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PERSONAL VIEW

Debate on hot money heats up

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Last Tuesday Chris Stals, the governor of the Reserve Bank, made himself available to the public at his Pretoria office to answer e-mail questions on the Bank's policy on interest rates.

The clamour for answers about interest rate policy was not surprising. Some people think that in this era of globalisation the state has lost control over interest rates as a balancing tool to protect the value of the currency, on the one hand; and to encourage investment, job creation, economic growth and a better quality of life for all on the other.

Interest rates were traditionally set by the state to make money as tight as it saw fit by making borrowing expensive.

Raising interest rates puts off investors, and unemployment grows. In this way, high interest rates protect the rand from inflation (rising prices) by making it difficult for consumers to pay higher prices. This forces inflation down; interest rates are then relaxed, investment, employment and the economy pick up and a new economic cycle begins.

But the opening up of our markets has introduced new factors into the setting of interest rates, some of which undermine the state's autonomy in managing its own economy. These factors need to be tackled through some new economic measures.

One measure, which Trevor Manuel, the finance minister, recently proposed to Stals, is related to South Africa's trade with other countries. "Inflation-targeted interest rates" involve the government setting a rate of inflation to match that of its major trading partners (1 to 5 percent). This would make South African exports competitive and so generate jobs.

The Reserve Bank, if it agrees with such a target, would set its interest rates to bring inflation to this level.

In Stals's question and answer session, he finally said he agreed with the principle of inflation- targeted interest rates.

Another measure, capital controls, relates to the openness of national money markets. Its purpose is to discourage financial speculators from weakening the rand.

Speculators park their funds at the touch of a computer button wherever it earns the highest interest (usually developing nations like South Africa and Malaysia), then move it out as soon as another destination offers a higher interest.

Such hot capital outflows exit with the high interest they have accrued (in foreign currency) without contributing anything to economic growth.

The estimated value of these outflows around the globe is 10 times the world's gross domestic product.

This depletion of foreign currency, moreover, weakens the rand's exchange rate (its price on the world money market), which affects South Africa's capacity to trade.

To protect the rand from such speculative attacks, the Reserve Bank has to compete with other countries to hold on to speculators' mobile capital and protect its own foreign exchange reserves by raising interest rates. And so the economy becomes shaky and the wolf pants at South Africa's door.

This is where capital controls come in. Making speculators pay a tax whenever they exchange currencies is a capital control.

At the moment, speculators play with investments to the tune of $1,2 trillion a day. A tax of 0,25 percent on this would generate a potential global revenue of $300 billion a year.

Of course, the actual revenue collected would be less if the tax succeeded in discouraging speculative transactions.

Either way, the world community would benefit. It would collect a huge amount of tax, which could be ploughed back into developing economies for job creation or social spending.

Alternatively, it would generate a smaller amount of tax but succeed in discouraging disruptive capital flows.

Chile and Malaysia have imposed capital controls to recover from the devastation to their economies caused by speculators.

Some analysts suggest that in doing so they have risked their niche in the global economy, and their efforts should be part of a global system on capital controls.

Others suggest a global tax would be easier to implement if used to regulate capital inflows rather than outflows, preventing the economic mess that outflows leave behind, rather than trying to deal with it after the fact.

Such considerations, as well as the technical feasibility of implementing the global tax principle, are part of a hot debate on hot capital flows. This debate pervaded the recent World Economic Forum meeting at Davos.

Some feel shaky economies had better get used to the shake, as a global capital control system is unworkable. Others feel where there is a political will, there is a technical way.

It would seem that a global tax fund, like inflation-targeted interest rates, could help put South Africa in charge of reconciling its need for a stable rand with that of full employment and equity.

It is a measure which South Africans must insist on in trying to drive the wolf from the door.