

Institution: SOAS
Unit of Assessment: 19 Business and Management Studies
Title of case study: Influencing monetary policy, financial sector policy in the emerging economy of South Africa (Laurence Harris et al)
<p>1. Summary of the impact (indicative maximum 100 words)</p> <p>Monetary policy and its effect on the wider economy are important for South Africa's objective of achieving both high economic growth and low inflation – which are deemed to contribute to the government's and electorate's greater objectives of reducing poverty and creating employment. The central bank (South African Reserve Bank, SARB) and the National Treasury have responsibility for both monetary policy and the oversight of the financial sector. Laurence Harris's research on the links between monetary policy, financial sector development, and their connection with the financing and investment decisions made by businesses has led both institutions to seek and act on his advice.</p>
<p>2. Underpinning research (indicative maximum 500 words)</p> <p>Laurence Harris has been Professor of Economics at SOAS since 1990 and became the founding Head of Department of the Department of Financial and Management Studies in 2001. In 2010 the Academy of Social Sciences awarded him the title Academician in the Social Sciences. His work on monetary policy and finance in models of advanced market economies has been internationally recognized since the publication of his <i>Monetary Theory</i> in 1981. His research since then, yielding some 100 publications, has expanded the reach and relevance of the theory of monetary policy by examining its links to firms' investment and financing, and relating them to the development of financial sector institutions in emerging economies.</p> <p>Harris's more recent research on monetary policy, the financial sector, and economic growth has had particular relevance for policy makers in South Africa because of its focus on issues relevant to poor countries in a global economy. Developing economies are susceptible to shocks emanating from global forces beyond their control (such as global interest rate and exchange rate fluctuations), and, with narrower economic bases and weaker institutions, are likely to lack resilience. Harris's research on monetary and financial sector policy in emerging markets has identified links between such shocks, firms' financing and investment decisions and economic growth. The following three examples illustrate:</p> <ol style="list-style-type: none"> 1. Following Harris's earlier research on the connection between South Korea's financial sector policies and financial shocks (published 1988 and 2000) he worked with B. Fattouh and P. Scaramozzino on a data base of South Korean firms (output a). Their estimates, applying quantile regression techniques showed for the first time the systematic differences between the debt-equity ratios chosen by different types of firms and related that to differentials in firms' resilience to macroeconomic shocks such as the exchange rate crisis of 1997. Further research enabled comparison of South Korean firms' debt-equity ratio behaviour with that of UK firms' (output b). 2. Exchange rate volatility and shocks are believed by business and government in emerging markets to affect negatively firms' investment and strategy. Harris built on his earlier research on South Africa's economy to work with Bassam Fattouh on a project to study what determines the level and volatility of South Africa's exchange rate, innovatively using Markov regression techniques (output d). The study's results, presented at the Strategic Planning Session of the South African Reserve Bank's Monetary Policy Committee in June 2009, demonstrated the effect on exchange rate volatility of structural changes in South Africa's economy and its monetary policy regime. 3. The research programme led to wider evaluation of the effects of financial sector development on economic growth in emerging market economies. Since 1993 numerous academic research

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studies of data from many countries have found that financial sector development has a systematic positive effect on economic growth. Harris's research project has examined the limits of such a relationship and its implications for financial sector policy specifically in African emerging economies. Studying the potential channels through which a positive effect of financial sector development is realised, Harris found no evidence for the theoretical effect working through raising countries' savings rates. His project located the main channel to exist because successful policy to foster financial sector development facilitates both firms' entrepreneurship and firms' ability to respond positively to macroeconomic shocks, such as exchange rate shocks. Significant implications for financial sector policy were drawn: for example, that policy should address the need to foster specialised institutions with the ability to finance entrepreneurial activity.

3. References to the research (indicative maximum of six references)

- a. "Capital Structure in South Korea: A Quantile Regression Approach", (with B Fattouh and P. Scaramozzino) *Journal of Development Economics* Vol 76, No 1 2005.
- b. "Non-Linearity in the Determinants of Capital Structure: Evidence from UK Firms", (with B Fattouh and P. Scaramozzino), *Empirical Economics*, 34 (3). pp. 417-438, 2008.
- c. "Capital flows and monetary policy in emerging market economies" and "Introduction" in *Challenges for Monetary Policy in Emerging Markets*, South African Reserve Bank, 2009. [http://wwwapp.reservebank.co.za/internet/Publication.nsf/LADV/072E4C59DA1B6C5542257601002B26AC/\\$File/Challenges+for+Monetary+Policy-makers.pdf](http://wwwapp.reservebank.co.za/internet/Publication.nsf/LADV/072E4C59DA1B6C5542257601002B26AC/$File/Challenges+for+Monetary+Policy-makers.pdf)
- d. "South Africa's Real Exchange Rate and the Commodity Cycle: A Markov Regime Switching Approach", paper presented at South African Reserve Bank, Monetary Policy Committee, Strategic Planning Session, June 2009.
- e. "From Financial Development to Economic Growth and Vice Versa: A Review of International Experience and Policy Lessons for Africa", *Journal of African Economies*, Vol. 21, Supplement 1, pp. i89–i106, 2012.

4. Details of the impact (indicative maximum 750 words)

Harris' body of research on developing economies has resulted in numerous invitations to advise the leading South African bodies responsible for the country's monetary and fiscal policy and the financial sector. Instances since 2008 include advising the Governor and Research Department of South Africa's central bank (SARB), the Director General of the National Treasury and the South Africa Minister of Finance. His advice has had a significant impact on macroeconomic policy making including interest rate policy, management of external capital flows and the exchange rate regime, fiscal policy and sovereign debt sustainability, and economic growth planning. He has also regularly contributed to research-led training of policy analysis economists from African banks, governments, and policy institutions hosted by the African Economic Research Consortium.

South African Reserve Bank (SARB)

In 2008 Harris was invited to present research on South Africa's real exchange rate and its implications for industrial sectors to the Governor and senior staff of SARB (output c), and the following year, in June 2009, he presented research results at the Strategic Planning Session of SARB's Monetary Policy Committee (MPC), (output d). The Central Bank's Governor has recently highlighted the importance of Harris' advice and research on these occasions:

"His research on the behaviour of South Africa's exchange rate and on the emerging economies' external capital movements were presented at the SARB and have influenced the macroeconomic analysis that underpins the central bank's policy. Published as "Capital Flows..." (output c) in 2009, the research was influential in South Africa's policy debates on the dangers and merits of capital controls as an instrument for insulating the economy from global shocks." Gill Marcus, Governor, South African Reserve Bank.

In November 2012 Harris was again asked to advise the SARB, on this occasion in respect of his then very recently published article, "From Financial Development to Economic Growth" (output e). Following this, In 2013 Harris was invited to advise on SARB's policy research and how the work of the SARB's Research Department comprising 150 economists could be best structured and communicated. The Head of Research at SARB believes this benefitted his organisation in two key ways by enabling, "our research to be of greater value for policy... both by serving better the Monetary Policy Committee's decision-making and by enabling the communication of SARB's analyses to interact better with market opinion and expectations (effective interaction with market expectations being a requirement for effective interest rate policy)." (Dr Rashad Cassim, Head, Research Department, SARB).

In May 2013 he was invited (as the only outsider) to address a special meeting of the MPC of SARB for a one-day session devoted to his recommendations including his recommendations on how the Committee should use research in making decisions on the policy interest rate. Two weeks after Harris's presentation of recommendations on the SARB MPC's use of research results, the MPC held its regular interest policy decision-making meeting of members only. At its close the central bank's Governor wrote to Harris (text message 23/05/2013) that at the meeting, "the quality of discussion and presentation was vastly improved, so thanks to you". More broadly, the draft official response (10/7/2013) of the SARB Head of Research to Harris's Report on policy research endorsed almost all of Harris's recommendations.

National Treasury and South African Minister of Finance

In 2006-8 Harris was appointed by the South African Minister of Finance as a member of the country's International Panel of Experts on Economic Growth. The Director-General of the National Treasury has confirmed the importance of the contributions of the Panel:

"The National Treasury appointed Professor Harris to its International Panel of Experts on the government's Accelerated and Shared Growth Initiative, ASGISA, 2006-08. Its recommendations, published in May 2008 by the Centre for International Development at Harvard University, have influenced the subsequent policies of National Treasury. Its analysis of binding constraints on growth in South Africa provided one foundation for the analysis behind the government's 2012 National Development Plan." Lungisa Fuzile, Director General of the National Treasury, South Africa

Further to this, Harris was appointed Economic Advisor to the South African Minister of Finance and to the Director General of the National Treasury, South Africa from 2010-12 as a direct consequence of his research on the volatility in South Africa's exchange rate under different policy frameworks. This had, according to Fuzile, "a direct impact on our policy during that year's [2010] period of exchange rate appreciation and large capital inflows (a period of intense policy difficulty for South Africa...)." He has also highlighted the significant input Harris has had on the South African government's Medium Term Fiscal Framework particularly in relation to debt sustainability and financial markets.

In October 2013, the Minister of Finance asked Harris to arrange and lead a private discussion at SOAS of global issues in economic policy; it successfully contributed to his knowledge in advance of his attendance at the Washington meetings of G20 Finance Ministers.

African Economic Research Consortium

The reach and significance of Harris's research in Africa goes beyond South Africa. It includes his research-led training of policy analysis economists from African banks, governments, and policy institutions in regular six-monthly visits to the African Economic Research Consortium (AERC), a Nairobi-based, non-HE sector training and capacity building institution for African countries. Funded and governed by the DFID, the EU, IMF, World Bank, and other governmental and non-government bodies, AERC promotes policy-relevant research within African universities and institutions. (4 below) For example, at the June 2013 meetings of the AERC Harris advised on research projects including Finance, Infrastructure and Economic Growth in sub-Saharan Africa;

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The Bank Lending Channels of Monetary Policy Transmission in Tanzania; Optimal Monetary Policy Rules and Exchange Rate Volatility in Zambia; Financial Sector Development and Economic Growth in Botswana; Insider Ownership, Competition, Probability of Failure, and Risk Taking Behaviour of Banks in Ghana and Togo. The policy analysts involved in the research included economic policy analysts from the Central Bank of Tanzania, the Reserve Bank of Zambia, Reserve Bank of Malawi, and other authorities. In the 2008-13 assessment period similar examples can be drawn from Harris's participation in research training at every six monthly meeting of the AERC.

5. Sources to corroborate the impact (indicative maximum of 10 references)

Evidence of the impact Harris has had on South African policy making, based on his research, is provided by testimony from:

1. Gill Marcus, The Governor, South African Reserve Bank;
2. Dr Rashad Cassim, Head of Research, South African Reserve Bank;
3. Lungisa Fuzile, Director General, National Treasury, Republic of South Africa.
4. African Economic Research Consortium (AERC): <http://www.aercafrica.org/> [Most recently accessed 22.11.13].