Who benefits from inflation

In 1999, amidst great fanfare, the South African Reserve Bank announced plans to implement inflation targeting. ***John Pape*** *explores what price is being paid by workers and the poor to ensure its successful implementation.*

As we near the end of the first year of this policy, it is obvious that inflation will be far higher than the Reserve Bank's 3% to 6% target range. For workers inflation has become more serious than at any time since the early 1990s. We have witnessed a massive increase in food prices, petrol prices, and more pressure to restrain wage demands.

Finance Minster Trevor Manuel.

Inflation targeting has brought no relief.

Controversy over inflation targeting has even led to public bickering between Reserve Bank governor Tito Mboweni and finance minister Trevor Manuel. But unpacking the story of inflation targeting requires more than simply examining personal rivalry between two of the most powerful men in the South African economy. As an economic policy issue, inflation and inflation targeting have an important context, both in South Africa and in the global economy.

Inflation targeting: An international trend

To understand the failure of inflation targeting, we need to look at the aims and origins of this policy. South Africa is not the only country to implement inflation targeting. New Zealand was the first country to do so in 1990. Since then a number of countries have followed suit.

On one level, inflation targeting has a certain popular appeal. Almost no one, workers included, likes to see prices skyrocketing. But inflation targeting is a very particular economic policy tool, with a very particular bias.

In virtually every instance, inflation targeting has been implemented as part of an overall shift toward a more free market economic policy. If inflation targeting were to be implemented along with a number of other targets holding equal priority, such as employment creation, housing delivery, or health outcomes, perhaps it could be seen as part of an overall effort to improve peoples' lives. But in South Africa, as in most other economies, inflation targets take precedence. No other indicator carries the same weight. Internationally a basic assumption of inflation targeting is that if a Reserve Bank governor fails to meet the target, most likely they will be sacked.

In South Africa unemployment rates and HIV/AIDS infections have continued to soar in the last six years while economic growth has been slow. Yet not a single Cabinet minister has been threatened over this debacle. Little wonder then, that Mboweni has often appeared almost obsessed with his targets. As early as May 2000 he warned: 'Fasten your seat belts as I'm very serious and determined to make my mark in bringing inflation rates down.'

Certainly Mboweni has made his mark – not by controlling inflation but by producing four interest rate hikes in the first three quarters of 2002. The use of interest rates increases, which Manuel and many others have labelled a 'very blunt instrument' follows the monetarist logic, which informs

targeting?

inflation targeting. According to classical monetarist theory, interest rates are supposed to reduce the amount of money in circulation, since people will borrow less. Mboweni has vowed to persist with his blunt instrument; warning rates may soar above 20% in 2003 if inflation continues to increase.

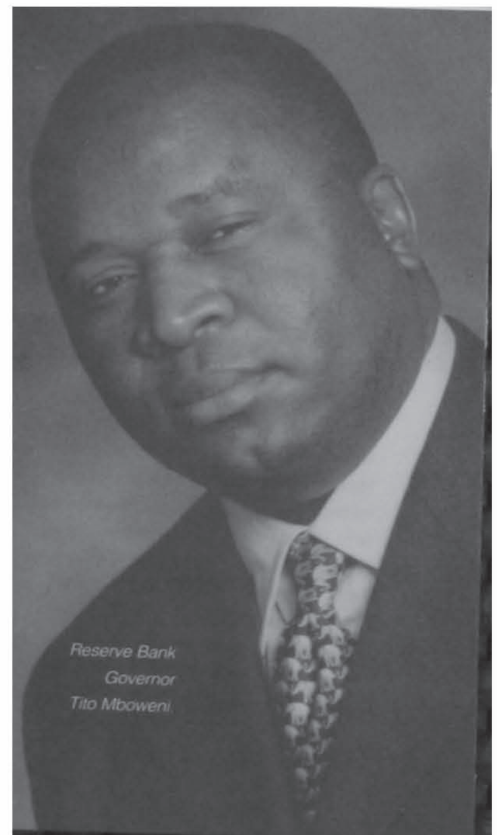
But focusing the discussion on interest rates obscures the real issue behind inflation targeting. Inflation targeting is first and foremost directed at pleasing the global markets, especially speculative investors For speculators, a high rate of inflation means that the value of their investment is declining. For example, if an overseas investor puts $1 000 into the JSE Securities Exchange or into South African government bonds, the actual value of their investment will decrease in a period of high inflation. When domestic inflation rises, the value of a currency on the international markets typically decreases. This means that when the speculator tries to cash in on their South African investment and convert it to dollars, it will be worth less than when the money came into the country. A low rate of inflation guarantees predictability and provides a good climate for this type of investor. Moreover, many speculators earn profits in the form of interest. Hence, higher interest rates are an incentive to keep their money in rands.

Mboweni's actions may reassure speculators and global markets, but for South African workers and even manufacturers, high interest spells only hardship. Borrowing is essential for creating jobs and producing goods and services to meet the needs of the 22 million South Africans living below the poverty datum line. Every time interest rates go up, jobs are lost. Moreover, workers and the poor face more adversity. They cannot pay off their debt. If they are able to meet their debt demands, then it is likely they will have to sacrifice other necessities like electricity, school fees or even food.

Structural inflation in SA

Both labour and business have repeatedly contested the monetarist assumption that inflation in South Africa is caused by expanding money supply. The bulk of inflation in South Africa is structural. It is the result of the country's natural resource base, its position in the global economy and the policies chosen by the government.

In this period of volatile oil prices, any country, which does not have its own reserves, is bound to face inflation. When the oil price goes up, everyone pays more not only for transport and goods made of petroleum-based chemicals (paint, plastics), but for everything However, structural inflation is not only linked to oil. The price of many other goods is now being set on the world market, not locally and is set in US dollars. In this regard, food is the most important component. Let us take the



Reserve Bank Governor Tito Mboweni

Perhaps it is time government begins to ask equity questions about abnormal profit levels for food retailers during times of starvation.

case of South African maize producers. The price for exported maize is fixed on the global markets, largely through the process of speculation. That is, there are people who buy maize, not for consumption but as a source of speculative profit – in the futures market. Speculators fix a price at which they agree to buy maize at a given date in the future. This then becomes the price that producers can get if they sell their maize on the global markets. If the value of the rand falls relative to the dollar, then maize becomes more expensive in the local market. Local producers will demand the international market prices if they are to sell locally. Otherwise, they will simply sell the food outside the country at the higher dollar price. The country could land up importing the same maize at an even higher price.

Food prices and especially that of maize and meat (where maize is used as stock feed) have been rising higher than all the other items in recent months. In August the annual inflation rate for food at manufacturing stood at 28.2%, more than twice that of the overall inflation rate of 11.4%. For workers who spend the vast majority of their wages on food, this is the worst form of inflation.

The food prices example further underscores yet another source of inflation in our economy – the extraordinary economic power of a few big corporations. In the retail food sector a few companies – Pick 'n Pay, Shoprite, and Spar dominate. But while consumers must struggle to cover food costs, the retail giants are declaring mammoth profits. In June 2002, Shoprite declared an increase of 67.5% in after tax profits over 2001. Pick 'n Pay fared almost as well, with trading profit up 39.4% over 2001. If the supermarkets are paying more to the wholesalers, quite clearly they are passing every cent of those increases (and maybe even more) onto the consumer. In late September the Competition Commission initiated an enquiry into food price collusion. But in a market with only a handful of important players, colluding to set prices is not a formal process. The giants simply agree not to compete with each other through price wars.

Are their alternatives?

Government can deal with inflation differently but most options are not in line with the dominant free market or neoliberal paradigm. The starting point, as Cosatu has pointed out, must be a focus 'on the real cause of inflation – soaring food prices'.

One obvious option is subsidies for food producers. This would guarantee a fixed price for producers and ensure that food produced in South Africa will be used to feed the local population. While the World Trade Organisation (WTO) allegedly outlaws subsidies, the superpower economies of the US and EU heavily subsidise their farmers. Southern countries have unsuccessfully challenged this double standard but clearly a more concerted effort is required.

A second approach to dealing with inflation would be to impose price controls on certain basic items, particularly for the large retailers. Price controls could also be combined with subsidies to farmers, thus ensuring profits for the agricultural producers and affordable prices for consumers. Alternatively, the government itself could become a producer of basic necessities, thereby assuring an acceptable supply at affordable prices. An entry by government into basic food production could also become an effective form of job creation and food security enhancement.

Thirdly, given the extraordinarily high levels of profitability in the retail food sector, government could also impose certain duties or taxes on sales. Such a tax, when combined with price controls, could become a source of revenue for subsidies. Perhaps it is time government begins to ask equity questions about abnormal profit levels for food retailers during times of starvation.

However, ultimately, we cannot view the problem of inflation in isolation from the general problems of the economy. Until recently few South Africans would have identified inflation as a major problem what with the current high levels of unemployment. Yet in keeping with global trends, the government has adopted an approach that prioritises the attack on inflation above all else. Moreover, the personal rivalry between Mboweni and Manuel may make the Reserve Bank governor even more dogmatic in his adherence to targeting and interest rate hikes. While Mobweni's recalcitrance may please the global markets, workers and local business owners will pay the price – never mind putting peoples' needs at the centre of the economic policy. ■

Pape is a researcher at Ilrig based in Cape Town.