AN EVALUATION OF THE IMPACT OF MONETARY POLICY ON A SMALL AND OPEN ECONOMY: THE CASE OF THE REPUBLIC OF SOUTH AFRICA, 1960 - 1997

by

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ABSTRACT

TITLE: AN EVALUATION OF THE IMPACT OF MONETARY POLICY ON A SMALL AND OPEN ECONOMY: THE CASE OF THE REPUBLIC OF SOUTH AFRICA, 1960 - 1997.

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The purpose of this study is to evaluate the impact of monetary policy on stimulating the economy of a small and open economy, in the light of the fervent and ongoing debate between Structuralists and Neo-liberal or Orthodox economists. Structuralists argue that monetary policy is ineffective in stimulating the economic growth of a small and open economy, which is said to be determined by the economic growth levels of its large and developed trading partners. Money supply and inflation are considered to be insignificantly related to economic growth. It is further argued that the monetary authorities cannot control money supply *changes* as desired, namely, to keep them *within* the *set money supply guidelines*, because of foreign external forces flowing out of international trade conducted with these large and developed partners.

By contrast, the Neo-liberal or Orthodox counter-argument affirms the efficacy of the money supply and inflation in influencing the economic growth of a small and open economy. Monetary authorities are said to be capable of controlling money supply via the bank rate (*repo rate*), that the *current level* of money supply is significantly related to that of the previous period. It is also argued that the *interest-elasticity* of foreign investment is too low to counteract or neutralise monetary policy objectives significantly.

In the case study of South Africa as a small and open economy, the empirical findings confirm the Neo-liberal or Orthodox arguments that the economic growth of a small and open economy is significantly related to changes in money supply and inflation, and that ability of monetary authorities to control money supply is constrained by external factors. While monetary policy is ineffective in controlling changes in the money supply, keeping it *within set target limits* or *guidelines*, it is able to influence the current level money supply by operating on that of the previous period.

The Structuralist argument that the monetary authorities of a small and open economy *cannot control* money supply changes, i.e. keeping them *within set target guidelines*, is confirmed. The basis of this argument is said to be the unfair terms of trade faced in dealing with large and developed countries. This is despite the significant relationship between the current level of money supply and that of the previous period.