE STUDY: UNITED STATES COMMUNITY REINVESTMENT ACT

Community re-investment legislation has succeeded in the United States, ensuring that banks reinvest assets in poor areas and provide credit to the poor. The background to the Community Reinvestment Act (CRA) sheds important light on the regulation of commercial banks in South Africa. Many of the initial conditions that prevailed in America prior to the CRA legislation, such as low rates paid on deposits and high rates on loans for poorer communities[45], are currently manifested in the South African commercial banking sector.

Financial deregulation in the United States involved the removal of interest ceilings on deposits, leading to high service fees and minimum balance requirements as well as inconvenient locations for low-income communities. Low-income households had a more difficult time obtaining basic services at affordable prices. Loans for homes and small businesses were frequently not available, or only at extremely high interest rates. Commercial banks maximised profits by reducing the number of banks in low-income areas and especially minority areas. Deregulation

[44] Stiglitz, Joseph E, 1998.WIDER Annual lectures 2. More instruments and Broader Goals: Moving Toward the Post-Washington Consensus. *World Institute for Development Economic Research*: United Nations University. Page 13.
[45] Economic Policy Research Institute, 1999. “A Survey of Commercial Bank Financial Services”.

saw a transfer of banks from low-income areas to high-income areas.[46] Community outrage led the establishment of CRA. The CRA encouraged federally insured commercial banks to help meet the needs of the local communities in which they were chartered. The CRA was based on the premise that the “failure of financial institutions to take advantage of sound lending opportunities in these neighbourhoods accelerated the rate of decay in these neighbourhoods and inhibited private revitalisation efforts. Support for the residential mortgage market and provision for home improvement and rehabilitation credit by institutional lenders was viewed as necessary to neighbourhood revitalisation and stability.”[47] The commercial banks were thus forced to reinvest in less affluent and minority communities. In order to meet effectively the needs of low-income communities, banks had to:

- Measure the credit needs of the community
- Publicly disclose the credit services available to the public. This meant that banks were held accountable for not giving low-income communities access to credit
- Banks had to define the local community it expected to serve, so as to better serve their needs
- Communication between banks, the community and individuals to better meet the needs of the community and the banking industry was also established
- A supervisory agency and negotiation mechanism was designed to better facilitate the needs of the community.
- The Appointment of Community Affairs Officers whose responsibilities were to advise community groups and banks on the procedures to follow in CRA disputes, was also established
- Before banks could get approval for a merger or for expansion of activities, they were assessed on how well they met community needs.[48]

OPTIONS FOR SOUTH AFRICA

Several lessons can be drawn from the American experience.

[46] Campen, J.T. 1998. Neighbourhoods, Banks, and Capital Flows: The transformation of the US financial system and the Community Reinvestment Movement. *Review of Radical Political Economics*, 30(4):29-59.
[47] Canner,G. and Cleaver,J.M. 1980. Community Reinvestment Act: A Progress Report. *Federal Reserve Bulletin.* Vol. 66. No.2 (February 1980)

- Requiring disclosure from banks regarding how well they serve disadvantag communities is the first step in successful community re-investment campaigns. Once the necessary information is available, both government and civil society can more effectively articulate appropriate policy responses.
- Civil society has a critical role in ensuring that regulatory authorities manage the responsibilities of commercial banks. If public information is available, civil society can provide important monitoring and even enforcement functions.
- Favourable discount rates can be offered to banks that outperform community re-investment targets. Likewise, penalty rates can be imposed on those banks that fail to comply with asset composition targets.

POLICY SCENARIO

The government implements legislation that requires all commercial banks to report the composition of their loan portfolios by demographic group. This information is audited to ensure accuracy and compliance with reporting requirements. Government uses this information to assess which commercial banks are most actively redressing discriminatory practices and serving the financial needs of the poor, and this assessment is factored into their choice of which banks to award public tenders. Government holds bank accounts only with those commercial banks that document a satisfactory record with community reinvestment. Other members of civil society also utilise this information to make their banking decisions. Labour unions, churches, non-governmental organisations, socially responsible businesses, and many individuals consider community reinvestment an important factor in their decision regarding with which bank to do business.

Over time, government identifies reasonable targets for the loan portfolios of banks. Banks that fail to satisfy these targets through community reinvestment face financial sanctions, which could include larger prescribed asset requirements, higher interest rates when borrowing from the Reserve Bank, or direct financial penalties. Banks that exceed the targets could offset the excess against their prescribed asset requirements or qualify for favourable interest rates on borrowing from the Reserve Bank. In order to manage loan portfolios optimally in poor communities, commercial banks establish more branches in these areas. Commercial banks are willing to offer financial products such as checking accounts at affordable levels—even at less

[48] Ibid., pp 88-91

than cost—because the establishment of strong customer relations supports the building of the mandated loan portfolio. Thus, regulations focused on the loan portfolios of commercial banks support a broad expansion of financial services for the poor.

RECOMMENDATION: THE POSTAL BANK

The postal bank must be strengthened and restructured to better serve the needs of the poor. Currently, postal bank resources are skewed towards historically advantaged communities, in spite of the fact that the poor are the primary depositor base. Also, low interest rates provided to depositors, withdrawal restrictions, and poor information impede the effectiveness of the postal bank. In order to break the low-level trap whereby poor service elicits weak demand for postal banking services, technology investment in historically under-served areas and more attractive savings terms are necessary. Electronic banking should be available at all post offices, withdrawal delays should be eliminated, and deposit interest rates should be increased.

POLICY ANALYSIS

Problems of incomplete information, incomplete or missing markets, market power, externalities and an inequitable distribution of income all ensure that resources are misallocated in the financial services industry. The case for government intervention in South Africa is particularly compelling since these problems are more acute in the South African financial system. One of the main reasons for informal financial institutions is the fact that many of the poor do not have access to the formal financial system. Incomplete information means that some people are excluded from the formal financial system. In this case there is a rationale for government to get involved and correct the market failure and hence close the credit gap. One way for the government to do this is through more effective development of the Postal Savings Scheme.

The government should try and revitalise the PostBank as a more effective source of financial services to the poor. One of the aims of the GEAR strategy's tight fiscal policy objectives is to increase national savings through increased government savings at the macro level. Yet at the micro level, market failure in the financial sector and an inequitable distribution of income means that the poor do not have access to formal financial intermediaries and therefore cannot mobilise savings at this level. One way of increasing savings as well as access to financial intermediation to the informal sector and the poor rural sector is through postal savings schemes. Postal saving schemes are an effective means of mobilising savings in developing countries. They can act as deposit-taking institutions in areas where there are no formal financial sectors. These systems can attract multitudes of savers by giving them security and convenient access. They can provide this access through a convenient branch network of post offices especially in the rural areas.[49] In South Africa the postal outlets are disproportionately located in former white area, and former black areas face inadequate postal services[50]. Even if there are post office outlets in urban non-white and rural areas they are scarce and lack the kind of infrastructure to effectively mobilise savings.

According to COSATU, a substantial number of people are being excluded from the banking system either due to lack of cheque accounts or savings accounts. As a result a huge amount of cash has to be held, and if money has been paid in a different town it has to be carried in cash by the person or an intermediary. A disadvantage of the cash based society is that a national mass market cannot be fully developed, as transactions are costly and difficult if they involve the handling of cash. An additional disadvantage of the cash-based society is that they do not attract deposits and balance in-transit, which are important sources of finance in most countries.[51]

A survey was carried out to identify how effective this system has been in mobilising savings from the poor. Post offices in the Western Cape were contacted in order to identify the effectiveness of the postal savings system. From the survey we determined that the PostBanks benefited the advantaged groups that already had access to the formal financial system. It was also found that the administration of such a system was complex and that poor service standards prevailed.

The following suggestions follow from an analysis of international experience and South Africa's situation:

• The maintenance of proper service standards in postal saving schemes are critical to their success. Currently, service standards differ across areas in South Africa. In

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[49] Stiglitz,J. and Uys, 1996. *Financial Markets, Public Policy and the East Asian Miracle*. The World Research Observer, vol. 11, no. 2 (August 1996), pp. 249-76.
[50] COSATU Parliamentary Submission on the Postal Services bill [B97-98] 17 September 1998. pp 7
[51] Ibid., pp 11

fairly low-income areas, service standards are frequently poor, yet in relatively affluent areas proper service standards are enforced. This is both unfortunate as well as ironic since the poorer areas are the ones that are most in need of these services.

• The development of an administratively simple system is essential if postal savings schemes are to serve the poor. An administratively complex system will reduce participation in the PostBank savings scheme and could also encourage fraud and rent seeking.

• Postal savings banks (PostBank) should be designed with new instruments to take care of the special needs of their clientele, which are usually the poor.

• It would also be beneficial for the post banks to provide additional services, such as checking accounts and electronic payment mechanisms, since this might require little or no increase in resources and greater access for the poor to services that serve their needs.[52]

• Payment of competitive returns on savings and the provision of convenient services should be guiding principles.[53] This will promote savings in disadvantaged areas.

• More aggressive promotion and diversification of operations are necessary.[54]

• Greater representation of Post Offices and hence PostBanks in rural and poorer communities. Most of the post offices are located in urban areas and generally away from the poor and rural areas.

POLICY SCENARIO

The PostBank focuses its resources on poor communities, particularly rural areas neglected by commercial banks. New products are developed and existing products are improved in order to serve the needs of the poor better. New investment focuses on electronic facilities, such as automated teller machines (ATMs) that include graphics that serve illiterate customers. The waiting period for withdrawing cleared funds from savings accounts is eliminated. The PostBank offers checking accounts and electronic payment mechanisms at affordable costs, reducing the reliance of the poor on cash transactions. The successful revitalisation of the

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[52] Soyibo, A. and E.O. Ogunkolo. 1996.Savings Banks in Africa: Performance and strategies for improvement. *African Review of Money Finance and Banking*. 1-2/1996

[53] Ibid.

[54] Ibid.

PostBank serves as a competitive impetus to commercial banks, whose need for the poor as a customer base is reinforced by community reinvestment legislation.

CONCLUSIONS

This report documents the failure of monetary and financial policy to promote job creation and serve the needs of the poor. Therefore, the following policy recommendations are warranted.

1. The Reserve Bank together with the government should refocus monetary policy on the Reserve Bank's constitutional mandate to "to protect the value of the currency ***in the interest of balanced and sustainable economic growth***." Excessively high interest rates not only fail to protect the value of the currency but also preclude the rapid job creation necessary for balanced and sustained growth. The imperative of balanced growth requires the Reserve Bank to take concrete steps to ensure an equitable financial system.

   a. The Reserve Bank's assessment of monetary policy frameworks considered inflation targeting, exchange rate targeting, and currency boards. The feasibility of nominal income targeting was conspicuously absent from the list of paradigms considered. The Reserve Bank should evaluate the desirability of nominal income targeting for providing a transparent yet development-oriented monetary policy framework.

   b. Even the International Monetary Fund has recognised that lower interest rates are appropriate for South Africa.[55] Any monetary policy framework adopted by the Reserve Bank should immediately implement lower interest rates in order to support job creation and long term development objectives.

   c. The current policy of financial liberalisation should be reconsidered. An appropriate framework that recognises the importance of national savings for South African development should be implemented. Detailed recommendations are provided in an accompanying report entitled "*Restoring Domestic Security in a Dangerous Financial Neighbourhood: South Africa's Need to Rethink Capital and Exchange Controls*".

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[55] World Bank, 1999. *World Economic Outlook*. Reported in *Business Day*, September 23, 1999.

2. The Reserve Bank and the government should institutionalise the promotion credit to socially targeted sectors of the economy. A lowering of interest rates alone will be insufficient to promote the job creation necessary for balanced growth, and sustainability requires the mobilisation of financial resources for social development.

   a. NEDLAC should establish a commission to identify priority sectors that require subsidised credit, including enterprises that promote desirable job creation as well as provide necessary social infrastructure.

   b. The Reserve Bank should promote the extension of credit to priority sectors through the imposition of prescribed asset requirements on banks and other financial institutions.

   c. The Reserve Bank should further support credit to priority sectors through favourable discounting of loans by commercial banks to priority sectors.

   d. A specialised development finance bank should be established to directly provide credit to targeted enterprises that are neglected by commercial banks and other financial institutions.

3. Economic growth will continue to be unbalanced as long as the poor are deprived access to essential financial services. Commercial banks have failed to provide adequately these services. International experience documents the value of regulatory imperatives in promoting equitable provision of financial services. Community reinvestment legislation that requires commercial banks to serve their broader communities is essential for guaranteeing equitable access by the poor to financial services.

   a. Commercial banks must be required by legislation to report demographic information concerning the loans they make. This information must be made available to the public and audited by an appropriate regulatory agency.

   b. All public institutions should be mandated to weigh the social responsibility profile of banks along with other factors in determining their choice of bank.

   c. Appropriate legislation should be drafted to ensure that banks provide adequate financial services in poor communities.

4. In order to provide a financial service safety net for the poor, the government should revitalise the PostBank and ensure that investment is directed towards poor communities.
   a. Additional resources should be provided to PostBanks in poor communities to ensure desired service levels.
   b. Given the role of the PostBank as a financial safety net for the poor, financial services should be designed to specifically meet the needs of the poor. For instance, withdrawals from savings accounts should be provided with no waiting period. Checking accounts and other non-cash payment mechanisms should be provided at an affordable cost.

Together, these recommendations will reorient monetary and financial policy towards job creation and the interests of the poor. The broad reform of monetary policy and directed credit will stimulate job creation and broaden economic development. Specific legislation promoting community reinvestment and the PostBank will ensure that the poor have access to the financial services that are required for socio-economic upliftment. The combination of public and private involvement will ensure that proper incentives mobilise the necessary resources for achieving social equity and pro-poor economic growth.

APPENDIX) INTERNATIONAL COMPARISON OF INFLATION-TARGETING PERFORMANCE

CPI INFLATION RATES

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	STD DEV
Inflation targeting countries										
New Zealand	6.1	2.6	1.0	1.3	1.7	3.8	2.3	1.2	1.3	1.7
Canada		5.6	1.5	1.8	0.2	2.2	1.6	1.6	1.0	1.6
United Kingdom				1.6	2.5	3.4	2.4	3.2	3.4	0.7
Sweden				4.6	2.2	2.5	0.5	1.0	0.0	1.7
Finland				2.1	1.1	1.0	0.6	1.2	1.4	0.5
Australia				1.8	1.9	4.6	2.6	0.3	0.8	1.5
Spain					4.7	4.7	3.6	1.9	1.8	1.4
								AVERAGE		**1.3**
Non-targeting countries										
Austria				3.6	3.0	2.3	1.8	1.4	0.9	1.0
Belgium				2.8	2.4	1.5	2.1	1.6	1.0	0.7
Denmark				1.3	2.0	2.1	2.3	2.3	1.8	0.4
France				2.1	1.7	1.8	2.0	1.2	0.7	0.5
Germany				4.5	2.7	1.8	1.5	1.8	1.0	1.3
Greece				14.4	10.9	8.9	8.2	5.5	4.7	3.6
Ireland				1.4	2.3	2.5	1.7	1.5	2.4	0.5
Italy				4.5	4.0	5.2	4.0	2.0	2.0	1.3
Japan				1.3	0.7	-0.1	0.1	1.7	0.7	0.7
Netherlands				2.6	2.8	1.9	2.1	2.2	1.9	0.4
Norway				2.3	1.4	2.5	1.3	2.6	2.2	0.6
Portugal				6.8	4.9	4.1	3.1	2.1	2.8	1.7
Switzerland				3.3	0.8	1.8	0.8	0.5	0.0	1.2
U.S.A.				3.0	2.6	2.8	2.9	2.3	1.6	0.5
								AVERAGE		**0.9**

REAL NATIONAL INCOME GROWTH RATES

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	STD DEV
Inflation-targeting countries										
New Zealand	-0.8	-0.5	-1.2	0.8	6.4	4.3	2.6	3.3	-1.2	2.8
Canada		-1.8	0.8	2.2	4.1	2.3	1.5	5.2	3.1	2.1
United Kingdom				2.1	4.3	2.0	2.1	3.2	----	1.0
Sweden				-2.2	2.6	3.0	1.3	1.7	2.9	2.0
Finland				-1.2	4.4	4.2	3.7	5.9	----	2.7
Australia				4.0	5.6	3.5	4.0	3.7	5.0	0.8
Spain					2.1	2.8	2.2	3.5	3.9	0.8
								AVERAGE		**1.7**
Non-targeting countries										
Austria				0.4	3.0	1.8	2.0	2.5	3.3	1.0
Belgium				-1.6	2.2	2.7	0.9	3.2	2.9	1.8
Denmark				1.5	4.2	2.7	2.4	3.1	2.9	0.9
France				-1.3	2.8	2.1	1.5	2.3	----	1.6
Germany				-1.2	2.9	1.9	1.3	2.1	----	1.6
Ireland				3.1	7.0	10.4	7.7	9.8	----	2.9
Italy				-1.2	2.2	2.9	0.7	1.5	----	1.6
Japan				0.3	0.6	1.4	3.6	1.0	----	1.3
Netherlands				0.3	2.6	2.3	3.5	3.7	3.6	1.3
Norway				2.7	5.5	3.6	5.3	3.4	2.0	2.8
Portugal				7.8	2.4	1.9	3.2	3.7	----	2.3
Switzerland				-0.5	0.5	0.8	-0.7	1.7	2.1	1.1
U.S.A.				2.2	3.5	2.0	2.4	3.9	3.9	0.9
								AVERAGE		**1.6**

The table above documents the inflation and economic growth performance of industrialised countries categorised into those who manage monetary policy with inflation targets and those who do not. Statistics are drawn from the International Monetary Fund's *International Financial Statistics*. The samples correspond to those employed by Jonnson.[56] The standard deviations of annual inflation rates and economic growth rates are calculated, demonstrating that countries that employ inflation targeting actually experience more volatile inflation rates and economic growth rates than those who do not employ inflation targeting.

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[56] Jonsson, G. 1999. "*The Relative Merits and Implications of Inflation Targeting for South Africa*". International Monetary Fund African Department. Draft version of forthcoming working paper. May. Washington, D.C.: IMF.