ANNALS OF ECONOMICS AND FINANCE **8-2**, 313–340 (2007)

Institutions, market constellations and growth: The case of South Africa

Arne Heise*

University of Hamburg Faculty of Economic and Social Sciences Department of Economics and Politics VMP 9, D-20146 Hamburg
E-mail: Arne.Heise@wiso.uni-hamburg.de

Post-apartheid South Africa is facing three major economic problems: (1) slack economic growth, (2) high and growing unemployment and (3) among the world's highest income inequality and poverty indices. South Africa is currently caught in a macro-economic straight-jacket of tight monetary, restrictive fiscal and a wage policy stance that raises NAIRU. The persistence of a sub-optimal 'market constellation' is created by an institutional setting of a non-accommodative Reserve Bank, a sectoral-regional and company level non-coordinated collective bargaining system, an austere 'sound finance regime' of public budgeting and the lack of any institution to co-ordinate macro-economic policy. To tailor a better fitting constellation, a social contract involving major reforms in macro-economic governance in South Africa is proposed.

Key Words: Monetary Policy; Fiscal policy; Wage policy; Macro-economic co-ordination.

JEL Classification Numbers: E12, E24, E6, O1, O23.

1. INTRODUCTION

One decade after South Africa's peaceful transition from apartheid to a modern democracy and its development from an economy that was heavily distorted towards racial economic interests and isolated from the world economy (see Cassim 2006; Klaasen 2002) into a steady growing, low inflation economy fully integrating into a rapidly globalising world, South African economic policy has made progress in microeconomic reforms, trade liberalisation and raised overall economic well-being

*This paper has been written while the author was a Visiting Professor at Stellenbosch University, South Africa. He has immensely profited from the invaluable help of Basil Moore and discussions with the staff of the Economics Department at Stellenbosch University. However, the usual caveats apply.

1529-7373/2007

(see e.g. Frankel/Smit/Sturzenegger 2006). Nevertheless, three basic problems remain: (1) Unemployment is far too high and shows an upward trend. Official rates of more than 20 percent and unofficial rates well above 30 percent are clearly unacceptable.[1] (2) Income inequality and poverty rates are persistently among the highest in the world and appear to have worsened over the last decade.[2] (3) Economic growth has recovered from the slump of the 1980s but remains lower than it was in previous decades, and much lower than in countries which have converged towards the OECD average.[3] The seriousness of these three problems has been stated clearly than by the OECD (2006: 461): "..., impatience regarding the unequal distribution of the benefits of growth appears to be building and could lead to political and social instability that would jeopardise these hard-won macroeconomic achievements."

These three problems are obviously intertwined[4]: Low growth rates directly reflect the disappointing employment performance. Countries that have lowered unemployment during the past decade (e.g. the USA and the UK) based their achievement on a growth recovery. High unemployment is the major driving forces for growing income inequality worldwide. Moreover, high income inequality and poverty are a severe constraint on growth and employment creation. In order to keep this paper concise, we will focus primarily on growth and employment C income inequality will be considered only marginally.

Many factors impact on economic growth—particularly when Total Factor Productivity (TFP) is considered in addition to the increased use of factors of production (capital and labour). South Africa's growth problem lies not only in its low growth rate, but also in its composition (see Cassim 2006: 76): Capital accumulation and employment have contributed very little, yet TFP-growth explains most. We are not primarily concerned with the micro-economic determinants of the latter, but with the macroeconomic potentials of the former. Let us start with a quick refresher of the traditional links between micro and macro-economic performance in relation to investment and employment.

[1] Official unemployment was 1.9 mill (= 16.7%) in 1995 and 4.2 mill (= 27.3) in 2002. Unofficial 'under- employment' was 3.8 mill (= 29.1%) in 1995 and 7.3 mill (= 39.5%) in 2002; see Bhorat (2006: 276). For an extensive elaboration on the issue of South African unemployment; see Kingdom/Knight (2004).

[2] Agüero/Carter/May (2006) report an increase in most income inequality indices based on market income and a slight decline if redistributive effects of government transfer are included.

[3] While, for instance, GDP growth in China was 7.5% on average during the 1990s and 5.3% in Ireland, it was a mere 2.0% in South Africa; see Cassim (2006: 76).

[4] For an overview of the links see e.g. Khan (2005).

2. MACRO VERSUS MICRO PERSPECTIVES—SHIFTING THE FOCUS

The traditional story explaining South Africa's economic problems is as follows: To create employment without inflationary pressure, extensive growth is needed. The backbone of economic growth is domestic and international savings which finance domestic and Foreign Direct Investment (FDI), assuming contested commodity markets, liberalised financial markets and deregulated labour markets. The latter is important to keep the natural rate of unemployment (NRU) and inflation low so long as the macro-economic policy environment is appropriate: monetary policy should be assigned to maintain price stability via inflation targeting ('sound money'), fiscal policy must remain sound by providing a 'near to balanced budget' ('sound finance'). National and international liberalised financial markets will raise interest rates to a level where (national and international) savings suffice to finance investment to create sufficient jobs to achieve full employment and reduce income inequality to the level consistent with productivity requirements.

The Growth, Employment and Redistribution (GEAR) strategy of the ANC government in 1995 was designed to follow exactly these footprints[5] — footprints that have been dubbed 'neo-liberal' in the mould of the infamous 'Washington Consensus' (see e.g. Epstein 2002, Ballard/Habib/Valodia 2006). The categorisation of GEAR is not important, but its achievements, as we have seen, have not lived up to its promises. Three separate reasons have been given for this under-achievement: (1) The 'more of the same' argument contends that commodity markets—particularly in sectors where former state monopolies and utilities had been privatised—are not sufficiently open and contested enough to produce the dynamics necessary to attract sufficient investment (see e.g. Cassim 2006, Naidoo 2006). The labour market has been unduly regulated by post-apartheid legislation with the result that the labour supply is inappropriate for a take off (see e.g. Bhorat 2006). (2) The 'inequality trap' argument maintains that income and wealth inequality have surpassed a threshold level, settling the economy in a low-growth equilibrium. Without a more equal distribution of financial, real and human capital and the income accruing from it, capital accumulation and growth can not rise because low-wealth and low-income households are unable to borrow and domestic demand is insufficient for a higher growth equilibrium (see e.g. Carter 2006, Murphy/Shleifer/Vishny 1989). (3) The macro-economic coat tailored by GEAR under the present institu-

[5]The ANC started in the 1994 elections with a Reconstruction and Development Programme (RDP) which was negotiated with the Confederation of South Africa's Trade Unions (COSATU) and which has been described as "... COSATU's vision of a socialist South Africa" (Venter 2003: 137). Once in office the ANC soon changed course from RDP to GEAR; see e.g. May/Carter/Padayachee (2004: 19).

tional framework is too tight for more rapid economic growth—forcing the economy into an ongoing 'suppressed expansion', as the European Union (particularly Germany) experienced on its way to monetary union in the 1990s (Heise 2002).

The micro-economic explanation of (1) relies on the NRU-, the 'savings fountain-' and the exogenous-money-hypothesis of mainstream economics. Explanation (2) can be complemented with macro-economic explanation (3) based on Post Keynesian theory. We will concentrate on this latter explanation keeping in mind Naidoo's (2006: 108) statement: "Macroeconomic stability is a necessary condition for faster economic growth; it is, however, not a sufficient condition for higher growth". No one would deny that the micro-economic, supply-side factors in (1) and (2) are important. But attention should be focused on the necessary conditions.[6]

Post Keynesian authors emphasize the importance of effective demand (constraints) in determining the overall volume of employment (and, hence, unemployment) independent of labour market failures.[7] Although Post Keynesianism is not yet a well defined and coherent body of economic theory (see e.g. Dunn 2000; Holt/Pressman 2001), some basic features stand out:

• Before we are able to study allocative processes on single markets (i.e. the optimal use of given resources in partial analysis), we must determine the extent to which resources will be used (i.e. the degree of utilisation in total analysis) in the aggregate. This is most important for the factor of production which may be taken as given (i.e. constant) in the short run and which is as much a social category as a factor of production: labour supply, i.e. the number of human beings willing (or forced) to sell their services to companies and employers and being mostly harmed if they do not succeed—**there is no such thing as a 'natural rate of (un)employment'**.

• The environment under which economic agents act is a **fundamentally uncertain** one. That is to say, that economic agents will never be able to dispose, collect nor process all the information that is necessary for optimal decisions featuring so prominently in neoclassical general equilib-

[6]There is some agreement that macro-economic stability (in the 'Washington Consensus' sense) was the primary aim of the first years of South Africa's transition after apartheid, and micro-economic reforms should be the new primary target; see e.g. Carter (2006), Naidoo (2006), Cassim (2006). We do not subscribe to this interpretation and re-emphasize the need for macro-economic stability (in a pro-growth interpretation). The point is to accept a Washington Consensus interpretation of macro-economic stability for an introductory period of transition (in order to gain confidence on international financial markets), and then to stress the need for a more growth and employment-oriented interpretation of macro-economic stability.

[7]Income distribution and fundamental uncertainty resulting in liquidity preference considerations play prominent parts in different Post Keynesian approaches; for a quick overview of Post Keynesian views on unemployment see King (2001)

rium (GE) models. Nevertheless, in order to decide (bounded) rationally, economic agents need rules and regulations, habits, codes of conduct and various institutions to reduce the number of possible alternatives.

• **Money** features prominently in Post Keynesian economics. Money is the institution in which not only spot transactions (barter) are denominated but also such transactions which are basic constituents to capitalistic economic behaviour: forward looking debt relations involving debtors and creditor. The decision to dispose with money (liquidity preference) for a certain period of time (into the uncertain future), i.e. to invest and create debtor-creditor-relationships, drives an economy. Therefore, the **endogenous supply of money** is always credit-driven.

• In neoclassical barter or real exchange models, all markets are equivalent and the Walrasian 'law of markets' accounts for an ever equilibrating process. This is not the case in a monetary production economy which is characterised by a **hierarchy of markets**: the motives and (trans)actions of agents (creditors and debtors) on credit markets logically proceed the (trans)actions on commodity and labour markets and, thereby, set budget constraints for all other market actors: in Keynes's terminology, it is the 'finance motive' providing the (liquidity preference) foundation of the investment and income generating production process (Davidson 1994: 86ff.). This reverses the savings-investment nexus (see Moore 2006).

• There is neither a single reference point towards which capitalist economies tend to move (no general equilibrium but multiple equilibria) nor a hydraulic way of governing an economy as 'old fashioned' standard Keynesianism seemed to believe in the 1960s and 1970s. Different sets of institutions, political and cultural factors and historical circumstances (such as international monetary systems and degrees of market saturation) determine **'market constellations'**[8] under which economic agents act and which show some persistence. The political actor (government) and other corporatist actors (such as social partners or Central Banks) are the agents of economic policy in a wider sense, and can in no way be regarded as 'exogenous' to market processes. They do not simply correct 'market failures' in a quasi-functional way but are rather market participants — important and powerful — faced with uncertain future developments and events and contingent reactions of other market participants. The contingency of economic governance is more obvious once the assumption of a unitary

[8]The term 'market constellation' sounds surely unfamiliar to most readers. It is intended to capture specific market outcomes which are determined by certain formal and informal institutions. An alternative term used for the combination of institutions and outcomes is 'regimes' — but as this termed as been appropriated by certain schools of though (the French 'Regulation' school and the American 'Social Structure of Accumulation' school), we would like to keep the somewhat cumbersome 'market constellation' term for distinction.

political actor is abandoned. If the key macroeconomic policy fields of monetary, fiscal and wage policies are controlled by independent actors, and an interdependence of these policy fields is assumed, the actors operate in a strategic environment where the policy outcome depends on the expectations and anticipations of each other, and the impact of particular policies depend on the expectations and anticipations of individual market actors.

The following analysis is built on Post Keynesian macro theory. A market participation theory of economic policy will be outlined in broad strokes and a cooperative approach to macroeconomic policy-making portrayed. This determines the way macroeconomic demand management is used to manipulate 'market outcomes' in a systematic but not hydraulic way. As a further step, we will inquire how far macroeconomic governance can explain the insufficient growth and employment experience of post-apartheid South Africa. Or to put it differently: what can be done to create more favourable 'market constellations'?

3. MARKET PARTICIPATION AND THE CREATION OF FAVOURABLE 'MARKET CONSTELLATIONS': SOME CONCEPTUAL IDEAS

Once the idea of a general equilibrium as the natural long-term position of any economy is replaced by a notion of multiple equilibria, unemployment becomes a systematic characteristic of decentralised market economies as opposed to merely being a 'market failure'. Therefore, economic policy towards establishing full employment is not solely a functional device of 'market creation' and 'market repair' but must be established by political will (normative target) and can only be pursued by participating in the market process. Therefore, the political actor is not a subject external to the market participants (objects) but a market participant (object) himself who is constrained by market forces just like any other market participant. Governmental (and other corporatist actors) interventions will have measurable impacts on quantities and prices. But as any other market participant, the political (or corporatist) actor must finally accept market outcomes, i.e. cannot ex ante discriminate between warranted quantity and unwarranted price effects. However, there are means to reduce the magnitude of contingency (or lack of sharpness in policy control) by introducing (codified) rules and regulations or developing or stimulating institutions that reduce the available number of options for market participants and, therefore, decrease the uncertainty about future actions. Obviously, there is a trade-off between transaction costs (due to the need to adapt to changing market situations) and uncertainty costs — so the optimal mix of 'laissez-faire' and 'regulation' is open to experience. Yet, uncertainty-reducing institutions and regulations are much easier to justify in a Post Keynesian framework

than in a neoclassical theory of 'market failure' (see e.g. Kregel 1980, Hodgson 1989). The goal is to create a 'market constellation' favourable to growth and employment.

Some of these uncertainty-reducing institutions — with particular respect to our purpose — are collective bargaining systems, institutional settings of Central Banks and institutional structures to coordinate different independent but interdependent political actors to establish an optimal policy mix. Collective bargaining systems can provide the necessary 'nominal anchor' in modern (fiat money) currency systems, the Central Bank design is critical in securing the scarcity of paper money. Both institutional set ups reduce otherwise precarious volatility of (nominal) wages and prices: It has become common sense that there is a strong correlation between the degree of independence of Central Banks and the inflation performance of an economy on the one hand and likewise a correlation between inflation performance and inflation volatility. There is less agreement about the influence of collective bargaining systems on wage settlements and inflation. An influential study by Calmfors and Driffill (1988) propose a 'hump-shaped' link while other evidence (e.g. Soskice 1990) suggest a negative correlation: the more decentralised the collective bargaining system is, the higher will be wage settlements and inflation rates.[9] Be it as it may, there is no doubt that collective bargaining institutions and the Central Banking design may impinge in a systematic way on the degree of uncertainty about inflation developments and the valuation of assets.

Recently the mutual causality (Wechselwirkung in a Kantian sense; see Hicks 1979: 18f.)) of collective bargaining systems and Central Banking designs has been studied in depth, and the 'conventional wisdom' about the (long term) neutrality of monetary policy and the 'free lunch' assumption of Central Bank independence has been shaken[10]. Moreover, it has been asked whether it is sensible to delegate half of demand management to an autonomous body such as the Central Bank (see Rankin 1998, Power/Rowe 1998) — creating a possible coordination problem between fiscal and monetary policies (see Nordhaus 1994). Both lines of discussion can be joined by realising that all actors involved — the political actor, the Central Bank and the social partners — pursue individual utility maximisation under the

[9]This relation becomes plausible if we assume strong trade unions at company level ('local pushfullness') and a signalling function of the wage settlements of 'key companies' (i.e. bigger, more visible companies).

[10]See e.g. Hall/Franzese (1998), Guzzo/Velasco (1999), Cukierman/Lippi (1999), Iversen (1999a). The 'free lunch' assumption has been particularly discussed by Grilli/Masciandaro/Tabellini (1991), Gärtner (1997), Posen (1998), Soskice/Iversen (2000).

constraint[11] of a Phillips curve trade-off[12], but may (and most certainly will) have different preferences with respect to inflation and unemployment. In a moment, we will see how this can evolve into a policy game which leaves not only the actors involved dissatisfied but also produces a sub-optimal result in terms of overall welfare. Therefore, if institutions that produce incentives for the actors involved — the political actor responsible for fiscal policy, the Central Bank responsible for monetary policy and the social partners responsible for wage policy — to cooperate may be able to create market constellations favourable for more rapid growth and employment.

3.1. The monetary-fiscal policy game

Since a three actor's game is too complex to be exposed, it will be split into two separate games in which the Central Bank is the connecting piece. This seems appropriate since it is the Central Bank's monetary policy which is the mutual focus of both wage policy and fiscal policy alike, but there is no direct interaction between the latter two. Let us start with the interaction of monetary and fiscal policy as portrayed in the so called Nordhaus-model (see Nordhaus 1994 or Balls/O'Donnell 2002: 101ff.): We assume that (1) the utility functions of both actors include the variables 'unemployment' and 'inflation', (2) both actors show different preferences with respect to unemployment and inflation (the Central Bank is more averse to inflation than the political actor), (3) there is a (short and long term) Phillips curve trade-off between unemployment and inflation, (4) both actors target a (different) volume of aggregate demand in order achieve the preferred combination of unemployment and inflation, and (5) the political actor additionally puts emphasis on the budgetary balance as it provides the means to offer public goods to the electorate (necessary to secure re-election). In fig. 1, the M and F curve portray the level of aggregate demand which the Central Bank (M) and the political actor (F) target respectively. They can do so by choosing a policy mix of monetary and fiscal policy here approximated by the instrument variables i (real interest rate) and S (budgetary balance): the same aggregate demand can be achieved through a more expansionary monetary policy and tighter fiscal policy (i.e. lower i and higher, or more positive, S) or, alternatively, through a more restrictive monetary policy in combination with a more expansionary fiscal policy (i.e. higher i and lower, or more negative, S).

[11] At least in the short run, there seems to be consensus about the existence of this trade-off among most economic schools. In the long run, the trade off is acknowledge by Post Keynesian theories but questioned by neo-classical theories. However, as the time horizon for political action can be assumed as being rather short term, this dispute need not be decided here.

[12] In case of the social partners, the original Phillips curve (linking nominal wages increases to unemployment) is important.

The difference between the M and F curve reflects the autonomous relevance that fiscal policy (budgetary balance S) has for the political actor. Point A and B represent the 'optimal' combinations of fiscal and monetary policy as preferred by the Central Bank and the political actor: as the Central Bank is more averse to inflation than the political actor, it favours point B at tighter monetary policy and the political actor favours point A at more expansionary monetary policy and higher budget deficits (as expression of the desire to have more room to manoeuvre). Obviously, both points A and B cannot be realised at the same time: either, there is some kind of coordination between fiscal and monetary policy and some point C on the contract curve will eventually be reached[13] or, in the case of conflict (or non-cooperation), we will end up at point D — which is a non-cooperative Nash equilibrium — or at point E which is a Stackelberg equilibrium[14]. Whether the cooperative point C will be preferred as compared to the non-cooperative points D and E depends on the preference structure of both actors: The more averse to inflation the Central Bank and averse to unemployment the political actor, the less likely it will be that the cooperative point C will be preferred (see Heise 2001: 62ff.).

3.2. The monetary-wage policy game

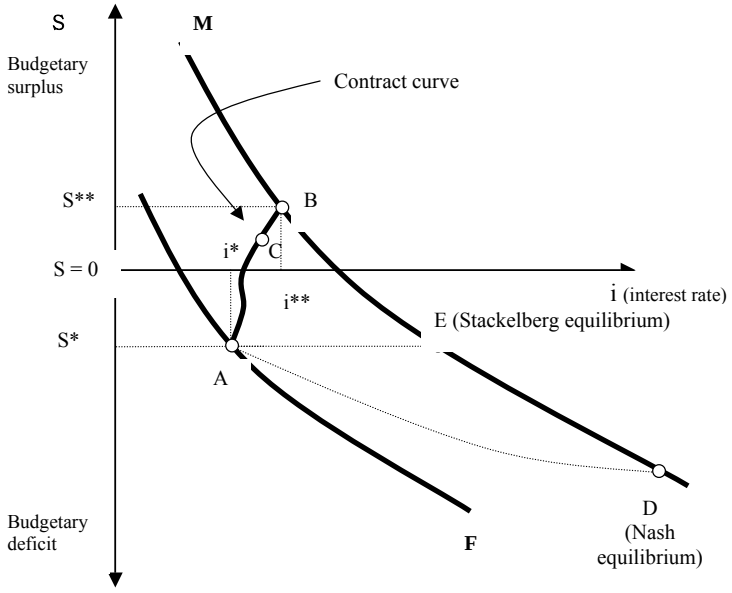
At this point, we are not concerned about (institutional) incentives necessary to increase the likelihood of cooperation (see Heise 2001: 73ff.) but will pose the question whether the underlying conflict can be mitigated by bringing the social partners into the picture. Indeed, this would be the case, if the social partners were able to prevent inflationary developments to accompany increasing employment — i.e. if they were able to suppress the Phillips curve logic. As the Phillips curve is based on the 'original Phillips curve' linking inversely nominal wage increases to falling unemployment, social partners may well have a stake in the game. From a large number of studies[15] we know that the potential to control the Phillips curve logic depends on the ability of the social partners to create external effects (i.e. nominal wage claims in excess of the distributional margin given by labour productivity growth and the targeted inflation rate) and the willingness to internalise such external effects: decentralised collective bargaining systems (acting at company level) are said neither to expose a willingness to internalise external effects nor to have the ability to create such external

[13] Where exactly on the contract curve such a cooperative point C will come to lie depends on bargaining position of both actors. This position is determined by the preference structure of the actors.

[14] A Stackelberg equilibrium can easily be imagined if the political actors accept the structural strength of the central bank to enforce its level of aggregate demand, although it maintains the enforcement of its preferred budgetary balance.

[15] See e.g. Franzese (2002); Hall (1994), Hall/Franzese (1998), Iversen (1999b), OECD (1997).

FIG. 1. Monetary and fiscal policy game



effects (Calmfors-Driffill case). Centralised collective bargaining systems[16], in which the social partners (and, most importantly the trade unions) act as 'encompassing organisations', do have the ability to create external effects but will also be willing to internalise them. They will do so once they have realised that any nominal wage increase will (ceteris paribus) be completely passed on to prices and leave the real wages unaltered. Intermediate collective bargaining systems (acting at regional or sectoral level), however, have the ability to create external effects, yet they are not willing to internalise them as the effect of the nominal wage increases on the overall price level will be a restricted one (for the restricted scope — regional or sectoral — of their bargaining power) and, hence, enables them to alter their (sectoral or regional) real wage rate[17]. This may also be the case with respect to decentralised collective bargaining systems if we allow for signalling effects of key companies and 'local pushfullness', i.e. strong and myopic trade unions at company level (Soskice case).

[16]Centralisation means that the collusion of heterogeneous interests into credible commitments is possible; i.e. decentralised but highly cooperative trade unions and employers' organisations may be de jure decentralised but act de facto as a centralised collective bargaining system in the above sense.

[17]Soskice (2000: 47) spells out the necessary, yet realistic assumptions: (1) industrial trade unions indeed only care about employment and wages of the labour force in their own sector, (2) they bargain independently.

FIG. 2. Monetary and wage policy game

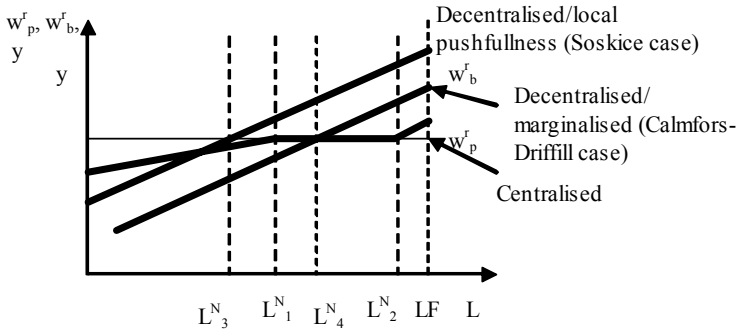


Fig. 2 depicts the different settings: w_b^r is the real wage rate which trade unions (as the crucial part of the social partners in this argument) are targeting[18] with respect to the level of employment. LF is the labour force which is, for the sake of simplicity, taken as given. w_p^r is the real wage rate which the employers are willing to accept (which is given by labour productivity growth and a mark-up accounting for imperfect competition on commodity markets). In the case of a centralised bargaining system, for a considerable margin trade unions are willing and able to suppress the 'Phillips curve logic' — from a level of employment L_1^N onwards, they will not ask for higher (targeted) real wages but increase the utility of the labour force (as their political aim) by increasing employment. Above employment level L_2^N, which can be interpreted as the point at which the number of unemployed equals the number of vacancies, real wages will start to increase either through higher collective claims or by way of wage drift. Below employment level L_1^N, pressure on trade unions will force them to accept lower (targeted) real wage increases than employers would be willing to pay at full employment levels.

3.3. Macro-economic policy games in different institutional embedding — the case for market constellations

Whether a fiscal and monetary policy mix will be able to establish employment level L_1^N or L_2^N depends on implicit or explicit coordination mechanisms: 1) if an institution — a concerted action, a social contract or macro-dialogue — empowers the actors involved to credibly commit themselves to pre-established policy rules, the Central Bank may be willing and forced to allow for a level of aggregate demand which reflects the prefer-

[18] 'Targeting real wages' means that trade unions bargain nominal wages under the expectation of price inflation. The assumption is that their expectations are met, i.e. no revision of plans is necessary.

ences of the political actor and the social partners - L_2^N in this case. 2) If the Central Bank pursues a monetary policy of 'testing the waters'[19] and the political actor and the social partners can bring themselves not to exploit the Central Bank's pragmatism, L_2^N may also be reached — this may be termed the 'Fed strategy' for it has allegedly been the policy stance of the US Federal Reserve Board during the 1990s (see Blinder/Yellen 2001: 35ff.; Bibow 2001). Almost the same scenario would be imaginable if the political actor was to take the more active (fiscal) policy stance, yet the Central Bank would not react in a restrictive manner but allow for aggregate demand to increase (i.e. any point on the contract curve in fig. 1). However, these options seem to be a very fragile and rather coincidental cooperation (see e.g. Horn 1999; Fritsche et al. 2005: 102f.) as the incentives for the actors involved not to defect (i.e. not to exploit) are not very strong — that at least is what game theory teaches us. 3) If cooperation cannot be established, the Central Bank will enforce its level of aggregate demand (at Nash- or Stackelberg equilibrium) preventing employment from rising above L_1^N — this may be termed the 'Bundesbank strategy' for it has been allegedly the policy stance of the German Bundesbank ever since it pursued an independent monetary policy (see Hein 2002a). 4) If the Central Bank were to accommodate whatever wage and fiscal policy stance[20], again L_2^N would be at reach, yet at a comparably high inflation rate (the exact amount of which depends on the inflation aversion of the social partners; see Guzzo/Velasco 1999, Hall/Franzese 2000).

As is summarized in tab.1, the market outcomes look quite different when we focus on decentralised, non-coordinated (company or industry level) collective bargaining systems: (1) If the Central Bank accommodates whatever wage claims and fiscal policy stance, the inflation rate will certainly be very high and possibly accelerating. As high inflation rates are typically associated with high inflation volatility, liquidity preference considerations of wealth owners will curtail investment spending, economic growth and employment — hence, employment will be below L_2^N, but probably above the level which a non-accommodating Central Bank under 'Bundesbank strategy' would enforce; for instance at level L_4^N. (2) A (explicitly) cooperative constellation including a non-accommodating Central Bank and non-coordinated social partners is hard to imagine as the number of actors (particularly on the side of the social partners) is too numerous for a strategic and credible commitment. (3) In case of a non-accommodating Central Bank, the result will be high unemployment (L_3^N) in combination

[19] 'Testing the waters' means that Central Banks risk expanding monetary policy as long as no inflation potential arises.

[20] In this case, the Central Bank either shows a low degree of independence or is led by a 'populist Central Banker' (as compared to the 'conservative Central Banker' of price stability orientation).

with low inflation whatever the Central Bank strategy is.[21] This is at least true as long as we assume an intermediate bargaining level (industry or region) or 'local pushfullness' at company level (i.e. the Soskice case). (4) Only under the condition of 'marginalised', decentralised social partners (i.e. the Calmfors-Driffill case) and a 'Fed strategy', employment may rise to levels between L_4^N and L_2^N — the exact position of the w_b^r curve (in fig. 2) depends on the extent of 'marginalisation'[22]. Nevertheless, this is likely to be an unstable constellation once disinflationary developments turn into a deflationary process due to the lack of a nominal anchor[23].

TABLE 1.

Unemployment and inflation in various market constellations — a broad institutional design board

		Monetary Policy			
		Accommodating	Non-Accommodating (Bundesbank strategy)	Non- Accommodating (Fed strategy and/ or active fiscal policy)	Non-Accommodating (Cooperative)
Wage Policy	Co-ordinated	UNR: low (L_2^N) INF: medium	UNR: medium (L_1^N) INF: low	UNR: low (L_2^N) INF: low	UNR: low (L_2^N) INF: low
	Non- Co-ordinated	UNR: medium (L_4^N) INF: high	SOSKICE case UNR: high (L_3^N) INF: medium -low Calmfors-Driffill case UNR: medium (L_4^N) INF: low - deflationary	SOSKICE case UNR: high (L_3^N) INF: Medium - low Calmfors-Driffill case UNR: medium - low (L_4^N - L_2^N) INF: low - deflationary	

Tab. 1 captures possible outcomes for employment and inflation under different market constellations which depend on collective bargaining systems, Central Banking designs and explicit or implicit mechanisms of coordination between the key macroeconomic policy fields. Assuming that the individual members of a society receive positive utility from low inflation and high employment (or, rather, low unemployment), it becomes clear that a non- accommodative monetary policy, either under the 'Fed

[21] This scenario can be interpreted as a Post Keynesian 'conflicting claims' version of the Non-Accelerating Inflation Rate of Unemployment (NAIRU); see e.g. Bhaduri (2000: 18ff.).

[22] 'Marginalisation' would be complete — and thus, the w_b^r curve would cut the w_p^r curve at point L_2^N — if the actors on the labour market were pure 'price takers'.

[23] It needs to be remembered that there may be an equilibrium real wage rate at $w_b^r = w_p^r$ but definitely no equilibrium nominal wage rate. Yet, the ghost of deflation can possibly be banned however, if demand-management will be used efficiently to control employment levels and/or downward barriers to nominal wage decline — such as effective minimum wages — are introduced.

strategy' or in cooperative orientation, coupled with a centralised collective bargaining system provides the best and preferred market constellations. The outcomes of tab. 1 also make it clear why we get a rather unambiguous picture with concern to a positive correlation between 'Central Bank independence' (non-accommodation) and 'inflation' on the one hand and why it is so difficult to establish a significant correlation between 'Central Bank independence' and 'disinflation cost' in terms of the sacrifice ratio on the other hand (see e.g. Alesina/Summers 1993), if different institutional settings are not being controlled for.

4. PUTTING POST-APARTHEID SOUTH AFRICA INTO PLACE

The questions to be answered now are: 'Does the market constellation approach produce sensible results for South Africa'? 'Where does South Africa fit into the picture'? In order to find answers, we must first paint a broad picture of South Africa's institutional setting in the field of monetary, fiscal and wage policies.

4.1. South Africa's Central Bank design

The above exposed conceptual framework has been tested on several highly developed countries (se e Heise 2006, Heine/Herr/Kaiser 2006) but not on emerging market economies (EME). Although differences may have to be taken into consideration, the general approach appears to be independent of the stage of development of an economy: the equilibrium growth path depends crucially on the institutional setting of the macro-economic governance structure.[24] South Africa's government granted the Reserve Bank of South Africa (SARB) full institutional and instrumental independence[25]. Yet the government has retained the right to set the target(s): the Reserve Bank is required to strive for price stability as measured by a range of 3% to 6% of CPIX (consumer price index excluding mortgage price costs). As is commonly the case, a second subordinated target is set by pursuing the goal of balanced economic development and growth, once price stability is not in jeopardy. Since 2000, the SARB conceptually followed an inflation targeting (IT) strategy which is particularly designed to address the monetary policy problems of transparency and credibility (see e.g. Aron/Muellbauer/Smit 2003: 5ff.). Ian Plenderleith (2003), then

[24] Interestingly, there is a huge literature on the effects of institutions on economic growth. However, none of theses studies cover institutions of the macro-economic governance structure but bureaucracies and their efficiencies, property rights systems and the like. For an overview see Aron (2000).

[25] See e.g. Swanepoel (2004: 736ff.). Moreover, the Reserve Bank of South Africa is a private institution, not a governmental or semi-public body as in most countries.

Deputy Governor of SARB, argued that it is even more critical and crucial for monetary policy in EME's (as compared to OECD countries) to convey the appropriate signals to economic agents so as to gain credibility in achieving price stability. To put it differently: it is difficult to gain trust, particularly for Central Banks in transitional economies, yet this trust is easily lost. Aron/Muellbauer (2006: 12, my italics) pinpoint the problem involved as follows: "The cost of expectations not being anchored to the target is that a more aggressive monetary policy may be required to gain credibility for the central bank and its price stabilising goal". Translated into the categories of our broad institutional design board, monetary policy in South Africa must not only be judged as 'non-accommodating', but an uncompromising 'Bundesbank strategy' can be assumed.[26]

4.2. South Africa's collective bargaining framework

Industrial relations and the collective bargaining system underwent considerable change in post-apartheid South Africa. South Africa has traditionally been a country with strong trade unions — in 2004 about 20% of the economically active population, but roughly 45% of the employees in the formal, non-agricultural sectors were Trade Union members[27]. Moreover, the incumbent ANC government can be expected to have enhanced the position of its former allies in opposition to Apartheid. With the enacting of the Labour Relations Act (LRA) in 1995, collective bargaining centralisation and a consensus-oriented employment system was promoted (see Nel 2002: 161). Collective and Statutory Councils replaced former Industrial Councils which served discrimination and oppression under Apartheid (see Madden 2006: 51). Collective and Statutory Councils conclude, administer and enforce collective agreements at the regional and industry-level, they also provide dispute resolution and administer social benefit funds (see Madden 2006). They are jointly set up under certain conditions of representation by Trade Unions and Employers' Organisations (Bargaining Councils) or can be established by the government under request of one of the two industrial relations parties involved (Statutory Councils) if the other party tries to block the establishment of a Bargaining Council. In 2004, 58 Bargaining Councils (see SAS 2006) covered about 25% of employees in the formal sector (see Madden 2005). However, their reach goes far beyond those directly covered since collective agreements have been extended to third-parties and have a strong signalling effect to collective bargaining at the company level. However, plant-level recognition agreements are the second pillar of collective bargaining in South Africa (see Nel 2002). In summarising this brief survey, industry-wide, interme-

[26] Taking the Balassa-Samuelson effect into account, even the seemingly high range of 3% - 6% of CPIX can be judged as ambitious.

[27] See SAS 2006 and Barker (2003).

diate sectoral-regional bargaining is most important in South Africa with a strong second pillar at the company level. In terms of our broad institutional design board, wage policy in South Africa may be portrayed as uncoordinated since the various Bargaining Councils and plant-level recognition agreements certainly do not make up for an 'encompassing organisation' in terms of the ability and willingness to internalise external effects (e.g. on inflation and employment) — but they have the strength to create such external effects. Additionally, strong company-level representation[28] is yet another hint to assume a Soskice-case wherever the company level is appropriate.

4.3. South Africa's fiscal regime

It is difficult to frame a fiscal policy regime. Recently, John B. Taylor has added a fiscal rule to his famous monetary policy rule (see Taylor 2000: 30ff.). In this rule, he distinguishes between cyclical and structural deficits:

$$\text{actual budget balance} = \alpha(\text{output gap}) + \text{structural budget balance}$$

where α is a parameter measuring the budget elasticity. Possible candidates for fiscal policy regimes would be a 'close to balanced budget' regime with structural deficits very low (≈ 0) and the actual budgetary balance to be governed by the automatic stabilisers (i.e. α[output gap]) — this could be termed 'sound finance regime' as it most certainly drives down the public debt ratio to zero in the long run.[29] Secondly, a fiscal policy regime may focus on striving for the 'golden rule'. This would set the structural budget deficit at a level of the public investment ratio (i.e. structural budget balance = I_G/GDP) assuming sustained public investment expenditure ($I_G/GDP > 0$). The UK's fiscal framework since New Labour took office in 1997, for instance, is based on such a 'golden rule regime' (see Balls/O'Donnell 2002: 168ff.). An outspokenly (old fashioned standard-Keynesian) 'anti-cyclical fiscal rule' is captured by the German 'Stability and Growth Act' (SGA) of 1967, in which not only the cyclical budget balance is governed by deviations of actual GDP from its potential level (i.e. the output gap) but also the structural budget balance is showing discretion with respect to output gaps. Finally, the structural budgetary balance could be made dependent not on the actual output gap but on the public investment ratio (as the 'golden rule') which, in turn, will be determined by the difference between trend-GDP and the trend in potential (i.e. full employment) GDP (which can be called 'trend output gap' for short). This elaborated version of the 'golden rule' regime can be termed 'capital

[28] For instance, the LRA allows for the creation of closed shop agreements which are usually seen as expression of strong 'local pushfullness'.

[29] According to simple fiscal arithmetic, this will be the case as long as we assume the nominal growth rate exceeds the 'low' structural deficit.

budgeting rule' as proposed by John Maynard Keynes in the first place (see Keynes 1943). To summarise, we have established four fiscal policy regimes:

(1) 'sound finance regime':

$$\text{actual budget balance} = \alpha(\text{output gap}) + \text{structural budget balance}(\approx 0)$$

(2) 'golden rule regime':

$$\text{actual budget balance} = \alpha(\text{output gap}) + \text{structural budget balance} \\ (=\text{public investment ratio})$$

(3) 'anti-cyclical regime':

$$\text{actual budget balance} = \alpha(\text{output gap}) + \text{structural budget balance} \\ (=\Psi[\text{output gap}])$$

(4) 'capital budgeting regime':

$$\text{actual budget balance} = \alpha(\text{output gap}) + \text{structural budget balance} \\ (=\text{public investment ratio} = \phi[\text{trend output gap}])$$

South Africa's fiscal policy regime is part of the afore-mentioned GEAR strategy which must be seen as a response to international financial market's fear of the incumbent ANC government to use the national tax resources for income redistribution in favour of their electorate at large scale. The answer was a strategy which, as Finance Minister Trevor Manuel said in parliament, was "not up for negotiations" (see Ajam 2004: 6). Taking into account that the ANC government in 1994 took over at a public deficit of about 7%, the fiscal policy stance of the first post-apartheid decade has been termed as 'conservative' and 'austere' even by an institution unsuspected of favouring prodigal budgetary behaviour as the OECD (see OECD 2006: 461). The 'sound finance regime' would probably fit best as a description although even a pro-cyclical curbing of the automatic stabilisers has been detected[30]. At any rate, there is no sign for 'active fiscal policy' as mentioned in our broad institutional design board.

To conclude, South Africa's market constellation appears to be characterised by an institutional setting that does not provide the pro-growth

[30] See Swanepoel/Schoemann (2003) who report a primary (i.e. interest payments deducted) structural budget surplus as high as 6% of trend output by the end of the 1990s.

environment which the economy needs to create the jobs and to fulfil the expectations of government and the people.[31] The combination of an unaccommodating monetary policy regime, an uncoordinated, intermediate collective bargaining setting with strong 'local pushfullness' at company level and a very restrictive fiscal policy regime, provides sub-optimal conditions resulting in low growth, medium to low inflation (yet higher than possible in a different market constellation) and very high unemployment (see tab. 1).

5. SOME EMPIRICAL EVIDENCE ON SOUTH AFRICA'S A SUB-OPTIMAL MARKET CONSTELLATION

Before we will take a closer look at empirical evidence for the explanations put forward here, let us extract some hypothesis: We would not only expect (1) a relatively[32] low growth rate and high unemployment for South Africa, we would also expect (2) relatively high interest rates which will cause (3) low private investment spending. (4) Inflation will be relatively high, even though the SARB is non-accommodating. This is mainly so because (5) nominal unit labour cost (NULC) are supposed to rise quite fast since the collective bargaining system does not provide incentives to care for the 'distributional margin' consisting of productivity increases and targeted (by the SARB) inflation. Therefore, we would also expect (6) an asymmetry in the wage setting behaviour: in a downward direction (i.e. in an economic downturn), the overall economic situation (i.e. the output gap) is not supposed to have a strong influence on wage settlements (since intermediate collective bargaining systems are not willing to internalise external conditions and are prone to 'insider behaviour'). However, in an upward direction (i.e. in an economic upturn), 'local pushfullness' may easily feed wage aspirations when the output gap is positive. Finally, it would be rather surprising (7) to find traces of cooperative behaviour in fiscal, monetary and wage policy stances.

5.1. High real interest rates and low private investment

There is not much dispute about the reversal in short-term real interest rates in post-apartheid South Africa after being negative in the 1980s (see Kahn/Farrell 2002), and their high average level since 1994 (see tab.2) is also widely acknowledged. Moreover, South Africa's short- term real in-

[31] The Growth and Development Summit (GDS) organised by the tripartite National Economic Development and Labor Council (Nedlac) in 2003 has set the target of halving unemployment by 2014; see Michie (2006: 86).

[32] 'Relatively' must be interpreted 'as compared to a counterfactual situation of more pro-growth market constellations (i.e. non-accommodative monetary policy/ FED-strategy and coordinated wage policy)' or as compared to a country showing such characteristics.

terest rates are markedly higher than in most OECD countries and also most EME as Chile and Mexico (see tab. 3). It is basically the latter phenomenon which has contributed to a less unambiguous interpretation of South Africa's interest rate performance: While Epstein (2002) attributes high interest rates to the restrictive monetary policy stance, Aron/Muellbauer (2006) partly blame a monetary policy strategy based on exchange rate targeting (during the earlier part of the 1990s), partly a country specific risk premium. Kahn/Farrell (2002: 21; our italics) of the SARB admit that "...,current rates reflect to a certain extent the Reserve Bank's overriding commitment to the inflation target". However, they haste to add that a different policy stance ('artificially low interest rates') would merely result in higher inflation and higher long-term real interest rates. This seems odd since they cite literature (e.g. Allsopp/Glyn 1999) that pinpoints the crucial importance of policy regimes in the sense that has been termed 'market constellations' in this work.

TABLE 2.

Selected macro-economic variables

Year	(a) GDP (% incr.)	(b) Total deficit (% of GDP)	(c) National debt (% of GDP)	(d) Inflation (CPI) (% incr.)	(e) Nominal short-term interest rate (repo rate)	(f) Real short-term interest rate (e - d)	(g) Real gross fixed capital formation (% of GDP)
1994	3.2	4.6	43.0	8.8	12.33	3.53	15.2
1995	3.1	4.5	48.3	8.7	14.50	5.80	15.9
1996	4.3	4.6	49.5	7.3	15.90	8.60	16.3
1997	2.7	3.8	48.5	8.6	16.75	8.15	16.5
1998	0.5	2.3	48.0	6.9	19.38	12.48	17.1
1999	2.4	2.0	48.0	5.2	17.78	12.58	15.5
2000	4.2	1.9	45.6	5.4	11.81	6.41	15.1
2001	2.7	1.4	42.0	5.7	11.00	5.30	15.1
2002	3.7	1.1	41.3	9.2	12.10	2.90	15.1
2003	3.0	2.0	35.8	5.8	11.66	5.86	16.0
2004	4.5	1.5	35.7	1.4	11.30	9.90	16.5
2005	5.1	1.0	35.7	3.4	n.a.	n.a.	17.1

Notes: n.a. = not available
Source: South Africa Survey 2004/05, Johannesburg 2006; SARB monthly bulletin time series

The low level of private investment has already been mentioned and its importance for the low growth and disappointing employment performance of the South African economy has also been highlighted above: The private investment share declined from 24.9% of GDP in 1980s to 15.8% during the period 1994-2004. This is not only low in historical perspective, but

also from an international perspective: in the latter period, the private investment share in Germany was about 21.5%, in Ireland 23.0% and in an EME such as Turkey, it was about 25%.[33]

TABLE 3.

Short-term real interest rate differential (South African real rates minus foreign real rates)

	1994	1995	1996	1997	1998	1999	2000
SA-USA	1.8	4.0	7.6	4.8	9.5	4.0	4.1
SA-Germany	1.4	3.6	7.8	6.2	9.9	4.7	4.5
SA-UK	1.7	3.8	6.2	4.0	8.8	3.3	3.9
SA-Ireland	−3.3	−1.6	2.1	5.1	14.1	13.6	7.5
SA-Mexico	−3.2	−7.0	12.6	8.3	3.6	2.0	1.0
SA-Chile	0.3	0.9	3.5	1.6	2.6	1.6	1.3
SA-Korea	5.2	5.9	9.6	6.9	16.9	4.6	4.0

Source: Kahn/Farrell (2002)

Although the restrictive monetary policy stance and the high real interest rates are certainly not the only factors of explanation — the high level of political and social risk[34] is always and rightly emphasized — the empirical literature is unambiguous about its power to explain the investment performance indicated in tab.1 (column g): Gibson/van Seventer (2000) as well as Aron/Muellbauer (2002) report statistically significant correlations using econometric models of the South African economy, whereas Gelb (2001) uses panel data from company studies to establish a clear link between capital cost and the growth of firms and their investment behaviour. And, finally, Epstein (2002) provides some evidence that Foreign Direct Investment (FDI) has not sufficiently substituted South African private investment as is sometimes argued — he suggests a reverse causality running from higher economic growth to higher FDI rather than vice versa.

5.2. Wage setting and inflation fighting

The SARB has officially adopted an inflation targeting (IT) approach in 2000. Prior to that date, it pursued a 'quantity of money'-approach (until 1997), an 'ecclectic' approach in 1997 and an 'informal inflation targeting approach' (1998 C 2000). The SARB was forced to change its policy as the quantity approach C a target of M3-growth from 6% − 10% - created uncertainty about expected behaviour when the close link between M3-

[33] All dates are own calculations from European Economy, statistical annex 2006.

[34] The standing term 'social risk' does not maintain that developments are predictable by probability calculation. Therefore, 'social risk' really refer to a situation of fundamental uncertainty.

growth and inflation ruptured in the mid-1990s.[35] Firstly, an inflation target of 1% − 5% was set in addition to the announced target of M3-growth, later the inflation target was raised and compressed to 3% − 6% while the M3-target was unchanged. Finally, the M3-growth target was completely abandoned while the IT target varied several times between a 3% − 6% band and a 3% − 5% band (see Aron/Muellbauer 2006). As can be seen from tab. 2 (column d), the SARB succeeded in bringing inflation down from double digit figures in the late 1980s and early 1990s. Moreover, since 2000 it has almost every year kept the inflation within its targeted band — however, always close to the upper limit. Consumer price developments in 2004 and 2005 seem to indicate a substantial further fall in inflation, but price movements at the actual margin show that inflation is trending upward again (9.9% in the III. quarter of 2006) and inflation expectations are steadily at about 5% − 5.5% (see SARB 2006).

Assuming, as Post Keynesianism does, mark-up pricing over unit costs, nominal unit labour cost (NULC) developments become the major factor in determining inflation. If wage developments and, hence, inflation were heavily dependent on output and employment gaps, a deflationary outcome would appear to be unavoidable in a country with 30% to 40% unemployment. Put differently, the downward rigidity of nominal wages in the presence of substantial labour market disequilibria serves as a stabilising device — the nominal anchor. Empirical studies show[36] that South African wage policy provides that nominal anchor: neither unemployment, or the employment rate or the jobless rate, the output gap or the change in the output gap have a statistically significant impact on the inflation rate — at least not in a downward direction. What is crucial for the stability in a world that does not oscillate around a natural unemployment rate, makes IT difficult: the lower the wage and price elasticity with respect to employment or output gaps (i.e. the flatter the Phillips curve), the more difficult it is to pursue inflation and output stability with a single monetary policy rule (see Carlin/Soskice 2006: 147).

The influence of NULC on inflation in South Africa is as well established (see e.g. Aron/Muellbauer/Smit 2003, Burger/Marinkov 2006) as the main factors determining NULC: past consumer price inflation, the wholesale price inflation of domestically produced goods, real house prices, and other minor factors (see Aron/Muellbauer/Smit 2003). As can be seen

[35] "In recent years, however, the M3 money supply has increased at rates consistently higher than the indicated guideline ranges for growth in M3, but inflation nevertheless declined, contradicting previous expectations. Considerable uncertainties have arisen about the behaviour of the velocities of circulation of the various monetary aggregates and there were difficulties with forecasting the relationship between money growth, nominal income growth and inflation" (SARB 1998: 54).

[36] See e.g. Aron/Muellbauer/Smit (2003), Hodge (2002), Nell (2000), Burger/Marinkov (2006).

TABLE 4.

Nominal unit labour cost (NULC) developments in selected countries; 2000 = 100

	South Africa	Germany	Ireland	Turkey	Poland
1994	73.0	97.4	98.0	3.9	47.6
1995	77.5	99.3	95.7	6.5	60.2
1996	82.8	99.5	95.7	11.8	72.9
1997	88.1	98.5	94.3	21.8	83.1
1998	96.1	98.8	97.9	38.3	91.3
1999	98.3	99.3	97.5	75.7	95.4
2000	100	100	100	100	100
2001	104.2	100.9	104.6	154.8	106.5
2002	129.8	101.8	105.9	196.1	104.2
2003	154.0	102.7	108.8	234.8	100.9
2004	165.6	102.5	114.6	258.7	99.0
2005	174.8	101.6	119.3	274.0	98.6

Notes: NULC for total economy in Germany, Ireland, Turkey and Poland; NULC for the non- agricultural sector in South Africa
Source: SARB monthly bulletin time series; European Economy statistical annex

from tab. 4, NULC rose much faster in South Africa than in Germany, but also faster than in a catching-up country such as Ireland, or an EME such as Poland which has managed to bring down inflation more rapidly than South Africa. Only Turkey — another EME accession contender to the European Union and notorious for its bad inflation record — shows a NULC development worse than South Africa. Taking into consideration the differentiation between NULC in the internationally exposed manufacturing sector[37] and NULC in the domestic service sectors in South Africa so characteristic for EMEs, NULC developments and inflation performance at the upper end of the targeted inflation band needs to be accepted in the nearer future.

Finally, there are several empirical traces of local pushfullness and 'insider behaviour': Burger/Marinkov (2006: 183) as well as Nell (2000) find a statistically significant relation between the output gap and the change in the output gap on the one hand, and the inflation rate on the other hand but only in an upward direction. And Aron/Muellbauer/Smit (2003: 27) report "(t)he other striking finding is how dominant are the concerns of workers in wage setting rather than of firms." In a Post Keynesian conflicting claims framework portrayed in figure 2, this implies a very high NAIRU.

5.3. Trace of policy coordination?

[37] Where the NULC index in 2005 is 122.4; see SARB monthly bulletin time series.

Although wage policy is crucial for inflation developments and inflation (past experience as well as inflation expectations) is important for wage setting, there are certainly no signs of institutionalised coordination of both policies in South Africa. Moreover, the findings reported above rather strongly suggest an implicit non-coordination (i.e. conflict at the actor's level).

In a recent paper, the SARB researcher Swanepoel (2004: 734) argued: "The close relationship between monetary and fiscal policies carries with it the possibility of conflict and sub-optimal policies,.... Coordinated monetary and fiscal policies are extremely important as uncoordinated policies could potentially slow the economy's long-term growth rate or cause unwanted surges in inflation". Having pinpointed the need for coordination and the consequences of its failure, Swanepoel convincingly shows that the macro-economic policy mix in post-apartheid South Africa has been un-coordinated. Moreover, the lack of coordination appears to be more pronounced in times of slack growth than in times of prosperity, i.e. Government and the SARB cooperate better in breaking a boom than in pushing out of a slump. The conclusion is straightforward: "The challenge is to ensure that the monetary-fiscal policy mix promotes macroeconomic stability and sustainable development" (Swanepoel 2004: 757).[38]

6. BY WAY OF CONCLUSION: TOWARDS A PRO-GROWTH SOCIAL CONTRACT

Once the interdependence of macro-economic policies has been recognised, neither monetary nor fiscal or wage policy can independently achieve the targets consigned to them: sustained growth (and high employment) under the conditions of price stability. The common 'Tinbergen rule' reminds us of the need of at least as many policy instruments as there are non-complementary targets (see e.g. Epstein 2002: 34). Since independence has been bestowed on the involved actors (the SARB, the Finance Ministry, the Social Partners) for good reason, so cooperation among them is necessary to solve the problem. But cooperation requires institutional incentives to overcome strategic action traps: (1) communication must be institutionalised, (2) policy rules for cooperative behaviour must be established, (3) credible monitoring and sanctioning devices must be designed.

[38] Two things remain unanswered in Swanepoel (2004): (1) Why does he not distinctively draw the conclusion that post-apartheid South Africa has suffered from an un-coordinated macroeconomic policy mix and (2) how can his vehement argumentation for coordination be translated into a traditional policy assignment which advocates later (Swanepoel 2004: 735f.)?

South Africa requires a social contract (or concerted action)[39] among the main macro-economic policy actors to engage in cooperation geared at low real interest rates, investment-oriented, sustainable fiscal expansion and moderate nominal wage increases that permit a reduction in industry-wage differentials and the acceptance of a distributional margin to stabilise NULC. A macro-economic dialogue organised, for instance, by the National Economic Development and Labour Council (Nedlac) can become the institutional basis for such a social contract. Employment-friendly monetary, fiscal and wage policy rules are available (see Heise 2001, Epstein 2002) and an academic advisory council consisting of trusted experts of the parties involved could serve as monitoring body. Sanctioning, however, must be restricted to non-cooperation in the next round of interactions ('shadow of the future') or institutional sanctions for defecting parties ('shadow of the law').

A better coordinated, institutionally embedded macro-economic policy mix will create the environment for a pro-growth market constellation for South Africa. It will not be able to solve all the economic problems underlying South Africa's low growth performance[40] but it will produce the means and resources (in terms of taxes) to invest in better infrastructure, human and social capital which will help to overcome existing supply-side restrictions pari passu.

REFERENCES

Ajam, T., 2005, Review of South African Fiscal Policy 1994-2004; paper presented at the conference on 'South African Policy Under Democracy: A Ten Year Review' held at Stellenbosch University, 28-29th October 2005, unpublished manuscript

Alesina, A., Summers, L.H., 1993, Bank Independence and Macroeconomic Performance: Some Comparative Evidence. *Journal of Money, Credit, and Banking* **Vol. 25, No.2**, pp. 151-162

Allsopp, C., Glyn, A., 1999, The Assessment: Real Interest Rates. *Oxford Review of Economic Policy* **Vol. 15, No.2**, pp. 1-16

Argüero, J., Carter, M.R., May, J., 2006, Poverty and Inequality in the First Decade of South Africa's Democracy: What can be learnt from Panel Data? Working Paper of the Department of Agricultural and Applied Economics, University of Wisconsin-Madison.

Aron, J., 2000, Growth and Institutions: A Review of the Evidence. *World Bank Research Observer* **Vol. 15, No. 1**, pp. 99-135

[39] See e.g. Moore (1998: 177). It has been pointed out to us that 'social contract' may be a misnomer with respect to marketing the idea of cooperation. Therefore, 'macro-economic dialogue' can be taken as an easy substitute. And it should not be remain unmentioned that the EU governance process knows a 'Macro-economic Dialogue' which has exactly the purpose to establish cooperation among the macro-economic actors. For its (poor) performance see Heise (2002a).

[40] For two very different accounts of the challenges ahead and possible policy proposals see Frankel/Smit/Sturzenegger (2006) and Pollin/Epstein/Heintze/Ndikumana (2006).

Aron, J., Muellbauer, J., 2002, Interest rate effects on output: evidence from a GDP forecasting model for South Africa. *IMF Staff Papers* **Vol. 49**, pp. 185-213

Aron, J., Muellbauer, J., 2006, Review of Monetary Policy in South Africa Since 1994: Centre for the Study of African Economies (CSAE) Working Paper No. 7, Oxford University.

Aron, J., Muellbauer, J.N.J., Smit, B.W., 2003, Modelling the Inflation Process in South Africa; Keynote Address Eight Annual Conference on Econometric Modelling for Africa, Stellenbosch University, 1-4th July 2003 (unpublished manuscript)

Ballard, R., Habib, A., Valodia, J., 2006, Social movements in South Africa: promoting crisis or creating stability?; in: Padayachee, V. (ed.); The development decade? Economic and social change in South Africa, 1994-2004, Cape Town 2006, pp. 397-422

Balls, E., O'Donnell, G., 2002, Reforming Britain's Economic and Financial Policy. Towards greater economic stability, Houndsmill.

Bhaduri, A., 2000, Nationalism and Economic Policy in the Era of Globalization; World Institute for Development Economics (WIDER) Working Paper No. 188, United Nations University.

Bhorat, H., 2006, Labor supply and demand constraints on employment creation: a microeconomic analysis; in: Padayachee, V. (ed.); The development decade? Economic and social change in South Africa, 1994-2004, Cape Town 2006, pp. 275-301

Bibow, J., 2001, Making EMU work: some lessons from the 1990s. *International Review of Applied Economics* **Vol. 15**, pp. 233-259

Blinder, A.S., Yellen, J.L., 2001, The Fabulous Decade. Macroeconomic Lessons from the 1990s, New York.

Burger, P., Marinkov, M., 2006, The South African Phillips Curve: How applicable is the Gordon model? *South African Journal of Economics* **Vol. 74, No.2**, pp. 172-189

Calmfors, L, Driffil, J., 1988, Bargaining structure, corporatism and macroeconomic performance. *Economic Policy* **No.1**, pp. 14-61

Carlin, W., Soskice, D., 2006, Macroeconomics. Imperfections, Institutions and Policies, Oxford.

Carter, M., 2006, Sequenzing micro and macro reforms: reflections on the South African experience; in: Padayachee, V. (ed.); The development decade? Economic and social change in South Africa, 1994-2004, Cape Town 2006, pp. 126-139

Cassim, R., 2006, Reflections on South Africa's first wave of economic reforms; in: Padayachee, V. (ed.); The development decade? Economic and social change in South Africa, 1994-2004, Cape Town 2006, pp. 55-85

Cukierman, A., Lippi, F., 1999, Central bank independence, centralization of wage bargaining, inflation and unemployment: Theory and some evidence. *European Economic Review* **Vol. 43**, pp. 1395-1434

Davidson, P., 1994, Post Keynesian Macroeconomic Theory, Cheltenham.

Dunn, S., 2000, Wither Post Keynesianism. *Journal of Post Keynesian Economics* **Vol. 20**, pp. 345-364

Epstein, G., 2002, Employment-oriented central bank policy in an integrated world economy: A reform proposal for South Africa, PERI Working Paper No. 39, University of Massachusetts Amherst.

Franzese, R.J., 2002, Macroeconomic Policies of Developed Democracies, Cambridge.

Frankel, J., Smit, B., Sturzenegger, F., 2006, South Africa: Macroeconomic Challenges after a Decade of Success; Center for International Development (CID) Working Paper No. 133, Harvard University.

Fritsche, U. et al., 2005, Macroeconomic regime and economic development: the case of the USA; in: Hein, E. et al. (eds.); Macroeconomic policy coordination in Europe and the role of the trade unions, Brussels, pp. 69-110

Gärtner, M., 1997, Central Bank Independence and the Sacrifice Ratio: The Dark Side of the Force. *Swiss Journal of Economics and Statistics* **Vol. 133**, pp. 513-538

Gelb, S., 2001, Socio-political Risk, Confidence and Firm Investment in South Africa, The Edge Institute, Johannesburg.

Gibson, B., van Seventer, B.E., 2000, Real wages, Employment and Macroeconomic Policy in a Structuralist Model of South Africa, University of Vermont (unpublished manuscript).

Grilli, V., Masciandaro, D., Tabellini, G., 1991, Political and Monetary Institutions and Public Finance Policies in the Industrial Countries. *Economic Policy* **Vol. 13**, pp. 341-392

Guzzo, V., Velasco, A., 1999, The case for a populist Central Banker. *European Economic Review* **Vol. 43**, pp. 1317-1344

Hall, P., 1994, Central bank Independence and Coordinated Wage-Bargaining: their Interaction in Germany and Europe. *German Politics and Society* pp. 1-23

Hall, P. A., Franzese, R. J., 1998, Mixed Signals: Central Bank Independence, Coordinated Wage Bargaining, and European Monetary Union. *International Organization* **Vol. 52**, pp. 505-535

Hein, E., 2002, Monetary policy and wage bargaining in the EMU: restrictive ECB policies, high unemployment, nominal wage restraint and inflation above the target. *Banca Nazionale del Lavoro Quarterly Review* **Vol. 55**, pp. 299-337

Heine, M., Herr, H., Kaiser, C., 2006, Wirtschaftspolitische Regime westlicher Industrienationen, Baden-Baden.

Heise, A., 2001, New Politics. Integrative Wirtschaftspolitik für das 21. Jahrhundert, Münster.

Heise, A., 2002, Optimal Public Debts, Sustainable Deficits, and Budgetary Consolidation. *Empirica* **Vol. 29**, pp. 319-337

Heise, A., 2002, The 'Cologne Process': a Neglected Aspect of European Employment Policy. *International Politics and Society* **No.2**, pp. 88-102

Heise, A., 2006, Market Constellations and Macroeconomic Policymaking: Institutional Impacts on Economic Performance. *Intereconomics — Review of European Economic Policy* **Vol. 41, No. 5**, pp. 272-281

Hicks, J., 1979, Causality in Economics, Oxford.

Hodge, D., 2002, Inflation versus unemployment in South Africa: Is there a trade off? *South African Journal of Economics* **Vol. 70, No.3**, pp. 417-443

Hodgson, G., 1989, Post-Keynesianism and Institutionalism: The Missing Link; in: Pheby, J. (ed.); New Directions in Post-Keynesian Economics, Aldershot, pp. 94-123

Holt, R.P.F., Pressman, S., 2001, What is Post Keynesian Economics; in: Holt, R.P.F., Pressman, s. (eds.); A New Guide to Post Keynesian Economics, London, pp. 1-10

Horn, G.A., 1999, Zur Koordinierung von Geld- und Lohnpolitik. Eine empirische Analyse für die USA und Deutschland; in: Filc, W., Köhler, C. (eds.); Macroeconomic Causes of Unemployment: Diagnosis and Policy Recommendations, Berlin 1999, pp. 419-440

Iversen, T., 1999, Contested Economic Institutions, Cambridge.

Kahn, B., Farrell, G.N., 2002, South African real interest rates in comparative perspective: theory and evidence; South African Reserve Bank Occasional Paper No. 17.

Keynes, J.M., 1980, The long-term problem of full employment (1943); in: Moggridge, D. (ed.); The Collected Writings of John Maynard Keynes (CW), Vol. 27, London, pp. 320-329

Khan, A.R., 2005, Growth, Employment and Poverty. An analysis of the vital nexus based on some recent UNDP and ILO/SIDA studies; Keynote address to the UNDP/ILO conference 'Strengthening the Employment Nexus between Growth an Poverty Reduction' held in Brasilia on the 11-12th of January 2005.

King, J.E., 2001, Labour and unemployment; in: Holt, R.P.F., Pressman, S. (eds.); A New Guide to Post Keynesian Economics, London and New York, pp. 65-78

Kingdom, G., Knight, J., 2004, Unemployment in South Africa: The nature of the beast. *World Development* **Vol. 32, Issue 3**, pp. 391-408

Klaasen, S., 2002, Social, economic and environmental limits for the newly enfranchised in South Africa? *Economic Development and Cultural Change* **Vol. 50**, pp. 607-642

Kregel, J.A., 1980, Markets and institutions as features of a capitalist production system. *Journal of Post Keynesian Economics* **Vol. 3, No. 1**, pp. 32-48

Madden, L., 2005, Bargaining Councils. Which way Gulliver? *South African Labour Bulletin* **Vol. 29, No. 1**, pp. 51-53

May, J., Carter, M., Padayachee, V., 2004, Is poverty and inequality leading to poor growth? *South African Labour Bulletin* **Vol. 28, No.2**, pp. 18-20

Michie, J., 2006, Macroeconomic reforms and employment: what possibilities for South Africa?; in: Padayachee, V. (ed.); The development decade? Economic and social change in South Africa, 1994 C 2004, Cape Town 2006, pp. 86-107

Morre, B., 1998, Accommodation to accommodationism: a note. *Journal of Post Keynesian Economics* **Vol. 21, No.1**, pp. 175-178

Moore, B., 2006, Saving is never a constraint on investment. *South African Journal of Economics* **Vol. 74, No.1**, pp. 1-5

Murphy, K.M., Shleifer, A., Vishny, R., 1989, Income Distribution, Market Size, and Industrialization. **Quarterly Journal of Economics**, pp. 507-564

Nel, P.S. (ed.), 2002, South African employment relations: theory and practice, Pretoria.

Nell, K.S., 2000, Is inflation a precondition for faster growth? The South African case, (unpublished paper).

Nordhaus, W. D., 1994, Policy Games: Coordination and Independence in Monetary and Fiscal Policies. *Brookings Papers on Economic Activity* **No. 2**, pp. 139-216

Naidoo, K., 2006, Operationalising South Africa's move from macroeconomic stability to microeconomic reform; in: Padayachee, V. (ed.); The development decade? Economic and social change in South Africa, 1994-2004, Cape Town 2006, pp. 108-126

OECD, 1997, Economic Performance and the structure of Collective Bargaining. *Employment Outlook 1997*, Paris, pp. 63-92

OECD, 2006, African Economic Outlook 2005/2006, Paris.

Plenderleith, I., 2003, Is Monetary Policy different in Africa?, Symposium on Monetary Policy and Uncertainty: Adapting to a Changing Economy, Federal Reserve Bank of Kansas City at Jackson Hole, Wyoming, 28-30th August 2003.

Pollin, R., Epstein, G., Heintze, J., Ndikumana, L., 2006, An Employment-Targeted Economic Program for South Africa, Cheltenham.

Posen, A., 1998, Central Bank Independence and Disinflationary Credibility: A Missing Link? *Oxford Economic Papers* **Vol. 50**, pp. 335-359

Power, S. Rowe, N., 1998, Independent Central Banks: Coordination Problems and Budget Deficits. *Economic Issues* **Vol. 3, Part 1**, pp. 69-75

Rankin, N., 1998, Is Delegating Half of Demand Management Sensible? *International Review of Applied Economics* **Vol. 13, No. 3**, pp. 415-422

Soskice, D., 1990, Wage Determination: The Changing Role of Institutions in Advanced Industrialized Countries. *Oxford Review of Economic Policy* **Vol. 6, No.4**, pp. 36-47

Soskice, D., 1999, Divergent production regimes: coordinated and uncoordinated market economies in the 1980s and 1990s; in: Kitschelt, H. et al. (eds.); Continuity and Change in Contemporary Capitalism, Cambridge, pp. 101-134

Soskice, D., 2000, Macroeconomic Analysis and the Political Economy of Unemployment; in: Iversen, T., Pontusson, J., Soskice, D. (eds.); Unions, Employers, and Central Banks, Cambridge, pp. 38-76

Soskice, D.; Iversen, T., 2000, The Non-Neutrality of Monetary Policy with Large Price Setters. *Quarterly Journal of Economics* **Vol. 115**, pp. 265-284

South African Reserve Bank (SARB), 1998, Annual Economic Report 1998, Johannesburg.

South African Reserve Bank (SARB), 2006, Monthly Bulletin, No. 242, December 2006.

South Africa Survey; 2004/05, Johannesburg 2006

Swanepoel, J.A., 2004, The monetary-fiscal policy mix in South Africa. *South African Journal of Economics* **Vol. 72, No. 4**, pp. 730-757

Swanepoel, J.A., Schoemann, W.J., 2003, Contracyclical Fiscal Policy in South Africa: Role and Impact of Fiscal Stabilisers. *South African Journal of Economic and Management Sciences* **Vol. 6, No. 4**, pp. 802-822

Taylor, J.B., 2000, Reassessing Discretionary Fiscal Policy. *Journal of Economic Perspectives* **Vol. 14, No.3**, pp. 21-36

Venter, R., 2003, Labour Relations in South Africa, Oxford.