CHAPTER TWO

STRUCTURALIST VERSUS ORTHODOX ECONOMIC THEORIES OF GROWTH

2.1 INTRODUCTION

By giving an overview of the debate between the structuralist view and the orthodox view, or what structuralists call neo-liberal economics, this chapterformulates the framework within which this study was conducted, namely the effectiveness of monetary policy, in a small and open economy in stimulating economic growth. This chapter outlines the key premises of the orthodox theory and of the structuralist school of thought or the Latin American school of development, as it is sometimes called. The purpose of this brief overview of the different views adopted is to test them against the South African objective reality. Structuralist theory evolved as an attempt to solve the Latin American economic growth problems, because the orthodox economic approach had not been successful.

2.2 STRUCTURALIST VIEW OR LATIN AMERICAN SCHOOL OF DEVELOPMENT

The main, if not exclusive, emphasis of the structuralist view is that the economy of small and less-developed countries, considered to be the periphery, is said to be rendered inflexible and constrained by economic activity in the large developed countries, regarded as the core. Accordingly, the price-mechanism operating through the markets is distrusted and disfavoured, and government intervention is advocated instead. This structuralist view does not accord with the orthodox and neo-classical economic
domestic manufacturing will be promoted, it is argued. This should be accompanied by measures to promote domestic savings. Underpinning this view is the desire to break away from the dependence on foreign economic conditions, which is considered detrimental to the domestic economic growth of developing countries. State participation in spearheading the growth process, considered essential to allow developing countries to modernise and industrialise, is also a must for addressing inequities in economic arrangements. When a reformist government came to power in Latin America, the United States of America launched its New Deal with Latin America, known as the Alliance for Progress. The emphasis was on what came to be known as "redistribution with growth", which was criticised in a report written by Levisin and de Onis (1970). The United States had to launch the programme in an attempt to contain the spread of reform sentiment after Cuban-style revolution.

2.3 IMPORT SUBSTITUTION, INDUSTRIALISATION AND THE TERMS OF TRADE

The close economic interaction between the periphery and the core, according to the structuralists, is characterised by a gap created by the industrial revolution, which increased the productivity of the factors of production for western developed countries and not for less developed countries. The core is said to have internalised the new technology by developing an industrial capital-goods sector, while spreading the improved technology to all economic sectors. In contrast, less developed countries have largely imported the new technology, which was not spread to other sectors of the economy. Instead, the technology was confined to primary commodity production in the export sector. This led to a dualistic economy, with an export sector and a subsistence sector, with a continuous labour surplus. Consequent low wages are said to prevent gains from technology, since productivity increases in the export sector are largely transferred to the developed countries, owing to the deterioration in the terms of trade (Rodriquez 1977:3). The structuralist argument is that the industrial revolution has transformed the western countries into industrial economies, while relegating the small developing countries to the role of producers of primary commodities, either agricultural or mineral. For
developing countries to be successful in pursuing outward-looking policies that are export-led, export earnings have to grow quickly and at a rate in excess of national income, since demand for imported industrial products rises faster than income that is the income elasticity of demand for industrial commodities is greater than one. This is said to be improbable for small developing countries, which face increasingly severe foreign exchange constraints as a result of deterioration in the terms of trade.

This argument is contrary to conventional international trade theory, which holds that comparative advantage and economic specialisation lead to mutual benefits for both developed and developing countries. According to orthodox theory, the income gap between developed and developing countries should diminish as perfect mobility of labour, capital or products interact to equalise prices and distribute the benefits of technology more equally between trading countries. The observed widening of the income gap between developed and developing countries is said, in an article written by Prebisch (1950), to be due to a prevailing international division of production and trade, confining developing countries to production of commodities. Since in the long-term the prices of primary goods tend to decline relative to the prices of manufactured goods, developing countries have to increase the quantities of raw materials they produce to be able to continue importing the same quantity of industrial goods. The deterioration in the terms of trade at the expense of the developing countries, the so-called "borrowing countries", and in favour of the developed countries, the "investing countries", is said to be due to what is known in the literature as the "Prebisch-Singer Thesis" (Singer 1982, 181).

The reason given for this deterioration in the terms of trade, from the demand side, is that imports of primary products from developing countries by developed countries rise at a lower rate than national income. In contrast, imports of industrial commodities from developed countries by developing countries rise at a higher rate than national income. Numerous factors are cited to explain the low income-elasticity of demand of developed countries. These include the following: as income increases a smaller proportion is spent on food; technical progress develops new ways of producing commodities requiring fewer raw materials, etcetera. On the other hand, the developing countries' income-elasticity of demand for imports is high because they mainly import industrial products, the demand for which rises proportionately more than income. On the supply side, the argument is based on a differential effect on the economic cycle. Whereas during an economic upswing, the
producers of primary goods are in a favourable position, their suffering is greater when the economic cycle is on a downswing. During business-cycle upswings, wages grow substantially in developed countries, while they hardly rise in developing countries, because of the existing labour surplus. During downswings, the fall in wages in developed countries is limited by trade union pressure. In developing countries, the downswing leads to a substantial drop in prices and wages, since producers can obtain cheap labour (Prebisch 1950:7).

Structuralists focus on the analysis of the terms of the trade that underlies part of their challenge of conventional international trade, proposing an alternative industrialisation approach. Industrialisation is believed to increase productivity and income, thereby reducing unemployment and raising low wages. Sustained increases in productivity are further believed to be a means of staving off a further decline in the prices of commodities and raw materials. It is argued that a relevant comparison is not between industrial costs and import prices, but between the increase in income obtained by employing the factors of production in industry and their alternative employment in the export sector. Thus, a protectionist policy must be pursued to promote survival and growth of the vulnerable fragile and infant industries of developing countries. The argument is that this should continue until the levels of productivity between developed and developing countries are even, or the differential is compensated for by wage differentials. However, the lowering of wages as an alternative to protectionism is not preferred, since it is to reduce the price of export commodities, further reinforcing the deterioration in the terms of trade. Excessive protectionism is also not favoured, since it is considered an inhibitor of agricultural production and industrial efficiency. Instead, "balanced growth" is preferred (Prebisch 1969:2).

"Balanced growth" is defined as "a means of getting out of the rut, a means of stepping up the rate of growth when the external forces are adverse, with trade expansion and foreign capital sluggish or inoperative" (Nurkse 1953:13-15). "Balanced growth" is explained as a synchronised application of capital to a wide range of industries. On the other hand advocates of "unbalanced growth" maintain that it maximises induced decision-making and takes advantage of forward and backward linkages in the production process (Hirschmann, 1971:3). Industries with "backward linkages" make use of inputs from other
industries. For example, automobile manufacturing uses products of machinery and metal-processing plants, which in turn use large amount of steel. Thus the building of automobile manufacturing plants will create demand for machinery and steel. Although initial inputs will be imported, the eventual result is that local entrepreneurs will experience a ready market for domestically made machinery and steel, which in turn stimulate the setting up of plants. Therefore, backward linkages are said to stimulate production in the largest number of additional sectors. With "forward linkages" what industries produce become inputs into other industries. Instead of starting with automobiles, a steel mill is set up, because of an existing supply of steel. Entrepreneurs are stimulated to put up factories that use steel, such as automobile assembly plants. Linkages suggest pressures that lead to creation of new industries. The ultimate objective is a degree of balance in the development programme. Thus, planners of growth have a choice between maintaining balance throughout the development process, or first creating imbalances with the understanding that eventually the linkage pressure will create the balance (Gills, Perkins, Roemer & Snodgrass 1992:135-139).

The implication of the above structuralist argument for industrialisation are that as long as the capital goods sector does not exist, underdeveloped countries have no choice but to import technology, even if it is not appropriate. This would dampen the employment gains from industrialisation, since the penetration of technology would create a capital-intensive economy, which would increase unemployment. Furthermore, there is the problem of lack of income and savings to finance a high rate of capital accumulation to absorb the surplus labour because of the high capital intensity of technology and high population growth. Thus, the inflow of foreign capital is welcomed, to promote growth and create jobs. However, by the 1960s it was becoming evident that import-substitution policies were ineffective. It became accepted that such policies aggravated the economy's external vulnerability, rather than ease them, leading to increasing denationalisation of industrialisation.

2.4 THE STRUCTURALIST ANALYSIS OF INFLATION

The structuralist challenge to orthodox economics is mainly directed against
“monetarism”, and is partly responsible for the structuralist school’s view of inflation. The Structuralist position on inflation is a reaction to the stabilisation policies pursued by Latin American governments on the advice of the International Monetary Fund (IMF). These policies were considered harmful rather than merely austere and growth promoting (Sunkel 1969:6). Structuralists, unlike monetarists, place greater emphasis on social and political origins of economic events. They also advocate government innovation to promote economic development and remove market deficiencies. These deficiencies were seen as the major cause of high inflation in these countries. Thus, the main requirement of economic development for structuralists is structural reform, which is both socio-political and economic in nature. While structuralists advocate an inward-looking and self-reliant development strategy, monetarists propagate an outward-looking development driven by the international market.

The problem of inflation, for structuralists, resides within the development problem of underdeveloped countries, but monetarists are less inclined to share this view. Accordingly, structuralists underestimate the role of price stability as a requirement for development, which to monetarists is essential. The structuralist position represents inflation as a result of socio-political tension, sectoral imbalances and expectations generated by the process of development itself. To monetarists, the inflationary process is the major obstacle to economic growth (Noyola 1984:16). Furthermore, structuralists challenge monetarism for its alleged failure to locate the problem of inflation within the world economy. Structuralists ascribe one of the sources of the problem of inflation in developing countries to the transition from taking an “outward-looking” or “export-oriented” development approach to taking one which is “inward-looking”, and in the stagnation of the purchasing power of primary exports owing to the deterioration in the long-term terms. Above all, the insufficiency of growth in demand by developed countries for the primary products of developing countries - the foreign exchange constraint – is at the core of the structuralist challenge of monetarism. It is further argued that because new local industries are less efficient and productive, their production costs are higher than those of western developed countries, the suppliers of imported industrial goods, resulting in a rise in prices. Accordingly, the industrialisation process is seen as leading to inflationary consequences, because of the described structural vulnerability of developing countries. The differences or debate between structuralists and monetarists is
concerns inflation. Whereas monetarists regard inflation a monetary phenomenon, arising from excessive demand, namely "too much money chasing too few goods", to structuralists inflation has its origin in structural adjustments and rigidities in the economic system. In rejecting the notion that inflation is a monetary phenomenon, structuralists regard inflation as the outcome of real disequilibria, reflected as increases in the general level of prices (Noyola 1984:16). In other words, structuralists emphasise supply factors, while monetarists stress demand conditions.

Structuralists distinguish between "basic" or "structural" pressures and the "propagating mechanisms" of inflation. These two types of pressures can vary from country to country, with inflexibilities in the agricultural and foreign trade sectors behind the "basic" or "structural" pressures. The growing population is said to be putting pressure on agriculture, which cannot meet the growing demand. It is claimed that the resultant rise is failing to stimulate sufficient increase in agricultural output. This supply elasticity is explained in terms of the traditional and unequal land tenure structure. Most agricultural land is concentrated in the hands of a few estate owners (latifundistas) who are largely absentee renters and are unresponsive to market conditions. On the other hand, owners of small subsistence farms (minifundistas) do not have the resources to expand production and have weak links with the market. In the foreign trade sector, foreign exchange earnings are said to have not grown enough owing to the inelastic supply of this sector and the deterioration of commodity terms of trade. On the contrary, imports have become inflexible because they are consist largely of raw materials, spare parts and the capital goods required to support import substitution industrialisation and food imports. The resulting foreign exchange gap is said to lead to periodic devaluations, resulting in internal price hikes (Sunkel 1977:8).

Structuralists regard what monetarists consider to be the cause of inflation as to be solely "propagating mechanisms" and not the origins of inflation. The first "propagating mechanism" cited is fiscal deficit, arising from the shortfall in government revenues to cover government expenditure. This is said to be caused by dependence on foreign trade and the regressiveness and inefficiency of the tax-collection system. To finance the fiscal deficit, as social pressure mounts, the government is compelled to resort to borrowing, revaluation of money reserves, printing new money and raising taxes.
These actions create inflationary pressures leading directly (through price increases in public goods or services) or indirectly (through an increase in the money supply) to higher prices. Thus, they are considered means that propagate inflation (Pinto & Knakal 1973:22). The second "propagating mechanism" is said to relate to the readjustment of salaries and wages. As the cost of living increases, employees and workers demand higher wages and salaries, to maintain their purchasing power. Real incomes of employees and workers are said to be constantly eroded as the prices of foodstuffs, public goods and service, taxes, etcetera increase. The devaluation of the currency increases the prices of imported goods. The hardest-hit are the low-income groups. Where trade unionism is strong, pressure is put on employers to raise wages and salaries, which fuels inflation (Noyola 1984:43). The third “propagating mechanism” is said to result from the readjustment in prices owing to increases in costs. Faced with higher wage costs, higher input prices and higher taxes, entrepreneurs in turn pass the burden to their customers, by increasing the prices of their commodities (Prebisch 1971:6). Another type of inflationary pressure postulated by structuralists is the so-called "cumulative" pressure, induced by the inflationary process itself and intensifying it (Sunkel 1960:10).

Structuralist measures to combat inflation are necessarily long-term since they involve structural changes in production systems, economic infrastructure and distribution of income, because of their "structural" nature. Radical changes are said to be required to reform the agrarian structure and the taxation systems (Seers, 1962:14). For the causes of inflation arising from the foreign-exchange constraint, increasing and diversification of exports is seen as a solution (Sunkel 1960:10). Another proposal is to boost of industrial exports. However, structuralists also propose shorter-term cures for dealing with the "propagating mechanisms" of inflation. It has been suggested that a mixture of monetary and fiscal policies could curb demand factors of inflation.

The IMF-type and monetarist anti-inflationary policies for combating inflation are attacked for not dealing with the basic causes of inflation, instead causing economic stagnation, unemployment and income inequality. Structuralists maintain that both the demand and the supply factors must be tackled in order to fight inflation, accusing monetarists and the IMF for only dealing with the demand factors (Pinto 1973:22). Above all, structuralists hold that national consensus is required to achieve stability and
economic development. They claim that such national consensus, could only be achieved through the strong will of a political majority in a democratic society. It is believed that in the presence of favourable external or foreign conditions, the task would be simpler (Sunkel, 1977:8).

2.5 ORTHODOX ECONOMIC GROWTH THEORY

According to orthodox theory, changes in prices bring about substitution in production and consumption, at home and abroad. Trade is considered important in allocating national resources more efficiently, in terms of the costs and benefits of production and consumption at the margin. This contrasts with the structuralist view, which regards trade as being determined by the level of foreign demand for the primary-goods of developing countries (Riedel, 1987:19-22). The external economic element is also covered by the orthodox theory, although differently. It is argued that international trade is crucial for economic efficiency, brought about by division of labour and specialisation. International trade is said to extend a nation's markets, thereby allowing it to specialise in the production that gives comparative advantage. Growth, it is argued, results from the accumulation of capital and other productive resources. Thus, in as far as trade allows for greater national income, it is considered to expand accumulation and hence growth.

According to Adam Smith's theory, trade and growth hinge upon efficiency between trade and income, income and investment, and investment and growth, which still represents the current orthodox view. However, the concept of comparative advantage reflecting the gains of trade flowing from economies of scale is added to the efficiency gains. The classical economists propagated the labour theory of value, regarding international differences in relative prices as the result of differences in the productivity of labour. On the other hand, neo-classical economists explain international differences in relative prices in terms of both supply and demand. In addition, technological differences relative to labour productivity and variations in tastes and preferences by different countries are considered determinants of trade. The most important factor as part of production, which determines the nature of trade, is capital relative to labour. The neo-classical argument is postulated by the so-called Heckscher-Ohlin theory (Du Plessis, Smit & McCarthy 1998:47-63).
The differences in gains from trade are explained in terms of differences in relative factor endowments, efficiency and scale of production, developed markets and availability of capital. Developing countries, as opposed to developed countries, are said to have a relative abundance of labour and scarcity of capital, and limited domestic markets, which preclude the attainment of an efficient scale of production in the absence of international trade (Corden 1971:117-143). Thus, according to neo-classical theory, the connection between trade and growth is indirect. Economic efficiency is the key determinant of the capacity to save, invest and hence to grow for developing countries, and not the external economic forces in the developed countries as held by structuralists.

2.6 ORTHODOX INWARD-LOOKING DEVELOPMENT THEORY

The inward-looking approach of structuralists in which growth is stimulated and domestic production is substituted for imports of manufactures, is condoned by orthodox economists. However, it is condoned if the protection that is given to promote the import-substitutes is moderate and temporary, aimed at international competitiveness (Bruton 1970: 123-146). This is possibly condoned in recognition of the fact that it is a helpful path which is also taken by currently industrial countries, following England after the Industrial Revolution, the United States in protecting American manufactures from cheap British imports and Germany in the mid-nineteenth century. This path has also been traversed by Japan (Gills, Perkins, Roemer & Snodgrass 1992:440-443). The rationale for import-substitution is said to be simple, based on firstly identifying the domestic markets indicated by substantial imports over the years. After that is ensured local manufacturers can master the technology or foreign investors can transfer the required skills. Thereafter barriers are erected, either tariffs or quotas on imports. Behind this approach is the so-called “infant-industry” protection argument. It is maintained that once import substitution has taken place, a return to free trade can always improve welfare compared with both the initial position without protection and the position during the subsistence of protection. However, most governments are said to impose tariffs, which pass the cost on to domestic consumers. In such cases, even the temporary tariff or subsidy is not justifiable if the establishment of the new industry is at the expense of society, that is if the benefits of the establishing the new industry are less than the cost of protection (Johnson 1965: 3-34).
2.7 ORTHODOX THEORY OF EXPORT-LED GROWTH AND THE TERMS
OF TRADE

From the above arguments of structuralists, it appears that primary exports by developing
countries cannot promote or stimulate economic growth, because of the deterioration in
the terms of trade, as a result of these countries' dependence on the economic conditions
of developed countries. Neo-classical economists emphasise the market-oriented features
of outward-looking policies. According to the neo-classical view, it is the market and
prices which determine allocation, with the government only being permitted to interfere
when the market collapses (Gills, Perkins, Roemer & Snodgrass 1992: 109-117). The
structuralist view on deteriorating terms of trade is criticised for using the net barter terms
of trade, $T_n$, that say nothing about income or welfare. The income terms of trade, $T_i$,
should have been used in the Prebisch-Singer hypothesis, to give any credence to the
structuralist argument. If for example a country increases its copper exports and causes
world prices to fall, but less than proportionately to the increase in volume, that is where
demand elasticity is greater than 1, then the copper revenue will increase and, in the
absence of import price changes, the income terms of trade will rise. It is argued that
income terms of trade of developing countries rose almost 6 percent a year from 1954 to
1988, contrary to the structuralist argument (Gills, Perkins, Roemer & Snodgrass

On protective tariffs, orthodox economists prefer subsidies, whereby governments are
restrained from interfering with the free-market mechanisms. The reason advanced is that
subsidies are more precisely targeted than protective tariffs, and can be paid to offset
high production costs. On the contrary, protective tariffs are said to compensate for the
high cost only by raising the domestic price of output. As to exchange rate management, it
is argued that an outward-looking regime structures price incentives that encourage
investment in export industries. Building of investor confidence is emphasised. The real
exchange rate, RER, is given as:

\[
\text{RER} = \frac{R_n P_w}{P_d},
\]

where \(R_n\) = index of nominal or official exchange rate, determined by the central bank; \(P_w\) = index of world prices, that is weighted average price in foreign currency of a country's imports, and \(P_d\) is an index of domestic prices, that is either the wholesale or the consumer price index.

Appreciation of the real exchange rate through rapid inflation leads to a decrease in the profitability of firms producing tradable goods, that is exports or import-competing goods. Thus, it is the appreciation of the real exchange rate which concerns investors. The central bank has policy instruments for managing the real exchange rate, that is used either to change the nominal or the effective rate or to contract money supply, in order to contain domestic price inflation if the budget deficit is under control. However, the central bank is not always successful in lowering the rate of inflation, which necessitates periodical devaluation of the official exchange rate (Gills, Perkins, Roemer & Snodgrass, 1992: 462-467), or to allow foreign capital to flow out and domestic interest rates to rise in the case of flexible exchange rates.

2.8 ORTHODOX THEORY ON INFLATION, INTEREST RATES AND ECONOMIC GROWTH

Real interest rates are crucial to our understanding of the role of monetary policy for economic growth, via the monetary transmission mechanism (see pages 3 and 4). In South Africa, for instance, the bank rate and later, the repo rate, are used by the Reserve Bank to provide 'accommodation' to commercial banks. This rate is determined by the wishes of the Reserve Bank and not by the money market, and it is announced to the market. This 'announcement effect' is meant to signal the intentions of the Reserve Bank regarding the increase/decrease of interest rates or these days, inflation targets relative to increases/decreases in money supply (Fourie 2001: 43-44). This empirical relationship between the repo rate (bank rate) and the money supply is tested in chapter nine. The nominal interest rate on loans is the stated rate agreed upon by lender and borrower at the
time the loan is made. It is an obligation to pay or the right to receive interest at a fixed rate regardless of the rate of inflation. Nominal interest rates are those quoted by banks on loans and deposits. On the contrary, real interest rates are nominal interest rates adjusted for inflation.

Theoretically, in evaluating the impact of financial policy on economic growth, a distinction is drawn between the implications of real interest rates for consumption-saving decisions and for decisions about the uses of savings. Consumption-saving decisions involve interest-elasticity of savings and decisions concerning the uses of savings involve demand-elasticity of liquid assets. With both elasticities zero, monetary policy can only play a minimal role in the growth process. Where both elasticities are high and positive, financial policy can substantially stimulate growth. It held that real interest rate has a significant impact on the demand for liquid assets (Giovanni 1983: 601-608). However, the role of real interest rates in influencing the demand for liquid assets is established even for developing countries. It should be noted that, according to Structuralists, in most developing countries an informal credit market co-exists with modern financial institutions for structural reasons. These markets arise in many forms. The savings of relatively wealthy individuals, like business people, generally finances informal credit. However, as modern credit institutions develop, they draw customers away from the informal market (Giovanni 1983; 601-608). These formalised actions then become more dependent on the real interest rates.

With regard to sources of inflation, considered "propagating mechanisms" by structuralists, orthodox economists refer to two components of money supply in developing countries, namely the domestic, (DC) and international, (IR) components, giving money supply, M, as:

\[ M = DC + IR \]  

(5)

Developing countries with open economies are said to operate under fixed exchange rates, which means that monetary expansion is no longer under the complete control of domestic monetary authorities. Thus, countries with fixed exchange rates are said to be sharing essentially the same money supply, because the money of each can be converted
into that of the others at a fixed parity rate. The central bank of a developing country can thus control domestic assets, DC, but has only limited control over net foreign assets, IR. Thus, attempts to keep inflation at home below the world inflation rate through restrictive monetary policy will not succeed. If world inflation is caused by monetary expansion abroad, it will initially exceed the domestic level of inflation. This will increase exports, lower imports and move the balance of payments of developing countries towards surplus, resulting in a rise in foreign reserves. Thus, the international reserve component of the money stock will rise, which will hamper the effort to prevent the importation of world inflation.

However, this is said not to confirm the structuralist argument of the foreign constraint on domestic development, for such a situation cannot continue for long. It is the excessive expansion of money and credit which should be seen as the cause of domestic inflation, since such excess will spill over into the balance of payments via increased imports, which in turn will reduce foreign reserves and lead to exchange rate problems. Thus, inflation has its origins from the workings of the world economy and/or domestic policies. Various anti-inflationary monetary policy instruments are available, like open-market operations; reserve requirements; credit ceilings; interest rate regulation; and moral suasion. It is said that open-market operations instruments are not available for most developing countries (Gill, Perkins, Roemer & Snodgrass 1992: 968).

2.9 CONCLUSION

Structuralists hold the view that growth in developing countries is directly dependent on growth in developed countries. It is argued, that developing countries are constrained by external demand for their exports and access to foreign savings determined purely by external supply. In response, the economic growth policy of "self-reliance" is advocated, whereby the increase in domestic savings, import substitution to reduce the scarcity of foreign exchange and the promotion of industrialisation are propagated. To structuralists, trade is an "engine of growth" for developing countries, despite the rejection of orthodox free-market mechanism in determining the ruling price. This is contrary to orthodox theory, which assumes that changes in prices bring about substitution in production both
abroad and in domestic markets (Lewis 1980: 555-564).

As stated above, the main substantive argument between structuralists and orthodox economists or neo-liberals is based upon whether money supply in a small and open economy is exogenous, according to the monetarist (orthodox) view, or whether money supply is endogenous, according to the structuralist view. Based on the monetarist view that money supply is exogenous, monetarists therefore conclude that monetary authorities can control it. Structuralists take the opposite view, namely, that money supply is endogenous and uncontrollable by monetary authorities, because when they intend to pursue an expansionary (contractionary) policy, they instead end up with the opposite effects, that is contractionary (expansionary) results. Thus, current period money supply, M₃, is not related to the previous period money supply, M₃₋₁. Accordingly, monetary policy is said to be ineffective in stimulating growth. Exogenous and endogenous money supply is covered in greater detail in chapter four.

Whereas orthodox theory links trade and growth indirectly, structuralists maintain that the growth of developing countries is directly dependent on their ability to export and import. Trade is considered an autonomous "engine of growth" in developing countries. Developing countries, accordingly to the structuralist view, are said to have dualistic economies, a subsistence sector and a small export sector, with the subsistence sector caught in a "vicious circle of poverty" - poor because it cannot invest and unable to invest because it is poor. On the basis of the development model (Todaro 1982:86-101), growth is said by structuralists to be possible to the extent that the small export-sector is able to expand exports.

It is argued by the structuralists that the subsistence or traditional sector specialises in primary goods for which demand is inelastic. The deterioration of the terms of trade is advanced as a justification for taking an inward-looking approach to advocating growth policies for developing countries. Underlying the structuralist view is the emphasis on the dualistic economic nature of developing countries, which negates the role of prices and the indirect link between trade and growth. While external factors affect the domestic economic performance of developing countries, they cannot be solely blamed for poor domestic economic performance. The blame is shared by imprudent domestic policies,
misallocation of scarce resources and corruption. Thus, the structuralist view has merit in factoring socio-political factors impinging upon economic growth, but a balance should be struck, by putting equal emphasis on the monetary discipline.

Accordingly, the next chapter presents monetary policy theory, which is required for the analysis of the problem studied, namely the structuralist approach versus orthodox or neo-liberal theories on the role of monetary policy in stimulating the economic growth of a small and open economy, in this case the Republic of South Africa.