A financial sector that works for job creation

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1 Problem statement

The South African financial sector has seen significant expansion over the last two decades and finance has come to play a more important role in the economy and the lives of South Africans. This is witnessed in: the growth rate of the financial sector's GVA and capital stock that well exceeds GDP growth rates; the volume of debt in the economy; employment in the financial sector; the local and international trading of rand assets; large appreciation on the JSE; indebtedness of households; and the increasing role of non-financial corporates in financial markets, amongst other indicators.

Despite this, the extent to which the expansion of finance has had a beneficial jobs-enhancing impact on the South African economy is questionable.

Some potential reasons why include: the channelling of funds away from real fixed investment and into financial markets and financial products; the negative role of short-term capital flows; volatility and appreciation in asset prices; over-indebtedness; a funnelling of highly skilled individuals (such as engineers) into the financial sector; facilitating capital flight; and a reinforcing the existing growth path.

2 Jobs impact

The proposal (given below) is that through various regulatory means finance can play a pro-active role in expanding the economy, in particular sectors of the economy that can be labour absorbing.

The proposals could also have dynamic effects on the economy, stimulating GDP growth, and help shift the economy away from a highly concentrated, capital intensive, monopolistic, mineral and finance centric growth path.

3 Theory of change

The proposal includes:

1. Shift patterns of bank lending (we have witnessed a fall in lending – as a share of total loans and deposits – to non-financial corporations by the major banks)
    a. Impose lending requirements on the major banks
    b. Support a more diverse banking sector, including local and cooperative banks
    c. Cap user fees
    d. Further limit the financial market investment activities of commercial banks

2. Make finance cheaper
    a. Reduce the interest rate spread (which is very high in South Africa), if necessary via offering state-financed lending to create competition in the market
    b. Reduce the cost of lending from quasi-state financing institutions such as the Industrial Development Corporation (IDC) and Development Bank of Southern Africa (DBSA) through government funding (or government-backed funding) and strengthen their developmental mandate
3. Stabilise financial flows
    a. Implement limited capital controls (such as minimum stay requirements) and reduce interest rates to reduce short-term speculative flows
    b. Encourage greenfield FDI through various state incentives
    c. Make South African government bonds lends less attractive as targets of carry trade by lowering interest rates
    d. Curtail capital flight and tax evasion through stricter controls and oversight
4. Reduce incentives for the focus on "shareholder value maximisation" to mean inflating stock prices and distributing dividends so that these funds can be used for long-term investment
    a. Restrict the use of share (and other) incentives as components of executive pay
    b. Provide tax incentives for spending on labour costs
    c. Ban share buybacks
    d. Increase capital gains and other wealth taxes, including by instituting a net wealth tax
    e. Encourage shareholder activism, particularly via union investment funds and the Public Investment Fund (PIC) to ensure that decisions taken by firms channel funds towards long-term investment in the economy

4 Existing initiatives/experience

There is a growing body of international evidence (including from the IMF) that "too much finance" is bad for the economy. There is also strong evidence that the expansion of finance in the ways described above ("financialisation") reduces investment in the real economy, and exacerbates poverty and inequality.

Few of the measures above have been implemented in South Africa and less-binding approaches, such as via the Financial Services Charter, have failed. Many of these measures have however been experimented with internationally or were common practice in the post-war period.

5 Constituency participation in implementation

The above approaches would need to be undertaken through government regulation. However, the business sector has a role to play in finding ways in which finance is channelled towards productive, growth-enhancing activities. Labour, and labour investment funds, can play an important role by exercising oversight over the decisions of companies within which they invest; such funds could also be used to start local and cooperative banks focused on affordable credit and productive investment. The PIC can also play an important role as an activist investor.

6 Benefits

What social/economic groups would benefit from the proposal directly and indirectly? Please use the following table, and do not list more than 5 groups. Please describe the benefits as precisely as possible.

Group	Job creation	Other benefits	Time frame for success
Non-financial corporations	Through the expansion of farming, mining, industry and services. Through the stabilisation of asset prices, in particular the exchange rate.		5 years
Small businesses and entrepreneurs	Small businesses and entrepreneurs are particularly starved of funding.		5 years
Manufacturing subsectors	Manufacturing subsectors struggle more than mining and large services to secure financing.		5 years
Consumers / ordinary people	More afford and less-exploitative access to finance.		5 years
Government	Allows for fiscal expansion.	Lower borrowing costs.	

7 Cost and potential sources of funding

What social/economic groups would bear the cost of implementing the proposal directly or indirectly? Please use the following table, and do not list more than 5 groups. Please describe the costs as precisely as possible. In the case of financial costs, who would pay them?

Group	Anticipated costs	Potential sources of funding to implement the project	Time frame for impact
Financial sector	The financial sector is likely to be less profitable as a result of these policies.		On-going
Government	The above would require regulatory intervention by government.		On-going

8 Risks

The main risk would be local and international financial investor confidence. This should not hamstring the approach as current patterns of investment are not optimal anyway. However, a staged approach should be taken. A further risk is non-compliance as financial and non-financial corporates try to evade the measures outlined. The government would carry some fiscal risk from capitalising the IDC and DBSA.

9 Risk mitigation

A staged approach should be adopted with stringent enforcement.

10 Additional comments