

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND TO THE PROBLEM STUDIED

The Keynesian/Monetarist debate on the effectiveness of monetary policy in stimulating the economy is an ongoing one. According to Mohr and Fourie (1998: 581), the experience during the Great Depression (1929 – 1933), when the income level of the world's economies did not significantly change even though monetary authorities expanded the money supply, sparked Keynesian doubt about the potency of monetary policy. Events during and after World War II, when fiscal policy appeared more effective than monetary policy, further deepened this doubt. Extremist Keynesians argued: “money does not matter” in stimulating the growth of the economy. The monetarist school, led by Milton Friedman, which became popular in the sixties, represented the other side of the debate. To monetarists, monetary policy is effective in stimulating economic growth, thus: “money matters”. The controversy between Keynesians and monetarists remains unresolved (Mohr & Fourie 1998:581).

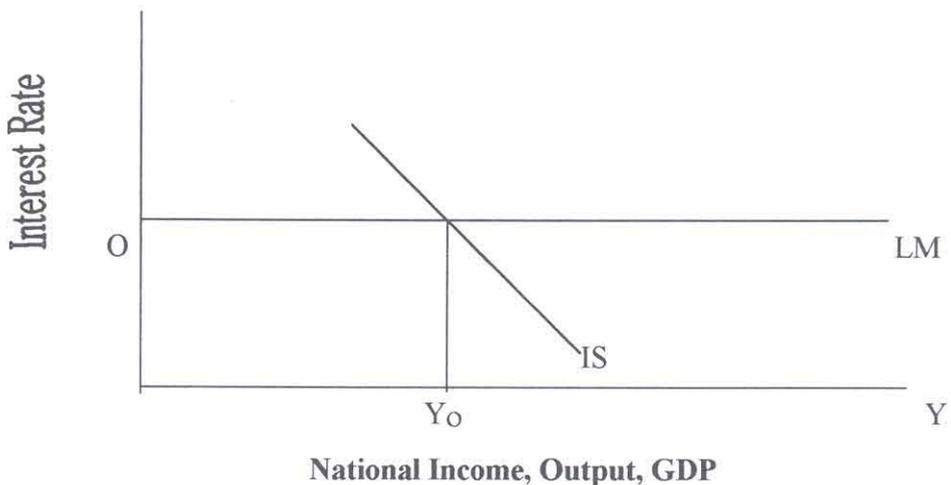
The pivotal debate amongst Keynesians and monetarists is the monetary transmission mechanism. Keynesians regard the link between the monetary sector and the real sector of the economy as very tenuous. However, an indirect link is suggested, with the interest rate as the crucial element. This crucial link connecting changes in money supply and economic activity via the interest rate is considered to be a two-stage process. In the first stage, an increase in the money supply (M^s) above the demand for money (M^d) causes an excess supply of money ($M^s > M^d$), at the prevailing interest rate and the level of income. To reduce this excess, money-holders to buying other financial such as bonds. The demand for these assets thus increases, and they command higher prices. Given the inverse relationship between the prices of financial instruments like bonds and their yield, this portfolio disequilibrium caused by an excess supply of money, leads to a drop in the interest rate (i/r). In the second stage, a drop in the interest rate causes an increase in aggregate demand resulting in an increase in investment (I).

Consequently, the increase in investment leads to an increase in national income or Gross Domestic Product (Froyen 1995:120). This can be represented as follows:

$$M^s \rightarrow (M^s > M^d) \rightarrow \downarrow i/r \rightarrow \uparrow I \rightarrow \uparrow \text{GDP} \quad (1)$$

Thus, according to the Keynesians, the transmission mechanism only operates when an increase in money supply causes a portfolio imbalance resulting in a drop in the interest rate (i/r), which in turn effects an increase in aggregate demand. By implication, if the portfolio imbalance caused by an increase in money supply does not cause significant changes in interest rates, the transmission mechanism becomes inoperative. This situation is the so-called Keynesian liquidity trap, in which the money market equilibrium condition is represented by a horizontal LM curve. This liquidity trap is said to occur when money supply is interest-inelastic and people are indifferent between holding money or financial instruments, like bonds, when interest rates, thus rendering monetary policy ineffective in stimulating the economy. Graphically, Figure 1.1 represents the liquidity trap as follows:

FIGURE 1: THE LIQUIDITY TRAP:



SOURCE: Dornbusch, Fischer, Mohr & Rogers 1996: 165.

where IS = real sector equilibrium. The only increase in economic growth, i.e. national income, will occur through movements in IS via fiscal policy (Dornbursch, Fisher, Mohr, & Rogers 1996:165). On the contrary, monetarists consider the monetary transmission

mechanism to be direct. They take the Irvin Fisher's equation of exchange, stated as follows:

$$MV \equiv PQ, \tag{2}$$

where

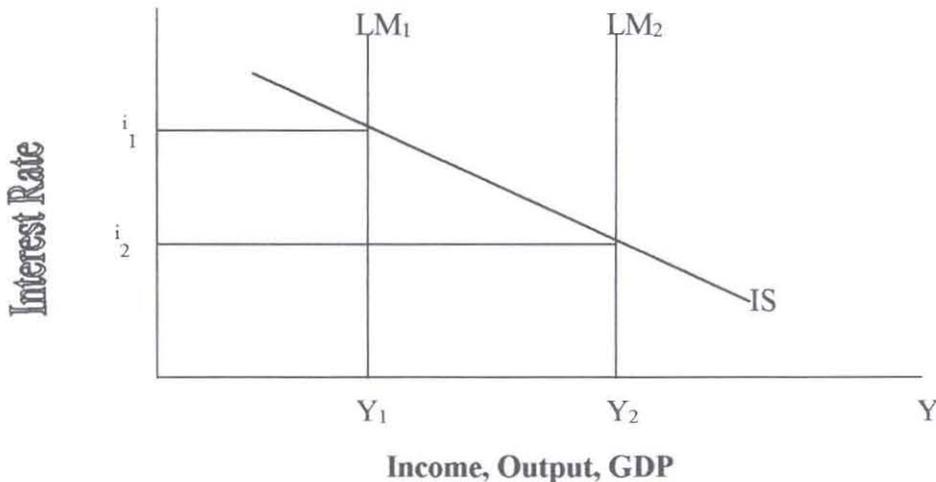
M	=	the quantity of money
V	=	the velocity of money
P	=	the average (or general) price level
Q	=	the real value or physical quantity of goods and services produced,

and convert it into the quantity theory of money. In terms of this theory, velocity of money in circulation (V) is assumed to be constant or stable, transforming the equation of exchange into:

$$MV = \overline{PQ} \tag{3}$$

If V is constant, then changes in money, M, result in an equi-proportional change in total production or output or income, PQ. This gives a direct monetary transmission mechanism, with changes in money supply directly changing the economy. As opposed to the Keynesian liquidity trap, monetarists consider the LM curve to be vertical rather than horizontal. This is the classical case is graphically represented by Figure 2 as follows:

FIGURE 2: THE CLASSICAL CASE



SOURCE: Dornbusch, Fischer, Mohr & Rogers 1996: 167

According to the classical case, demand for money depends solely on the level of income

and not on the interest rate. Thus, changes in national income are said to be better brought about by shifts in the LM curve rather than the IS curve. Consequently, monetarists consider maximum effect on the level of national income or economic growth to take place via monetary policy (Mohr & Rogers 1996:165).

The economic problem addressed in this study flows directly from the Keynesian/Monetarist debate outlined above. Whereas Keynesians consider the monetary transmission mechanism to be indirect, while monetarists regard it to be direct, the emphasis is somewhat shifted in the case of the problem under examination. The focus in this study is on whether or not monetary policy via the transmission mechanism can stimulate the economic growth of a small and open economy. Just as the Keynesian revolution came about as a result of the ineffectiveness of monetary policy during the Great Depression, the failure of the market economy to address the socio-economic problems in Latin America sparked an economic school of thought called structuralism. The structuralist theory, also known as the Latin American School of Development, developed as an alternative to what was considered the failure of orthodox economics, referred to as neo-liberalism by structuralists. The Latin American countries, which were undergoing socio-political transformation, made little economic progress. These countries began to question the dependence of their developing economies on those of large developed western economies, which are said to benefit at the expense of the small developing countries with which they trade. The structuralist theory is based on the belief that the problems of small economies trading with large developed economies are structural rather than economic. Accordingly, markets are distrusted and disfavoured by structuralists, who instead advocate government intervention.

The champion of the Latin American structuralist school is Raul Prebisch from Argentina, who was the Executive Secretary of the Economic Commission for Latin America (ECLA), a United Nations agency founded in 1947 and located in Chile. The major purpose of ECLA was economic development, with social problems like poverty receiving close attention. Emerging liberation sentiments contended that large and developed western countries impoverished those small and developing countries with which they traded. Domestic monetary policy is thus said to be ineffective, because the economic growth problem faced is not monetary but structural (Bruce 1980:33).

Structuralists argue that because domestic monetary authorities in an open and small economy cannot control money supply, they cannot control or stabilise the interest rate, through which the real sector is influenced. For instance, intended expansionary policy to reduce interest rates will be undermined by outflows of foreign capital as interest rates drop, resulting in a contraction of money supply. On the contrary, contractionary policy to increase interest rates is said to attract inflows of foreign assets, thereby increasing money supply and neutralising or reversing the intended contraction of money supply (Pinto & Knakal 1973:22).

Furthermore, Structuralists do not consider inflation to be primarily a monetary phenomenon controllable by monetary authorities. Instead, inflation is said to be inherited from the large developed western countries with which small and open countries trade, with no impact on economic growth. Accordingly, changes in the money supply have no impact on portfolio balances, with no influence on interest rates. Consequently, domestic investment is said to depend neither on the interest rate, nor on monetary policy, but on the economic growth of those developed economies with which international trade is conducted. It is also argued that exports are not a monetary phenomenon, and have nothing to do with economic growth via foreign exchange. Because the economic growth problem of small and open economies, such as that of South Africa, is structural and not monetary, monetary policy is said to be ineffective in stimulating economic growth (Rodriguez 1977:3).

Parallel with the pursuit of economic growth by structuralists, are social reform, income redistribution and political reform. It is argued that industrial revolution has rewarded western countries and relegated developing countries to be producers of raw materials. As such, inward-looking policies with import substitution are advocated, as a means of circumventing the shortage of foreign exchange and unfair terms-of-trade. This is contrary to orthodox theory which calls for austere monetary policies and outward-looking economies, supported by the International Monetary Fund and the World Bank, who are blamed for this advocacy.

As opposed to structuralists, neo-liberalists consider monetary policy to be effective in stimulating the economic growth of a small and open economy, such as that of the Republic of South Africa. Neo-liberalists argue that monetary authorities can control the domestic money supply of a small and open economy thereby stabilising the interest rate. The basis of this argument is the interest elasticity of short-term capital movements. When restrictive monetary policy is pursued and domestic interest rates rise, the impact on the inflow of foreign assets is said to be smaller than that of the reduction of the money supply. Similarly, when expansionary monetary policy is implemented, the impact on the drop of domestic interest rates is said to necessitate an outflow of foreign assets lesser than that of the growth in money supply. Consequently, because of the low interest-elasticity of short-term capital movement, the monetary authorities are said to be able to control or change money supply in a small and open economy as desired. Accordingly, the monetary transmission mechanism is said to operative. Also, inflation and exports are said to be mainly monetary phenomena, influenced by changes in money supply, that is, monetary policy, thereby impacting on the economic growth of a small and open economy. The foregoing structural considerations.

1.2 STATEMENT OF THE PROBLEM: THE CONFLICT BETWEEN STRUCTURALIST AND NEO-LIBERAL/ORTHODOX THEORIES

According to structuralists, monetary policy is ineffective in stimulating economic growth in small and open economies. *Small economies* are those in which neither the supply of exports nor the demand for imports has a noticeable impact on the world prices of these commodities and services. Economies are *open* in that trade or capital flows across their borders in sufficient quantity to influence the domestic economy, particularly prices and money supply (Gills, Perkins, Roemer & Snodgrass 1992:580). The monetary transmission-mechanism, through which changes in money supply lead to changes in economic growth, via changes in domestic interest rates, foreign exchange rate and aggregate demand, is said to be non-operative. Expansionary monetary policies to decrease money supply in order to decrease domestic interest rates, or contractionary policies to reduce money supply in order to increase domestic interest rates, are said to achieve, instead, the opposite of the desired effects. In other words, i.e. there is no

significant relationship between current money supply levels and those of the past.

Orthodox or neo-liberal theory contends that monetary policy is effective in stimulating the economic growth of a small and open economy. Accordingly, changes in money supply are said to disrupt portfolio balances, leading to changes in domestic interest rates and the foreign exchange rate which in turn cause changes in aggregate demand, thus impacting on economic growth. The monetary transmission mechanism is thus said to be operative.

The problem remains that while there is extensive literature on structuralist and neo-liberal/orthodox theories, the debate as to whether monetary policy is effective or not in stimulating economic growth in a small and open economy, via the transmission mechanism, is still ongoing, fervent and unresolved.

1.3 PURPOSE OF THE STUDY

The purpose of this study is to undertake a comparative analysis of two contending economic views, that is structuralist and neo-liberal theories and to apply it to the South African economy. According to the structuralist view, monetary policy can do little to promote growth because of the external factors constraint. Deflationary policies, via changes in the money supply, are said to accentuate the downswing in income, resulting from a fall in exports. This is held to be equivalent to accepting economic depression and a period of slow growth. Structuralists, further postulate that offsetting the deficit in external demand is likely to result in further imbalance in the foreign sector, since imports accelerate with the pace of domestic demand. Consequently, an inward-looking policy of import-substitution is considered an effective alternative to outward-looking export-promoting policy, for harnessing the external sector in the long term and insulating the domestic economy against foreign shocks in the short term.

Allied to the structuralist view is the advocacy of industrialisation policies. The goal here is to reduce dependence on the agricultural exports of developing countries, which face inelastic foreign demand. So how should the direct effect of fluctuations in agricultural output due to adverse weather conditions be treated? Once again, monetary policy

actions are said to be impotent in overcoming the agricultural cycle and the deteriorating terms of trade for agricultural products. Import substitution policies are again advocated. Underlying the structuralist view are similar twin-theories, the "trade engine" theory and the "two-gap" theory. According to the former theory, by generating the foreign exchange required for imports of capital goods by developing countries, is considered the only way for developing countries to break out of the "vicious circle of poverty" in which they are trapped by the insufficiency of domestic savings.

The "two-gap" theory modulates the "trade engine" theory, asserting that domestic savings could be sufficient, but if they cannot be converted into foreign exchange required for important capital goods, they are of no avail. It is thus argued that the inflow of foreign savings must simultaneously fill two gaps, that is, the gap between the desired level of investment and the attainable level of domestic savings, and that between the required level of imports and the exogenously dictated level of exports. Foreign savings would, for them to stimulate economic growth. The latter gap, called the "foreign exchange gap" is said usually to be the larger of the two gaps, thus imposing a more binding constraint on the economic growth of developing countries. In short, the "two gap" theory stresses the inflow of foreign savings, while the "trade engine" theory emphasises the promotion of exports. In terms of the "two gap" theory, exports are exogenously determined. "Trade engine" theory maintains that foreign capital flows are a given, while exports are externally determined.

The contending neo-liberal view regards financial development as almost a prerequisite for growth. It is argued that the misuse of factors of production and inefficient allocation of resources, are a result of the fragmentary nature of markets, especially capital and money markets, in developing countries. The prescriptions for growth, according to this school of thought are:

- (1) to design a non-inflationary monetary policy
- (2) to encourage flexibility of interest rates to respond to market forces

Both prescriptions pivot around a policy of high real interest rates, with simultaneous

execution of financial stabilisation and liberalisation of portfolio and interest rate regulations, in both the short run and the long run. This differs from orthodox or monetarist doctrine on stabilisation policy, which has been called a policy of “shock treatment”. The monetarist doctrine only takes into account the necessary restriction of money supply, which frequently results in a severe credit crunch during the initial stages, with adverse social and political consequences. However, with financial reform, authorities are said to have no fears in attempting to reduce the inflation rate, otherwise considered to impact adversely upon investment and production. Higher interest rates tend to stimulate total saving and increase the degree of financialisation, acting as a conduit for investment. With domestic financial reform under way, it is asserted that governments would undertake sensible reforms without jeopardising political and social goals.

This study will conduct an empirical comparison of the two views, to evaluate both the structuralist and the neo-liberal theories on the effectiveness of monetary policy on the economic growth of a small and open economy, in this case South Africa. Since in South Africa, the goal of monetary policy has been to protect the value of the Rand and to control inflation by changing the levels of money supply (M3), the first aim of this study, is to determine whether or not monetary authorities can control changes in M3 (The recent shift to inflation targeting has of course changed and reduced the emphasis on money supply). Related to this aim is the concurrent determination of whether or not the level of money supply in the current period, $M3_t$, is significantly determined by the level of the previous period, $M3_{t-1}$. Because curbing inflation, CPI, is of primary concern to the monetary authorities in South Africa, while Structuralists argue that it is imported and cannot be controlled by changes in money supply, the other aim of this study is to determine whether or not CPI is dependent on changes in M3. Lastly, the overarching aim is to determine whether or not both M3 and CPI determine economic growth (GDP). Here the distinction between nominal and real GDP is, of course, very important.

The empirical results of this study will make a contribution towards resolving the ongoing debate between structuralists and neo-liberal economists, by revealing some new empirical information that will either confirm or disprove the economic theories underlying their arguments. The findings of the study will have significant implications for the monetary

authorities in the small and open economy of South Africa, especially if it can be found that these authorities cannot control changes in M3, and that economic growth is related to M3 and CPI. The significance and importance are derived from the argument that domestic problems faced by developing countries are said to be complicated by external factors, which further inhibit and constrain their efforts at economic development.

Rising oil prices caused steep declines in the prices of other primary commodities of developing countries, in turn adversely affecting their terms of trade and pushing real interest rates extremely high. Consequently, those countries that continued to incur foreign debt faced serious problems in servicing such debt. These countries may have continued the borrowing spree, because the jump in real interest rates was not anticipated, with a lagged effect. Commercial banks became reluctant to advance voluntary loans, putting added pressure on many developing countries. This is the balance of payments constraint faced by the monetary authorities of a small and open economy.

1.4 THE SCOPE OF THE STUDY

The primary focus of this study has to determine how monetary policy can contribute to stimulating sustained economic growth in South Africa. Lessons for South Africa will hopefully find application in most developing and industrialising countries. The motivation for the study has the remarkable growth rate achieved by a number of developing countries such as Singapore, Taiwan and Malaysia, while South Africa is lagging behind. If these countries and others can manage to grow, while the global economy is slowing down, this suggests a possibility for others to grow as well.

In order to establish the tenability, or lack thereof, of the postulated hypotheses and to gain an understanding of the underlying problems, a study of theories of monetary policy and economic growth, that is, transmission-mechanisms, was undertaken, as well as a brief study of the strategic management of technology and human capital, privatisation of public assets, global competition and change management. This was followed by an empirical analysis, using an econometric model for the South African economy. The study was concluded with recommendations for growth through

monetary policy.

In terms of scope, this study was limited to the evaluation of the effectiveness of monetary policy, or lack thereof, in stimulating economic growth, without entering into an analysis of the underlying reason. The period covered by this study covers is from 1960 to 1997, that is, monetary policy before the election of 1994, the bank rate period, and the post-1994 elections up to 1997 - the Stals era. While the period from 1998 to 2001, the repo era, falls outside the scope of this study, it will be covered in evaluating the controllability of money supply, relative to money supply targeting.

1.5 THE OBJECTIVE OF THE STUDY

The primary objective of this study was to empirically evaluate the impact of monetary policy of a small and open economy, that of South Africa in this case, in stimulating economic growth using monetary targets or guidelines. The opposing structuralist and orthodox or neo-liberal economic theories were used a framework within which the evaluation was undertaken. According to the structuralists, monetary authorities cannot control money supply changes and economic growth (GDP) is said to have no significant relationship to money supply (M3) and domestic inflation (CPI), which is said to be imported. Instead, the GDP of such a small and open economy is said to be determined by those of large countries with which international trade is conducted. Orthodox or neo-liberal economists take opposing positions to these structuralist arguments. The obtained results of the study will contribute towards the assessment of the effectiveness of monetary policy in South Africa, which is criticised for the almost exclusive focus on protecting the value of the Rand, the domestic currency, and on inflation, via changes in money supply. This monetary policy is said to be too restrictive, responsible for the relative high domestic interest rates, which discourage investment and exacerbate the already high level of unemployment.

In addition, the results of the empirical analysis and evaluation will cast further light on and contribute towards a resolution of this on-going debate between the structuralist and

neo-liberal/orthodox economic theories. The obtained results will in turn suggest policy implications of the official macroeconomic policy of the Republic of South Africa, that is, Growth, Employment and Redistribution (GEAR).

1.6 THE AIMS OF THE STUDY

- (1) To examine the extent to which monetary authorities can *control* changes in money supply
- (2) To determine whether or not money supply in the current period is significantly related to that of the previous period
- (3) To establish whether GDP is determined by M3 or CPI, and if so, whether that relationship is predicated upon *controllability* of money supply changes

1.7 UNDERLYING PROBLEMS AND QUESTIONS

In order to achieve the above objectives a number of problems and questions have to be addressed. The problem areas includes, *inter alia*, the following:

- (1) Is economic growth influenced by changes in money supply?
- (2) Can employment be created without sound monetary policy?
- (3) Can monetary policy stimulate growth and thereby address socio-economic problems?
- (4) Is the economic growth strategy of South Africa, Growth Employment and Redistribution (GEAR), influenced by monetary policy?

- (5) Do labour movement wage demands influence growth?
- (6) Is inflation caused by changes in money supply?
- (7) Can monetary policy determine current level money stock, by operation on the previous period's stock?

Solutions to the above problems will also answer the following questions:

- (1) How do different economic schools of thought postulate monetary policy?
- (2) What the link is between economic growth and monetary policy?
- (3) Does inflation affect growth?
- (4) Is current money supply related to that of the previous period?
- (5) Which are the socio-political and economic factors said to influence economic growth?
- (6) Can monetary policy protect the value of the Rand via controllability of money supply, thereby curbing inflation?
- (7) Do money supply and inflation significantly relate to economic growth?
- (8) What is the impact of exchange rate changes on money supply?
- (9) What measures are taken to protect the value of the Rand and the exchange rate?

1.8 THE HYPOTHESES OF THE STUDY

Using the debate between structuralist and orthodox or neo-liberal economists as a framework, the opposite of the structuralist and orthodox core arguments are used as the null hypotheses to test their validity. If these arguments cannot be rejected, then they must be accepted. These arguments are:

- (1) Null Hypothesis for Structuralist Argument -- The monetary authorities, the central bank (SARB in South Africa) *can* control changes in the money supply, M3;

NB: The alternative hypothesis: The monetary authorities in South Africa *cannot* control changes in money supply, M3. Thus, if the null hypothesis is rejected, then the alternative hypothesis must be “accepted”, confirming the structuralist argument. The opposite is the case when the null hypothesis, which is one of the orthodox economists core arguments, cannot be rejected, thereby validating the orthodox argument.

- (2) Null Hypothesis for The Structuralist Argument -- *Previous* period money supply, $M3_{t-1}$, *does* determine that of the current period, $M3_t$;

NB: Again, the alternative hypothesis, is a core orthodox argument and the argument in (i) applies *mutatis mutandis*.

- (3) Null Hypothesis for Structuralist Argument -- Money supply, M3, and domestic inflation, CPI, are *significantly related to* economic growth, GDP.

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1.9 RESEARCH METHODOLOGY

The ordinary least squares (OLS) regression technique was used to test the tenability or correctness of the two contending economic, namely structuralist theory and neo-liberal/orthodox theory, on the role of monetary policy in stimulating economic growth in a small and open economy. A single-equation model was used, to which commonly used measures, namely the coefficient of determination, R^2 , the adjusted coefficients of determination, \bar{R}^2 (called R-Bar-Squared), and the correlation coefficient, r , were applied to determine how well the estimated equations fitted the actual data. OLS was used because it is commonly used and not because it is the only technique. The main reason for OLS's popularity is the useful properties of the estimates it generates, which are mean zero and constant variance. To fulfil the assumption of normally distributed error terms, the time series used have to be stationary, with joint and conditional distributions being time-invariant. This will produce error terms, which satisfy the assumption, thereby allowing the use of t-test and F-test to test the hypotheses propounded.

However, most time series are not stationary. Consequently, performing ordinary regression on non-stationary time series will “..... often lead to a problem of spurious regression, whereby the results obtained suggest that there are statistically significant relationships between variables in the regression model when in fact all that is obtained is evidence of contemporaneous correlation rather than meaningful caused relations” (Harris 1995:14). Accordingly, to avoid spurious correlation from the regression analysis, the co-integration of non-stationary time series was tested. The error correction model (ECM) approach was not followed, because the purpose of this study was to establish the *presence* or *absence* of a significant relationship between economic variables. Short-run models or ECMs are important from a forecasting perspective, which has not been part of this study (Harris 1995:23). “The economic interpretation of co-integration is that if two (or more) series are linked to form an equilibrium relationship spanning the long-run, then even though the series themselves may contain stochastic trends (i.e. be non-stationary) they will nevertheless move closely together over time and the difference between them will be stable (i.e. stationary). Thus the concept of co-integration mimics the existence of a long-run equilibrium to which an economic system converges over time.” (Harris 1995: 22).

1.10 THE OUTLINE OF THE STUDY

This study is divided into three parts. The first part, theoretical framework, has three chapters. Chapter one is the introduction, which briefly outlines the problem of whether or not monetary policy is effective in stimulating the economic growth of a small and open economy. This chapter also covers the purpose, scope and method of this study. Chapter two presents the literature survey on the different views postulated by both structuralist and neo-liberal/orthodox theories on the impact of monetary policy in stimulating economic growth in a small and open economy. In chapter three, a brief exposition of the literature on monetary policy theories is given.

Part two of the study deals with monetary policy and economic growth in South Africa. The three chapters that make up this part are on the socio-economic environment of the South African economy; monetary policy as applicable in South Africa; and the characteristic features and problems of the South African economy. In chapter four, the socio-economic characteristics of the South African economy reflect the context within which the economy operates. Chapter five gives an overview of the historical application of monetary policy in South Africa. Chapter six deals with the unique economic features of the South African economy, which help to shed light on the empirical analysis that is covered in part three.

The empirical evaluation of part three explains, in chapter seven, the techniques used to conduct the empirical study. Chapter eight covers the evaluation and the analysis. In this chapter the results of the empirical analysis of real data collected to test the hypothesis, that is the central arguments postulated by the structuralist and neo-liberal/orthodox theories, on the effectiveness of monetary policy in stimulating economic growth of a small and open economy (that of the Republic of South Africa) are presented. Chapter nine, the final chapter, presents the conclusion of the study.

1.11 SUMMARY

The purpose of the study has to determine what makes an economy grow, particularly in developing countries. While no two countries are exactly alike, the thesis of this

study is that an extrapolation of the results will have application in most developing countries. A further thesis of this study is that external constraints should not be used as an excuse for poor economic growth, and the implementation of bad policies. Thus, the structuralist argument that external constraints inhibit the growth of developing countries was tested, since all developing countries are searching for solutions to their economic problems.

The results on such tests should be compared with the contention of the neo-liberalists that the recipe for growth is low inflation and flexible interest rates, responsive to the market forces. In opposition to the structuralist view, the misuse of factors of production and inefficient allocation of resources, are held to be inhibitors of growth by neo-liberal or orthodox economists. Developing countries, structuralists claim, are characterised by fragmented markets, especially capital and money markets, which is not conducive to growth. This school differs from the neo-liberal school, which is based on the monetarist doctrine of stabilization policy, and which instead propagates simultaneous financial stabilisation and liberalisation of portfolio and interest rate regulations. High interest rates, it is held, tend to stimulate savings and increase financialisation, as a conduit for investment. Given the South African past, with vast and elaborately inefficient application of resources, for of political reasons, a careful understanding of the neo-liberal view is crucial, especially given the vicious attacks on its official macroeconomic policy.

Experience does not seem to support the structuralist view, since a number of developing countries, as stated above, have posted and are still posting impressive growth rates. This study has therefore proved instructive in that it has pointed to a successful policy for growth, in the light of both the structuralist and the neo-liberal views. The study does not pretend to comprehensively cover all the aspects of the debate between the structuralists and neo-liberal or orthodox economists. The empirical results of this study are instructive in suggesting effective monetary policy for the economic growth of developing countries in general, and South Africa in particular.