

## **Note on fiscal and monetary policies development in Nigeria and South Africa**

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### **Abstract**

This economic note presents the fiscal policy and monetary policy environment in Nigeria and South Africa being the largest economies in the continent. The discussion is expected to be a source of motivation and learnings for other countries from the continent to learn from the successes and woes if any of these big economies for overall prosperity of the African continent. The rest of the note is structured as follows. Section 2 gives the summary of political and economic developments in the two countries. It is followed by section 3, which highlights the overview of the key fiscal indicators. Section 4 examines monetary policy regimes and monetary policy performance in both countries. While the last section gives the synopsis of the study.

**Keywords:** Fiscal and monetary policies, development, Nigeria, South Africa.

### **1. Summary of political and economic developments**

#### **1.1 Nigeria**

The modern Nigeria got her 'flag of independence' in 1960 amidst other African nations. However, the democratic system of government was intercepted by a military coup in January 1966 (Ayodele & Falokun, 2003). The country has since then experienced six successful military coups, and a Civil war. The country returned to democratic system of government in 1999 with the adoption of a presidential system of government as adopted at the inception of the second republic in 1979 before the 1983 military coup (Falola & Heaton, 2008). Nigeria as a democratic nation has been able, peacefully and successfully to hand over power from one democratic government to the other since 1999. The last handover of power witnessed was on 29 May, 2015 where for the first time, a ruling party peaceably handed over power to an opposition party (Afolabi, 2015).

It is worthy of note that at Nigeria's independence, expectations and hopes throughout the country were great and the capacity for development were boundless (Oko, 2001). These were so, because of her abundant resources and her favourable climatic condition which supports variety of agricultural activities. In fact, the developed

countries believed in her capacity to champion human and technological civilisation in the continent of Africa.

Regrettably, the Nigerian economy has remained perpetually underdeveloped. There is massive underutilisation of capitals and other resources. Also, the industry sector of the country is not operating at optimum level (Okon, 2001). Despite being abundantly blessed with material and human resources, cost of production remains perpetually high with mounting unemployment (Osigwe, 2014: 1-256). In addition, crude oil is the only natural resource endowment being tapped, and its production has been unfavourably hindered by the crisis in the Niger-Delta area of the country and massive corruption (Osigwe, 2014). The International Monetary Fund (IMF, 2002) categorized Nigeria as highly indebted nation with serious problems of servicing the debt despite huge revenue realised from oil. As of March 2021, Nigeria's total public debt has hit N33.1 trillion (\$87.24 billion). (Debt Management Office, 2021). Undoubtedly, these create serious obstacles to national drive for socio-economic and political development.

The peculiar nature of Nigeria's economy since 1970 that is worthy of mention. She heavily depends on petroleum and this is responsible for more than 87 percent of her export and more than 77 percent of the total revenue (NBS, 2015). Volatility in oil as well as prices was also an important feature of the economy in the 1980s. This situation was witnessed again in 2015 (NBS, 2015). Nigeria's development profile shows that endowment of rich and abundant natural resources is not a guaranteed for economic development. Abundant natural resources must be supported with sound macroeconomic policies, purposeful leadership, sound regulatory framework, efficient and functioning judicial system and zero tolerance for corruption (NBS, 2015).

## 1.2 South Africa

The fall of the Soviet Union brought the resolution of many political deadlocks worldwide. For South Africa, 1990 marked the start of political talks to bring full democracy to South Africa (Cassim, 2015:2). South Africa faced enormous political, economic and social challenges and issues of reconciliation and reconstruction. Prior to this period, South African politics were controlled by Afrikaner nationalism (Abedian, 2012:5). Apartheid formally known as racial segregation and white minority rule came into existence in 1960 (Abedian, 2012). On 27<sup>th</sup> of April 1994, after years of struggle and global opposition to apartheid, the ANC gained victory in first democratic election in which everyone could vote irrespective of their colour (Stone, 2006). Since 1994, the politics of South Africa has been dominated by ANC, in an uneasy alliance with the South African Communist Party (SACP) and the Congress of South African Trade Unions (COSATU). The peaceful and stable transition of South Africa to democracy was universally recognised as one of the major achievements of the 20<sup>th</sup> Century (Hedley, 2014).

The Reconstruction and Development Programme (RDP), a unified socio-economic plan, was adopted in 1994 so as to transform the economy after several years of the apartheid policy (David, 2015:3). The central goal of RDP was to ensure a fair society and entrust equity via re-establishment and economic expansion. The RDP

aimed at creating a sound economy and developing human potentials. It also aimed at ensuring fair employment and promotion and ensuring economy at the regional level. The last aim of RDP was to democratise the state and society. These aims were popularly known as the five policy programmes of RDP. More essentially, the policy programmes were aimed at solving various problems of inequality in the economy (Stone, 2006:2). Originally, the 1994 RDP document stated thus “to mobilise all our people and our country’s resources towards the final eradication of apartheid and the building of a democratic, non-racial and non-sexist future” (Stone, 2006).

Although the RDP recorded success in some areas such as social security and welfare system, it however faced serious hitches in several areas such as fiscal and organisational constraint. The hitches could be associated to inefficient public service and lack of state capacity (Cassim, 2015:2). The overall resultant effect of these constraints was the inability of the RDP to deliver the dividends of democracy as was expected. This left South African government in search of alternative economic policies. In 2016, government bureaucracy, restrictive labour laws and inadequate manpower were among the most serious challenges facing the country. However, the banking sector of the country was rated among the best in the world (World Bank Report, 2016). The nation was also ranked among the G-20 (World Bank Report, 2016).

## 2 Overview of fiscal policy indicators

### 2.1 Nigeria

An appropriate understanding of the fiscal system of a country demands adequate and coherent explanation on the trend and the pattern of revenue and expenditure over time (Ayodele & Falokun, 2003). Nigeria’s economy has remained perpetually undiversified from the oil boom days. The greater share of exports and government revenue has consistently depended on oil (Okonjo-Iweala, 2011). Expenditure of government in Nigeria has been fluctuating and highly unstable. The volatility in government expenditure could be associated to the fact that spending of government has been increasing with increase in oil prices and revenue, until 2014 and 2015 declines in oil prices.

Succeeding administrations in Nigeria have continuously recorded high expenditure during oil. The country’s loose fiscal policy and fiscal indiscipline aggravated the volatility in prices and revenue. Government revenues from oil and spending increased as oil prices increased (Okonjo-Iweala, 2011).

As a result of the fluctuation of expenditure, the fiscal stance of government of Nigeria have been largely in deficits with the exception of 1970s when fiscal positions were surpluses (Sanusi & Akinlo, 2016). The total budget surplus as a percentage of GDP fluctuated from only 1.5 percent in 1973 to 9.8 percent in 1974 (Okonjo-Iweala, 2011, Sanusi & Akinlo, 2016). The recorded surpluses of the early 1970s were truncated decrease in oil prices at the global market. The total deficit-GDP ratio rose to 7.8 percent in 1978 from 2.0 percent in 1975 because of the inability of the government to adjust its expenditure in response to the declining oil revenue (NBS, 2015).

Capital and recurrent of the federal government were further spiked in the 1980s

by the execution of programmes like creation of state and increase in wage (Oko, 2001). The newly created institutions required grants and important infrastructures to kick off their operational activities. The resultant effect of this is increase in deficit by up to 5.7 percent of GDP in 1986, and 1993 as well (Ayodele & Falokun, 2003). As a result of the falling oil revenue, the gap between declining oil revenues and rising expenditures were financed by means of foreign borrowing and central bank's interventions. Pressures were mounted on the government to cut expenditure because of the unpleasant effects of both sources of financing deficits (Sanusi & Akinlo, 2016). Financing of the most of the capital expenditures and other infrastructures were halted due to paucity of funds (KPMG Reports, 2015).

The return of democratic system in 1999 marked the beginning of another period high expenditures commonly characterised democratic system of government. The oil sector of the economy was faced with another challenges in 2014 with average daily production falling to 2.2mbpd as against the budget bench mark of 2.38mbpd. On the average, the sector grew only in the first quarter by 5.14% while decline of 6.6 percent and 3.6 percent were recorded in the second and third quarters respectively (DMO, 2015).

The GDP growth rate was projected to be 0.5 percent for 2015 because of the falling prices of oil and challenges of production. An aggregate expenditure of N4.358 trillion was specified in the 2015 budget. This was 8 percent less than the amount for 2014 (DMO, 2015: 11). The more worrisome situation was that recurrent expenditure rose by 6.5 percent while capital expenditure declined by 43 percent. Dejectedly enough, amount expected to expend on debt servicing was proposed to increase. More specifically, debt servicing was proposed to increase by 32.4 percent as against the 20.3 percent in the 2014 budget estimate, (Punch News Paper, 2015).

Conclusively, the deficits' profile of Nigeria has got to an alarming level. The government of Nigeria has been incurring deficits since 1967. The deficits have persistently been increasing and the instant effects are damnable. For example, the external debt size as at 2015 was put at USD60billion. Nigeria's external debt rose by \$11.77bn between mid-2015 and the mid-2018, (DMO, 2018). Unfortunately, there is no signal that it might decline in subsequent years, especially as the country approaches 2019 which is another election year.

## 2.2 South Africa

At the inception of democracy in 1994, the economy was weak and crisis dominated (South African Act of Parliament, 1994). The budget deficit was said to be historically high in 1994 though with limited exposure to foreign debt (Department of Finance, 1996). The limited exposure to foreign debt was as a result of restricted access to international capital markets prior 1994 (Department of Finance, 1996). The overriding goal of fiscal policy has been to attain and sustain a progressive decline in the budget deficit, reduced government expenses (Department of Finance, 1996). Investment spending was also projected to increase.

Budget deficit that could not be sustained implied cost of borrowing would increase with paucity of funding for essential government programs. However, the budget balance became better as deficit fell 4.8 percent of GDP in 1994 to 0.5 percent by 2005

(IMF, 2010). The aftermath of budget deficits of the subsequent years made it possible for government to raise her spending without resulting to borrowing. This was partly sequel to improved tax revenue collection. During the worsening economic crisis of 2009, the debt of government increased seriously (Industrial Development Corporation, 2013). Government had to borrow more in order to finance the increased fiscal deficit.

The economy incurred another huge deficit after 2008/09 and the ratio of debt and GDP was 36.3 percent by 2012/13 (Industrial Development Corporation, 2013). After 2000s, government had adopted a counter-cyclical stance. Within the framework of counter-cyclical stance, infrastructural investments, human capital investments, discouragement of importation were seen as important factor for accelerating growth (International Budget Partnership, 2012). The cyclical stance includes stabilisation of expenditures in order to stimulate growth and development (International Budget Partnership, 2012). The level of debt was believed to be viable with various measures being adopted. Consequent upon steady and good budgetary policies, South Africa was able to explore global bond markets with minimum sovereign risk spreads. South Africa was rated second among about 90 countries surveyed in 2012 in terms of transparency and accountability of budget processes (International Budget Partnership, 2012). Nevertheless, Recent rating has not been impressive due to slow growth, increased debt and current account problem.

### **3 Monetary policy regimes and performance**

#### **3.1 Nigeria**

This section of the study examines the various monetary policy regimes in Nigeria and monetary policy performance under various regimes. Monetary policy is an important instrument of economic management and control aimed at attaining certain economic objectives (Nnanna, 2002: 15). Monetary policy intends to achieve the basic macroeconomic objectives which includes full employment, high growth rate, price stability and exchange rate stability. These objectives are known as main goals of monetary policy. The section is divided into the following sub-sections;

##### *3.1.1 Monetary Policy Frameworks in Nigeria between 1986 and 2013*

The monetary policy framework is commonly referred to various governmental arrangements which enhances the making and executions of monetary policy. As a result, any meaningful analysis of framework monetary policy is not limited to the confine of central bank (CBN Reports, 2010).

Monetary policy management has been described as the mechanism for regulating the supply and cost of money at optimum levels that will ensure the attainment of optimum use of resources, stable price level and high rate of economic growth (CBN Reports, 2010). According to Akatu (1993), monetary management in Nigeria is made up of the behaviour Central Bank of Nigeria (CBN) aimed at influencing the availability of volume, direction and the cost of credit in the economy.

The CBN is mandated with the provision of a stable framework for the economic

development of Nigeria through effective and transparent implementation of monetary policy as well as the management of the financial sector (Akatu1993). Thus, the need to achieve some national economic objectives, the prevailing macroeconomic and socio-political environment and the expediency of the economic situation among other factors have, over the years, determined the particular policy framework adopted in Nigeria.

Numerous factors determine the conduct of monetary policy framework by central bank (Nnanna, 2002:26). These factors include:

- Structural dissimilarities: This is made up structure of the financial system, debt levels and types, trade openness and fiscal restraint, amongst others.
- Indexation Degree: This is associated with economies at various economic integration level integration which need various types of indexation.
- Institutional arrangements: This describes total of institutions that monetary authorities consist of, institutional laws, availability of data and other factors that determine the way in which monetary policy authority responds to changes in macroeconomic conditions.

To set the discussion in perspective, three policy frameworks are identified in Nigeria. They are;

- The exchange rate targeting framework, 1970-1973
- The monetary targeting framework, 1974 – 2001
- The inflation targeting framework, 2002 – 2015

### 3.1.2 *The Exchange Rate Targeting Framework, 1970-1973*

Nigeria was colonised and ruled by British colonial masters until October 1, 1960, when she gained independence. The dependence on the prevailing economic condition in Britain to manage the Nigerian economy during the colonial government was extended to the post-independence period. The management of monetary activities during the period involved the use of exchange rate, which was fixed at par with the currency of the colonial masters, British pound. The exchange rate part at this period provided a relatively more effective and efficient mechanism for controlling inflation and sustenance of viability in balance of payment (Nnanna, 2002).

In 1967, the fixed parity system was interrupted when there was a devaluation of British currency. However, rather than devalue the Nigeria's pound, Nigerian currency was pegged by apex bank to the US dollar with regulation of imports (CBN Reports, 2010). The dollar peg was abandoned as a result of global economic crisis of 1970s till 1973, when Naira was again pegged to the US dollar. These situations informed the de-facto devaluation of the Nigerian currency despite the fact economic fundamental did not justify the devaluation (Ogun, 2007).

The institutional crises of 1966 to 1970 had serious effects on the performance of the economy and altered the trajectory of economic transformation that had begun in the previous years. Public policy in the early 1970s was geared towards legitimising a centralised federal system, entrenching peaceful co-existence and establishing political stability in the country. In the immediate post- civil war era, one strategy of government was concentrated on taking control of the commanding heights of the economy – the strategic sectors, as a means of influencing the pace and direction of

economic development (Olaniyi, 2004).

The disruption of productive activities by the civil war increased dependency and inflow of petrol-dollars (which were largely monetized due to the quadrupling of oil prices by the OPEC cartel in 1973). It also led to a structural transformation of the economy from its dependency on agriculture to petroleum. A tremendous inflationary trend was experienced in the Nigerian economy from early 1970s, despite huge share of investments in the economy (Ojo, 1992).

The monetary authority in Nigeria embarked on restrictive monetary and financial policy during this period in a bid to reduce over-dependency on external sector, as well as to reduce deficit finance that resulted from civil war prosecution. The monetary policy, at this period, were geared towards restoring the economy by ensuring a healthy balance of payments position, relative price stability as well as sustenance of high real GDP growth rate. The level of growth at this period was 13.18 percent and this rate has not been surpassed since then (Ogun, 2007).

### 3.1.3 *The monetary targeting framework, 1974 – 2001*

The independent conduct of monetary policy in Nigeria especially since 1974 has basically involved monetary targeting. Under monetary targeting, the monetary authority sets the appropriate level of money stock, after which, it observes the actual changes in targeted variables (Anyanwu, 2002). Then, when the objectives are not being attained, it adjusts its policy instrument (money supply). The monetary targeting policy framework in Nigeria consists of direct and indirect controls (CBN Reports, 2009:30).

- **Direct control, 1974-1992**

As the oil boom continued after the mid-1970s, the role of government in the economy became more pronounced. Moreover, the over-dependence on the crude oil earnings and deficit financing persisted. As a result of these and other factors, the inflationary trend persisted. The Udoji Award of 1974 aggravated the inflationary pressure at the period (Anyanwu, 2002).

During the 1974 to 1992 period, independent monetary management commenced in Nigeria. The main objective was to enhance rapid and sustainable growth. Thus, interest rate ceilings and credit ceilings were levied on deposit money banks. The sectorial and selective allocation of credits to various sectors of the economy were implemented. Agriculture, manufacturing and construction sectors were preferred first in the selective allocation of credit (Jimoh, 1991).

The dominant monetary policy instruments used by the CBN were the credit targeting to the domestic economy and use of low interest rates (Nnanna, 2002: 15). As a result, the monetary authority allocated more credits to the selected (leading) sectors of the economy. This was done to enhance rapid development through credit availability. In an attempt to save the economy from collapse, resulting from severe economic difficulties experienced in the early to mid 1980s, the Structural Adjustment Programme (SAP) was adopted in 1986. This was done in order to reform the entire economy (Anyanwu, 2002). Thus, the dismantling of the direct monetary era, mainly associated with a fixed system of credit allocation, interest rate regulation and regulation of exchange rate, was embarked upon. The SAP led to various financial

sector reforms that was characterised by liberalisation and deregulation of financial system (Ojo). Despite various measures introduced in the economy, the inflation rate during this period remained high. The growth in the real activity was very low compared to the growth in the money supply.

• **Indirect control, 1993 – 2001**

Although SAP was adopted in 1986, the adoption of indirect or market-oriented monetary policy by the CBN required a phased approach. The phased approach for the eventual take-off was slated for 1993. This was necessitated by the need to introduce some institutional, regulatory, technical and administrative measures to enhance the process of monetary policy reforms (Ogun, 2007).

Oke (1995) hinted that the strategy of SAP was to introduce policies that would increase financial sector competition, enhancing the regulatory power of CBN, advance the structure financial system and combat the financial repression. The introduction of indirect monetary control was subsequently adopted.

The year 1993 (September precisely) championed the elimination of restrictions on credit for banks. Likewise, there were various amendments (CBN Decree 25 of 1991, the Banks and other Financial Institutions Decree, BOFID, 25 of 1991; CBN (Amendment) Decree (Number 37, 1998) to give more discretion and autonomy to the bank in the conduct of monetary policy. This thus significantly formed the platform for the pursuit of growth and developmental objectives of price stability amongst others by the CBN (Onyindo, 2000).

The operational arrangement for indirect control involves the use of indirect instruments to control and contain the growth of important aggregates. These framework permits the market to determine the interest rates and allocate credit while the monetary authorities target only the monetary base or its components. Among the instruments of indirect monetary policy, open market operation (OMO) is major. Other instruments include reserve requirement, discount window operations and moral suasion (Onyindo, 2000).

Unlike the direct control regime, where bank credit was controlled, bank reserve balance is what is being controlled under indirect monetary control. With monetary targeting under the indirect approach, the CBN aimed at achieving a particular level of base money (or high powered money) which was basically related to the money multiplier by the formula  $M = mH$ , where,  $M$  is the broad money stock and  $m$  and  $H$  are money multiplier and high-powered money respectively Oke (1995). When the base money is determined, the CBN will then compute the  $H$  that needs to be drained from or injected into the banking system to keep money supply growth along the desired path. This level of bank reserves, therefore, serves as the operating target (Jimoh, 1991). The difference between the computed optimal level of reserves and actual reserves becomes the target for open market operation within the framework of liquidity management. The discount window then plays the safety valve role by providing the short-run reserve needs of the banking system for meeting short-term liquidity obligations. The market is then left to determine interest rates.

The growth in money supply,  $M_2$ , grew rapidly from 19.4 percent in 1995 to 62.2 percent in 2000. The rates were consistently above their projected targets of 10.1 percent and 14.6 percent for 1995 and 2000 respectively (CBN Reports, 2002). The growth in



monetary stock could be attributed to oil inflows monetization, wages adjustments, and expansionary policy. The average rate of inflation for the period was 19.6 percent - a figure that was above a single-digit target for the macro-economic variable. With 2.91 percent average growth rate of real GDP, the economic performance of the period was rather unimpressive. For instance, rate of inflation was 72.8 percent in 1995, while low inflation target was attained in three years out of nine, between 1993 and 2001 (CBN Reports, 2002). The low inflation rate that materialised was attributed to improved agricultural production. Furthermore, growth in real GDP declined considerably from 2.3 percent in 1993 to 0.4 percent in 1999. By 2001, the growth rate was 4.6 percent, a rate that was far below the projected targets of 10 percent (CBN, 2005).

### 3.1.4 Inflation targeting framework, (2002 – 2015)

According to general principle of macroeconomic control under SAP, monetary policy aimed at encouraging liberal financial system for efficient funds mobilisation (Ojo, 1992). It was expected that the prevailing economic difficulties would be overcome with this shift to a market-oriented financial system. However, a critical appraisal of the economic performance of the years before 2002 indicated, among other, an unimpressive performance including a severe inflationary pressure (Omoke & Oruta, 2010). In addition, the growth rates in real GDP in the same period were still below their yearly projections while the share of investment in the GDP remained relatively low. The 72.5 percent rate of inflation in 1995 was and still remains the highest rate of price changes recorded hitherto in Nigeria. Coincidentally, the year 1995 was a period of indirect monetary control (CBN, 2005).

As a result, the CBN modified its development role by preferring price stability to other objectives including output growth. Specifically, the CBN issued a medium-term circular that contained its preparedness to be committed to the pursuit of low inflation rate (CBN, 2002; Omoke & Oruta, 2010). This is consistent with what several countries introduced in the 1990s- measures that focuses on inflation rate stability. This policy is labelled inflation targeting policy.

Inflation targeting is defined as monetary policy arrangements in which apex bank predetermined a target rate of inflation rate and employ all the necessary policies to achieve it. Inflation targeting could be described as the pursuance of a certain inflation rate with or without increase in economic growth. Bernanke, Laubach, Mishkin and Posen (1999) submit that countries such as New Zealand, Canada, Israel, U.K, Sweden, Finland among others had used inflation targeting to attain price stability.

The Nigerian experience of inflation targeting is evolving and largely informal. This is because a formal proposal and announcement of the policy would be expected to be made before its implementation. As was the case in New Zealand, which pioneered the inflation targeting policy, the Reserve Bank of New Zealand (RBNZ) set the inflation targets via a Policy Targets Agreement (PTA) between the Reserve Bank and the government. This was done in order to encourage fiscal discipline in the government dealings (Choi, Jung & Shambora, 2003).

Prevalence of liquidity overhang was the order of the day in Nigeria (as indicated by the growth in money supply at the rates above the projected rates in most years) since the introduction of SAP. Consequently, the CBN has been treating inflation

from monetary perspective which requires the setting of the monetary growth equal or below the desired rate of inflation in order to attain a given level of economic growth. However, maintaining a given level of money stock in Nigeria has been very difficult. Thus, the need for a framework that focuses not only on instruments, but also on goals (CBN, 2003). This agrees with the suggestion by Tella (2004), that a more dynamic approach towards monetary policy formulation and implementation should be adopted in order to grow and develop the Nigerian economy.

Regard the behaviour of macroeconomic aggregates, the results in the few years of inflation targeting are mixed. While the real domestic output growth remained relatively high but unstable, the inflation rate was still high (though it is declining) and double-digit. Monetary growth was about 18.98 percent during the period. The share of investment remained low, compared to the 1970s and 1980s. However, it is too early to make conclusions about the effectiveness or otherwise of the framework. It is pertinent to note that there are measures to be put in place before such policy can be effective in any economy. These measures include:

- Determination of the precise and definite relationship between rate of price changes and output.
- Estimation of the rate of inflation for target growth rate in the economy.
- Determination of the appropriate measure of inflation for the economy.
- Ascertainment and sustenance of the autonomy of the central bank.
- A commitment to fiscal discipline and agreement to the terms of policy by the fiscal authorities must be sought.

### 3.1.5 Critique

From the foregoing, it can be observed that monetary policy regime in Nigeria has undergone several developments and change, depending on the state of the economy. Despite the development and improvement in successive monetary policy regimes in Nigeria, monetary policy variables have not been impressive. Inflation in the economy remains high and exchange rate has remained largely volatile and deteriorating. It is also worthy of note that the nature of fiscal policy holds serious implications for the optimal performances of monetary policy. This is because fiscal policy influences the inter-temporal solvency of government, and any change of fiscal policy can require changes in monetary policy.

## 3.2 South Africa

The conduct and effects of monetary policy in the middle-income economies such as South Africa vary from one economy to the other (Van den Heever, 1997). South African Reserve Bank (SARB) which is responsible for the conduct and practice of monetary policy was established in December 1960 (Stals, 1992). Prior the establishment of SARB, some monetary policy frameworks such as conventional approach to money and credit, conservative Keynesianism had been adopted, most especially from the end of the Second World War. It should be noted that monetary policy conduct during this era was primarily influenced by Keynesian theory and macroeconomic quantification (Stals, 1992; Mollentze, 2000). Monetary policy aimed at enhancing the capacity of commercial banks for money creation. The Reserve

Bank consequently controlled the money stock by regulating the cash reserves (RSA, 1986: A10). The principal monetary policy instruments during this phase were rediscounting and moral suasion. However, discussions in this study consider monetary policy framework and regimes from the establishment of South African Reserve Bank in 1960.

The monetary policy arrangements in South Africa could be classified under five broad frameworks. To set the discussion in perspective, the following policy frameworks are identified:

- Liquid asset ratio-based system with quantitative controls over interest rates and credit, 1960-1981
- Mixed system during transition, 1981–1985
- Cost of cash reserves-based system with pre-announced monetary targets (M3), 1986–1998
- Daily tenders of liquidity through repurchase transactions (repo system), plus pre-announced M3 targets and informal targets for core inflation, 1998–1999
- Formal inflation targeting, 2000

### 3.2.1 *Liquid asset ratio-based system with quantitative controls over interest rates and credit, 1960-1981*

The monetary policy under this framework is discussed under two different phases:

- **The Technical Committee approach**

Monetary policy framework in this era was initially influenced by the reactions of the Gurley & Shaw and Radcliffe Committee in United Kingdom to the 1950s Monetarists. Gurley and Shaw (1961) and the Radcliffe Committee were of the opinion that money, though a financial instrument does not possess special features that would make money supply changes play a role in defining the behavior of economic events. Technical Committee in 1961 was appointed in South Africa to advise the monetary authorities in respect of making desirable changes to the extant banking laws and building societies. The report of the committee was published in 1961 and the reports laid significant foundation for the Banks Act of 1965. The report of the committee was seen as a new monetary policy approach because it was in conflict with conventional and the revolutionary approaches (Gurley & Shaw, 1961).

The Banks Act of 1965 came up with collective legal financial conditions for all the players in financial systems (Truu, 1968). The banks' liabilities were nevertheless from the common statutory financial requirements for all banking institutions. The Act also gave privileges for near-banks to be brought under the watch-light of monetary policy of the reserve bank. In addition, the liquid asset being held by financial institutions was further narrowly defined down. As such, the Reserve Bank could vary as the occasion demand the percentage of liquid assets that all them monetary banking institutions had to observe in relation to their liabilities (SARB, 2011). It should be noted, however, that as laudable as the recommendation of the committee, they did not recommend monetary targets adoption which was at variant to the position of the monetarists.

- **The use of direct monetary control measures**

This period was greatly influenced by Keynesian thought and views. In other words,

fiscal policy was the main macroeconomic tool used in the pursuit of macroeconomic objectives (Svensson, 1997). While monetary policy would also play a supportive role. This however was in sharp contrast to the previous post world perspective that monetary policy should serve majorly perform an accommodating function. Stals (1997) described the application of this policy as demand management method under which monetary policy would be used to reduce demand when the economy was inflationary and to stimulate demand when the economy is recessionary. Nevertheless, the idea that the supply of money and interest rate should play a supportive role continued to dominate. The resultant effect was that South Africa adopted direct instruments such as credit ceilings towards the end of 1960s. The consequence of this was the scarcity of credit from banks and building societies. The direct monetary controls adopted by the Reserve Bank included ceilings on bank credit to the private sector, deposit rate control, foreign exchange control and outright control of hire-purchase and consumer credit (RSA, 1984).

The use of indirect approach of controlling money supply such as open-market was strongly discouraged. Debt control and its financing could also impede the attainment of monetary policy objective. The bank rate was fixed, rediscounting rate and Interest rates were all fixed and hardly changed (Mollentze, 2000). The South Africa's financial markets were still underdeveloped and evolving. Market-related control measures had to be discouraged.

### 3.2.2 *Mixed system during transition, 1981–1985*

This period was characterised with significant changes in monetary policy as it was in most economies. The conduct and practice of monetary policy changed majorly from direct control method to market-based monetary policy (ABSA Bank, 1995). The Keynesian demand management approach was dropped however. This was as a result of the argument that demand management approach had promoted instability and volatility in the economy (De Wet, Jonkergouw & Koekemoer, 1995). De Kock (1979) described the theoretical foundation of the first interim report on exchange rate as a combination of conventional Keynesian demand approach and realistic monetarism. During this period, the Reserve Bank vigorously pursued active short-term stabilization policy. However, majority of the recommendations of the committee were not put into consideration (Meijer, 1997a). The monetary authorities purposely began to adopt interest rate variability according to the dictates of invisible hand. Consequently, direct controls measures were gradually being replaced by more market-oriented measures (RSA, 1984).

### 3.2.3 *Cost of cash reserves-based system with pre-announced monetary targets (M3), 1986–1998*

At the early period of this phase, the endorsements of the De Kock Commission were adopted. The committee also came up with market-oriented framework which aimed at enhancing attainment of monetary policy objectives (RSA, 1986: A10).

Reserve Bank (1986) adopted precise growth rates for all monetary aggregates. The rationale for adoption of monetary targeting was to augment monetary policy so as to control inflation. The De Kock Commission suggested that the instruments such

as debt management, policy accommodation, and intervention in global exchange markets. The adoption of these instruments were to be reinforced by other instruments such as quasi-market instruments. The central objective was to curb inflation for larger part of this era. Apex bank deliberately pursued policy to cut interest in order to boost investment in order to speed up the rate of growth.

By 1990, the Reserve Bank began the pursuits of single monetary objective which was to sustain and maintain the external competitiveness of Rand (SARB, Annual Economic Report, 1991). It should however be noted that the external value of a currency is influenced by global economic events which sometimes are not within the control of the domestic monetary authorities. Nevertheless, noticeable success was recorded in this regard as a result attainment and sustenance monetary discipline (Stals, 1992: 1-2 and ABSA Bank, 1995).

#### 3.2.4 *Daily tenders of liquidity through repurchase transactions (repo system), plus pre-announced M3 targets and informal targets for core inflation, 1998–1999*

New monetary policy framework was adopted by the Reserve Bank in 1998 with daily tenders of liquidity through repurchase transactions. Guidelines for money supply were still being proclaimed, but they were not prominent in monetary policy formulation. (Casteleijn, 2003; Aron, & Muellbauer, 2001a; Aron, & Muellbauer, 2000). Emphasis were placed on transparency with the belief that it would increase monetary policy credibility and attainment of price stability.

#### 3.2.5 *Formal inflation targeting, (2000-2015)*

Attainment and sustenance of stability of price has been unanimously recognized as the main goal of monetary policy. There was however contention on how it could be attained. The contention has remained largely unsolved (Van der Merwe, 2004). Several countries have assumed inflation targeting as a strategy for attaining price stability. It is on record that it was New Zealand that first implemented this strategy in 1990. This move was followed by other notable countries such as Australia, Brazil, Canada, Chile, Mexico, Sweden and the United Kingdom (Carare & Stone, 2003).

In 2000, South Africa announced the adoption of formal inflation targeting as the monetary policy framework. Prior this period, “informal inflation targeting” was already being applied by the South African Reserve Bank. There was emphasis on the attainment of price stability there was no specification of time frame over which this would be achieved (Mboweni, 2004).

SARB was able to bring down inflation to lower levels during the practice of informal inflation targeting. For instance, CPI that was moving around 15 per cent by the end of 1980s and the beginning of 1990s came down as low as 5 per cent in 1999 (Van der Merwe, 2004). The question is why did the monetary authorities adopt formal inflation targeting despite substantial achievements of informal inflation targeting.

- **Reason for adoption of formal inflation targeting**

According to Reserve Bank (2000), formal inflation-targeting as a monetary policy framework was adopted because of the following reasons:

- Uncertainties about the monetary policy stance commonly associated with informal inflation targeting. For instance, Van der Merwe (2004) argued “the

growth in money supply and bank credit extension in the 1990s was above the guidelines of the authorities for a considerable period. In these circumstances the public expected an increase in short-term interest rates. However, in analysing the situation, the authorities realised that the high growth in the monetary aggregates was mainly due to structural changes in the economy resulting to a large extent from the liberalisation of the financial system. Contrary to general expectations they accordingly did not apply more stringent monetary policy measures.”

- Formal inflation targeting ensures effective and efficient coordination between monetary policy and other economic policies given that the target is not at variant with other macroeconomic objectives.
- Increased monetary discipline and central bank’s accountability associated with formal inflation targeting. This is because during formal inflation target, clear targets are set and apex bank must meet the targets by necessity. In case of any deviation between actual inflation rate and the target rate, convincing explanations must be offered by the apex bank.
- Formal inflation targeting directly or indirectly affect inflationary expectations. This in turns ensures reduction in inflation as long as the targets are perceived to be credible by the public.

- **Assessments of formal inflation targeting in South Africa**

Like many middle income countries, South Africa also suffered the effects of rising global oil prices in early 2000s (Van der Merwe, 2004). South Africa however was able to withstand the effects than many other countries. Consequent upon the adoption of inflation-targeting, interest rate has been more stable.

Though monetary policy committee was still using money supply as policy variable, it was not prominent again it was in the 1980s and 1990s. SARB began to shift its attention to gradually strengthening of foreign reserve holdings. As a result, SARB was able to finance easily the current-account deficit by means of foreign direct investment and other inflows. The balance of payments significantly improved and there was increase in the value of rand in early 2000s.

The inflationary forces were lowered by exchange rate appreciation and this trend was also notable in the 2005-2006 period and again 2009-2010 periods and high level of reserve accumulation. It should be noted that there must be an efficient communication to all concerned parties when adopting inflation targeting as a policy. Consequently, SARB was always communicating its policy direction to all the concerned parties

It must be noted that appropriate econometric models which is made up of important policy variable are important aspect of an inflation targeting framework. The apex bank often makes available to the public the models used to forecast and predict monetary policy variables. IMF report South Africa (2007) states that reduced inflation and lowering real interest rates were all notable effects of inflation targeting in South Africa. The growth rate had been steadier until recently when it entered recession in 2018. Remarkably, South Africa was rated as largest economy in Africa in GDP terms in 2015. However, problem of unemployment and poverty incidence are still high.

### 3.2.6 Critique

From the foregoing, it can be observed that monetary policy regimes and performances in South Africa have undergone several developments and change like that of Nigeria. Unlike Nigeria, monetary policies variables have been relatively better compared to Nigeria. The value of the Rand has been relatively stable. However, inflation in the economy has been gradually increasing and average price level could be said to be relatively unstable compared to what it was in early 2000s. Recent upsurge in corruption trend in the country could be said to be undermining the performance of monetary policy variables and largely contributing to their deterioration.

In addition, the current increase in inflation in the economy has contributed to a significant fall in the value of the rand. High inflation discourages foreign investments by wiping out the benefits of high interest rates to foreign investors. Current account deficit is also among factors perceived to contribute to dismal performance of monetary variables in South Africa. The deficits in the current account becomes bigger when capital outflow is less than capital inflow. In addition, the inability of monetary authority to guard the economy against the external shocks and imbalances contributed significantly to woes of Rand. For instance, 26 percent of the value of the Rand were lost in six months after the Chinese economic crisis of 2015. This occurred because Chinese's apex bank suddenly devalued Yuan which altered the way it was traded with other currencies.

## 4 Synopsis

This letter revealed the political and economic development in both Nigeria and South Africa. The letter also gave insight into fiscal and monetary policies development in both countries. It is evident from the fiscal profile of Nigeria that her deficits have reached a level of deep concern to many and the deficits profile in South Africa has been growing upwardly, and the public especially the researchers and policy makers, are beginning to be worried. On the other hand, looking at the growth rate of inflation and the relative exchange rate stability, monetary policy management in South Africa seem to be better than that of Nigeria, especially with the adoption of inflation targeting in South Africa.

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