

Labour union voices in South Africa and arguments to scrap inflation targets – a historical and 21st Century debate

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Samevatting

Inflasietekens wat inflasieverwagtings anker, is die primêre doelwit van monetêre beleid van sentrale banke in ontwikkelde lande. Binne 21e eeuse debatte kritiseer vakbonde, en spesifiek Congress of South African Trade Unions, die regering dat die monetêre beleid ekonomiese groei en indiensname benadeel. In hierdie bespreking word die skraping van inflasietekens bespreek teen die agtergrond van 'n historiese fokus rakende vakbonde en arbeid in Suid Afrika. Swart werkers het teen die toe-heersende wetlike gesag in die sewentiger jare gemobiliseer en die rol van vakbonde het gestalte in 1973 gekry met 'n eerste groot staking in Durban. Die eertydse Wiehahn Kommissie het die rol van vakbonde ondersoek en wetgewing wat op die kommissie se verslag gevolg het, het kollektiewe bedinging meegebring. Die invloed van vakbonde het vanaf die tagtigerjare beduidend vergroot. Vakbonde en veral COSATU, is egter histories nie met suiwer vakbond aangeleentheid betrokke nie. Vakbonde en veral COSATU is aktief betrokke in politieke prosesse as alliansielid van die African National Congress regering, arbeidswetgewing en inspraak met makro ekonomiese beleid in Suid Afrika. Die rol van COSATU met betrekking tot monetêre beleid word onder die soeklig geplaas en hulle meer resente kritiek teen die beleid van inflasietekens word bespreek. Die Ministerie van Finansies in die tyd van Minister van Finansies Trevor Manuel het die beleid van inflasietekens in 2000 geïmplementeer en onderskryf. Die daaropvolgende Minister van Finansies (Pravin Gordhan) het na die verkiesing van mnr Zuma as nuwe president in 2009 in sy eerste begrotingstoespraak in 2009 bevestig dat die Regering nie sal afwyk van die inflasietekens beleid nie afgesien van voortdurende kritiek van COSATU.

Keywords: History; COSATU; Labour Unions South Africa; Monetary policy; Inflation targeting (IT); Economic growth; Employment.

Introduction

Labour unions in South Africa have a history which goes back as far as 1917 when black workers began to organise themselves and established the Industrial and Commercial Workers' Union of Africa.¹ The government passed the first labour union legislation, namely the Industrial Conciliation Act in 1924. This act recognized trade unions, but the weakness of this legislation was that only white workers were recognized. During the 1930s the South African Trades and Labour Council (SATLC) came into being which was based on non-racial foundations. This council advocated for legal rights of black trade unionists in South Africa.²

The stature of labour unions gained momentum from the nineteen seventies when the Wiehahn Commission³ tabled a report about the collective bargaining system regarding African workers. The gradual mobilisation of black workers forced the government to address labour concerns and needs. Unity talks between competing labour unions followed during the nineteen eighties. These competing groups established the Congress of South African Trade Unions (COSATU) in 1985.

COSATU, as the biggest labour union in South Africa, has a history of being critical against government policies and was involved over time with various activities outside the associated sphere of labour unions. COSATU has been since inception critical about various economic policies of government. Examples are the leading role of COSATU in the struggle against apartheid which displaced the National Party government in the 1994 political elections, their role to establish the transformation Reconstruction and Development Policy (RDP) in 1994 and their fierce criticism against the Growth Employment and Reconstruction Policy (GEAR) in the middle nineteen nineties to create a sound economic strategic path for South Africa. Further examples are their leading role in the promulgation of the labour legislation of the nineteen nineties in favour of the workers and their membership of the tripartite alliance with the African National Congress (ANC) and South African Communist Party (SACP) to govern South Africa.

1 D Yudelman, *The emergence of modern South Africa* (Cape Town, David Phillip Press, 1983).

2 J Lewis, *Industrialisation and trade union origin in South Africa, 1924 – 1955* (Cambridge, Cambridge University Press, 1984).

3 The Wiehahn Commission tabled their first report on 1 May 1979 which gave legal recognition to black labour unions. This change in attitude of Parliament increased political rights and participation of black South Africans.

Against the primary goal of labour unions to improve the conditions of work of their members and their various activities outside the associated sphere of labour unions, the continued criticism of COSATU against government policies, specifically monetary policy, is analysed in this article. The South African government introduced formal inflation targeting as a new monetary policy in February 2000.⁴ Inflation targeting (IT) surfaced as a common approach world wide in the conduct of monetary policy in the 1990s.⁵ Inflation targeting puts price stability as the primary objective of monetary policy and the inflation target provides what is known as the nominal anchor for monetary policy. COSATU opposes this policy of the South African Reserve Bank (SARB) since inception for failure to increase economic growth and employment.

Against the primary goal of SARB to create price stability and to anchor inflation expectations, the criticism of COSATU to scrap IT as a policy is analysed in this article. Firstly, a historical overview explains the development and role of labour unions in the South African context. Secondly a short literature analysis describes IT as monetary policy strategy. Thirdly, criticisms of labour and COSATU in particular are discussed amidst inflation expectations, theoretical foundational theoretical issues and the role that SARB plays to create a stable economic environment. Lastly, alternatives to IT explain the complexity of alternatives to prove that the IT monetary policy is indeed the best policy for South Africa and thus also for labour unions and employment in the long term.

A conceptual understanding of labour unions and inflation targeting

Various studies were done by British and American contributors to analyze the nature, the organisation and functions of labour unions. Collective bargaining is an important element of labour unions and the work of Dunlop⁶ established a general theory of industrial relation systems. This theory addressed the rules governing the industrial relations amongst managers, workers and government agencies. Ideology plays an important role, because the ideas and beliefs of all the role-players must be compatible to create a

4 EJ van der Merwe, *Inflation targeting in South Africa*. South African Reserve Bank Occasional Paper No 19 (Pretoria, Government Printer, 2004).

5 FS Mishkin & K Schmidt-Hebbel, *One Decade of Inflation Targeting in the World: What do we know and what do we need to know?* NBER Working Paper Series no 8397, 2001.

6 JT Dunlop, *Industrial Relations Systems* (New York, Henry Holt & Co, 1958).

stable labour environment.

Labour unions are social units which are purposefully created.⁷ Secondly, unions have continuity over time despite changes in membership and official personnel and lastly, unions should have a defined administrative structure. Labour unions are thus a source of power which became a central defining characteristic of the organisation itself. Two main functions of labour unions are their economic activities and their role as agents of social change.⁸ Since the very early days there existed disunity in the clarification of the role of labour in labour unions. Various issues were analysed for example discipline, methodology, ethics and political conviction. Two schools of thought developed, namely the approach based on ethical values that determined labour union growth and character and the structuralist approach which emphasised the conditioning effects of their organisational and external environment.

Monetary policy and fiscal policy on the other hand are two important policies of any country in the conduct of general government policies to manage and to influence the economic behaviour of the inhabitants of a country. Fiscal policy, which is not described in this research, is about the spending behaviour of a government and the taxation practices to influence the economy of a country. Monetary policy refers to the control of the government's bank, also called the central bank, of the liquidity in the economy. Central banks manage the liquidity in an economy to ultimately influence the inflation rate of an economy.

Central banks can stimulate economic activity by means of a decrease in the interest rate pattern of a country. Central banks can also buy securities from the private sector to increase the money supply. Central banks can also apply a contractionary policy. In such a case central banks increase the interest rate pattern of a country or sell securities to the private sector to decrease the money supply. The ultimate goal of these monetary actions is to maintain financial stability.

The application of policy measures by monetary policy authorities in the world changed because of two major developments in the international economic scenario. Firstly, monetary policy authorities used to manage the

⁷ M Poole, *Theories of Trade Unionism: A sociology of industrial relations* (London, Routledge & Kegan, 1981).

⁸ J Child, R Loveridge, & M Warner, "Towards an organisational study of trade unions", *Journal for Sociology*, 7(7), 1973, pp. 1-91.

liquidity in a country by means of money supply targets. This method became cumbersome because of globalisation and big swings in liquidity in the international financial markets. South Africa also became a bigger role player in the international financial markets after 1994 and the monetary authorities could not control the money supply effectively any more. Foreign investors and speculators make investment decisions which the South African central bank can not manage or can not influence. Secondly, in economic literature, the traditional Phillips curve refers to a negative relationship between the inflation rate and the rate of unemployment. The traditional relationship between the inflation rate and the rate of unemployment changed to the expectations augmented Phillips curve because of changed international economic circumstances (refer to IT theory section).

The important feature of IT is that the monetary authority looks forward regarding possible inflation pressures. This policy therefore anchors inflation expectations through regular monetary policy announcements. This policy application targets the inflation rate by means of an inflation index. The South African Reserve Bank, as the central bank of South Africa, used the consumer price index (CPIX) initially which is the consumer price index (CPI) excluding the interest rate component in the basket of consumer goods.⁹ The South African Reserve Bank changed this CPIX index to an updated CPI index in later years as a new and more representative basket of consumer goods to calculate the inflation rate. If the inflation rate is expected to move outside the target range of the index in use, the monetary policy authority of South Africa will react proactively. Inflation targeting is about the current actions of the monetary authority regarding the expected future trend of inflation, whilst the old method of money supply targets analysed the inflation rate in a historical perspective.

A history of labour unions and labour union attitudes on economic policies in South Africa

A concise history of labour unions

The history of trade unions in South Africa goes back as far as 1917 when black workers began to organize themselves and established the Industrial and Commercial Workers' Unions of Africa. The government passed the first

⁹ T Otto & G Henderson, *SA financial markets* (Johannesburg, Profile Media, 2006), p. 83.

labour union legislation, namely the Industrial Conciliation Act in 1924. This act recognized trade unions, but the weakness of this legislation was that only white workers were recognized. During the 1930s the South African Trades and Labour Council (SATLC) came into being which was based on non-racial foundations.¹⁰ This council advocated for legal rights of black trade unionists in South Africa.

SATLC was disbanded in 1954 and replaced by the Trade Council of South Africa (TUCSA). The membership of this labour union included whites, coloureds, Asians and blacks of dependent organisations.¹¹ Membership by independent black unions was excluded from affiliation. Labour unions which were previously associated with SATLC founded shortly thereafter the South African Congress of Trade Unions (SACTU). SACTU later merged with the Council of Non-European Trade Unions and eventually became the labour union associated with the ANC.

Black labour unions became prominent in the 1970s and organized the biggest strike in Durban since the origin of unions in 1973.¹² This mobilization of black workers forced the government to change their attitude towards labour unions. This mobilization of black workers forced the government to appoint a commission of inquiry into labour relations. The report released by the Wiehahn Commission persuaded the government to change their attitude towards the collective bargaining system regarding African workers which was established in a new act. Prior to 1979 the legislation only recognized unions that had white, coloured and Indian members. Since all references to race were removed from the Labour Relations Act of 1979, the creation of new unions developed faster.

Workers established the Federation of South African Trade Unions (FOSATU) in 1979. The creation of the Council of Unions of South Africa (CUSA) followed in 1980. The next big labour union to follow was the National Union of Mineworkers (NUM) in 1982.¹³ This labour union was deeply involved in the political conflict against the ruling National Party and became one of the biggest unions in South Africa. Unity talks between competing unions and federations followed and various competing unions established the Congress

10 J Lewis, *Industrialisation and trade union origin in South Africa, 1924–1955* (Cambridge, Cambridge University Press, 1984).

11 South Africa. 2010 (available at <http://www.sahistory.org.za/organisations/TUCSA.htm>, as accessed on 23 April 2010).

12 A Butler, *Contemporary South Africa* (New York, Palgrave MacMillan, 2009).

13 See A Butler, *Contemporary South Africa*.

of South African Trade Unions (COSATU) in 1985. FOSATU merged into COSATU in the same year. Since inception, COSATU as a far bigger labour representative union played a leading role in the struggle against apartheid.

The then government released a new Labour Relations Act in 1988 which restricted labour union activities. An example was the power furnished to the Labour Court to ban lawful strikes and lock-outs. These powers were short-lived, because negotiations between COSATU and other role players like the South African Committee on Labour Affairs (SACCOLA) produced in 1991 an amendment which effectively repealed the powers of the 1988 act. SACTU, known for their underground activities from exile, dissolved in 1990 and advised its members to join COSATU. COSATU eventually became a member of the tripartite alliance with the ANC and SACP and provided material support in the form of strikes which created both political and economic unrest. These labour union activities eventually lead to the displacement of the National Party and the victory of the ANC in the 1994 democratic elections.¹⁴

Against this background the progressive labour legislation of the 1990s originated in South Africa. The new Labour Relations Act was promulgated which is regarded a result of the ANC and its alliance parties. The legislation of labour is described by Levy as amongst the most labour friendly in the world. Radical reform expressed the sentiments of the majority of trade unions shop stewards and workers. The ideas of radical reform were institutionalized during 1995 when NEDLAC was established. The workers could express their political support through their membership of the ANC while at the same time get their labour demands addressed via their COSATU membership.¹⁵ According to Webster, four parties were involved, namely government, organized labour, organized business as well as communities. Community representatives were however not represented at the National Economic Development and Labour Council (NEDLAC) launch. This poor and marginalized group found it difficult to develop their capacity in NEDLAC since inception. The interests and aspirations of the skilled workers were attended to, whilst the interests of the semi-skilled and unskilled workers were neglected.

¹⁴ African National Congress. 2009 (available at [http://www.anc.org.za/press statements.htm](http://www.anc.org.za/press%20statements.htm), as accessed on 30 May 2010).

¹⁵ E Webster, A Joffe & J Maller, "South Africa's industrialization: The challenge facing labour" in S Frenkel & J Harrod, *Industrialization and labour relations: Contemporary research* (Ithaca, Industrial and Labour Relations Press, 1995).

Past labour union attitudes on economic policies

Labour unions had a political struggle all along in South Africa. Since the new legislation in the 1970s, the support for labour unions (which included black workers) grew rapidly. During the 1980s the political struggle gained momentum and with the establishment of COSATU in 1985 the black workers' voice against government became more prominent. Labour was an important actor in precipitating the transition to democratic order in South Africa. COSATU continued to criticise government after 1994 even though they were a member of the alliance. It is against this historical background of political struggle and criticism against government, that their views regarding economic policy and specific monetary policy are scrutinized.

The militancy of COSATU, particularly during the late 1980s, was a crucial factor in pressurizing the National Party government to lift the ANC ban in 1989. COSATU had a few options to pursue their goals. The option that they have chosen was democratic socialism or also known as radical reform. A key attribute of this radical reform was the process of multiparty negotiating forums. This forums empowered the unions to shape macro economic policy and affecting the country as a whole, therefore broader than pure labour union issues.

One of the major activities of COSATU outside the traditional union sphere was the launch of the Reconstruction and Development Program (RDP). This reconstruction policy was launched by COSATU in January 1993. The SACP also became involved in the new reconstruction and development programme (RDP) since 1993. This development was so important for the SACP that they incorporated the RDP policy as the main theme of their 1995 congress. They used the RDP as a forum for their anti capitalistic revolutionary policies. Although the SACP is more dependent organisationally on the ANC than COSATU, it distances itself from any corporatist bargaining. The SACP therefore has its own ideological identity. The SACP did not immerse in the ANC and their policies, but continued as a lobby group in ANC government against international capitalistic powers.

COSATU has a history of being critical against government policies. During 1996 COSATU published for example two documents regarding their labour and macro economic view. COSATU apposed the 1996 Growth Employment and Redistribution (GEAR) macro economic policy of government since inception and had a different view than government regarding interest rates

and unemployment. Labour unions and specifically COSATU were also directly involved in the promulgation of the progressive labour legislation of the 1990s.

COSATU believed in their ability, particularly during the first years of ANC rule, to influence the government through radical reform. These reforms did not only include worker rights and worker issues, but also the RDP regarding redistribution and therefore broader macro economic policy matters. The union also sent representatives to NEDLAC to negotiate with government and also used mass action to bolster their demands.

Inflation targeting in South Africa since 2000

The history of inflation targeting in South Africa is far shorter relative to the history of labour unions. Inflation targeting (IT) surfaced as a common approach world wide in the conduct of monetary policy in the early 1990s. The South African government introduced formal inflation targeting as a new monetary policy in February 2000.¹⁶ South Africa changed to this new monetary policy method in the pursuit of financial stability in the South African financial markets because of the changed international investment behaviour.

The inflation target was initially an annual average rate of increase in the CPIX. The target rate was between 3 and 6 percent initially, but soon changed to between 3 and 5 percent for the years 2004 and 2005. The target increased again during 2005 to a range between 3 and 6 percent because the monetary authorities continued to miss the lower target range. The annual average target rate was replaced in 2006 by a continuous target. This new target measure must be obtained by the monetary authority continuously per month over a 12-month period.¹⁷

Inflation expectations and theory

Central banks world wide formulate monetary policy strategies to achieve

16 EJ van der Merwe, "Inflation targeting in South Africa", Occasional Paper 19, 2004 (available at <http://www.resbank.co.za>, as accessed on 5 May 2010).

17 O Issing, V Gaspar, O Tristani & D Vestin, *Imperfect knowledge and monetary policy*. The Stone Lectures in Economics (Cambridge University Press, UK, 2005).

price stability. Central banks also face two impediments in this process. The first is the incidence of exogenous shocks that create short-run variation from price stability. The second impediment is the likelihood that private expectations could cease to be synchronized with price stability and become fixed on an inflationary or deflationary pathway. This inflationary bias can be addressed by anchoring the expectations of consumers and financial markets to align to the inflation target.¹⁸ The key characteristic of inflation targeting therefore, if compared with other approaches to control inflation, is that the adjustment of policy instruments relies on a systematic assessment of future inflation.

The South African government implemented inflation targeting in South Africa for four reasons. Firstly, the previous system of informal inflation targeting created uncertainty in the minds of the South African public regarding the exact monetary stance adopted by the monetary authorities. Secondly, the decision-makers agreed that inflation targeting improves the co-ordination between monetary policy and the other economic policies implemented by government. Thirdly, formal inflation targeting was seen as an improvement from the previous system to discipline monetary policy and increase the central bank's accountability because of the clear targets which the central bank has to meet. Fourthly, inflation targeting has a positive impact on the inflation expectations of the public, which generally leads to a reduced inflation rate.

Aron and Muelbauer found that the transparency and effectiveness of monetary policy have improved since the adoption of inflation targeting in South Africa. According to their research, volatility of interest rates and inflation decreased because inflation expectations were anchored in the target range. Monetary policy is under continued attack regardless of this South African empirical study. COSATU and all other parties that criticize IT fail to comprehend that interest rates will remain the main monetary policy instrument as long as the primary goal is to maintain price stability.

In the event that the central bank abandons the attainment of IT and therefore price stability as its primary objective, a decrease in interest rates can be expected to improve the living cost of the poor. This is indeed what COSATU demands, but it is merely a short run trade off. Living cost should

¹⁸ EJ van der Merwe, "Inflation targeting in South Africa", Occasional Paper 19, 2004 (available at <http://www.resbank.co.za>, as accessed on 5 May 2010).

decline because borrowing cost at banks will decrease and instalments on existing loans will decrease and disposable income will therefore increase. In the long run, the inflation rate will continue to increase because inflation expectations are not addressed by the monetary policy authorities. This short term policy will hurt the very poor that COSATU are trying to protect the most, because of rising and unsustainable prices in the long run. The poor also lack the necessarily skills and instruments to hedge themselves against rising inflation.

In the last cycle of restrictive monetary policy since writing, the South African Reserve Bank increased interest rates once again in August 2007. COSATU reacted to this increase in interest rates as follows:¹⁹

COSATU is appalled that the Reserve Bank announced yet another increase in interest rates by 0,5% bringing the total increase over the past 12 months to 2,5%. The relentless rise in the cost of basic foods and other essentials is already devastating the lives of the poor. Now they face the added burden of higher costs for housing and loan repayments. Recent strikes are more than ever justified by the latest assault on the living standards of workers and the poor. The fundamental mistake the Reserve Bank keeps making is the failure to identify high levels of unemployment and poverty, rather than inflation, as the key challenges facing the country.

Various theoretical arguments support prudent monetary policy. According to Taylor²⁰ the main difference between inflation targeting and other monetary policy frameworks is that IT incorporates all the information contained in the macro variables to set the basic interest rate, while other regimes' only incorporates part of the information that is available to determine the interest rate. An important element of the Taylor rule is that nominal interest rates rise more than one-for-one with inflation so that the real interest rate can increase in relation to the inflation rate.

The Fisher equation is another theoretical argument which states that the level of nominal interest rates is equal to the real interest rate plus the level of inflation expectations. This relationship implies that the level of interest rates is affected by inflation expectations. Therefore, if inflation expectations are not anchored, inflation expectations may continue to increase, resulting in a higher level of nominal interest rates in the future.

¹⁹ As reported by SAPA, "Rate hike appalling", 16 August 2007

²⁰ FS Mishkin, *International experiences with different monetary policy regimes*, NBER Working Paper Series no 6965, 1999.

Unemployment and inflation are two economic goals that are sensitive issues for the public and therefore difficult for the policy makers to address. Phillips²¹ stated that there is a trade-off between inflation and unemployment, therefore that unemployment and inflation are negatively related. If the monetary policy makers reduce inflation, they therefore create unemployment. This negative relationship which became known as the Phillips curve, lasted for many years. Empirical work since the first oil crisis in the early 1970s proved that the negative relationship between unemployment does not exist any more.

The negative relationship between inflation and unemployment vanished since the beginning of the 1970s according to the studies of Nobel Laureates Milton Friedman and Edmund Phelps. They emphasized a new relationship and proved that there is not a stable negative relationship between these economic twin evils. Their empirical research proved that a negative relationship exists between unanticipated inflation (the difference between actual and expected inflation rates) and cyclical unemployment (the difference between the actual and natural unemployment rate). This relationship became known as the expectations augmented Phillips curve.

The empirical work done by Friedman and Phelps proved that the trade-off between inflation and unemployment exists only in the short run.²² The world experienced cost push inflation in the nineteen seventies after the first oil crisis which suggested that the theory of the original Phillips curve did not last any more. The key factor that central banks have to manage according to this changed environment is inflation expectations. The arguments of a negative relationship between unemployment and the inflation rate based on the initial Phillips curve by COSATU have therefore no foundation since the adoption of the expectations augmented Phillips curve.

COSATU comments about the negative relationship between inflation and unemployment as represented by the original Phillips curve and the expectations augmented Phillips curve as follows:²³

COSATU condemns in the strongest possible terms the incompetence displayed by SARB in its decision to leave the repo rate unchanged in the face of an economic recession and massive job losses. The Monetary Policy

21 AW Phillips, "The relation between unemployment and the rate of change of money wage rates in the United Kingdom, 1861 – 1957", *Economica*, November (25), 1958, pp. 283-299.

22 AB Abel, BS Bernanke & D Croushore, *Macroeconomics* (Pearson, New York, 2008).

23 Anon, COSATU condemns interest rate freeze, 26 June 2009 (available at: <http://www.liberationafrique.org>, as accessed on 10 June 2011).

Committee (MPC) has got it grossly wrong on the basis of its statement to use the inflation expectations as a guide even in the context of a recession. The MPC statement says nothing about how its decisions address existing macroeconomic imbalances. COSATU will be arguing vigorously within Nedlac and the Alliance for a complete review of interest rate policy and will be mobilising its members to campaign for reductions in the repo rate.

Macro policy

It appears against the historical background of labour unions in South Africa, that COSATU were involved with economic legislation and labour policies which is not a true reflection of labour unions' functions. COSATU opposed the GEAR macro economic policy of government since inception in 1996. According to the GEAR policy²⁴ the government maintains that they have hegemony as coordinator amongst the various rival sectors of the economy, in particular between capital and labour. The ANC feels that labour is a conduit to capital, which in turn is important for industrial investments and therefore to create jobs and social services. The state expects of the unions to mobilize the masses. The state believes through the unions' links with the masses that they can convince investors of their ability to guarantee industrial peace.²⁵

Various other examples can be stated of COSATU about activities outside the associated sphere of labour unions. During 1996 COSATU published documents regarding their labour and macro economic view. COSATU had significant neoliberal reforms in mind and accused the government for lack of consultation with its alliance partners. According to these documents COSATU has a different view than government regarding interest rates. COSATU encourages direct government intervention and lower interest rates. The government was reluctant to decrease interest rates and to increase government spending at the time, because of the fear of higher inflation in the longer term.

Government also encourages a model by means of wage flexibility according to the Growth Employment and Redistribution (GEAR) strategy. COSATU on the other hand supports a minimum wage policy. COSATU's neoliberal

24 South Africa. 1996. Department of National Treasury (available at <http://www.treasury.gov.za/publications/gear>, as accessed on 12 May 2010); A Levy, *Annual report on labour relationships in South Africa 1996 – 1997* (Johannesburg, Andrew Levy and Ass, 1996) .

25 South Africa. 1996. Department of National Treasury (available at <http://www.treasury.gov.za/publications/gear>, as accessed on 12 May 2010).

reforms and criticism against GEAR also involved tariff reforms, the removal of exchange controls and opposition of any government institutions being privatized. These recommendations are not part of the scope of a labour union. These reforms were also according to government announcements outside the scope of COSATU as a labour union and against the spirit of reform.

Black Economic Empowerment policy

Another example of the ANC and its alliance parties outside the traditional union sphere was the implementation of the Black Economic Empowerment (BEE) policy in 2000. Through empowerment charters, medium- and long-term goals for black ownership, skills empowerment and capacity building were set as a government strategy to promote black ownership of companies in the economy. This strategy of government laid the foundation for the Department of Trade and Industry (DTI) to launch the Broad Based Black Economic Empowerment Code of Good Practice.²⁶ This empowerment code focused on targets for black equity and ownership, employment equity, skills development, equity procurement and enterprise development by a points system for South African companies. The broad target which government set for companies was 25% black ownership by 2014. This approach has the potential to change the face of South African industry by means of transformation. There are examples of penetration by various black individuals in the corporate sector. Some of them have accumulated spectacular wealth, for example, the well known names like Tokyo Sexwale, Cyril Ramaphosa and Patrice Motsepe.²⁷

The above mentioned race-preferring policies have a long history in South Africa mainly because these policies are popular with voters. Various studies and articles argue that the BEE policy from an economic growth perspective decreases economic growth. Only an elite group of citizens enjoy the benefit of this policy whilst the poor and unemployed masses do not share in an improvement of living standards. This policy also gives rise to other costs that reduce economic growth, but an analysis of the BEE policy falls outside the focus of this research. The political cost of implementing black race-preferring policies also induced inefficient distortions into the economy. It can be

26 South Africa. 2004. The Department of Trade and Industry (available at <http://www.dti.gov.za/BEE>, as accessed on 22 April 2010).

27 Anon, The richest black man in South Africa, 2010, (available at: <http://www.therichestman.org/nation/richest-black-in-south-africa>, as accessed on 31 July 2010).

politically deduced that an efficient BEE level must exist but deviations from what is regarded as efficient have a negative impact on economic growth. It is argued that white human and financial capital have been alienated (in a country where both types of capital are scarce) and black human and financial capital have been channelled toward redistribution rather than the generation of new enterprises.

The impact of the redistribution of wealth, together with the failure of government to use government revenue economically, created a negative impact for economic growth.²⁸ Labour unions became more militant over time with industrial actions regardless of the high South African unemployment levels. Strikes became a common avenue for labour unions to express their dissatisfaction with employers. These losses of production in industry worsen the already high cost of South African production which reduces international competitiveness even further. Wage demands by labour unions are also pitched higher than inflation. This tactic of labour increases inflation, especially if this demand for higher wages is not matched by an increase in productivity.

Inflation targeting policy versus other economic policies

COSATU has a history of being critical of what it perceives as the SARB's damagingly strict application of IT. Contemporary statements of COSATU confirmed their continuation to criticise the IT policy. COSATU's argument is that the SARB should run an expansionary monetary policy, allowing inflation to increase in order for unemployment to decline. A 2007 claim of COSATU states that inflation targeting:²⁹

.....contributed directly to slowing down the rate of economic growth and thus of job creation and poverty alleviation.

COSATU in 2008³⁰ explained their disappointment with economic growth figures below the targeted 6% of government as follows:

At the heart of the problem is the Government's disastrous inflation targeting policy, which is based on the false belief that inflation and excessive consumer spending, rather than unemployment and poverty, are the major problems we

28 Compare D Carline, CA Pissarides, WS Siebert & PJ Sloane, *Labour Economics* (London, Longman Group, 1985); COSATU, 2007, (available at <http://www.cosatu.org.za/press/2007.htm>, as accessed on 15 June 2010); COSATU, 2008, (available at <http://www.cosatu.org.za/press/2008.htm>, as accessed on 25 May 2010).

29 COSATU, 2007 (available at: <http://www.cosatu.org.za/press/2007.htm>, as accessed on 15 June 2010).

30 COSATU, 2008 (available at: <http://www.cosatu.org.za/press/2008.htm>, as accessed on 25 May 2010).

face.

While the effect inflation targeting has on growth and employment should not be ignored, this effect is trivial when compared to other more prominent barriers to employment creation in South Africa. South Africa's unemployment rate is unresponsive to both inflation and growth due to structural inflexibility of the labour market.³¹ Various other policies of government need a review to improve employment, for example a simplification of the tariff structure of the trade and competition policy and a shift in focus of the Industrial Development Corporation regarding the financing of new activities.³² Further examples of actions that the government should engage are to increase the low saving rate in South Africa, to control the population inflow at the South African borders, to implement measures to improve productivity and to increase the investment in human capital.³³

COSATU also has grievances about the exchange rate policy of SARB. COSATU believes that inflation targeting has damaged South African exporting industries. The argument is based on the fact that inflation targeting has caused:³⁴

An overvalued currency ... a consequence of the significant inflow of capital; attracted by relatively high interest rates.

The argument begs the question: If COSATU sees an inflow of foreign capital as negative, how do they plan to fund the investment necessary for growth in South Africa? This challenge is near impossible against the low savings rate of South Africa. Foreign investment is generally considered positive for growth. Populist economic policies are short term based, whilst the vision of the SARB is forward-looking and seeks the optimal policy for long-run financial stability.

COSATU also called for a reversal of foreign exchange measures to relax exchange controls and for taxes on short-term capital flows in 2010. COSATU wants the Rand exchange rate much weaker at 10.0 to the USA dollar to support the manufacturing sector. COSATU stated:³⁵

31 FS Barker, "On South African labour policies", *South African Journal of Economics*, 67(1), 1999, pp. 1-33.

32 COSATU, 2007 (available at: <http://www.cosatu.org.za/press/2007.htm>, as accessed on 30 July 2010).

33 J Aron & J Muellbauer, Personal and Corporate Saving in South Africa. *The World Bank Economic Review*, 14(3), 2000, pp. 509-544.

34 COSATU, 2007 (available at: <http://www.cosatu.org.za/press/2007.htm>, as accessed on 30 July 2010).

35 As reported by Reuters, *COSATU seeks forex policy reversals*, 14 Sep 2010.

The Reserve Bank must resist pressures on the real exchange rate to appreciate.....and must accumulate reserves aggressively.

ANC politics

After the ANC-COSATU-SACP Alliance Summit meeting of May 2008 a statement was released. This statement reaffirmed the ANC-led alliance power regarding strategic political and economic issues:³⁶

It was agreed that the Alliance will work together to formulate policy, and monitor its implementation through joint ANC/Alliance policy committees and other mechanisms. This will include the drafting of the ANC Election Manifesto for the 2009 elections and matters pertaining to deployment. These kinds of interactions will become a permanent feature of alliance processes in the formulation, implementation and monitoring of policies.

After the ANC-COSATU-SACP Alliance Economic Summit in October 2008 a statement was released by the ANC on behalf of the alliance members that South Africa's economic strategy requires:³⁷

A discussion on the mandate and practices of the SARB to include considerations of employment and economic growth in addition to the mandate on price stability.

Another contemporary statement of COSATU³⁸ and SACP confirmed their involvement in political activities. These two alliance members have been the united forces behind the presidential ambitions of Mr Zuma. They supported him all along to become the new President of South Africa and have called him sharply into line after becoming president over specific issues. The most notable example was regarding his comments in support of a more flexible labour policy.

The strong influence of COSATU and the SACP, reflected in the above declarations, is clear evidence that COSATU operates outside the scope of a pure labour union. COSATU was all along actively involved with politics, labour legislation through radical reform as well as the formation of macro economic policies.

36 African National Congress, 2008 (available at <http://www.anc.org.za/press statements.htm>, as accessed on 10 June 2010).

37 African National Congress. 2008 (available at: <http://www.anc.org.za/press statements.htm>, as accessed on 12 June 2010).

38 COSATU. 2008 (available at: <http://www.cosatu.org.za/press/2008.htm>, as accessed on 20 June 2010).

Supply shocks and international experience

An adverse supply shock typically raises inflation and lowers aggregate demand (by reducing the purchasing power of consumers) and thus pushes output down. South Africa experienced a series of supply side shocks in 2008 and 2009, stemming mainly from international energy and food markets, causing an upsurge in inflation. According to the South African Reserve Bank, South Africa has been outside of its target range of 3 – 6% since early 2008.³⁹ If such a supply shock scenario exists, the question remains: should monetary policy stimulate the economy to reduce the fall in output or apply a contractionary policy⁴⁰ to counter the rise in inflation expectations?

Under an IT framework, the monetary authorities want to achieve price stability, as it is their primary objective. The prices in the economy are not the operational variable, but nominal interest rates are and therefore SARB should continue to achieve price stability through higher interest rates to offset the second round impact of the supply shocks. SARB is not increasing interest rates to control exogenous price factors. They are raising interest rates with the intention of controlling the second round effects of inflation expectations. Rising inflation has the effect amongst consumers to expect a continuous increase in inflation. If the policy makers do not increase interest rates in such an event, inflation continues to increase based on perceived inflationary pressures rather than real price pressures.

What COSATU needs to appreciate is that, firstly, the economy has been exposed to supply side shocks in 2008 and 2009 and secondly that this condition does not hold in the long term. It therefore makes no justifiable sense to pursue a policy that has possible short run employment and output benefits but generates imbalances in the economy in the long run. Against this background, it will not serve the interests of the South African monetary authorities to lift the inflation targeting framework if a supply shock occurs. It is also a well known fact that excessive government expenditure induces inflationary pressures, especially in developing countries such as South Africa.⁴¹

39 South African Reserve Bank, Monetary Policy Review, May 2008 (available at <http://www.resbank.co.za>, as accessed on 5 May 2010).

40 A contractionary policy means that inflation is rising too fast and that the monetary authority increases the repo rate to reduce the impact of the negative factors, thereby reducing economic activity and thus ultimately to stop the rising trend in the inflation rate.

41 South African Reserve Bank, Monetary Policy Review, May 2006 (available at <http://www.resbank.co.za>, as accessed on 5 May 2010).

In the table below an analysis of growth and inflation rates indicates what happened in five countries 10 years before and 10 years after the implementation of IT as a policy framework. According to this comparison the inflation rate declined after the implementation of the IT framework in all the countries. This study also confirmed that the growth rate improved and that there was no negative trade off relative to growth.

Table 1: Inflation Pre and Inflation Post

Country	Inflation – pre	Growth - pre	Inflation – post	Growth - post
NZ	11.4	1.8	2.1	3.0
Canada	5.7	2.8	2.0	2.7
UK	5.5	2.5	2.5	2.9
Australia	6.0	3.2	2.6	3.8
Sweden	6.7	1.9	1.5	2.5
Average	7.1	2.4	2.1	3.0

Source: Federal Reserve Bank of Philadelphia⁴²

Into the future with inflation expectations

Considerable theoretical debate exists whether monetary policy measures can affect real economic variables in the long run. The South African Reserve Bank emphasizes the importance of price stability at all times.⁴³ An independent monetary policy is crucial to reduce the negative impact of inflation on economic growth. This theoretical fact, proved in practice in various countries, is crucial to create employment in the long term.

Various alternatives to inflation targeting exist according to Mishkin⁴⁴ and Epstein⁴⁵ and will be referred to briefly. The first alternative available to countries is exchange rate targeting. This form of monetary policy involves either fixing the exchange rate to a commodity, or fixing the exchange rate to the currency value of a large economy with a low inflation rate. This form of targeting is criticised because of the loss of an independent monetary policy,

⁴² Federal Reserve Bank of Philadelphia, 2006 (available at: <http://www.philadelphia.fed.org/research-and-data/publications/business-review>, as accessed on 20 May 2010).

⁴³ South African Reserve Bank. 2002. The Objectives and Importance of Inflation Targeting, a new policy framework. (available at: <http://www.resbank.co.za/policy>, as accessed on 1 June 2010).

⁴⁴ FS Mishkin, International experiences with different monetary policy regimes. NBER Working Paper Series no 6965, 1999.

⁴⁵ G Epstein, *Alternatives to inflation targeting monetary policy for stable and egalitarian growth: A brief research summary*, Paper, First Annual Conference for Development and Change (ACDC) - Trespassing in Development Theory and Practice: Towards a New International Policy Agenda, Antigua, Guatemala, 2003).

which diminishes the ability to respond effectively to domestic supply shocks.

A second alternative is monetary targeting. Exchange rate targeting is not possible where a country is too large or no obvious country exists to which it can peg its currency. If such a scenario exists, then monetary targeting is a better alternative. This method is criticised because it can only be employed if a strong and reliable relationship exists between the goal variable and the targeted aggregate, implying that there should be no velocity instability.

A third alternative method is price level targeting. Price level targeting aims to keep the general price level within a certain limit. Since inflation is the continuous increase in the price level, this policy seems to be much the same as inflation targeting. The key difference lies in the approach to time: whereas inflation targeting is a forward-looking policy, price-level targeting adopts a backward-looking stance. By adopting a backward-looking approach, the problem exists that there is no objective measure which can be used to anchor either public or central bank behaviour.

A fourth method is employment targeting. According to this viewpoint, high unemployment is the cost of fighting inflation, the so-called sacrifice ratio. A real variable is proposed to meet this challenge, for example employment growth or unemployment. This alternative focuses on a macroeconomic variable that has an immediate association with social welfare in South Africa. This target method is close to what COSATU argues for, but it is very complex because no monetary target is targeted. It therefore requires new monetary policy tools.

A fifth method is close to the fourth target method. A real target is used according to Epstein⁴⁶ which is appropriate for a particular country, for example poverty levels. This is exactly what COSATU is advocating for because they argue that important real variables are often ignored for the sake of price stability. This target method is however very complex with comparable problems as is the case with the previous mentioned target. A further disadvantage is the considerable theoretical debate whether monetary policy can affect real economic variables in the long run.

Lastly, monetary policy with an implicit anchor can be used, namely a coherent policy that exists to meet the goals of the central bank in the long run

⁴⁶ G Epstein, *Alternatives to inflation targeting monetary policy for stable and egalitarian growth: A brief research summary*, Paper, First Annual Conference for Development and Change (ACDC) - Trespassing in Development Theory and Practice: Towards a New International Policy Agenda, Antigua, Guatemala, 2003).

and which is combined with a definite forward-looking behaviour. Monetary policy has long lags between implementation and results, thus it makes sense for policy makers to be pre-emptive. There are numerous disadvantages to this strategy, namely the lack of transparency, the lack of accountability to judge the success of the central bank because no clear criteria exist and there is a strong dependence on the preferences, skills and trustworthiness of the central bank.

Conclusion

Black labour unions in the South African economy before 1970 experienced lack of recognition by the government. The mobilization of black workers since 1973 persuaded the government to change their attitude towards collective bargaining regarding African workers. Prior to this period the legislation only recognized unions that had white, coloured and Indian members. The Wiehahn Commission was a watershed period in the history of South African labour unions. The Labour Relations Act of 1979 followed and all references to race were removed in the legislation. New labour unions developed faster since this legislation and labour unions obtained gradually more power.

Workers established more labour unions and were deeply involved in the political conflict against the then ruling National Party. Unity talks between competing labour unions followed and various competing unions established COSATU in 1985. This labour union as a far bigger representative union played a leading role in the political struggle and also economic policies.

The history of COSATU is layered with economic legislation, criticism of economic policies and promulgation of labour policies to improve work conditions in favour of the workers which is not a true reflection of a labour union's functions. Examples are the launch of the Reconstruction and Development Program by COSATU in January 1993, the severe criticism of the GEAR macro policy in 1996 where COSATU had a different viewpoint than government regarding interest rates and unemployment and the big impact of COSATU to promulgate the new labour policies of the nineteen nineties.

COSATU influenced the government in numerous ways, for example through radical reform, being a summit member about strategic issues in South Africa and also as an alliance member to direct political activities in South Africa.

As an alliance member of government COSATU were involved with activities outside the traditional union sphere, for example the implementation of the Black Economic Empowerment (BEE) policy in 2000.

COSATU has a history of being critical about economic policies of government. COSATU criticises the SARBs damagingly strict application of IT and regularly calls, for a review of the inflation targeting policy framework in South Africa.⁴⁷ The debate on the merit of IT is contentious due to the relative short time dimension associated with this policy framework in South Africa. The past performance of inflation targeting has proven that there is no comprehensive evidence to abandon the policy framework. Empirical studies proved that if IT is dropped as a policy measure, it will result in a higher nominal interest rate spectrum as inflation expectations will not be anchored by the SARB.

The vision of the SARB is very clear namely to achieve and to maintain price stability.⁴⁸ The function of the SARB as an independent political institution is anchored in the South African Constitution and also in an act. The main focus of SARB is to create a stable financial scenario and not to create employment. The creation of growth and employment is anchored in fiscal policy as recorded by the well known theory of Keynes.⁴⁹

COSATU's concerns are reasonable but they represent a great deal of misconceptions about inflation targeting. Various populist statements by COSATU lack basic economic reasoning. If COSATU's monetary policy demands are met to reduce interest rates in the short run, the circumstances of the very poor that COSATU are trying to protect, will merely worsen in the long run. If the inflation rate continues to increase because the causes of inflation are not addressed by the monetary policy makers, the poor will be hurt by high and unsustainable prices in the long run which will reduce their spending power and worsen their living standards.

COSATU share in the blame for the rise in unemployment in South Africa. As a member of the political alliance which governs the country, they are involved with issues that are not related to the true nature of a labour union.

47 African National Congress. 2009 (available at [http://www.anc.org.za/press statements.htm](http://www.anc.org.za/press%20statements.htm), as accessed on 10 May 2010).

48 South African Reserve Bank. 2005. Mission statement. (available at: <http://www.resbank.co.za>, as accessed on 20 May 2010).

49 JM Keynes, *The General Theory of Employment, Interest and Money*, 13th ed. (Cambridge, Cambridge University Press, 1973).

They advocate for example continuously for higher wages without improved productivity of their members, whilst their activities to change labour policies in favour of the workers in South Africa increase the costs of labour. Rigidities in the labour market fuelled higher wage agreements, surpassing increases in labour productivity growth. The contribution of COSATU towards the rigidity and high cost of the South African labour market, therefore reduces access opportunities for the vast number of unemployed people in South Africa.⁵⁰

Furthermore, all labour union arguments that propose monetary policy to reduce unemployment have to consider the studies done by Laubscher⁵¹ where he emphasizes the important difference between cyclical and structural unemployment. According to this research cyclical unemployment is caused by a decline in demand and structural unemployment is caused by factors such as skill shortages and poor education. The problem with the South African economy is not that it is not growing, but that the growth rates achieved are less than what it should be to reduce the high unemployment rates over various decades.

According to the Department of Statistics⁵², the unemployment rate in South Africa in 1993 was 30,1% and by 2010 it dropped to 23,5%. These figures, though it shows improvement, still reflect a high unemployment rate in South Africa that is a lasting problem which is driven by structural unemployment. As an economic problem, unemployment can not be addressed by monetary policy only which focuses on liquidity factors and not other factors like skill shortages, poor education and lack of infrastructure development.

The performance of inflation targeting exceeds that of any alternative monetary policies. The newly appointed Minister of Finance in 2009 stated in his first budget speech in February 2010 that the IT policy and target range will stay intact. The Minister of Finance confirmed in his budget speech of 2011 that the IT policy stays intact. Prudent monetary policy and the maintenance of financial stability in South Africa in the long term stay thus intact regardless of the criticism of COSATU.

50 J Laubscher, 2009. Monetary policy – everybody's favourite straw man (available at: <http://www.sanlam.co.za/eccommentary>, as accessed on 30 April 2010).

51 S du Plessis, Proposals for Strengthening the SARB's Inflation Targeting Regime. *South African Journal of Economics*, 73(1), March 2005, pp. 337-354.

52 South Africa. 2010. Department of Statistics, (available at: <http://www.statistics.gov.za/indicators>, as accessed on 15 June 2010).