BEYOND A TREASURY VIEW OF THE WORLD:

REFLECTIONS FROM THEORY AND HISTORY ON HETERODOX ECONOMIC POLICY OPTIONS FOR SOUTH AFRICA

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Introduction

It is nearly ten years since the dramatic collapse of Lehman Brothers Holdings precipitated one of the most severe financial crises in modern economic history. Some progressive scholars hoped, even expected, that the crisis in financial markets and in the real economy would bring down the edifice of neoclassical economics, around which a seemingly impenetrable "new consensus macroeconomics" had been constructed. It is worth remembering that in 2003 Economics Nobel Prize winner Robert Lucas, Jr. confidently concluded that "macroeconomics ... has succeeded – its central problem of depression-prevention has been solved for all practical purposes" (in Mitchell and Fazi, 2017: 173); furthermore, in 2009 the International Monetary Fund's (IMF) Oliver Blanchard (2009: 1) was able to claim that the "state of macro" under the new consensus was "good".

Heterodox economists expected that the crash would see the end of the stultifying policy-speak associated with this world view – a lexicon that included terms such as "rational expectations", "policy ineffectiveness", "dynamic time inconsistency", "efficient market hypothesis" and (believe it or not) "expansionary fiscal contraction".[1] Yet ten years later progressive economists of all kinds – from Marxists to post-Keynesians, from neo-Ricardians to evolutionary and institutional economists – are still fighting the juggernaut that is New Consensus Macroeconomics in whatever form it appears, both in the universities and in policy-making institutions such as national treasuries and central banks.

This paper has a modest aim: to set out some alternative, mainly post-Keynesian, macroeconomic policy ideas for further debate and research in the context of the interdisciplinary research of the Wits Inequality Project led by the Southern Centre for Inequality Studies (SCIS). My assertion is that unless we have a supportive macroeconomic framework, many other economic and social policy interventions for addressing growth and inequality will likely fail to gain much traction for budgetary and related reasons.

I draw on both history and theory to demonstrate the early and respectable roots of heterodox economic thinking and support for a more activist state-led macroeconomic policy. Those supportive of alternative heterodox policy ideas are often and quickly labelled macroeconomic populists or madmen, and I aim to show that such approaches to growth and development also have a rich history and respectable theoretical pedigree behind them.

I comment briefly on the American New Deal and the recommendations of the South African Macroeconomic Research Group (MERG). Both were examples, in very different eras, of progressive macroeconomic policy interventions based on a state-led investment and "crowding in" approach to development in direct contrast to a private-finance, market-led and "crowding out" neoclassical orthodoxy. The first succeeded beyond the imagination of most through a combination of the genius of John Maynard Keynes's ideas and the political mastery and will of Franklin Delano Roosevelt; the

[1] This term is associated with former UK Chancellor George Osborne who argued that cuts in public expenditure would lead to increases in private expenditure, driving growth and higher tax revenue in the longer term. Or at least something like that!

second, despite sound policy ideas, was unceremoniously dumped by the ANC political leadership on the grounds that there was no alternative at that time to the dominant orthodoxy view. This is followed by a consideration of some general heterodox, mainly post-Keynesian, policy ideas, before we end with a few crisp and possibly provocative policy proposals aimed at generating further research and debate around growth, employment and inequality and at forcing a re-think of the current orthodox and conservative approach.

In making an appeal to a new approach to the 2018 South African budget, a civil society group made the following statement:

> We would like to see a new approach from Treasury in this new administration, including in the budget, which reflects active support for a pro-poor agenda. Civil society appreciates the role Treasury needs to play in fighting corruption, including through its public procurement office, but also recognises the conservative role, particularly regarding economic policy, that Treasury has played historically. In no sphere of government can we afford to revert to 'business as usual' (PSAM, 2018: 1–2).

A few years after the Lehman Brothers crash, a paper was published by Carmen Reinhart and Kenneth Rogoff (2010) in which the authors purport empirically to show the negative consequences of rising public debt on growth. In this now-famous and influential paper, published in the world's top mainstream economics journal, the *American Economic Review,* Reinhart and Rogoff argue that over the period 1946–2009 advanced economies with a public debt-to-GDP ratio above 90 per cent had an average real annual GDP growth of –0.1 per cent. Where this ratio was at lower levels, average annual growth ranged between 3 and 4 per cent. Public debt levels of such a magnitude were, in other words, bad for growth. This is a key argument behind what constitutes the Treasury or orthodox view of economics and the basis of the bizarre term "expansionary fiscal contraction".

In a powerful rebuttal published in the post-Keynesian *Cambridge Journal of Economics,* Herndon, Ash and Pollin (2014) replicated the Reinhart and Rogoff analysis. They come to the conclusion that growth rates in fact averaged 2.2 per cent, not –0.1 percent, over the same period for the same group of countries. They conclude:

> We … believe that the debate generated by our critique of Reinhart and Rogoff has produced some forward progress in the sphere of economic policy making. In particular, it has established that policy makers cannot defend austerity measures on the grounds that public debt levels greater than 90% of GDP will consistently produce sharp declines in economic growth (Herndon et al., 2013: 22).

Despite this critique, the Reinhart and Rogoff paper remains highly influential in the United States and Europe, and sadly also in some countries in the Global South. Though written only in 2010, it captured the spirit of the neoclassical position on debt that has dominated thinking on fiscal policy since the early 1980s and reset the policy agenda for a post-crisis world. Nobel Prize winning economist Paul Krugman, a fierce critic of Reinhart and Rogoff, has conceded that

their paper "may have had more immediate influence in public debate *than any previous paper in the history of economics*" (in Herndon et al, 2013: 5, my emphasis).

The effect of these new neoclassical interventions since the1980s has been to severely limit, if not entirely exclude, a role for the state in macroeconomic policy. It is not my intention fully to engage the Reinhart and Rogoff debate here, save to use it to show that policy-makers concerned about growth and inequality can be spooked by such paralysing analyses, leading them to hand total control of monetary policy to an independent central bank, to reject any activist role for fiscal policy, and to funnel all attention on reducing public debt to the almost total exclusion of growth-enhancing public investments. That appears to have been what happened under the African National Congress (ANC) in South Africa since 1990. It is time for some degree of pragmatic rebalancing.

The historical origins of the Treasury View

New Consensus economics, according to Blanchard (2009), has a long history and many labels. Perhaps the earliest popular term to describe its essential character is the "Treasury View" – a term attributed to Keynes in reference to Churchill's defence of austerity in the early years of the Great Depression.[2]

Two major features define the Treasury View: reduce the public debt and the budget deficit as a percentage of GDP at all times. The argument is that such austerity will not adversely affect the economy, rather that the opposite will happen as government cuts will be met by increased private-sector spending. Increasing the budget deficit will, in this view, "crowd out" more productive private investment and should be strongly discouraged.

Fiscal restraint, holding down expenditures and public debt, tightly controlling and directing the public purse, opposition to capital controls, support for sound money and private bankers –these are just some of the policy content of the Treasury View everywhere, but there is more to the Treasury View than this economic content. And who better to describe this broader socio-cultural context than the great British economist John Maynard Keynes? Pipped to a Treasury appointment by Otto Niemeyer following the Civil Service exams of 1906, Keynes was invited to lead a new Treasury Department in the early years of the First World War. He began work there on 18 January 1915. Richard Davenport-Hines sets out Keynes' view of the Treasury as follows:

> The aloofness of the Treasury was not a piece of old-fashioned absurdity, but a real part of the ritualism for the preservation of the prestige of the department. There is a good deal of it rather tiresome and absurd once you

[2] "In 1931, Treasury officials in the UK put pressure on the government to implement an austerity budget – tax increases and cuts to unemployment benefits in the middle of a recession. It led to the minority Labour government breaking up, with most Labour MPs leaving the government. The hapless Ramsay McDonald was left to form a National Coalition government with mainly Conservative MPs" (Pettinger, 2013: 1).

> begin to look into it, yet nevertheless it is an essential bulwark against overwhelming wickedness… (Davenport-Hines, 2015: 77).

The central dilemma we have faced for many decades in thinking about Treasuries all over the western capitalist world lies here: tiresome in their insistence on fiscal restraint above all else, but crucial in the eternal fight against wickedness, the kind of wickedness so prominent in our public life today, not least in modern-day South Africa. So, can a case be made for redefining fiscal policy in a more progressive direction while retaining the Treasury's essential watchdog role against wickedness and profligacy? And what of monetary policy which, like fiscal policy, is held hostage to Treasury orthodoxy under the spell of dynamic time inconsistency, independence and inflation targeting since the 1980s?

Why has this conservative view persisted across the decades (albeit under different names) in the face of different economic systems and vastly different economic challenges? Was there ever a time when any government broke with this "tradition" or ideology? Why have we in South Africa since democracy been so enamoured of this approach to policy? Can we today envisage and implement an alternative, more progressive fiscal stance in the face of slow or no growth, mounting unemployment, high levels of poverty and growing inequality?

State-led economic policy in history

Defenders of free-market, neo-liberal policy love to cover themselves in the cloak of "respectability" that most mainstream university economics departments and business schools give them. They tell us that theirs is the only game that finance ministers can play, without risking ruin and inviting wickedness. We are told that the only responsible choice involves small government, balancing the budget, tight money and the free international movement of goods, capital and people. The rest is just "macroeconomic populism", the choice of madmen unschooled in the history of economic thought and theory. None of this is true.

The truth is that models of state-led investment in the national economy are as respectable and as old as their laissez-faire alternatives, possibly even older. For every laissez-faire Sallustio Bandini writing around the turn of the seventeenth century there is an Antonio Serra, a remarkable Neapolitan who argued for industrial policy and active government. In his path-breaking treatise of 1613, Serra called for an active government promoting manufacturing enterprises that would enjoy ever-advancing technology and indefinite declines in unit costs (Sumberg,1991: 365; Reinert, 2005). Mercantilist writers, very much aware of the importance of the state's role in an economy, included Thomas Mun, a director of the East India Company, whose writings in the wake of the severe depression of 1620 apparently roused the government to embark on unparalleled activity in support of local cloth production and trade (Supple, 1954: 91). Our free-market orthodox friends love to trace their pedigree from Adam Smith (1776) and David Hume (1748) to David Ricardo (1819), suggesting that free markets and an international free-trade economy is the only one worth modelling. But as David Reisman has argued,

> Adam Smith was not a single-minded advocate of a laissez-faire market in which the minimal State had no more than a protective function. Rather, he was a pragmatic social thinker who in each case selected the tool that was the best suited to his meta-objective of rapid economic growth… Over and above the protective functions of defence and justice, Smith assigned a third duty to the State. This was 'the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain' (Smith [1776/1961, II], in Reisman, 1998: 357, 374).

A contemporary of the classical economists, Thomas Robert Malthus (1766–1834) argued in favour of the need to maintain aggregate demand and to support key sectors of the economy, like agriculture, an argument which his great friend Ricardo could not grasp. Best known for his Theory of Population, Malthus is referred to by Keynes himself as the "first Cambridge economist" and "the grandfather of his own theory of 'effective demand'", noting that "if only Malthus, instead of Ricardo, had been the parent stem from which nineteenth-century economics proceeded, what a much wiser and richer place the world would be today" (Keynes, 2015: 489–90). Thomas Attwood argued for policy to support industry, and Friedrich List wanted the state to establish a well-developed railway network and tariffs to help infant industries. Then came John Maynard Keynes – with his Cassandra-like warning around 1930 about the catastrophe that a free-market, Gold-Standard orthodoxy and fiscal and monetary policy austerity would likely bring. When small markets and balanced budgets did not work, when unemployment remained stubbornly around 25 per cent, and when the "rational" and "efficient" stock market crashed in 1929, followed by the banking system in 1931–1933, then supporters of the Treasury View were left naked, their orthodox cloak ripped away from them, leaving them unable to make sense of a world falling apart, despite decades of governments following their advice. The same story tragically repeats itself 80 years later, around 2008.

The New Deal: a successful state-led approach

In his brilliant book, *The Money Makers: How Roosevelt and Keynes Ended the Depression, Defeated Fascism, and Secured a Prosperous Peace*, Eric Rauchway (2015) analyses Roosevelt's New Deal. Arriving in the White House in early 1933 in the midst of the Great Depression, Roosevelt took the United States off the Gold Standard (the darling monetary mechanism of the sound money men); he devalued the dollar but ensured that all paper profits from the devaluation would go to the Treasury; he targeted growth and employment and went hard at the biggest economic challenge of his time, "deflation", to secure a sustainable economic recovery. He did this backed by Keynes' ideas and a regular transatlantic correspondence.

On 20 March 1933 Congress passed the Emergency Banking Act, allowing the President to cut veterans' benefits among other expenditure. However, despite such cuts the budget, far from shrinking, grew by about $6.7billion. Four days later a reporter asked Roosevelt if he would balance the budget. The President replied as follows: "It depends entirely on how you define the term, 'balance the budget'. … We will balance the budget as far as the ordinary running expenses of the government go." But fighting the Depression required borrowing, to put people back to work and "'keep human beings

from starving in this emergency. *As desirable as a balanced budget might be, the needs of recovery came first* (Rauchway, 2015: 59, my emphasis).

Urged on by a letter from Keynes in December 1933 in which he advised Roosevelt that monetary expansion alone would not secure recovery, Roosevelt – against local advice and in the face of opposition from southern Democrats, Wall Street and private bankers – created the Civil Works Administration, which saw four million jobless Americans returning to work by building "swimming pools, parks and gardens, schools and roads, among other projects, working through the winter" (Rauchway, 2015: 97). Under pressure from Congress, Roosevelt was forced to make concessions on some plans that would benefit wider constituencies than the poor and blacks that Roosevelt initially targeted. Keynes met Roosevelt at the latter's Columbia University honorary degree ceremony. Then, and later in an open letter in the *New York Times*, Keynes urged Roosevelt not to cut down spending just yet. In his letter Keynes argued that the recovery depended on "the direct stimulus to production deliberately applied by the administration" and specifically upon "the pace and volume of the government's emergency expenditure. Rather than let it fall, Roosevelt, Keynes urged, should increase it to $400 million per month" (Rauchway, 2015: 99). The mood of Congress appeared to rule out this Keynes remedy, but Roosevelt let Congress know in no uncertain terms that he needed as much money and spending authority as he could get. Rexford Tugwell of the Agriculture Department observed, "After Keynes's visit I fancied we heard a good deal less about economy and a balanced budget", forcing the White House budget director Lewis Douglas to resign. Keynes perhaps immodestly observed "the extent, variety and spread of the recovery is outstanding in economic history". Most scholarly assessments would support Keynes's boast. Under the New Deal,

> [the] US economy grew at rapid rates; growth of about 9% per year on average was achieved in Roosevelt's first term, the strongest four-year economic growth in peacetime American history. The future, both Keynes and Roosevelt believed, should lie in younger state bureaucrats. 'We shall have a new form of government this summer', the President said; 'the Under-secretaries, even the assistant Secretaries, will be in command' (Rauchway, 2015: 100).

We could go on, but perhaps this is enough and a good point to take stock.

In a message to Congress on 29 April 1938 Roosevelt observed:

> Among us today a concentration of private power without equal in history is growing. This concentration is seriously impairing the economic effectiveness of private enterprise as a way of providing employment for labour and capital and as a way of assuring a more equitable distribution of income and earnings among the people of the nation as a whole (Roosevelt, 1938: n.p.).

Franklin Roosevelt took on all vested interests, and in particular the monopolies and private bankers, in driving his state-led recovery agenda, and it worked beyond anyone's wildest dreams. The New Deal set the platform for the thinking that informed the Keynes–White Bretton Woods agreement for regulating global finance in 1944. Little known is the fact that Roosevelt ensured that no private bankers attended the Bretton Woods talks from the US side, so ensuring that real

economy and not private finance imperatives drove the complex discussions. Despite his successor Harry Truman's best efforts at rolling back Roosevelt's agenda, New Deal thinking set the framework for America's vast economic power in the post-War era.

Yet it is important to note that this successful partnership between Keynes and Roosevelt, which carried through into the Golden Age of capitalism, was founded on more than a combination of brilliant ideas and politics. Mitchell and Fazi (2017: 24–5) remind us that it should also be "viewed as the outcome of the fortuitous confluence, in the aftermath of World War II, of the 'right' social, ideological, political, economic, technical and institutional conditions', the 'result of the complex interaction between different dimensions of the historical process'". That makes its replication across time and space very difficult, though not impossible.

The orthodox Treasury View was built around fiscal conservatism, low budget deficits, sound money and opposition to capital controls – variously referred to in recent times as the "main street view", the Washington Consensus or neo-liberalism. It has come under fire from many quarters including, from post-Keynesians and Marxists, and for many good reasons. Chang and Graebel (2004), for example, argue that such orthodox policies have not been notable for their success in developing country contexts, and that there is mounting evidence that there are multiple routes to development. In a recent paper published by the International Monetary Fund, the authors argue with many qualifiers that some of the claims of neo-liberalism may have been "oversold" (Ostry, Loungani and Furceri, 2016: 38)). Chang and Grabel express their cautious pleasure that

> …recent research by the IMF now recognizes, albeit some seven decades after John Maynard Keynes, that unrestrained flows of liquid international capital can lead to speculative bubbles and financial crises. We are also encouraged by acknowledgment, six or so decades after Karl Polanyi, that institutions, governance, and distribution matter (Chang and Grabel, 2004: 274).

MERG and crowding-in: a South African approach

In the transition to democracy in South Africa, an attempt was made to place on the table a state-led investment programme aimed directly at promoting growth and employment and at reversing the legacy of racial and class inequalities that lay at the heart of the apartheid–capitalist project. That was the aim of the ANC's own macroeconomic policy think tank, MERG, which engaged the services of over 50 progressive economists from all over the world. The team included world-renowned American macroeconomist Lance Taylor, as well as Bill Gibson, Stephen Gelb and the Development Bank of Southern Africa's Dirk van Seventer, as well as the brilliant yet eccentric Australian economist Peter Brain.

The theoretical foundations of MERG's economic policy framework lie in what I would characterise as a Cambridge, post-Keynesian or structuralist approach to economic policy where effective demand failures and the possibility of

under-full employment equilibrium are recognised as key problems. In contrast to the rival Normative Economic Model of the apartheid state, which was underpinned by a "crowding out" or Treasury View of the world, MERG envisioned a two-phase, "crowding-in" approach to South Africa's development. The latter was a powerful state-led social and physical infrastructure investment programme focusing on housing, education, health and physical infrastructure investment as the growth drivers in the first phase, followed by a more sustainable growth phase which would see private-sector investment kick in more forcefully as growth picked up (MERG, 1993: Chapter 1). In the light of post-1994 developments, it is worth spelling out some of the proposals made then in respect of the crucial state-led first phase, though the numbers of course have little meaning in today's context:

> 1. In education, MERG proposes a minimum of R5 billion [in 1992 prices] in annual recurrent and teacher training expenditures and a lifting of annual education expenditures from the current R0.5 billion to R5 billion…
> 2. In adult basic education, MERG proposes a four-year programme for persons already in the workforce, at the rate of 50 000 new trainees per year; and a programme for unemployed persons who will be engaged on physical infrastructural projects, and who will receive training similar to that for employed workers, at the rate of 100 000 new programme entrants per year…
> 3. In health, MERG proposes a programme to provide 2 000 clinics at a capital cost of R300 million [in 1992 prices] and a recurrent cost of R1.5 billion per year; and a basic health care and nutrition programme which will be implemented at a cost of R1 billion per year.
> 4. In housing, MERG proposes that the government triples the number of housing sites from the current 100 000 to 300 000 per year. The number of formal houses completed should rise, step by step, from the current levels of approximately 38 000 per year to 350 000 per year by the early part of the next century.
> 5. MERG proposes the establishment of a realistic statutory minimum wage, set initially at about two-thirds of the Minimum Living Level (MLL). Such a policy will have positive macroeconomic and microeconomic consequences (MERG, 1993: 3).

In addition, the MERG proposals focused on industrialisation, trade, exports and so on, all aimed at driving up effective demand, sustainable growth and redistribution.

These policy measures resonate powerfully with the broad-based political economy agenda of the Wits Inequality Project being driven from the Southern Centre for Inequality Studies.

The approach was fully consistent with the required macroeconomic balances over time. "The realisation of MERG objectives [over the longer term] will be impossible unless policy is characterised by prudent …fiscal, monetary and balance of payments management" (MERG, 1993: 4). It called for prudence and vigilance against the "wickedness" that Keynes had warned against but crucially within the parameters of a very different and state-led pro-growth approach to macroeconomic policy. So much for the charge laid against it then by the ANC's economics leadership and by business that MERG was advocating "populist" macroeconomic policy. In a 2016 opinion piece, commentator Peter Bruce rightly criticises the ANC government for failing to concentrate on any one priority. He goes on to observe: "Just imagine how far we would have come in 21 years had the top priorities been education, health, housing and infrastructure, and they had been attended to and resourced with money and expertise in that order" (*Sunday Times*, 17 January 2016).

The Treasury View and macroeconomic populism are not the only policy games in play, but that was how the ANC leadership set up the options, the better to reject any alternative to neoclassical orthodoxy.

As we know the ANC chose to dump MERG and did not even debate it within the movement. Two years after gaining power it introduced its own homespun neo-liberal macroeconomic policy framework – the Growth, Employment and Redistribution programme (GEAR)– with the announcement that it was non-negotiable. As Alec Erwin (2016: 145) put it twenty years later, "we were so preoccupied with influencing our exchange rate and the markets, [we decided that] we could not have a public debate around GEAR.... In hindsight we were too cautious".

I would like to end this section with two brief quotes on MERG.

Langa Zita, at the time a senior member of the South African Communist Party (SACP) and later to be Director-General in the national Department of Agriculture, had the following recollection of MERG:

> I can still remember the first MERG draft. It was a very important and well-thought-out framework for the country. It was not radical, ok? But it was progressive. It was what I would call a social democratic, third-world framework. … It was a useful point of departure, and it was far more scientific than the RDP [Reconstruction and Development Programme]. There had been processes of economic modelling done around it. There was serious work done by economists on it. I thought it was a very decent piece of work (Zita, interview, 10 August 2017).

Dale McKinley, an independent, progressive writer and researcher, neatly captures the positioning of MERG in the spectrum of political and economic ideas:

> While the [MERG] report did not set out the kind of more radically anti-capitalist development path that many in the broad liberation movement desired, it was designed to directly address the historical, systemic inequalities of the apartheid era and create the conditions for the redistributive path to economic growth through a participatory and democratically accountable interventionist state... Its fundamentals were brushed aside as 'idealistic' and effectively ignored. Instead the ANC chose to join the liberal chorus of corporate capital, the National Party as well as powerful western countries and international financial institutions... (McKinley, 2017: 75).

Political philosopher Laurence Hamilton's explanation for the ditching of MERG lies in the nature of the "elite" economic compromise:

> The quick and sorry demise of the ANC's 'Making Democracy Work' policy [MERG] is ... indicative of the way in which the elite economic compromise sacrificed many of the ANC's previously stated goals for the perceived absolute priority to secure monetary and fiscal policy that was attractive to international investors. … As an attempt to turn the general promises of the Freedom Charter – for housing and health care – into practical policies, it was the most important research base for the ANC in the early stages of its unbanning (Hamilton, 2014: 102).

This story of what really happened in the economic negotiations in the 1990s is the subject of my forthcoming book with Robbie van Niekerk, entitled "Shadows of Liberation".

Having looked at these specific examples – one successful and one that failed to be debated – it is time to take a step back and review some progressive theoretical reflections on appropriate economic policy options to address growth, employment and redistribution. In the context of the Wits Inequality Project, we prioritise issues of distribution.

Macroeconomics and inequality: key heterodox prescriptions

Anthony Atkinson (2015: 301) has observed that the attack against growing inequalities has to be fought on many fronts: "Within government it is a matter for the Minister responsible for science as well as for the Minister responsible for social protection; it is a matter for competition policy as well as labour market reform." While we fully endorse this view, we limit ourselves here to more traditionally understood macroeconomic policy: fiscal, monetary and exchange-rate policy. But before we turn to examine these policy options in the South African case after 1994, we need to set out some key policy options of our essentially post-Keynesian approach.

In contrast to Marxist and post-Keynesian economists, the vast majority of mainstream economists believe that the capitalist system is endogenously stable and that crises arise from exogenous shocks. Furthermore, prior to the recent crisis mainstream theories and models did not regard inequality as a destabilising factor.

For Ben Fine, given the way orthodox macroeconomics has gone – with representative individuals, perfect markets, monetary policy to the fore, and state (policy) ineffectiveness – it is hardly surprising that inequality and (re)distribution is largely absented from the mainstream (Personal communication, 21 March 2017). The attempts that have been made by mainstream economists have tended to be fairly predictable and largely based on human capital differentials (see, for example, Bound and Johnson, 1992).

The severity and length of the post-2008 Great Recession appeared to have awoken even some mainstream economists and institutions to the destabilising role of inequality. Writing in the IMF journal *Finance and Development*, Kumhof and Ranchere go so far as to argue for the restoration of workers' earnings by, for example, strengthening collective bargaining rights, so allowing them to work their way out of debt over time. "Restoring equality by redistributing income from the rich to the poor would not only please the Robin Hoods of the world, but could also help save the global economy from another major crisis" (Kurnhof and Ranchere, 2010: 30).

Treeck and Sturn (2012) agree with this general line of argument, but they also make the important point that differences across nations do still matter. They study China and Germany among others, and they conclude that while there may now

be wide discernible consensus that reducing inequality may be positive for growth and macroeconomic stability, there is little agreement about the appropriate policy measures to address such inequality in the countries they studied: "…the retreat of institutions developed during the New Deal and World War II – such as progressive tax policies, powerful unions, corporate provision of health and retirement benefits, and changing social norms regarding pay inequality" all appear to have contributed to rising inequality, quite apart from technological changes (Treeck and Sturn, 2012: 53).

There is discernible a high degree of consensus among Marxists and most post-Keynesian on the role of inequality as a root of the 2008 financial and economic crisis and beyond. As Thomas Goda observes:

> …for many post-Keynesians possible aggregate demand problems due to changes in the functional income distribution between workers, capitalists and rentiers are … at the heart of the analysis; but fundamental uncertainty and Minskyian instability are [also] prominent in post-Keynesian crisis theories (Goda, 2013: 26).

Post-Keynesians have adopted a greater focus on inequality, and tend today to focus on the impact of inequality on effective demand on consumption and investment, and the implications for workers and the poor. But within the post-Keynesian tradition, there are some differences of emphasis suggestive of a rich yet constructive debate, as compared to the sterility of orthodoxy. Mark Lavoie distinguishes five strands of post-Keynesian economics:

- The first strand is represented by the fundamentalist Keynesians, directly inspired by John Maynard Keynes, the older Joan Robinson, as well as Hyman Minsky, G.L.S. Shackle, and Sydney Weintraub, with fundamental uncertainty, the features of a monetary production economy, financial instability, and methodological issues as major themes.

- The Kaleckians are the second strand, drawing on the works of Michael Kalecki, Josef Steindl, and the younger Joan Robinson, with cost-plus pricing, class conflict, effective demand, income distribution and growth as major themes.

- The third strand consists of the Kaldorians, basing their work on the contributions by Nicholas Kaldor, Roy F. Harrod, Richard Goodwin, John Cornwall, and Wynne Godley. The major themes are economic growth, productivity regimes, open economy constraints to growth, and the nexus between the economic and the financial system.

- The Sraffians or neo-Ricardians constitute the fourth strand, drawing on the work of Piero Sraffa and Pierangelo Garegnani, and focussing on issues like relative prices in multi-sectoral production systems, choice of techniques, capital theory, and long period positions of the economy.

- The fifth strand are the Institutionalists, relying on the work of Thorstein Veblen, Gardiner Means, P.W.S Andrews, John Kenneth Galbraith, Abba Lerner, and Alfred Eichner, and concentrating on themes like pricing, the theory of the firm, monetary institutions, behavioural and labour economics (Lavoie in Hein, 2016: 4).

Typical of the broad principles of a post-Keynesian view, the themes of economic growth, effective demand, public sector investment, full employment, production and distribution run across all of these variants. Post-Keynesians also pay attention to the matter of the proper coordination and timing of the different strands of macroeconomic policy as well as

coordination within each, especially fiscal policy coordination, to bring about more effective policy impacts on demand and distribution. A coordinated grip on consumption and investment demand is what is needed, argue Dullien, Herr and Kellermann (2011: 104), in the interest of the economy and society as a whole. This does require intervention by the state as well as greater coordination between the private and public sectors and some appropriately designed and capacitated institutional body or mechanism to ensure this.

Cutting through post-Keynesian varieties is one simple idea and two policy suggestions, the glue that holds the edifice together. In *Keynes, the Return of the Master*, Skidelsky summarises these as follows:

> Keynes' big idea was to use macroeconomic policy to maintain full employment. His specific suggestion was to use monetary policy to secure permanently low interest rates and fiscal policy to achieve a continuously high level of public or semi-public investment (Skidelsky, 2009: 179).

With South African unemployment officially at 27 per cent, and more accurately over 45 per cent, who can argue against the imperative to make employment generation THE central goal of both fiscal and monetary policy?

Two factors need to be taken into account here as qualifiers in responding to these policy proposals today. One relates to the global economic environment, the second to the effects of financialisation. So first, it is worth drawing attention to the limits of national economic policy-making because of the powerful global forces which have been driving inequality and instability, especially after the collapse of the Bretton Woods arrangements in 1971. In short, there is an urgent need to establish an appropriate international regulatory framework like the Bretton Woods system that will provide a supportive global regulatory integument, yet one that does not trammel national sovereignty in policy-making. The hollowing out of national sovereignty "has been an essential element of the neo-liberal project" (Mitchell and Fazi, 2017: 3). So we would need to fashion a new global regulatory system that allows for discretionary national macroeconomic policy, including, for example, the imposition of capital controls when unavoidable in the way that both Keynes and White championed at Bretton Woods in 1944.

Secondly, macroeconomists also need to understand better the effects of financialisation on demand, growth and inequality. A wide interdisciplinary heterodox literature on financialisation suggests that the dramatic growth of financial markets, financial instruments and debt levels has negatively impacted investment, growth, employment and income distribution (Palley, 2017).

Engelbert Stockhammer (2015: 936–7), using a post-Keynesian argument, points to four macroeconomic effects of rising financialisation on inequality. First, inequality places downward pressure on aggregate demand since poorer people have high marginal propensities to consume. Second, financial deregulation allows countries to run large current account deficits for longer periods. Third, inequality leads to higher household debt as working-class families struggle to maintain

consumption levels and norms. Fourth, it increases speculation as wealthier families buy into and hold onto riskier financial assets such as sub-prime derivatives and hedge funds.

Fiscal policy options for fighting inequality in South Africa today

In line with these progressive ideas, what fiscal and monetary policy alternatives could South Africa explore today? The big issue is to determine how the state can act as a driver of growth, effective demand, employment and equality through its national budget and tax policy.

One policy option, which critics of government's neo-liberal policy have been proposing for two decades, is the introduction a Basic Income Grant (BIG) in South Africa.

Most post-Keynesians favour job creation and the right to work or a job guarantee programme[3] over a Basic Income Grant; they worry that BIG would be a kind of excuse by government not to focus policy attention on job creation. It is potentially also a gift to the private sector, a way of stimulating aggregate demand without any cost to them. Furthermore, it is often used by neo-liberals to justify the elimination of social programmes administered by "inefficient" governments, in favour of a simpler method of dealing with poverty and inequality. In other words, it is a way of reducing the role of the state.[4]

This anti-state logic has led to support for BIG from some right-wing sources. Milton Friedman, for example, argued for BIG through a negative income tax mechanism as a way to raise effective demand without growing state intervention. And inter-war conservative party activist Juliet Rhys-Williams, a dissident member of the 1942 Beveridge Commission, supported BIG as a way of eliminating the welfare state.

However, William Jackson, employing a Keynesian model, is supportive of a basic or universal income grant:

> Basic income, being unconditional, avoids labelling any particular group of benefit recipients as dependent on the rest of society. All citizens receive basic income as an entitlement, and there is no means testing or monitoring of personal characteristics. Ideally basic income would be enough to sustain an adequate but relatively low living standard. Most people would continue working, which would not be strictly necessary for subsistence but essential for material affluence (Jackson, 1999: 641).

The idea of a Basic Income Grant or Universal Grant was originally proposed in 2003 by the Committee of Inquiry into Comprehensive Social Security in South Africa (the Taylor Committee). The idea was to use this to eradicate destitution

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[3] A job guarantee programme "involves the government making an unconditional job offer to anyone who is willing to work at a socially acceptable minimum wage and who cannot find work elsewhere" (Mitchell and Fazi, 2017: 230–1). It creates a buffer stock of jobs that rises or falls in line with changes in private sector activity.

[4] My thanks to Louis Philippe Ronchon (Toronto) for making this point.

(a consequence of mass unemployment), and through this to lift a substantial number of the poor out of poverty. Government's response at the time was lukewarm, based on concerns that it was either unaffordable or likely to cause "dependency". Charles Meth (2004) has argued convincingly and at length that little evidence exists to support either of these contentions.

That debate was most intense in 2010–2012 but was dropped when those in national government who argued that BIG would create a culture of dependency and stifle the work ethic won out. South African taxpayers now foot the bill for a social grant – child support, old age, disability, etc. – that covers some 17 million citizens, about one-third of the population. The relationship between BIG, if it is introduced, and social grants would need to be assessed to reduce overlaps, and to optimise on costs and coverage. Clearly there is a need to resurrect this debate in South Africa today and to assess the relative merits of BIG and a Job Guarantee programme.

The other major issue to investigate here in respect of fiscal policy relates to state infrastructure investment spending, housing and the potential for free tertiary education to promote growth and address inequality, in part by crowding-in the private sector as suggested by MERG.

Of course, any discussion of fiscal policy would have to consider its impact on the indebtedness of the state, and neither Keynes nor Piketty are in favour of high and rising public debt over the longer term as a general principal. Piketty is also concerned with the impact government borrowing has on income distribution. He is critical of government deficits because the large majority of government bonds, created when the government goes into debt, are owned by the very wealthy. To a large extent, he argues, they benefit from rising government debt. With little risk, they are able to receive positive returns on their money (Pressman, 2015: 149).

But the crucial issue here is to unpack and understand the drivers of high current state expenditure, including the size and growth of the public-sector wage bill. Few economists of any persuasion fail to see this as a major problem (see, for example, Rossouw, Joubert and Breytenbach, 2014).

Monetary policy, central banking and the fight against inequality in South Africa today

The impact of monetary and exchange rate policy on inequality is very complicated. Moreover, it is not a field that has been well studied as yet. The results of existing studies vary widely. Nathalie Lambrecht has argued that since Piketty's path-breaking study:

> Many possible explanations for the rise in income inequality of the recent decades have been examined…. Yet, monetary policy has hardly been considered as a likely candidate. This is partly due to the fact that central bankers are charged with the task of inflation stabilization and output gap stabilization. Therefore, the distributional consequences of monetary policy have been largely ignored in monetary policy discussions.

> Moreover, current practice employs representative-agent monetary policy models which precludes the possibility to analyse the redistributive effect of monetary policy…. The little existent [*sic*] literature that deals with this topic is both theoretically and empirically divided into two groups. One claims that contractionary monetary policy increases income inequality, whereas the other claims the opposite (Lambrecht, 2015: 1).

There is no doubt that it is essential to try to make sense of the possible impact of monetary policy and institutional changes in the monetary policy regime on inequality in South Africa. A monetary authority (the South African Reserve Bank, SARB) that was historically subordinate to the National Treasury and Parliament since its inception in 1921 was granted full constitutional independence in 1996, and the country adopted an Inflation Targeting regime in April 2000. Arguments persist about the best way to understand SARB monetary policy and changes in the repo/interest rate in relation to global developments, including the Great Recession, as well as in the context of the massive and mounting challenges of low growth, rising unemployment and growing inequality for most of the period since 1994.

A number of issues including the role of monetary policy in reducing inequality and in promoting employment and growth have arisen in South Africa in 2017. At the moment, in terms of Section 224 of the Constitution, the independent and privately owned SARB has an exclusive price stability mandate. There have been many arguments that this is inappropriate for South African conditions.

In the early 1990s an argument was made for the SARB to remain within the structures of the "democratic state-in-the-making" in order to improve macroeconomic policy coordination and public accountability while having greater operational autonomy than it ever had under apartheid. That view, as argued by the Macroeconomic Research Group and in a commissioned paper by Rustomjee and Padayachee[5] was rejected without any debate. About a decade ago local, mainly union-based "serve-society" advocates of monetary policy (in contrast to "sound money" advocates), as well as some international academic experts including Bob Pollin and Gerry Epstein, have made submissions calling for an employment-focused monetary policy. I urge that these and similar submissions should be reconsidered through a properly structured process.

Comert and Epstein argue that the SARB should set its interest rates

> …to achieve an overall real growth rate consistent with the plan which has an employment target at its core. As part of its mandate, the Reserve Bank would try to reach an inflation constraint that is mutually decided upon [with the state] as part of the overall program. In addition, the Reserve Bank would manage some of the credit allocation programs that are part of the components of the over-all employment targeted macroeconomic policy. Finally, the Reserve Bank would manage the capital account as needed to maintain the exchange rate (Comert and Epstein, 2011: 108).

My own view is that wholesale changes to the institutions that manage and oversee monetary and exchange rate policy, including the SARB, may not be necessary and would be too risky and costly. Any major changes to the status of SARB,

[5] Reproduced in Padayachee (2015).

such as nationalisation or reversing its independence, will be very damaging to the South African economy, to capital inflows and to investment in general; neither will these changes necessarily positively change the way the SARB operates and sets monetary policy. The question to ask is what we are trying to achieve and whether can we realise these objectives without tampering with central bank independence or nationalising the bank. Changing the mandate of the SARB, on the other hand, is necessary and feasible and effective, provided it is done responsibly through Parliament and involves proper public participation and debate, not in the surreptitious and devious manner attempted in 2017 by the Public Protector.

There are many alternatives to inflation-targeting for a country like South Africa. As far back as 1999 Epstein and Maimov (1999: 33) proposed that, given the state of the South African economy, the SARB should adopt an *investment target* subject to an inflation constraint. Later Comert and Epstein (2011) proposed a revised *employment-targeted* mandate for the SARB (which must include a price stability mandate, of course) and regular consultation between the National Treasury and the SARB to improve macroeconomic policy coordination. If the thrust of economic policy to drive growth is an initial phase of public-sector investment, to be followed by a more sustainable phase led by the private sector, then the former suggestion (an investment target) may make much sense.

Consideration should also be given to restructuring the Monetary Policy Committee (MPC) to include up to two independent, external voting members. MPC minutes, including how members voted and why, should be published one month after each MPC meeting. There should also be more regular accountability to Parliament via open meetings of the Parliamentary Portfolio Committee on Finance where each MPC member would be required to explain his/her stance and vote at the last MPC as happens in the United Kingdom.

There is another relatively important institutional "arrangement" that should be ended, which could help to lower the interest rate structure. It would appear that some kind of informal and cosy arrangement was entered into between the SARB and the major private banks in 1933 that allows a spread of 3.5 percentage points between the SARB's repurchase or repo rate and the prime lending rate. This is simply too large and inappropriate to South African reality today. However, as evidence of the power of the local banking sector, efforts by the SARB in the late 1990s to use moral suasion to get the private banks to reduce this spread proved unsuccessful. Something stronger than moral suasion may be needed now.

Moral suasion and if necessary legislation may also be needed to force private banks to cut what many consider to be very high bank charges and to encourage them to increase their exposure to credit-worthy small and medium business, especially those that are black-owned and owned by women, as part of a broader programme of economic transformation. It is critical to consider all reasonable means to move the "highly sophisticated" South African financial system in the direction of a bank-based system of raising capital for development.

We need to restore finance's role in supporting domestic industrial development instead of becoming self- referential, an end unto itself and untouchable. South Africa has followed Britain's Anglo-American model rather than Germany's bank-based model in this regard. Jonathan Michie has recently suggested what needs to be done in the British case; his suggestions are very applicable to South Africa, too:

> A century ago Britain was the world's leading economy, before losing out to the US and Germany, then Japan and China – all because their industries outperformed Britain's. Why did that happen? Unlike industry in the US, Germany, Japan and China, Britain's has been dominated by finance. The City of London developed largely to service Britain's empire, while the financial sectors in the other countries invested primarily to service domestic industry. Churchill by contrast had wanted to see 'finance less proud and industry more content' (Michie, 2017: n.p.).

As popular pressure against the "proud" and highly sophisticated South African financial system mounts, it is that Churchillian balance that we need to develop in South Africa today (Timm, 2016: n.p.).

Capital controls essential in the fight against inequality

Under the spell of old Washington-Consensus thinking, South Africa's democratic government abolished exchange controls that had been in place since the early 1960s (after Sharpeville) and which served the apartheid regime well in retaining scarce funds within the country. In fact, the IMF had to advise the new government to move more gradually in this regard than it wanted to. Now there are no capital controls on non-residents and only limited controls on residents. From about 1997 the government permitted some of its major corporations to list abroad, mainly on the London Stock Exchange, with the result that there was a steady flow of capital and dividend income out of the country.

The quantum of illicit capital outflows is obscene:

> [Calculations show that] capital flight between 2001 and 2007 was on average 12 per cent of GDP per year. This figure increased year on year from 2001 and peaked at 23 per cent of GDP in 2007. In particular, trade mis-invoicing remains a significant channel for capital flight by companies. Capital flight on such a scale has profound implications for South Africa's economic performance… Indeed, regularising capital flight for it to become legal could have the effect of scuppering any attempts to adopt more progressive and interventionist economic policies (Ashman, Fine and Newman, 2011: 9).

I argue strongly for capital controls in our situation for a limited period. For many years talk about capital controls was regarded as a sign of madness by orthodox economists and policy-makers. Now, at what looks like the beginning of a post-austerity, post-crisis world order, such ideas are no longer simply rubbished. In 2012 even the IMF signalled a slightly more flexible approach:

> The International Monetary Fund has cemented a substantial ideological shift by accepting the use of direct controls to calm volatile cross-border capital flows, as employed by emerging market countries in recent years. Although the fund continued to warn that such controls should be 'targeted, transparent, and generally

> temporary', the policy, announced in a staff paper released on Monday, is a sharp change from the Fund's enthusiasm for liberalising capital accounts during the 1990s (Alan Beattie in *Financial Times*, 3 December 2012).

So here, too, there is an important policy debate that needs to take place in South Africa. Should the country consider the re-introduction of exchange controls to limit capital flight of all kinds? Should this be restricted to residents only, or also be applicable to non-residents? For what period, of what forms? In considering this policy, we need to caution that the capacity that once existed within the SARB to oversee exchange control regulations and monitor capital flows has been weakened and would need to be restored.

Key policies for growth, employment and redistribution in South Africa requiring further debate

In light of the foregoing, here are some practical and technical post-Keynesian policy issues for further debate within the Wits Inequality Project, especially the macroeconomics theme led by Patrick Bond. Similar discussions could also take place at some representative forum, an Economics Codesa if you like. This could include role-players such as government, civil society organisations, the trade unions and the private sector, possibly administered by the National Economic Development and Labour Council (Nedlac).

Fiscal policy

At the heart of fiscal policy should be a commitment to drive public capital investment to promote growth and increase employment, while not losing sight of the dangers of profligacy. In order to assist in this regard, serious attention needs to be given to the separation of the budget into two accounts – a current budget and a capital budget. The current budget would be balanced annually; the capital budget deficit would be limited to no more than an average of 3 per cent of GDP over, say, a five-year cycle. A cap has to be placed on the size and growth of the government wage bill, which offers the greatest threat of the current budget deficit spiralling out of control (Rossouw et al., 2014). Contrary to some perceptions, this imperative to control the current budget deficit is very much in line with post-Keynesian ideas as well as those of inequality researchers such as Thomas Piketty and Steve Pressman. The separation would allow for greater transparency in the budget process, with the overall objective of ensuring control over profligate consumption expenditure, especially in the government's wage bill. At the same time, it would allow for growth-enhancing capital expenditure in areas such as infrastructure, and non-wage expenditure on education and health among others to grow even at the short-term risk of running deficits.

Having separate capital and current budgets is not new to South Africa. In 1937 the government, "*onder die invloed van Keynesianisme*"[6] (Gildenhuys, 1989: 641), established a Revenue Account separate from a Loan Account. Current expenditure was financed from the former and capital expenditures from the latter. These accounts were only

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[6] Translation: "under the influence of Keynesianism".

reintegrated from 1967 on the recommendation of the Franzsen Commission and in the wake of the dismantling of Keynesian thinking (Browne, 1973: 2, 22).

Once a separate capital account is set up, consideration must be given to the establishment of a representative National Investment Board to make decisions on allocation of funds for all capital expenditures in line with social and economic needs and across sectors, regions and other dimensions. Both Keynes in 1928 and Beveridge in 1942 proposed such a capital allocation institution located within the state. But I would not go as far as Beveridge, who proposed that even private entrepreneurs "must win approval of the National Investment Board" before undertaking investments (Wasson, 1960: 218).

Monetary policy

I would argue that it is imperative that the SARB mandate be constitutionally expanded to make employment targeting its highest priority, while retaining price and financial stability as secondary goals. I support the nationalisation of the SARB at some stage, not because I believe that a nationalised SARB will inevitably adopt more progressive policies but in order to bring it into line with the global norm (most central banks are state-owned). The SARB's independent status should be maintained as there is little value but only great cost and reputational damage in changing this *now*. Recall that most state-owned central banks are also independent to varying degrees. Timing in such matters is key, and while the timing for change was right in the early 1990s as proposed by MERG, the timing now is problematic. The terms of the Monetary Policy Committee must be revised to include greater transparency and regular accountability to Parliament, and the MPC structure and composition should be revised to include two independent members. The legal complexities related to potential conflicts of interest also need to be addressed.

The spread between repo rate and prime rate must be reduced via moral suasion in discussions between the SARB and the major banks, or by law if necessary. The current 3.5 per cent spread (apparently agreed to in the early 1930s) is based on greed and most be closed to reduce the cost of borrowing.

Exchange rate policy

I believe that it is essential that capital controls must be reintroduced for a limited period, say five years, and that the SARB's capacity to monitor capital flows is enhanced. That capacity and skills set, so powerfully entrenched in the SARB since the early 1960s, has been effectively dismantled in line with the gradual dismantling of exchange controls themselves after 1994.

Social policy

One of the following approaches is needed in respect of social policy to underpin security and contribute to effective demand. The first option is to introduce an easily administered basic income or universal grant in an amount to be determined. If the amount is set appropriately, it may require an adjustment or even the abolition of the existing corruption-riddled social grant system – but in such a way that no current beneficiary is worse off. The second option is a job guarantee scheme. In principle, I prefer the latter alternative.

Conclusion

My plea is that in the field of macroeconomic policy, progressive economists of all stripes in South Africa and elsewhere today have to begin the urgent task of populating and thickening the policy space between an abominable neo-liberal project and the dream of a centrally planned economy. Vivek Chibber has reminded us that:

> We have to start with the observation that the expectation of a centrally planned economy simply replacing the market has no empirical foundation. We can *want* planning to work, but we have no evidence that it *can* … we have to seriously consider the possibility that planning as envisioned by Marx might not be a real option…. It's quite astonishing how little attention this issue gets on the Left today, compared to, say, the energy poured into deconstructing Bollywood movies (Chibber, 2017: 8, our emphasis).

It surely wouldn't be a wasted effort for the Left to dedicate some energy to working through radical social democracy and complementary heterodox macroeconomic models, including post-Keynesianism – whether we see these approaches as just interim measures on the path to socialism or as the ultimate state and form of the good society.

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