Debate

South African Reserve Bank independence: the debate revisited

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Introduction

In the early 1990s, during the negotiation phase of South Africa's transition to democracy, there was debate in some academic and policy circles about what the status of the Reserve Bank should be in a post-apartheid South Africa (see eg MERG 1993). Since its establishment in 1921 the SARB was both legally and practically subordinate to the Ministry of Finance and to the government of the day. It fact it was widely believed that the Presidency under PW Botha intervened directly over monetary policy decision-making for political ends as illustrated by the 'infamous' Primrose by-election on November 29, 1984) (see Rossouw and Padayachee 2011:S60-61).

It would appear that the ANC political leadership at the World Trade Centre (WTC) negotiations requested the ANC's own economic think tank, the Macroeconomic Research Group (MERG), to assist it in making a recommendation about the status of the SARB (most importantly about the form and degree of its independence) for its consideration and then to debate with its main political opponent, the National Party, then still in government. MERG co-ordinator, Vella Pillay, requested Cyrus Rustomjee and Vishnu Padayachee, both at the time researchers in the MERG project, to draw up a memorandum on this matter. The authors had one weekend to research and write up this paper, which they did in Word Perfect on a 286 personal computer in the home of Cyrus' parents in Reservoir Hills, Durban.

That document, not previously published, appears after this introductory contextual note. Our recommendation, that the SARB be made subordinate to the National Treasury, and the case for this, was either not considered or it was rejected at the negotiations. In the end the SARB was granted full, constitutional independence.

I argue here that it may be worthwhile to revisit these debates in the context of South Africa's poor economic performance since the mid-2000s. While I see no value, and only potential loss of credibility, in reversing the constitutional independence of the SARB, there may be some value in debating whether or not ownership of the SARB should be transferred to the democratic state. Recall that most independent central banks are also state-owned entities so there is nothing exceptional in this proposal. While such a step (call it nationalisation, if you will) would not automatically democratise and re-align decision making on monetary policy within a broader developmental framework, it may open up the space for a thorough discussion about matters of private shareholding, governance and some operational issues, such as the prudence of maintaining an exclusive inflation target mandate, as well as the role, composition and transparency of the Bank's monetary policy committee.

So what happened at the negotiations?

Some within the ANC alliance had argued against the global trend, evident since 1989, of gradually increasing the autonomy of central banks. Thus, for example, the ANC's own economic think tank, MERG, in its report published on December 3, 1993, argued (largely in line with the Rustomjee and Padayachee recommendation) that 'the independence of the Reserve Bank … which divests the elected government of significant economic powers, is not a sound way to build international confidence in South Africa' (MERG 1993: 262) and it called for the subordination of the Reserve Bank to the Ministry of Finance (1993:264).

The MERG proposal on the future of the SARB was first publicly presented at the Oliver Tambo Memorial Lecture on November 5, 1993 and according to Bond (2000:75) it was rejected by ANC Department of Economic Planning (DEP) deputy head, Tito Mboweni, 'a few hours later'. Bond goes on to note that the DEP decision in favour of full independence was nevertheless reversed at the National Executive Committee of the ANC a few days later, at which meeting it was apparently agreed to make the Bank 'subject to the powers of parliament' (Bond 2000:76). However, independence was granted in terms of the interim 1994 Constitution and confirmed in 1995 during a parliamentary debate over the final constitution, and this view was enshrined in the final 1996 Constitution, though with minor changes.

Although some confusion surrounded the issue at the time, this independence was understood to mean *both* goal and operational or instrumental independence. Independence was enshrined in the new Constitution of the Republic of South Africa (South Africa 1996:224(2)):

> The South African Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice, but there must be regular consultation between the Bank and the Cabinet member responsible for national financial matters.

The Reserve Bank's main objective, as defined in terms of the South African Reserve Bank Act and in the Constitution (South Africa 1996:224(1)), is 'to protect the value of the currency in the interest of balanced and sustainable economic growth in the Republic'. However, the Bank still has the freedom to interpret this objective in any way it sees fit and to make and implement decisions in pursuit of this objective as it chooses. Inflation targeting was proposed by the government in 1999 and adopted and implemented from early 2000 though with some adjustments since then. At present, the SARB is mandated to achieve an inflation rate within a band of 3-6 per cent.

Some clues have since emerged that help us to understand at least the broad context of these debates, though much still remains unknown. In their book *The Politics of Transition* David Spitz and Matthew Chaskalson (2000) point out that in the debates dealing with constitutional principles, the National Party and government (which each had separate delegations) argued strongly for the independence of a number of 'state' institutions, including the South African Reserve Bank, the Public Service Commission, the Auditor General and the Public Protector while the ANC prioritised its arguments around guarantees of trade union rights. In the end after some tit for tat debate (Spitz and Chaskalson 2000:84) it would appear as if some kind of trade-off occurred with each side getting its way on the matters closest to them. Spitz and Chaskalson argue that the ANC had the power to stand its ground on the independence debate but chose not to do so.

As the likely majority party in the Constitutional Assembly, the ANC did not need a constitutional principle guaranteeing trade union rights and collective bargaining. It would have been able to ensure the enactment of the necessary provisions in the final constitution merely by using its strength in the Constitutional Assembly. It could, therefore, have stood its ground against the inclusion in the principles of a constitutional guarantee of the independence of the Reserve Bank and the Public Service Commission. Given the dynamics of the negotiating forum, however, it seemed easier to give the NP/government its principle on autonomy in return for getting the ANC principle on labour rights (2001:84). Spitz and Chaskalson acknowledge that assistance they received from the Inkatha Freedom Party's (IFP) Mario Ambrosini, thanking him for letting them have access to the records held in his personal archive (2001:7). In addition to this clue, I was led to believe that Ambrosini played a leading role in the drafting of sections 222-225 of the constitution which deals with the SARB, by a reference and footnote in a recent controversial book by a former SARB non-executive director, Stephen Goodson (see eg Goodson 2013:24, fn3). Ambrosini has since passed away, but I was granted access by the IFP's archivist Anthony Mitchell to the following extract from Ambrosini's posthumous, as yet unedited, book manuscript (Ambrosini nd). I quote from Mitchell's e-mail which is in turn drawn from the manuscript.

> Another one of my regrets are the constitutional provisions relating to the South African Reserve Bank. It is unusual for a constitution to entrench the position and functions of the central bank. I admit that when I drafted those provisions I did not have a clear understanding of what a central bank does and I ascribed to them entirely benign functions that had to be protected from a potential evil ANC government. I drafted the provisions regarding the central bank first in the constitution of KwaZulu-Natal of 1992 and then in the constitutional proposals that the IFP submitted at the World Trade Centre. Comparing the language of what I drafted with what can be found first in the interim Constitution and then in the final Constitution shows how it was indeed the case that the entrenchment of the central bank of South Africa came from my pen, so much so that it is a set of unusual provisions in most modern institutions and neither the ANC or the NP or DP had any proposal with respect of the central bank. The greatest regret is that I drafted language entrenching what I referred to as the ordinary functions of a central bank, which is still the language of section 225 of the Constitution which states that the South African Reserve Bank must perform those powers which are 'customarily exercised and performed by central banks'. The fact is that at the time I did not have a clear idea of what those powers and functions were and neither did most of those at the World Trade Centre. As a result, those provisions were included with little awareness of their enormous implications.

But other sources cast doubt on this claim. I raised this matter in a telephonic interview with Pravin Gordhan, one of the ANC's chief negotiators at both Codesa (Convention for a Democratic SA) and the World Trade Centre negotiations. Gordhan refuted Ambrosini's claim that he alone drafted these sections, or even that he had any role in the process, arguing that the decision was, in all likelihood, made largely through an agreement between the two major parties (the ANC and the NP) where policies were sometimes traded off between these two parties. But he himself was not directly involved in this particular matter. The governor of the SARB at the time, Chris Stals, has informed me that he was asked by the then minister of finance (Barend du Plessis) to draft a memorandum on the central bank's mandate and independence. The minister later informed him that some party or parties at the negotiations wanted changes to include growth and employment objectives as part of the mandate. He addressed this only indirectly by including a reference to the SARB performing its functions in the interest of balanced and sustainable growth without making this an explicit objective. It would appear that this was accepted, with the phraseology used above. He did recall that the text was changed marginally for clarity between the interim (1994) and final constitution (1996) where the reference to protecting the internal and external value of the rand, was changed. A later governor, Tito Mboweni, who was deputy head of the ANC's Department of Economic Policy (DEP) at the time of the negotiations totally refuted any claim that Ambrosini was involved in any way in the writing of these sections of the constitution, arguing that the position adopted on the SARB was in fact the position of the DEP and the government of the day. What we do not yet know is whether or not Ambrosini was part of the technical legal drafting team. If so this would have been purely a functional role and not a substantive policy-making role.

But following the chronology of events, it would appear that the story does not end there and gets picked up later that year. On November 2, 1993, MERG co-ordinator Vella Pillay delivered an opening address at the Oliver Tambo Memorial Lecture given by bishop Trevor Huddlestone. Pillay presented some of the main findings of the MERG draft report, stating, among other recommendations, that MERG would present a case against SARB independence. DEP deputy head Tito Mboweni was quick publicly to refute this idea, emphasising that the MERG position is not ANC policy. He said that the ANC was 'developing' (note the present participle) its own approach to monetary policy which would not require the Bank's nationalisation, but that an independent SARB would be constitutionally bound to consult the finance minister in conducting monetary policy, and that the Bank should act in support of the general economic policy of government.[1] This policy line, which appears quite reasonable on the face of it, appears to have been recommended by a 'technical committee' at the WTC talks, though it is not clear what was the status or membership of this committee or to whom it reported (*Business Day* November 8, 1993, *Guardian* December 4, 1993). The full MERG report was presented at the (old) Rosebank Hotel on December 3, and it was immediately and unceremoniously dumped by DEP head Trevor Manuel at that same meeting.

… with what consequences for development?

Monetary policy is a key determinant of an economy's macro-economic policy, and in democratic countries elected governments are invariably held accountable for that performance. Where fiscal policy is constrained by budget stringency (as was the case in South Africa around the time of the transition), monetary policy ought to have become the main instrument affecting macro-economic policy (Stiglitz 1998a: 216). Yet it was precisely at this very time and context that the ANC gave up control over monetary policy to an independent SARB. Why?

Sylvia Maxfield in her survey of central banks in developing countries notes that a concern for respecting central bank independence usually coincides with the desperate need to attract foreign capital into the country in question (Maxfield 1997:68-70, 86, 119, 137). Given the dire financial situation, which had forced the apartheid government to the negotiating table in the first place, the first post-apartheid governments can arguably be forgiven for prioritising policies that would assure foreign capital. But what has been the consequence of this independence of the South African Reserve Bank? In the interest of 'protecting price stability', the SARB, encouraged by its international colleagues, maintained one of the highest real interest rates in the world in the 1990s. There is no reason to doubt the motive of the SARB leadership in getting inflation under control, but it is worth considering the consequences of these actions. Unlike some South East Asian countries, which actively encouraged production over consumption, and maintained a competitive currency policy in support of their industrial policy, South Africa chose to cast its gaze to the West where the preoccupation was with budgets, inflation, consumption and finance. By maintaining a strong rand in the early post-apartheid period, along with strict adherence to its price stability mandate, it became relatively easy and even profitable for Old Mutual, Anglo American, South African Breweries, Dimension Data and Billiton to exit rand denominated investments in favour of those denominated in the currencies of the central banks of the US and Europe. However the cost of defending the rand led to a massive increase in the country's Net Open Forward Position (the NOFP or dollar debt) and paved the way for speculators to have a field day betting against the rand for many years, until, under Tito Mboweni's governorship, this debt was finally settled around 2003.

So given this context, which sectors of the South African economy attracted investment? There was very little investment into our agricultural sector, which has shed over a million jobs since the early 1990s, very little investment in our manufacturing sector which also had to deal with the stripping away of most of their tariff protections, and not a lot of investment into our mining sector, which was also not expanding employment. Instead, as is typical of a country implementing a Washington Consensus-type orthodox monetary and fiscal approach, the investment growth came in the FIRE sector (Finance, Insurance, and Real Estate) and in consumption. Notable foreign direct investment took place in one of South Africa's large banks (ABSA) and in the marketing sector (Edcon, Massmart).

Finance for consumption was extended with little concern for security. As a result both Capitec Bank and African Bank expanded, and consumer spending exploded. Anyone who cares to look at the share price graphs of retailers Mr Price and Shoprite Checkers over the past 20 years will see evidence of the gains from the extension of consumerism to low income South Africans in this period. Though Capitec Bank continues to do well, the recent difficulties at African Bank (post-September 2014) are perhaps the clearest indication of this trajectory finally running out of steam.

Overall South African inflation since democracy has been mostly exogenously driven, cost-push and driven by rising petrol, energy and food prices under conditions of slow and low economic growth. Yet every time the upper limit of the inflation target comes under pressure, our independent Reserve Bank under its current inflation targeting mandate has raised the repo rate on the grounds, among other reasons, that, by not acting, inflationary expectations among the public will rise. This has had negative consequences for consumption itself as well as investment, growth, small business development and employment.

Given all these real economy developments, some academics and trade unions have returned to consider this issue of SARB independence in the context of a renewed academic interest in the politics of South Africa's negotiated settlement (Spitz and Chaskalson 2000). Jason Hickel, an anthropologist from the LSE currently researching the history of the SARB observes with reference to our 1993 memorandum that such a document allows us

> …to get a sense for the 'minority report', so to speak – the alternative direction that we might have taken but didn't. This will help us understand that the particular direction we did take was not predetermined, or sewn-up – and therefore that the existing order of things is not inevitable. (Hickel 2015)

The views expressed in the document reflected the positions of the authors at the time and do not necessarily reflect their current views or that of any agency of government, international organisation, private sector or university with which they may have since been associated. However, as one of the authors (who later on went on to serve nearly 12 years as a non-executive director of SARB), I set out my own views on what, if anything, should be done about the independence of the SARB, as we approach the twentieth anniversary of the approval of the South African Constitution, which entrenched the Bank's independence.

Continuing challenges from the left and the right

The question of whether or not the 'right decision' was made at the negotiations or not, has not been settled in the economic policy debate since 1994. Some parts of the trade union movement COSATU, and especially its now expelled affiliate, the National Union of Metalworkers (NUMSA), have been vocal in their critique of the decision finally approved in 1996 to grant the SARB full constitutional independence, arguing that independence was a major constraint on the power of the democratic government to frame an effective policy to address the problems of slow growth and rising unemployment. Both the left, most notably NUMSA, but also the right, including a group of shareholders and at least one non-executive director of the SARB, have questioned the correctness of the stance taken, and called for the SARB's nationalisation or its return to full state ownership, albeit for very different reasons: the left because it does not believe that an independent central bank will adopt a monetary policy stance in favour of the working class and the poor and of development more broadly. Although denied, their call by the right to nationalise the bank appears to have more to do with wanting to cash in on the proceeds of the sale of their shares to the state, hopefully for them, at a more market related price. Let us consider both the left, as represented by NUMSA and then the right, as represented in a recent book published by former non-executive SARB director Stephen Goodson (2014).

NUMSA has consistently articulated their unhappiness with the Reserve Bank for six main reasons (NUMSA 2015):

- Failure to pursue the Bank's mission:

  > Our view is that the Reserve Bank has failed in pursuing balanced economic development and growth in its pursuit of price stability…. The central bank has therefore failed to control inflation within its targeted band, and has in the process contributed significantly in generating the current recession.

- The democratic deficit:

  > The Bank, in its operations, has not demonstrated transparency and accountability…the composition of the Monetary Policy Committee (MPC) remains impervious to democratic processes…. The monetary policy statements of the Governor are grossly inadequate, because they do not reflect the views that were expressed by individuals in the Monetary Policy Committee. Our view is that the Reserve Bank is held hostage by particular economic interests.

- Inability to adapt to changing developmental imperatives:

  > As the mandate of the electorate from the 2009 general elections states, all macro-policies should have employment creation as a central focus, yet the Central Bank continues with its old inflation focus with a fixation of the 3 per cent to 6 per cent band against all odds. The Reserve Bank is yet to announce how it sees its new role in the emerging developmental state.

- High interest rates:

  > The Central Bank has been very conservative in responding to the recession. South Africa still has [a] high interest rate compared to its trading partners and comparable economies. This has led to the attraction of speculative capital inflows, which strengthen the Rand, encourage imports, discourage exports, and thereby worsen the current account deficit….Our view is that the persistent deficit will make it difficult for the planned infrastructure spending to lift the economy as fast as possible out of the recession.

- Incompetence of the Bank to resolve macroeconomic imbalances:

  > The manner in which the …Reserve Bank pursues price stability makes it incompetent to resolve existing macroeconomic imbalances. The current account deficit is not going to be resolved in the context of this policy. Domestic demand is not going to be encouraged, because of the slow pace of interest rate reduction.'

- Incapacity to respond to the impact of the global crisis of capitalism on the South African economy and society:

> To date, the Reserve Bank has failed to produce a technically sound piece of paper detailing how the global capitalist crisis has affected the South African economy, and how it expects to play its role in moving the country out of the recession. Yet, the Reserve Bank is charged with the responsibility of maintaining balanced growth and development, financial stability and minimizing the impact of the business cycle on the South African population.

Right-wing shareholders and activists have since around 2003 used the occasion of the Bank's annual ordinary general meetings and other forums, as well as the media, to push for various changes in the SARB, including on dividends policy (currently capped) and issues related to the limits on shareholding. It would appear to me as a participant at SARB OGMs (ordinary general meetings) from 1996-2007 that one plausible strategy underlying the actions of these shareholders is to force the government to nationalise the Bank so that they would then have to be paid out at market value. However, some right-wing critics of the SARB, such as former non-executive director Goodson, have instead called for the SARB and all central banks to be reformed and converted into state banks under the control of the Treasury. Goodson claims that the nationalisation of the SARB per se as proposed by some trade unions will not make the slightest difference, unless the system is changed (from fractional to full reserve banking) and the reconstituted bank falls under the direct control of the Treasury (Goodson 2014:123). I don't agree with the change in the banking system he proposes, but there is something of merit on this particular point.

How did SARB cope with the 2008 financial crisis?

Arguably the most serious crisis which the SARB has had to address since being granted independence followed upon the global financial crisis of 2008. On balance, I would argue that the SARB response to the crisis was satisfactory.

The South African Reserve Bank's response, within the limits of its current constitutional mandate, focused on the following interventions:

- successively but gradually lowering the repo rate (so influencing onward lending rates);
- further improving banking regulation and supervision, improving its institutional capacity to ensure financial stability, while avoiding the dangers of over-regulation;
- using moral suasion to get the banks to tighten their lending criteria, while letting credit to flow (Padayachee 2014).

Even notable critics of the Bank's policy stance such as Hassan Comert and Jerry Epstein argue that the Bank reacted fairly well. They point out that 'the SARB policy regime as well as its rhetoric about monetary policy significantly changed in response to the crisis of 2008' (2011:S94). In essence flexibility and pragmatism have characterised its approach.

The political context within which the Bank conducts monetary policy also changed following the crisis, though not as a result of any constitutional amendment. In the 2010 budget, finance minister Pravin Gordhan, requested the Bank to apply monetary policy within a

> …flexible inflation targeting framework ie that in achieving its inflation target, the 'Bank is expected to take cognisance of the implications of its actions for the gap between actual and potential economic growth, asset bubbles, employment, and the stability and competitiveness of the exchange rate'. (Kahn and de Jager 2011:S78)

What this means in practice is that the MPC will not any longer automatically raise interest rates if the inflation rate breaches or threatens to breach the upper limit of the inflation target. Consideration will have to be given to the output gap. If this is considered wide enough interest rates may be retained. However the crisis has refocused attention to whether or not central banks everywhere can simply return to a business as usual approach. As pointed out in a recent discussion by Princeton professor Jean Pierre Landau at the 2012 SARB Monetary Policy workshop, a return to the status quo ante in respect of central bank policy, mandates and operations (post-crisis) is neither desirable nor indeed feasible (November 2012).

But will nationalising the SARB make a difference?

During the course of the twentieth century an undeniable shift can be discerned from state to market in the conduct of overall economic affairs and economic management. This is not, however, the case in respect of the ownership of central banks. Before 1936 only a tiny number of central banks, including many established in a wave in the 1920s, were state-owned institutions. The majority had total or majority or significant private shareholders, including to pick a few relevant ones for this discussion: Denmark, New Zealand, France, Germany, India, Indonesia, Mexico, Norway, Turkey, United Kingdom, the United States and of course South Africa. In 1935 the Reserve Bank of New Zealand was nationalised, followed by the Danish Central Bank in 1936. Nationalisation gained momentum after the Second World War, and apart from further nationalisations of existing banks, all newly established post war central banks had no private shareholdings. By 1974 only about 14 central banks retained some private shareholders (Rossouw and Breytenbach 2011:S125). Five of these (including South Africa, Switzerland and the US) had no government shareholdings at all. In the mid 1970s many more of the 14 noted above nationalised, including Chile, Mexico, and Venezuela. In June 2010 the Austrian central bank was nationalised by transferring all shares not held by the Republic of Austria to the government. Today one can count only about nine central banks with private shareholdings: South Africa, Belgium, Italy, Greece, Japan, Pakistan, Switzerland, the US, and possibly Turkey.

There is little or no evidence to show, in respect of SARB that private shareholders (who elect seven of the Board's current 15 non-executive directors) have made any material difference to the overall functioning and operations of the SARB that would have affected the realisation of its mandate and objectives as a national institution. At no time have private shareholders had either the power or the inclination to affect the conduct of monetary policy, after 1994 or even after 2002, when a period of relatively greater shareholder activism can be detected. In 1932, a group of Cape Town holders of SARB shares managed to unseat a Board member. In 2003 private shareholders did lobby to vote in a new member (Stephen Goodson) instead of a sitting non-executive director proposed for re-election by the Bank's Board of Directors (then Billiton CEO Brian Gilbertson).

An argument has in fact been made to show that the relatively unique ownership structure of the SARB has contributed to greater transparency and democracy. Rossouw and Breytenbach (2011) have pointed out that the private shareholding obliges the Bank to call an annual general meeting at which the governor, the Board and the executive management can be questioned over the Bank's monetary policy and any other matters related to the conduct of the affairs of the Bank and are legally obliged to respond. At issue, however, is the question of who the private shareholders are and what interests they represent. The number of private shareholders of the Bank now stands at about 660 (including many if not all private banks and financial institutions) and they own the 2,000,000 shares issued. There are legal limits on what number of shares private shareholders may own and receive by way of dividends: no one single shareholder is allowed to own more than 10,000 shares, though this is open to abuse. Dividends are limited to 10c per share. Any surplus after dividends are paid, after normal tax obligations are paid over, and after a transfer to reserves (that has to be approved by the minister of finance) is then also transferred to government. Clearly it is the government, rather than private shareholders who benefit from the Bank running consistent and large surpluses.

Despite being wholly owned by private shareholders the Bank has certainly since 1994 taken seriously its duty to communicate to the South African public which it does in many ways: first through its engagement with the elected representatives of the people in the form of parliament's finance portfolio committee at which the annual report of the Bank is presented and debated; then through the regional monetary policy forums at which a diverse range of individuals, institutions and stakeholders are routinely invited and through regular presentations by the Bank's executives at academic, business and other forums.

The government's position on SARB independence has remain unchanged, despite the letter of the finance minister to SARB, referred to above. In 2014 the deputy president expressed that position as follows:

> The Reserve Bank has a critical role to play in supporting the National Development Plan. A capable Reserve Bank is a crucial part of a capable state. The Constitution provides it with a clear and unambiguous mandate: 'To protect the value of the currency in the interest of balanced and sustainable economic growth in the Republic.' The independence to execute monetary policy without fear or favour, without regard for political or electoral cycles, is a critical aspect of our policy architecture. Independence does not however mean that the central bank is not accessible or accountable. The Reserve Bank is accountable to the people of South Africa and reports to parliament on its activities. In a democracy, continued accountability of the central bank is critical for its credibility and for its ongoing independence. It needs to constantly engage with South Africans on its policies and its decisions. (Ramaphosa 2014)

As I indicated above, I do not believe that nationalising the SARB will automatically bring about the changes in structure and policy that proponents of nationalisation believe. But this does not mean that things should stay the same. The process of assuming state control should not necessary affect the independence of the SARB (note that most other independent central banks are state owned). But taking state control of the Bank may open up opportunities to re-examine a number of issues of both governance and policy-making that may be far more useful and practical to the country's growth and development agenda.

Nationalisation will not necessarily or automatically affect in a progressive way how the Bank operates, including how it sets interest rates. As constitutional expert Pierre de Vos correctly observes:

> It does seem rather strange that the SARB has private shareholders though, but in practice this makes no difference to how the Bank operates. While seven of the 14 members of the Board are appointed by the President and seven more are appointed by shareholders, the Governor of the Bank has a deciding vote on the Board, giving control of the bank to those appointed by the President. Shareholders cannot remove the governor or the other members of the Board and have very little power over the Bank. (De Vos, January 28, 2010)

So I do not believe that there is anything to be gained by reversing the constitutionally entrenched independence of the SARB that now exists, although it is true that the SARB is now only among a handful of central banks in the world with private shareholding. However, it makes sense to me to make a case for taking SARB ownership from private shareholders to the state, based on the grounds that the current situation of full private ownership of the SARB is totally out of step with global trends. Neither will this pose any inevitable constitutional challenge or crisis. To cite De Vos again:

> The SARB Act can be amended without any constitutional problem to abolish private shareholding in the Reserve Bank – as long as those shareholders are adequately compensated. But, once again, this will make no difference to how the Bank operates as its independence is constitutionally guaranteed.

It is important to remind ourselves again that there is no necessary contradiction between central bank independence and state ownership. Most central banks with operational independence are also state-owned. The process for taking the SARB back into full state ownership to comply with global norms may therefore represent an opportunity for a frank and open discussion about the way in which the SARB operates; about the nature of its accountability to parliament; about its governance structure and possible broader representation on the Board; about clarifying the role and mandate of the single shareholder (if state ownership occurs); about the way the MPC is constituted and the manner in which it operates; about whether inflation targeting needs to be revisited; about how the work of the SARB and the Treasury can be better and more transparently co-ordinated, etc. But any such process will have to be very carefully and skillfully managed. If it is not, such a move could backfire on the country, through loss of credibility and reputation.

All these discussions should be aimed to set up a new or reformed institution that is primarily designed to accelerate economic growth and employment while managing inflation and the deficit within reasonable parameters, and, critically, to use exchange rate policy and capital controls to prevent or stem the long term illegal haemorrhaging of capital that has been such a powerfully negative force in post-apartheid South Africa (see Ashman et al 2011).

There are no technical difficulties in developing a broader more developmental target for a central bank to strive towards. Epstein has shown that the current neo-liberal approach to central banking is both highly idiosyncratic and 'dramatically different from the historically dominant theory and practice of central banking' (Epstein 2006:abstract) where central banks have played a role in supporting industrial policy, supporting some economic sectors, contributing to developing their financial sectors, allocating credit, etc. both in the developed and developing world (2006:1-4). The use of nominal GNP targeting or Walsh optimal contracts as alternatives to inflation targeting have been debated in the economics literature for many decades (see also Comert and Epstein 2011). The SARB, Treasury and government generally need to be convinced that there is much value in debating these options transparently and responsibly rather than simply claiming that there are no alternatives to neo-liberal central banking. After all only about 26 countries in the world have adopted full IT (Inflation-Targetting) regimes.

Another key issue is to think through what mechanism one could consider to improve the quality and range of the debate within the MPC. Stiglitz (1998b:19/20) may have a point when he writes:

> Indeed, central bankers typically do not have even the training that makes them suited for judging the macro-economic consequences of their policy decisions – arguably their central concern…. it is certainly the case that one could achieve a high level of expertise which was at least as high as that achieved today in many, if not most, central banks, which was more representative of the national interest and affected parties and which would combine professional judgments with values that are more in accord with society as a whole.

Central banks, like the IMF and World Bank, tend to attract economists who share a common and highly orthodox approach to economics. So though I am assured that much robust debate does take place within the MPC, it would seem that these are not about the big policy issues and challenges of the day. Perhaps it should, as in the UK, appear before parliament's portfolio committee in open session to explain and debate their positions at some agreed time after each MPC meeting. Perhaps the minutes could be published after a lapse of some agreed time, as in the US. Perhaps, to address the issue of representativity, two additional independent rotating external members could be added onto the MPC, again as in the UK. I am fully aware of the myriad of problems that this could cause from a legal point of view. In the Bank of England, for example, these independent external members, usually drawn from the City or academia, are formally co-opted to the Bank staff for their tenure in order to reduce the danger of conflicts of interest, but in a way which defeats the objective of having independent voices on the MPC.

Conclusion

In short, much could and should be done by government and the Bank and by other stakeholders like COSATU and NUMSA and organised and small business creatively to rethink an issue that is so critical to the effective application of macro-economic policy in South Africa in the continuing context of the massive economic problems that the country faces. Simply calling for nationalisation of the SARB without any real understanding of how a central bank is governed or operates in the blind hope that something will be done differently and more 'progressively', or simply reiterating the position of successive governors and the government that the Bank's only mission is price stability (latterly also financial stability) in the face of the scale and magnitude of the crisis of unemployment, poverty and inequality that faces South Africa 21 years after the institution of democracy, may be constitutionally correct, but it is not economically or politically sustainable. Alternatives to neo-liberal operational policies and practices of central banking do exist and these are worth debating in a responsible manner, and without requiring potentially risky constitutional amendments.

Let me end by making some of these arguments in another way: I am not arguing in this paper to reverse the constitutional independence of the SARB, nor am I arguing for nationalisation because I believe that this will magically or inevitably change the way the SARB is governed or the way decisions, including monetary policy decisions, are made. Rather I am arguing that taking the SARB into state ownership (nationalisation, if you will) will bring the SARB in line with most central banks in the world in terms of the balance of private and state ownership, and that the process of doing this, if well managed, does offer an opportunity, transparently and democratically, to re-examine the internal and external structures of governance, operations and policy-making, including about the narrow focus on inflation, in order to address broader issues of growth and employment, and even industrial and sectoral policy in South African today.

But those who do go so far as to argue to reverse SARB's constitutional independence because they do not accept that only independence guarantees low inflation, will find support in the example of the Bank of Japan, which has historically presided over low inflation but is equally a central bank which has been massively influenced by its ministry of finance (Hayo and Hefeker 2002:657). But that is an issue for another paper.

Notes

1 The views expressed here are my own and have not been canvassed with Cyrus Rustomjee, the co-author of the 1993 document reproduced below.

2 It is worth noting the ANC's official and approved policy document at that point, 'Ready to Govern' released on May 31, 1992, makes no reference to the ANC's position on the independence of the SARB, under section D3 (dealing with Fiscal and Monetary Policy).

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Appendix

Memorandum on the Issue of Central Bank Independence. Private and Confidential, July 28, 1993.

To: ANC Constitutional Negotiating Team, via CDE, Vella Pillay, MERG.

From: Cyrus Rustomjee and Vishnu Padayachee

Introduction

We regard the prospect of enshrinement of Central Bank (CB) independence in the National Constitution as a development which would be particularly threatening to the success of democratic economic policies for reconstruction and development of the South African economy. Far-reaching, viable and substantive economic policies for economic reconstruction are likely to be pursued by future democratic government. A CB whose independence is constitutionally enshrined will present an enduring potential obstacle to the success of these policies.

Furthermore, we believe that it is fundamentally undemocratic for an unelected body to be assigned such enormous constitutionally-enshrined powers. The call for constitutional independence of the CB appears to be an ideological vestige, representing a polar or extreme view inconsistent with the overall objectives of building a democratic economy. Although we regard the economic arguments for a nationalised CB to be clear-cut in South Africa's case, we accept that there may be sound political reasons for not pursuing such an option in the most uncompromising way.

The arguments that follow are therefore an attempt to ensure that the overall macroeconomic objectives of a democratic government are not undermined by a CB which can, if it chooses, simply rely on its entrenched constitutional rights to override such objectives. We would strongly recommend that issue of CB independence not be addressed in the National Constitution, but (if at all) in a revised SARB Act. Moreover, in the SA context, we consider the CB/Treasury relationship to be one which can be adequately addressed through appropriate dispute resolution arrangements. Some of these are addressed in this brief memorandum, which has been prepared at short notice. For clearly, the issues that are being addressed here should preferably be dealt which in detail and [sic] sophistication.

However, should it still be deemed essentia1, we would support a clause in the Constitution along the lines of that suggested in the Memorandum from Cramer et al.

General Issues

1. The need for a close working relationship between the CB and the Ministry of Finance is unlikely to be seriously questioned. Ideally this working relationship should function in such a way that in practice there is no need to decide who has the final say if there is a difference of opinion. It is assumed that differences will be solved by discussion and compromise. In all countries, furthermore, there is extensive cooperation at the civil servant level between the CB and the Government, through consultations, committees and on a personal basis. Accordingly, the legal status of the CB, whether independent or nationalized (at either extreme) or relatively autonomous within broad guidelines) is not per se the crucial issue; rather, provisions for resolving disputes between the CB and the Treasury are crucial.

One motive in calling for an independent CB is to prevent profligacy in government expenditure, which, should it occur, would threaten monetary stability. There are important advantages in arrangements under which the CB has enough independence to insulate the management of its operations from the political side of government and to ensure that the CB can act as a formidable obstacle to the misuse of monetary instruments.

However, in most democratic countries, it is not regarded as acceptable for the CB to be able to thwart the government if the latter is prepared to take complete responsibility for bringing about a change of monetary policy. This is particularly the case if these issues are placed before the public in a clear and open manner.

2. The legal status of the CB therefore does become a crucial issue when it is proposed that the operations of the country's CB are enshrined in the Constitution as independent of the operation of the Treasury. A CB whose independence is constitutionally enshrined represents an extremist approach in resolving dispute. There are, however, many less extremist, workable options, which do not include Constitutional independence, for dispute resolution. Within the context of any particular country, for example South Africa, there is no reason why procedures which provide for adequate dispute resolution cannot be developed, taking specific cognisance of the existing relationships between government and the CB.

A realistic and constructive approach to the relationship which characterises future SARB/Ministry of Finance interaction is to acknowledge that the major task of economic reconstruction and infrastructural development will *inevitably* generate dispute, whether or not the CB is formally subordinate to the Ministry of Finance. Constitutional independence of the CB will detract from the flexibility which will inevitably be required in formulating economic policy, by limiting scope for dispute resolution.

The focus, in considering how the relationship is to be managed, ought therefore to be on developing constructive mechanisms for dispute resolution, together with deciding whether such mechanisms are to allow for conflict to be made public: certainly not for hiving off a crucial institutional element in the reconstruction process and placing it (the SARB) in a position in which it is constitutionally free to confound national economic policy. Further, if such dispute-resolving provisions are to be formally legislated, their place ought to be in a new SARB Act, not in the national constitution. Examples of such dispute-resolving mechanisms are outlined in Section 5.

3. Arguments for CB subordination to the Treasury. The most direct reason for CB subordination to the Treasury is that CB independence presents a threat to the development of a coordinated strategy for economic reconstruction and development. An independent CB may choose to pursue price stability in isolation from other goals of macroeconomic policy (an approach which has been applied in South Africa). Constitutional independence of the CB is in any event no guarantee of price stability.

A likely reason for calling for CB Independence is the desire to achieve zero inflation. As a macro-economic goal in isolation, the policy is very desirable. Yet when placed within the context of the South African economy, there are exceptionally high costs associated with a policy of pursuing zero-inflation. Some of these costs have clearly been manifested in South Africa since the current Governor's tenure of office: massively rising unemployment, severe reduction in business confidence when policies to pursue price stability have failed; and limiting economic growth by curbing effective demand.

There have been substantial calls for easing of tight monetary policy from the current business establishment, including major commercial bank economists. A constitutionally-independent CB pursuing price stability as its only objective will be free to ignore such appeals indefinitely; a CB subordinated to the Treasury will be able to be called to account when (as in the current economy) monetary restraint brought about by a dog-headed desire to control prices, at the exclusion of all other macroeconomic goals, patently begins to cripple the fabric of the economy.

4. **Arguments against CB Independence**

4.1 *The call for independence is founded on negative fears, not a positive and dynamic break from the past.*

In South Africa, the argument for CB Independence is partly founded on the assumption of weak, profligate and misdirected government policy, uncoordinated spending priorities, wasteful expenditure on specific components of current consumption and failure to apply national financial resources to fixed investment and infrastructure development. All of these features have characterised past South African government policy, particularly since 1975 when a trend break occurred in the pattern of government consumption and investment expenditure (refer Table 1 attached).[1]

There is however, no convincing evidence that these policies are to be continued by a future South African government. All policy documents emanating from the democratic movement have identified and acknowledged price stability to be an integral component of prudent monetary policy. A Constitution which espouses a vision of a prosperous future economy should not be founded on fear of avoiding a disastrous past, but on principles which promote confidence in government and its ability to successfully confront the heritage of apartheid.

4.2 *Independence is an extremist position, not an approach which is founded on moderation*

There are several reasons why the call for CB independence to be enshrined in the nation's Constitution is an extremist position: (i) In no country in the world does the CB actually operate in complete independence of the Treasury. This applies even to the Bundesbank, where extensive and ongoing interaction exists between government and the Bundesbank. The Bundesbank is, of course, the role model of an independent CB.

Enshrining such a principle in South Africa's constitution will render the principle *de facto* redundant *ab initio*. If the country's Constitution is to have any credibility, it cannot be filled with clauses which are, in practice, unworkable. A more practical approach is to recognise that all over the world, the respective Treasuries and CBs require suitable mechanisms to *co-*

ordinate policy, not mechanisms to keep the two institutions apart. No opening is provided to identify any element of coordination, in a formulation which enshrines CB independence in the Constitution.

There is a sinister component to the call for constitutional independence: the South African Reserve Bank (SARB) has functioned without constitutional independence since inception. Precisely at the moment of political transition to a democratic majority, it appears more than odd that senior personnel in the government and the SARB are attempting, rather crudely, to enshrine independence constitutionally. The impression given is one of clear determination to remove crucial levers of power from a future democratic State.

Why should this be a priority now? The constitution was changed in 1983 but there was no urgent call for CB independence then. Key personnel have had important opportunities to press for change: the current Governor held three positions between 1985 and the present. Appointed Director-General of Finance on 1 September 1985, he assumed the position of Special Economic Adviser to the Minister of Finance in June 1989 and became SARB Governor in 1989. With his extensive experience, one might have imagined him immediately calling for CB independence, not awaiting the onset of democratic government to do so.

5. **Examples of Dispute Resolution**

5.1 In the Netherlands, the Minister of Finance can, when s/he deems it necessary for the purpose of coordinating monetary and financial policy with the policy of the CB and after the Bank has been heard, issue a directive to the Executive Committee of the CB aimed at such coordination. If the Executive Committee does not agree with the directive (and this must be the assumption for issuing a directive) it is free to bring the case before the Cabinet within three days, which has to decide the case and, unless it is contrary to the national interest, publish the objections of the Executive Committee and the governments' reasoned decision.

5.2 In Australia, the law specifies that if a matter cannot be resolved by negotiation between the Treasurer and the CB (which is the first obligation of both) the Board of Directors shall forthwith furnish to the Treasurer a statement in relation to the matter. The statements of the government and the Board are required to be tabled in Parliament. The Minister shall make a recommendation to the Governor-General, who on this basis shall decide the matter. Clearly, scope for some degree of autonomy of CB decision-making authority is desirable. Where, at the limits of such authority, dispute arises, several mechanisms exist to enable CBs to raise the subject of their concern and to pursue such concern through dispute-resolving mechanisms.

In the event that disagreement persists, there are also a number of further deadlock-breaking mechanisms. In Laurence Harris's submission, reference is made to such procedures, through which potential CB /Ministry of Finance disputes can ultimately and satisfactorily be resolved. (Refer to the New Zealand example cited in Section 7.6 of his paper.)

6. **Methods for Improving Transparency of the CB**

6.1. *Limiting the tenure of office of directors*, some of whom have served three or four consecutive terms of office. (In one case an individual served for 24 years as a director).

6.2. *Publishing minutes of committee meetings*. Of course, publication will require waiting completion of the conduct inter alia of the SARB's open market operations decided in committee; but there is no need to cloak SARB operations in the level of secrecy which has characterized its operations through much of the past two decades.

7. **Methods to reduce SARB encouragement of government profligacy**

7.1. *Reduce the coincidence of the terms of office of the Minister of Finance and the SARB Governor.*

7.2. *Improve the image of the SARB as an institution concerned with broader economic issues, not only price stability*. In the South African context, such improvement is only likely to arise when price stability ceases to be the sole and entirely-overriding objective of CB policy.

7.3. *Disputes between the CB and the Ministry of Finance should be open to parliamentary and broader public scrutiny and debate.*

Summary

The major fear aroused by a CB subordinate to the Treasury is that the latter will be able to call for funding without resistance. There are several examples of workable arrangements, among CBs which are subordinate to the Treasury, in which substantial and effective resistance is provided for: the ability to question the intention of the Minister; to formally record a difference of opinion; and to enable arbitration of such dispute; all of which delay delivery of funding.

That the current SARB and its senior personnel have proved incapable of offering resistance is no argument for the merits of an independent CB; rather the failure is at worst an indication of the weakness of the current personnel. Policy has clearly been weak since 1975: refer Table 1 which highlights the destination of government expenditure; and at best of the failure to include appropriate structures within the CB/Ministry of Finance relationship which (a) can curb government profligacy and (b) which offer the SARB Governor meaningful tools to resist profligate spending.

The CB's ultimate subordination to the Treasury is a norm in industrialised democracies, as well as in democracies in developing countries. Within this normal framework, very substantial scope exists for operational independence of the CB. Constitutional independence of the CB is, by contrast, an extreme position and ought to be characterised as such. The more substantial issue is the nature of the relationship between the CB and the Treasury: the extent of CB independence *within* government, not *from* government.

The economic crisis facing SA requires far-reaching, innovative and new economic strategies, such as those proposed by the ANC.

Resolution of the crisis will require a high degree of coordination between the major components of economic decision-making. Hence the proposal for a degree of cooperation between the Treasury and the SARB, which accepts the integrity of their respective views; which is founded on the need for exceptionally close coordination of policy; which involves procedures for the resolution of conflicts as they arise; but which is ultimately underpinned by subordination of the CB to the authority of the democratic state, represents the only consistent institutional arrangement if the economic reconstruction programme is to be successfully concluded.

Note

1. For the purposes of reproduction of this document [in its original form], the table to which reference is made in the text here and below is not included as superfluous to comprehension of the argument.