

**THE LEGAL FOUNDATION OF THE INDEPENDENCE OF CENTRAL BANKS - A COMPARATIVE STUDY**

**by**

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I declare that THE LEGAL FOUNDATION OF THE INDEPENDENCE OF CENTRAL BANKS – A COMPARATIVE STUDY is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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## INTRODUCTION

A central banking system is a crucial factor in the growth of every economy. Central banks play a pivotal role in the implementation of monetary policies. Initially, these banks were created as autonomous institutions, and designed to regulate payment systems. The power of running monetary policies was conferred on them only at a later stage. Their functioning was expressed, either in the charters that created them or in other legal arrangements. In the past, it has been observed that, in the discharge of their duties, some policymakers have tried to interfere with their activities in order to achieve their own objectives.

This method of operation has sometimes been reflected in monetary expansionary tendencies, which have caused harmful effects on the values of currencies, and several economies have been seriously affected as a result. This often occurred in periods of large spending by governments, such as general elections. In fact, during such periods, some governments do everything possible to meet the electoral pledges that they have been unable to implement during the period of their political mandate. After this trend had been discerned in some jurisdictions, efforts were made to address the issue. Although the main reason for pushing for the legal independence of central banks is to maintain sound monetary policies by avoiding expansionary measures to artificially stimulate economy; much of the economic and financial literature that prevailed twenty years ago had constantly continued to see 'politicians using monetary expansion as a means of stimulating the economy in the interest of short-term electoral popularity'.<sup>1</sup> Surprisingly, in present days, the same view still lingers, and it is still said that some 'governments and parliaments are tempted to use the printing press to meet their financial needs; thus neglecting the risks and detriments of inflation'.<sup>2</sup>

While this seems to be the essential motive put forward to substantiate the need for the separation of political and monetary authorities, some experts are sceptical about this generalization, and one of them holds the view that 'evidence that monetary policy follows the electoral cycle is thin'.<sup>3</sup> In other words, every case should be examined on its own merits, and empirical evidence shown that a government has actually indulged in such practices.

From the above, it may be inferred that when people express their views on this matter, they should exercise caution, and not try to consider expansionary money an evil that is always linked to the electoral process alone.

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<sup>1</sup> Ross Cranston *Principles of Banking Law* 1 ed (1979) 120.

<sup>2</sup> Rosa Maria Lastra 'Independence of the European System of Central Bank' (1992) 33 *Harvard International Law Review* 476.

<sup>3</sup> *Ibid.*

Unfortunately, in many jurisdictions around the world, there is a persistent suspicion that political undue influence is sometimes exerted on central banks to print money for illegitimate ends. If these allegations proved to be true, it would indeed amount to public financial malpractice with a negative impact on economy. In such situations, an independent central bank, it is said, would deprive those politicians of the temptation to take this easy path;<sup>4</sup> since printing of money<sup>5</sup> is a process that follows strict rules, and requires certain standards of macroeconomic variables, such as an increase in production or maintenance of full employment, otherwise, the purchasing value of the currency would depreciate; and the primary objective of central banks would miss its target.

In order to curb such a tendency and other undesirable practices in this area, a number of countries including South Africa have set up a series of safeguards; one of them being the inclusion of the independence of central banks in their constitutions. In so doing, they have recognised the role expected to be played by those institutions;<sup>6</sup> and decided to ensure that their protection is embedded in the highest law of the Land. (why caps?) In fact, a constitution has been considered by many as a social contract between the people themselves as to how they should be governed, on one hand, and the rulers who are expected to be limited in their power by that contract, on the other. The values cherished by the people are enshrined therein, and it is the duty of governments to uphold them. Therefore, respect for central bank independence is an obligation binding both governments and monetary authorities. However, despite the existence of that autonomy, central banks are also expected to work in consultation with governments; and account for their actions before relevant authorities.

The analysis of this concept is the main objective of this short dissertation. Its purpose is to explore the legal dimension of the independence of central banks, bearing in mind that the nature of the topic, and the areas in which these institutions operate are interdependent; this is why this study will build on the views of economists, financial experts and lawyers. In fact, both lawyers and economists play an important role in the economic regulatory process. Their close cooperation is useful in the formulation of wise and effective regulations.

Consequently, this dissertation will be tackled within an interdisciplinary perspective because mercantile law in general and banking law<sup>6</sup> in particular deals with legal aspects of finance, economics and business.

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<sup>4</sup> Ibid.

<sup>5</sup> A currency is a potent symbol of a polity's unity, integrity and perhaps strength. Governments interfere with it at their peril (Cranston op cit (n 1) 118).

<sup>6</sup> The law is usually subdivided into two categories, namely public and private law. Public law is that part of law which regulates the legal relationship between the State and a subject in which the State acts from a position of authority, whereas private law regulates the legal relationship between legal subjects acting on a basis of equality. Areas of the law, which in particular are related to trade and commerce, are classified as mercantile law. Some

In chapter one, a brief reference to the historical background of central banking in general will give an insight into the topic. In chapter two, the general theory of the independence of central banks will be considered. The third chapter will deal with the legal independence of the South African Reserve Bank (hereinafter called the SARB or the Bank). The concluding remarks will sum up the main ideas developed in the dissertation.

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mercantile subjects consist largely or entirely of private applied law, for example, the law of partnership and insurance law, while others such as tax law are mainly public; company law is an example of mercantile law comprising both public and private rules. Banking law is presented as a mercantile law subject and regulates both public and private relationships. Public banking law regulates the legal relationship between banks and organs of the State, which are in a position of authority, and comprises those legal rules which make provision for control by the State of money and activities of banks in particular (An Oelofse *UNISA Study Guide Mercantile Law LML-407-U LWB 7-9 Banking Law and Usage* (2002) 4-5).

With regard to public banking law, Cranston remarked that 'banking lawyers have taken little interest in central banks. Central banking law, at least in the common law countries, has been regarded as a specialized subject, mainly for public lawyers. But public lawyers have generally done little, although the debate about the European Central Bank is generating a great interest on their part. There is hardly any literature about central banking' (Cranston op cit (n 1) 117). This probably may explain the reason why a number of economists have ventured into dealing with the independence of central banks, some with wonderful contributions and others with economic bias. However, given the nature and object of central banks, it is also not easy for lawyers specializing in this area, not to borrow from economic history, economics and finance to substantiate some legal concepts. Similarly, it is not possible for a lawyer involved in banking supervision to ignore the concepts of corporate finance, financial engineering (financial innovation) and corporate governance. However, even though the language used in their writings may have a smack of economics; finance and commerce, the overall of their literature is expected to have a legal perspective.

Concerning the expansion of banking law, in South Africa, there is a significant literature on banking law in general, and an impressive development of private banking law both in academic writings and judge made law. This is probably due to the fact that many legal experts are in agreement with the opinion expressed by Schulze that among the phenomena influencing banking law, there is the fact that 'banking law is not an autonomous branch of the law; but rather an application of concepts and techniques of the general law of obligations'. (See, WG Schulze 'The Source of South African Banking law- A twenty first Century Perspective' (2001) 14 *SA MercLJ* Part I) 439). See also, FR Malan; JT Petrorius & SF du Toit Malan on *Bills of Exchange, Cheques and Promissory Notes in South African Law* 4 ed (2002) 335.

Therefore, the law of contracts being wide in scope, so becomes the law related to private banking law. Furthermore, Schulze, in describing the principles likely to exercise a decisive influence over the development of banking law, declared, *inter alia*, that other important considerations when studying banking law (...) are the fundamental changes taking place in the banking sphere which affect the economics of banking. Some of these economic changes, which may have an influence of the development of a future South African banking law, include the far greater competitiveness in the bank market and its products: increased asymmetric competition; excess capacity in the market and the far reaching impact of technology and financial innovation (ibid).

With regard to public banking law, as above described by ~~An (or simply, Oelofse, no initials or firstname is necessary when referring to an author for a second time, unless there is more than one author with the same surname.) Oelofse,~~ there are also a number of lawyers who have written on public banking law, mainly, in the area of banking supervision, money law, money laundering, legal aspects of financial institutions, etc. Therefore, the remarks of Cranston (*supra*), which were relevant some years ago, and which may still prevail in some other countries, may not necessarily apply to South Africa as such.

## CHAPTER ONE

### 1.1 A BRIEF HISTORY OF MONEY AND CENTRAL BANKING

#### 1.1.1 Role of money in society

Walter Rogers, an American humorist, once said ‘there have been three great inventions since the beginning of time: fire, the wheel and central banking’.<sup>7</sup> He certainly forgot the invention of money around which central banking systems revolve.<sup>8</sup> In fact, at all times, money has occupied a central stage in people’s lives. History tells us that money has been linked to religion and, in ancient times, the Romans banked in the temples of the goddess Juno, also called *Moneta*<sup>9</sup>, the Latin root of the word money.<sup>10</sup> This practice carried with it another religious dimension in that Roman coins were minted in temples,<sup>11</sup> and sanctified by the priests, an act that made the currency acceptable by society as a reality.<sup>11</sup> In this regard, Voet also declares that it is well known that ‘the Romans often deposited their things for safe keeping in a holy temple... sometimes with bankers and money changers’.<sup>12</sup> This is probably why banks have always been considered sacred institutions from the time of their creation to this day.

Similarly, money has become an object of almost universal veneration. Some people are convinced that money makes everything possible, and this is probably true if one considers its value of exchange and the material enjoyment it brings to those who own it. Consequently, the place it holds in social relations explains the need for societies to seek its protection and stability. In this regard, it has been said that ‘there are few things more important to society than stable money,<sup>13</sup> and efficient and reliable means of transferring it from one person to another’.<sup>13</sup>

<sup>7</sup> *The Economist* September 2000 80.

<sup>8</sup> In antiquity, money took the form of ornaments, household utensils and tools. In Egypt, circa 2000BC rings, anklets, necklaces and bracelets were used extensively as a common means of exchange. The legendary King Croesus of Lydia in Asia Minor is generally credited with the honour of introducing a formal and sovereign coinage system when official silver and gold coins were struck in his kingdom between the years 560 to 546 BC. In Athens, coins were apparently introduced by Solon (638-559) who fixed money payment for fines and dues formerly paid in cattle; probably before this time coins had been in use in China. (See, eg, Houston *The Fundamentals of Money* [1935]10; see also ‘Market Intelligence’ [2004] *The Nairobi Business and Financial Journal* 28).

<sup>9</sup> The most important goddess of the Roman state, wife of Jupiter; she was originally an ancient Italian goddess; the Greek equivalent is *Hera* (Jidy Pearsall & Patrick Hanks (eds) *The New Oxford Dictionary of English* [1998])

<sup>10</sup> *The Latin term moneta came to signify money; you have already mentioned this in the text to foot note 10*

<sup>11</sup> Robert W Kolb & Ricardo J Rodriguez *Financial Institutions and Markets* 2 ed (1996) 38.

<sup>12</sup> *Ibid.*

<sup>13</sup> Nigel Willis *Banking in South Africa* (1981) 184.

<sup>13</sup> Guy David ‘Money in Canadian Law’ (1986) *The Canadian Bar Review* 192.

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In effect, money is the common denominator in several human transactions, and the means of discharging the obligations thereby created.<sup>14</sup> From barter to counter-trade, its modern form, people use money as a medium of exchange to facilitate transactions,<sup>15</sup> as a unit of account which helps determine with precision the value of the goods exchanged, and the services delivered. Money is also a store of value equal to or near its face value.<sup>16</sup> In this regard, money is any medium, which in practice fulfils the function of exchange and which is accepted by those who use it.<sup>17</sup> This is why 'money has evolved from cowrie shells (in South Pacific Islands) to cattle (in Africa) to cigarettes (in prisoner-of-war camps) and then to gold'.<sup>18</sup> Among all these forms of money, only gold was easy to handle, divisible and durable; thus it was preferred to other kinds of money.

As history continues to say, the increase in the volume of trade transactions in ancient times gave rise to the need for people to have a safer place to keep their money other than in their homes. In this connection, it is said that 'recourse was hard to some individuals, such as priests, and wealthy merchants to keep it for them in the vaults they had for the safekeeping of their own gold'.<sup>19</sup> The movement led to various associations of individuals or legal entities to form banks. From the activities of those banks, which were commercial in nature, came the idea of a central banking system that is examined below.

### 1.1.2 Emergence of central banking

A central banking system is a recent phenomenon when compared to commercial banking system. Commercial banking system is believed to be much older. Its beginning may be traced back to somewhere in the Middle Ages, from the European institutions that provided depository safekeeping services when, as seen earlier, the goldsmiths and silversmiths having facilities in which to keep their own valuable inventories, found that 'they could earn additional income by storing valuables for a fee'.<sup>20</sup>

By contrast, the emergence of central banks is located somewhere in the 17<sup>th</sup> century.<sup>21</sup> These banks were essentially created to assist their governments with finances. For example, the Bank of England Act 1694

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<sup>14</sup> Ibid.

<sup>15</sup> David S Kidwell, Peterson & Blackwell *Financial Institutions, Markets and Money* 7 ed (2000) 5.

<sup>16</sup> Ibid.

<sup>17</sup> See, Guy op cit (n 13) at 205.

<sup>18</sup> Jerry Jordan 'Money, Central Banking and Monetary Policy in the Global Financial Arena' (2001) *FMF Mnograph* 27 15.

<sup>19</sup> See, Oelofse op cit (n 6) 22.

<sup>20</sup> Kolb et al op cit (n 10) 404.

<sup>21</sup> Sveriges Riskbank of Sweden was created in 1668; it was followed by the Bank of England in 1694, the Bank de France in 1800, the Bank of the Netherlands in 1814, the National Bank of Belgium in 1850, the Bank of Spain in 1856, the Bank of Russia in 1860, the Bank of Japan in 1882 (Rene du Plessis 'The Structure and Operations of the Reserve Bank and its Relationship with the Government' (1984) *BM* 86-93. See also Jeremy Leaman *The Bundesbank Myth Towards the Critique of Central Bank Independence* [2001] 52).

authorized the incorporation of the Bank by means of public subscription. Originally, the object of the Bank was to raise money required by the war with Louis XIV.<sup>22</sup> It is further said that ‘the Bank was prohibited from engaging in general trade but was authorized to deal in bills of exchange and in the equivalent of promissory notes’.<sup>23</sup> The duties of that bank included keeping the accounts of the government, issuing banknotes and were also allowed to trade in gold coins, bullion and silver.<sup>24</sup>

As private institutions, central banks were created as independent bodies. With time, a number of countries, which were satisfied with the way they were handling money, came to realise that they could also play a macroeconomic role.<sup>25</sup> As a result of this realisation, some of them have been entrusted with the handling and protection of currencies on behalf of governments. As their function grew in importance, central banks were also given the power to formulate monetary policies on behalf of governments. In addition to this, they received additional duties, such as; supervision of banks and other financial institutions.

Furthermore, because of their expertise, they also began to serve as governments’ advisors on financial matters. With these new roles, central banks went from strength to strength, which is why it was said that ‘never before, have central banks reached the pinnacle position and obtained the widespread interest they now command’.<sup>26</sup> It is owing to their role in macroeconomic policy that they are now the focus of a great number of researchers in different fields.<sup>27</sup> This movement was probably due to financial global expansion.<sup>28</sup> In fact, since 1973, almost all the nations in the world have been operating fiat monetary systems<sup>29</sup> in which the goods and services value of a unit of money rises or falls with the parsimony or profligacy with which the central bank issues its money.<sup>30</sup>

<sup>22</sup> EP Ellinger, Eva Lomnica & Richard Hooley *Ellinger’s Modern Banking Law* 4 ed (2006) 29.

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

<sup>25</sup> When central banks were created, the notion of macro economy as such had not yet appeared.

<sup>26</sup> GM Wessels ‘Cycles in Central Bank independence’ (1997) 12 *The South African Journal of Economic History* 1 153.

<sup>27</sup> See, GM Wessels ‘On the Meaning of Central Bank Independence’ (1998) 1 *South African Journal of Economic and Management Sciences* 2 254.

<sup>28</sup> The global expansion was characterised by the expansion of the European Monetary Union, the former Eastern Bloc States, Chile, UK, France, New Zealand and a number of other countries where central banks statutes have been amended or completely revised in order to strengthen their independence. The independence of central banks received attention in South Africa during the constitution-making phase in that independence was debated and eventually included in the Constitution (Jordan *op cit* (n 18) 1).

<sup>29</sup> Fiat money is paper money that is backed only by the issuing government’s decree that it is acceptable as legal tender currency. Its value stems from public confidence rather than being convertible into gold or other hard currency (Thomas Fitch *Dictionary of Banking Law* 3 ed (1997) 182). Legal tender is the money recognised by law as acceptable payment for creditors also called lawful money (Fitch *op cit* (n 29) 261). It is the money people use in their daily businesses, such as banknotes and coins. For further details, see section 17 of the South African Reserve Bank Act 89 (Act 90 of 1989) as amended.

<sup>30</sup> Jordan *op cit* (n 18) 27.

This helps maintain the balance in the money supply.<sup>31</sup> Nations today no longer provide an anchor to their currencies by a legislative declaration of gold value. Therefore, central banks have themselves become anchors for the stability of their respective currencies.<sup>32</sup> It is on the basis of these considerations that, nowadays, a central banking system is entrusted with the duty of formulating and implementing financial policies with the ultimate end of protecting the value of the currency and fostering economy. This crucial role has resulted in central banks being included by the will of the peoples in the well-cherished values at the same level as national symbols, such as flags, national anthems, systems of governments and Bills of Rights in constitutional dispensations. It is also because of the claim of national ownership by central banks, in some countries, that the appointment of the leadership of those institutions is strictly scrutinised, and carried out by governments, sometimes, with the approval of parliaments. All these legal and administrative precautionary measures have been designed to avoid any subordination of those institutions to governments; because it could facilitate inflation and even hyperinflation,<sup>33</sup> which are considered a threat to the life of any currency. The theory of the independence of central banks highlights this concept even more.

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<sup>31</sup> The central banking wisdom is that there should be neither too much money in circulation nor too little (see, David Colander *Economics* 1 ed (1994) 278). Central bankers are expected to keep the balance according to the moods of the economy.

<sup>32</sup> Jordan op cit (n 18) 15.

<sup>33</sup> Inflation is a continual rise in price level. It is also a continuous decline in the value of the money. Inflation is an ongoing rise in the price level; a rise generates another rise in an exponential manner and the spiral is hard to stop. Once inflation hits 5 or 6% it is no longer insignificant, inflation of 10% (double digit) or more is significant and once it hits triple digits of 100 or more it is called hyperinflation (see, Colander op cit (n 31) 149).

## CHAPTER TWO

### 2.1 THEORY ON THE INDEPENDENCE OF CENTRAL BANKS

The term 'independence' is defined as a state of being free of influence, guidance or control of another or others. To be independent is a state of being free from outside control; not depending on another authority.<sup>34</sup> To be independent is also to act personally without external pressure. Within the context of a central banking system, this means autonomy from government.<sup>35</sup> It is a restriction made on governments against interfering with the handling of monetary policies. In fact, granting independence to central banks essentially represents elevating monetary policy to a more consecrated level beyond the fray of politics.<sup>36</sup> As noted previously, since some people think that political interference in the implementation of monetary policies weakens the credibility of central banks by restraining their ability to perform in a predictable and sound manner, their independence means freedom to execute monetary policies without fear of any political retaliation; otherwise, the entrenchment of that independence in constitutions would be meaningless. In this regard, it was said that 'empirical evidence has shown that countries with an independent central bank enjoy a low inflation rate and small budget deficit without at the same time exhibiting reduced economic growth'.<sup>37</sup>

In order to strengthen this independence, it has continuously been thought that the power to create ~~money~~ and the power to spend it should be separated for central banks to operate as a check on governments, particularly over its fiscal policies, and prohibiting the financing of government deficit. In this regard, the idea of separation between monetary authorities and governments was mooted in the 19<sup>th</sup> century even though its application has taken a long time to gain wide recognition. This will be explained in the following section.

<sup>34</sup> Pearsall op cit (n 9) 928.

<sup>35</sup> The anomaly of the independence of central banks is illustrated by Sayers, who states that the authority of the State over the central bank is always necessarily absolute. All that is open to question is the extent to which the sovereign body should detail its command to the central bank for the monetary laws are such a command (Gianni Tiniolo in Tiniolo (ed) *Central Banks' independence in Historical Perspective* (1988) 42). To make sure that this command will be obeyed, the Governor of the Central Bank of England and the government negotiated a deal of allegiance, which provides that 'as long as I am the Governor of the Bank, I shall do my utmost to work loyally and harmoniously with you and for you as a Chancellor of the Exchequer, and I shall continue if you allow me to tender you such advice as I consider it my duty to offer, fully realize that I must not attempt to impose my views on you' (ibid). This is an example of a bank, which really had its hands tied and was under the direction of a Government. However, according to Ellinger, the election of a Labour government in 1997 resulted in two momentous changes in banking regulation. First, the Bank of England Act 1998, as well as giving the Bank independence in determining monetary policy, also transferred its responsibility for banking regulation to the Financial Services Authority (the 'FSA'). (See, Ellinger et al op cit (n 22) 28). Therefore, the Bank, which was nationalized in 1946, and ever since subject to government control, has now recovered its independence.

<sup>36</sup> Ignacio Mass *Central Bank Independence, A Critical View from A Developing Country Perspective* (1994) 4-5.

<sup>37</sup> Markus Lusser 'Autonomous Monetary Policy in a Small Country' (1994) 13 *South African Journal of Economic and Management Sciences* 3.

### 2.1.1 Hallmark of central bank independence

A distinctive feature of independence of central banks, namely autonomy from governments and non-financing of budgets, was identified by one of the famous British economists in a paper on the establishment of a national bank in England in 1824 in which he stated that 'the government could not be entrusted with the power of issuing paper money that it would most certainly abuse it'.<sup>38</sup> For him, to avert the danger, commissioners should be allowed to control the use of public finance, and should not authorize the lending of money to governments without proper justification; on the other hand, governments should not try to use their dominant power to convince the commissioners to do so. He further stated that 'if the government wanted money, it should be obliged to raise it in the legitimate way',<sup>39</sup> such as applying wise fiscal policies or participating in financial markets like any other institution, but 'in no case, should it be allowed to borrow from those who have the power of creating money'.<sup>40</sup>

It is clear from the above that the speaker had in mind a system of checks and balances in the financial sector, but his vision that the representatives of the peoples should have a final say in public financial management is somehow blurred by the current view that 'although parliaments once exercised effective control of government budgets, today [in many countries], parliamentary control of government's budget is a mere formality rather than a real check'.<sup>41</sup> Because of this situation, the last hope of the people on these matters is placed in the role to be played by an independent central bank. Their expectation is that a central bank would not systematically finance deficits; rather, serious studies and consultations should be conducted to examine the merit of the requests of the government before any disbursement of funds is carried out.

The separation of monetary authorities will shed more light on this concept.

### 2.1.2 Separation of duties of governments and central banks

Although the independence of central banks is topical in many countries, it is still a controversial issue. Those who advocate the idea of that autonomy tend to compare the legal independence of central banks

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<sup>38</sup> BW Fraser *Reserve Bank of Australia Bulletin Central* (1994) 1 [www.rba.gov.au/publications](http://www.rba.gov.au/publications) and Research/Buttein/bu-dec94/bu 1294-1pdf. [Visited 4 May 2004]. This theory has been largely expounded by David Ricardo (1772-1823), a British economist and a successful stockbroker of Dutch-Jewish parentage who is also credited with several other economic theories, such as the theory of wages in the economy and the theory of comparative advantage in international trade (see, Colander op cit (n 31) 14, 113-114).

<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

<sup>41</sup> Lastra op cit (n 2) at 77.

with the independence of the judiciary. The attempt to use this analogy as an example to separate monetary authorities and governments is probably by reference to the traditional system of checks and balances between the three traditional branches of power, namely the executive power, the legislative power and the judicial power as featured in several constitutions around the world.

They probably view this mutual control where 'no one branch can exercise power decisively without the support or the acquiescence of the other'<sup>42</sup> as an efficient mode in the conduct of monetary policies and another way of fostering decentralisation and avoiding the abuse of power. Although the analogy may be somehow self understood because in some countries, independence of the judiciary, and independence of central banks are entrenched in their constitutions, the reality is that independence of the judiciary is an almost universally accepted concept. On the contrary, the idea of central banks' independence in constitutional systems is a new concept, which does not enjoy universal recognition. The reason being that there are still a number of countries in which the principle of independence of central banks is not yet recognised, and where the idea is not even on the agenda of their financial policies.

Another reason, which may lead one to think that the independence of the two institutions is different in their essence, is the fact that central banks are part of the executive branch of the state. This is still true even in those countries that have opted to enshrine the independence of their central banks in their fundamental laws. The framers of those constitutions perhaps never thought that their central banks were meant to be the fourth estate of power. Even the press itself has never managed to be elevated to the level of a fourth power despite the freedom it enjoys, and the role it plays in political orientation.

Therefore, it is not because the independence of central banks is provided for in some constitutions that central banks may consider themselves separate from governments. There are many other state agencies, the independence of which is written into constitutions, that are still considered administrative and advisory bodies, such as the Financial and Fiscal Commission or the Independent Authority to regulate Broadcasting as respectively stipulated in s 220 and s 192 of the Constitution of the Republic of South Africa Act 108 of 1996; as well as similar institutions in many other countries around the world.

Furthermore, it is true to say that the courts enjoy the authority of *res judicata*,<sup>43</sup> which gives final decisions of the courts a binding character. By contrast, the decisions of central banks do not enjoy the

<sup>42</sup> Thomas E Patterson *American Democracy* 5 ed (2001) 44.

<sup>43</sup> The complete expression is *res judicata pro veritate habetur* meaning that 'a judgment will have a binding effect on another' (Bryan A Garner (ed) *Black's Law Dictionary* 8 ed (2004) 1337); it also means that the judgment that has been definitely decided is held as a truth and has a binding character (see, eg, Raymond Gullien & Jean Vincent *Lexique de Termes Juridiques* 5 ed (1981) 373). It is also called 'judicial precedent' and by way of generalization, judicial precedent may be described as a judicial decision that serves as example and authority for

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same privileges because central banks, as administrative institutions, may be made to account to relevant institutions or seek consultation with pertinent administrative bodies. By contrast, the judges do not need such kind of consultation in their decision-making process.

The view that the two forms of independence are different is shared by many; this is why it was said that 'the definition referring to a relationship between central bank and government which is comparable to the relationship between the judiciary and the government ...' is not helpful<sup>44</sup> because this would entail a strict separation of powers in the traditional meaning of the word, which would amount to elevate the independence of central banks to a level of another power not recognized by law, the comparison simply 'suggests a degree of autonomy to be reserved to central banks'.<sup>45</sup>

From the above, it may be inferred that independence of central banks seems to be more administrative than political; administrative in the sense that its main objective is to reinforce the delegation of powers conferred on them in consistence with the principle of the division of labour, which consists of organising the financial sector into different constituencies to ensure greater efficiency and effectiveness in the management of the economy. However, as a general rule, governments retain the big role of conducting public affairs, and are primarily accountable for their actions to the peoples through institutions of control, such as parliaments in countries where the rule of law prevails; this is why it was said, 'viewed broadly, an elected government in a democratic society has the ultimate power to formulate and implement macroeconomic policy and is also responsible for it'.<sup>46</sup> In practice, however, it is hard for governments to carry out all these tasks alone. Some of them are entrusted to other institutions; or state agencies provided those governments retain control, because, as it is commonly said, 'delegation of power without control is improper'.

To achieve this end, there has to be a regulatory mechanism to avoid conflict and duplication of duties. This kind of delegation may be considered a routine matter in any administration or bureaucracy. It is sometimes discretionary, but in the case of central banks, the position is different because some of them derive their independence from constitutions or statutes of their respective countries. Thus, governments have no other alternative but to comply with law. The delegation is thus compulsory, but not

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deciding a later case, either by the same or by another court. In Latin concept of judicial precedent is embedded in the maxim of *stare decisis et non quieta movere*, meaning to stand by precedent and not to disturb settled points (see, Schulze op cit (n 6) at 447).

<sup>44</sup> Philip Brentford 'Constitutional Aspects of the Independence of the European Central Bank' (1998) 47 *International and Comparative Law Quarterly* 88.

<sup>45</sup> Ibid.

<sup>46</sup> Wessels op cit (n 26) at 255.

discretionary. However, this does not mean that central banks will cease to be closely associated with the general administration whatever their legal status and their degree of independence.

Furthermore, one of the legislature's motives in granting that independence is clearly to avoid the misuse of authority by governments by compelling central banks to adopt measures that may adversely affect their respective ~~currencies~~ ~~or~~ currencies or impact negatively on their overall economies.

It is beyond dispute that governments also have the interests of the people at heart; but they are comprised of human beings with all the weaknesses linked with human nature, for instance, the voters may pile pressure on them by claiming to cater for their needs at all costs, especially when elections are around the corner. In that event, when they cannot exercise self-restraint, and resist the temptation of succumbing to those pressures, they may act in panic, and use public finance as a vehicle to regain their electoral mandate. To avoid this temptation, it was suggested that governments should draw a lesson from Ulysses<sup>47</sup> of Greek mythology who decided to have his ears plugged with wax to avoid the temptation to hear the beautiful melodies of the sirens, which otherwise could have cost him his life.

Similarly, the legitimacy of independent institutions may also be understood by reference to the 'Robinson Crusoe' paradigm. Just as an individual imposes constraints on himself in order to channel his own expedient behaviour towards rationally selected norms,<sup>48</sup> so a government limits itself by allowing or creating autonomous or independent bodies, recognising its own weakness in the face of temptation.<sup>49</sup> Otherwise, it may tend to make decisions that exhibit inflationary biases, and thereby undermine the legal independence of central banks.

Where such a restraint proves impossible, governors of central banks and their teams should be able to voice their disagreement freely when pressure to print money is unjustifiably imposed on them. In case of conflict, the dispute should be resolved by the relevant state agencies in total adherence to due process of law.

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<sup>47</sup> Ulysses (also called Odysseus in Roman mythology) and his sailors plugged their ears with wax to be immune to the songs of the sirens which lured unwary sailors to their death. Ulysses asked the sailors to tie him to the mast to protect him from the temptation of removing the wax, and when they were in the middle of the voyage, he was tempted to hear the songs and asked the sailors to assist him; his sailors followed his instructions and refused to remove the wax from his ears or to release him from the mast. His life was saved because he recognised his weakness and protected himself from it. Furthermore, experience teaches that cherished values may be put in jeopardy by the passion of the moment. Ulysses tied his own hands but constitutions bind present and future generations; a constitution is an attempt by a society to tie its own hands to limit its ability to fall prey to weaknesses (see, Erwin Chemerinsky *Constitutional Law Principles and Policies* 1 ed (1997) 7).

<sup>48</sup> Lastra op cit (n 2) at 479.

<sup>49</sup> Ibid.

However, despite the autonomy of central banks, as observed earlier, it is also stressed that ‘an independent central bank is not an omnipotent institution devoid of supervision and accountability but a part of democratic society’.<sup>50</sup> As such, there are limits to its powers and restrictions on the scope of its discretionary policy.<sup>51</sup> Independence for a central bank does not therefore mean that the bank occupies the position of a state within a state; it is impossible to have two sovereign authorities in a single state.<sup>52</sup> The economic policy of a country cannot be anything but the policy of the elected people.<sup>53</sup>

In the same vein, it was also said that, ‘although governments have the final say in the management of their countries, and none has granted absolute independence to central banks, governments do grant or delegate monetary powers to central banks’.<sup>54</sup> As the argument goes ‘a mandated independence means that the bank is insulated from day to day political interference and short term affinity’.<sup>55</sup>

It is also useful to mention that, even in those countries where the independence of central banks is not provided for in constitutions, they are somehow granted charters giving them a certain autonomy allowing them to conduct monetary policies in a more relaxed atmosphere, and some of them have had impressive inflation records. In this regard, it may be said that the success of central banks depends much on an effective leadership. For example, Margaret Thatcher was persistently hostile to statutory independence for the Bank of England; but under her rule, inflation was kept at a reasonable level.<sup>56</sup> This happened when there were divergent points of view with her long-serving Chancellor Lord Nigel, who was a keen advocate of independence for the Bank of England.<sup>57</sup>

From a historical point of view and observation, some experts believe that the role of the legal independence of central banks rose and declined with the application of economic ideologies, which originated from England and expanded to some other parts of the world, as briefly expounded below.

### **2.1.3 Central bank independence with economic ideologies**

According to economic history, there are two important economic theories with regard to how the British government approached the conduct of economy in the past and contemporary period; namely classical

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<sup>50</sup> Wessels op cit (n 26) at 155.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> Ibid.

<sup>54</sup> Ibid.

<sup>55</sup> Ibid.

<sup>56</sup> H Preece ‘Right to be wrong’ (1993) 57 *Finance Week* 10 8.

<sup>57</sup> Ibid.

economy, spearheaded by Adam Smith (1723-1790) under the doctrine of *laissez faire*;<sup>58</sup> and interventionist economy developed by John Maynard Keynes (1883-1946).<sup>59</sup> These two concepts have had an impact on the legal independence in countries, which applied them beyond the United Kingdom.

From the above, the perception of many financial experts and economists is that there is no big difference between the doctrine of *laissez faire* long time considered the embodiment of the system of capitalism and the basis of freedom of contract and the economic philosophy of interventionism. Their conclusion is based on the fact that Smith does not totally rule out the intervention of government in the management of economy;<sup>5</sup> and Keynes also recognizes the interplay between the forces of the market; as well as a system of market oriented economy. However, there is a middle-of-the road theory, essentially developed by the so called classic economists,<sup>60</sup> and which, currently, is claimed by those who profess it to be the most suitable for the conduct of economy despite its being still controversial in the eyes of many others.

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<sup>58</sup> In economics and politics, *laissez faire* (let alone) is a doctrine that economic system functions best when there is no interference by government. It is based on the belief that the natural economic order tends, when undisturbed by artificial stimulus or regulation, to secure the maximum well being for the individual and therefore for the community as a whole (see, Paul Lagasse et al (eds) *The Columbia Encyclopedia* 6 ed (2000) 1574). Historically, *laissez faire* was a reaction against mercantilism, a system of commercial controls in which industry and trade, especially foreign trade, were merely seen as means of strengthening the state. Navigation laws, trade monopolies, taxes, paternalist regulations of all kinds bore heavily upon the rising class of merchants in the period of European colonial expansion. It was on behalf of this class that the French PHYSIOCRATS, pioneer economists in 18<sup>th</sup> century first formulated the principle of *laissez faire*. With the physiocrats, state non interference became a cardinal teaching; they especially opposed the taxation of commercial pursuits. Opposition to mercantilism and state paternalism also motivated Adam Smith, father of classical economics, whose name, more than any other, is connected with the British *laissez faire* doctrine, which he developed after his stay in France. Smith believes that individual welfare rather than national power was the correct goal; he thus advocated that trade should be free of government restrictions. When individuals were free to pursue self interest, the invisible hand of rivalry or competition would become more effective than the state as a regulator of economic life. Smith did not believe in *laissez faire* in an absolute sense; he found a place for government in public works, such as the building of canals and docks to facilitate trade and in the regulation of foreign commerce to protect certain home industry (ibid).

<sup>59</sup> Some centuries later, another English economist and monetary expert, Keynes John Maynard (*supra*) came up with another theory, which was perceived as departure from classical economy. His position dated from the mid 1920s, when he formulated the Liberal Party program to promote employment by a program of government spending on public works. Keynes came to believe that such a program would increase national purchasing power and foster employment in complementary industries. For the sake of full employment, Keynes also modifies the classical belief in international free trade. The basis of his doctrine is mainly based on large scale government economic planning and the intervention of government in the regulation of economic activities. His doctrine appealed to both practical politicians and theoretical economists with equal force; perhaps because he attacked the problem of employment and income while remaining faithful to the requirements of rigorous economic thought. Although he favored controlled investment and an active public sector, he never waived his faith in capitalist economy. In Keynesian theory, government action is designed to stimulate the market, not to eliminate it (see, eg, Lagasse op cit (n 58) 1524).

<sup>60</sup> Since the two ideologies exposed above have some convergent points of view, the economists who accept Smith's ideas;<sup>5</sup> and at the same also recognize some of the ideas of Keynes, are known as 'Neo Classic Economists' (see Colander op cit (n 31) 318).

With regard to independence of central banks, this brief exposition of economic ideologies will help the reader understand that the position of those who favour that concept have continued to believe that central banks prevailed under the influence of the doctrine of *laissez faire*; while others think that, nationalisation or centralisation of main economic institutions and thereby the subordination of central banks to governments, were much influenced by the doctrine of interventionism.

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In fact, a number of countries have been following these theories depending upon the party controlling the government of the day. To maintain financial stability, some of them have found that it was good to institutionalise a legal framework that permits governments and central banks to act in close cooperation.

In this regard, a few banks have been randomly selected, without any inclination whatsoever –towards anyone of the ideologies exposed above, but to simply highlight the importance of granting legal independence of central banks in the conduct of economic and financial affairs.

#### 2.1.4 The Bundesbank

In Germany, the Central Bank is called the Bundesbank. It has a reputation as a fierce inflation fighter,<sup>61</sup> in large part because of the historical legacy of the German hyperinflation of the late 1920s and early 1930s.<sup>62</sup> Commentators and policymakers are almost unanimous on the fact that ‘the Bundesbank is the bastion for price stability and a symbol of monetary discipline around the world’.<sup>63</sup> The anti-inflationary record of the Bundesbank is typically cited in literature as the quintessential example of the inverse relationship between inflation and central bank independence.<sup>64</sup>

The aim of stability, which became enshrined in the Bundesbank Act of 1957,<sup>65</sup> was coupled with the strong desire of the German people to put an end to a financial crisis that was worsened by the burden of the war reparation debt. In their effort to revamp their economies, a series of measures were put in place among which the independence of the Bundesbank was prominent.

<sup>61</sup> David Colander *Economics* 4 ed (2001) 684.

<sup>62</sup> *Ibid.*

<sup>63</sup> Maria Rosa Lastra & GP Miller ‘Central Bank in Ordinary and Extraordinary Times’ in Jan Kleineman (ed) *Central Bank Independence, The Economic Foundations, The Constitutional Implications and Democratic Accountability* (1999) 12.

<sup>64</sup> *Ibid.*

<sup>65</sup> The German Constitution includes some dispositions about the Bundesbank, but does not mention its legal status or whether it will be a private or a public body. (See, eg, Felix Olkers *Central Bank Law in German and South Africa*, unpublished LLM dissertation University of Cape Town (1992) 1).

The success of the German economy in the above-mentioned period is also largely attributed to the combined efforts of the Bundesbank and its predecessor, the Bank Deutscher, which led to a period hailed as the miracle years<sup>66</sup> during which stable high growth, low inflation, full employment and healthy external balances were realised and which was also called a magic square.<sup>67</sup>

This phenomenon is illustrated by the fact that from the lowest rate of growth in the 1950s, which hovered around 3.5 percent up to 1958, the year the Bundesbank Act came into force, the average growth for the decade was 8 percent and, for the sixteen years (1951-1966),<sup>68</sup> it was still an impressive 6.8 percent. Inflation averaged less than two percent in 1950 to just one percent in 1960 and the rate of unemployment fell.<sup>69</sup>

There was widespread belief that the success was not only due to the legal independence of the Bundesbank but also, particularly, to the teamwork of all political, economic and financial institutions in applying positive policies and using top talents to achieve those results.<sup>70</sup> This was further strengthened by German legislation on the monetary system, which included decisive measures to contain access by the state to central bank credit.

In this regard, it was declared that the Bundesbank could lend directly to the Federal and Lander governments only to a limited extent and only for a short period.<sup>71</sup> The credit lines thus granted could be used only for cash advances, that is, to bridge short-term cash deficits that arise during the implementation of the budget, but not to finance deficit budgets themselves.<sup>72</sup> This is reflected in s 20 of the Bundesbank Act, which sets a ceiling on the credit the Bank can grant to government.<sup>73</sup> Moreover, the Bundesbank may not acquire bonds issued by public authorities direct from the borrower but only in the open market on the terms ruling there.<sup>74</sup>

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<sup>66</sup> Leaman op cit (n 21) 114.

<sup>67</sup> In the United States, Humphrey & Hawkins Act on Full Employment and Balanced Growth (1978) translates this theory into reality. In fact, apart from the requirement of voting and implementing a balanced budget, the Act expressly requires the coordination of economic policy between the president, Congress and the Federal Reserve System, and the setting of 3 percent adult employment as the official target for public policy (see, Robert B Carson *Macroeconomic Issues Today Alternatives, Approaches* 4 ed (1987) 180-181). Furthermore, the Act, as it stood by that time, explicitly required the nation to aim at four ultimate goals: full employment, growth in production, price stability, balance of trade and budget (ibid).

<sup>68</sup> Leaman op cit (n 21) 114.

<sup>69</sup> Ibid.

<sup>70</sup> See, eg, Leaman op cit (n 21) 113.

<sup>71</sup> Ibid.

<sup>72</sup> Ibid.

<sup>73</sup> See, Lastra op cit (n 2) at 490.

<sup>74</sup> Ibid.

In this effort of economic revival, the Bundesbank was also given a rule-making power, that is, it was permitted to issue regulations with a binding character through the principle of delegated legislation. However, the by-laws passed by the Council of the Bundesbank are subject to the approval of the Federal Government, and are published in the Federal Gazette. Therefore, by law, the Bundesbank has both goal independence (formulation of monetary policy) and instrumental independence (freedom in the implementation of the monetary policy).

In order to strengthen teamwork, Germany has introduced an element, which is not common in many countries, that is, the cooperation between monetary authorities and the government in such a way that ministers who are in charge of economic and financial matters and monetary authorities are by statute obliged to act as close allies in the handling of economic and monetary policies. For example, the members of the Federal Government are entitled to attend meetings of the Central Bank's Council, even though they have no right to vote; they can nonetheless propose motions.<sup>75</sup> A reciprocal privilege is extended to the Governor of the Bundesbank.<sup>76</sup>

However, in this innovative style of seeking a synergetic action to achieve high results, 'there is no formal liaison or interchange of staff members, but the Bundesbank and the Ministry of Finance work together closely in national and international bodies, such as the International Monetary Fund'.<sup>77</sup> This *modus operandi* is in line with the German Central Banking Act of 1957, which provides that 'the Bundesbank is independent from the Government in the conduct of monetary policy; but it must cooperate with the Government'.<sup>78</sup> Moreover, 'the Bundesbank needs the Federal Government's approval in order to participate in institutions serving the purposes of supra national policy or international payments and lending'.<sup>79</sup>

In the same perspective, there is another central bank that has achieved success in its own right. This bank is the Reserve Bank of New Zealand.

### **2.1.5 The Reserve Bank of New Zealand**

The Reserve Bank of New Zealand was established in 1934.<sup>80</sup> At the time, it was under the tutelage of the Bank of England. The Reserve Bank was perceived as an essential tool in the economic development of the country and a subject of national pride. It was created as an independent institution under the

<sup>75</sup> Section 13 (2) of the Bundesbankgesetz.

<sup>76</sup> Section 13 (3) of the Bundesbankgesetz.

<sup>77</sup> Lastra & Miller op cit (n 63) 488.

<sup>78</sup> Lastra & Miller op cit (n 63) 45.

<sup>79</sup> Ibid.

<sup>80</sup> Geoffrey Wood 'Central Banks independence' in Jan Kleineman op cit (n 63) 10.

inspiration of the then Governor of the Bank of England.<sup>81</sup> His idea was presented before the New Zealand House of Representatives. Some of the elements of the report are still topical today. The recommendations to establish a Reserve Bank were subject to two fundamental conditions. In the first place, the bank must be entirely free from both the actual fact and the fear of political interference.<sup>82</sup>

The Bank would not be able to discharge its duty if its room for manoeuvre were limited. Best practice in banking management has shown that to allow a bank to work as a private entity with its own capital owned by individuals or corporations with an autonomous board of directors appointed by the shareholders would allow the central bank to attain its objectives and realise better performance.

The approximation to the framework of the advisor did not last long because of the advent of a new government. In 1936, the Bank was nationalised. The power of monetary policy as provided for in the Act creating the Bank Act of 1989 was put in the hands of the Government; the Bank had to execute the directives from the Minister of Finance. It was only in 1984 that the independence of the New Zealand Reserve Bank was revived. A series of reforms started to give the Bank back its lost powers. This was especially due to continued economic crises. In light of the German miracle, there was a general feeling that an independent central bank could better facilitate economic development in New Zealand.

The Reserve Bank of New Zealand is currently regulated by the Reserve Bank Act of 1989 No. 157 as amended. This new legislation requires the Governor of the Reserve Bank of New Zealand to negotiate a monetary policy agreement with the Minister of Finance. Under this arrangement, the agreement must be made public. Under previous law, this requirement was not present; the Governor could be directed to follow a particular policy without that directive being released publicly. Currently, 'the Reserve Bank of New Zealand has the very specific goal of pursuing an inflation target of between zero and two percent'.<sup>83</sup>

This has helped inflation decline from double-digit levels to lower than two percent. Owing to this achievement, 'the Reserve Bank of New Zealand is regarded as a forerunner in establishing institutional structures which ensure central bank independence with a formalized performance contract arrangement'.<sup>84</sup> In fact, its independence is in the form of a bilateral contract, in which the fight against inflation is the object. The Governor commits himself to meeting the targets agreed upon in the contract. If the set targets are not achieved, dismissal may occur.

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<sup>81</sup> Otto Nyeemer was the advisor of the Bank of England; he subsequently became director of the Bank (1938-1932).

<sup>82</sup> Ibid.

<sup>83</sup> Fraser op cit (n 38) 3.

<sup>84</sup> Jackson MKC 'Reserve Bank Independence A Post Keynesian Perspective' (2002) 70. *The South African Journal of Economics* 129.

To facilitate the execution of the agreement, the role assigned to the Reserve Bank of New Zealand is to maintain price stability; other economic objectives are set aside. The Governor, in the implementation of this obligation, agrees that he will direct those under him or her towards the achievement of goals stipulated in the contract. In fact, he or she has no other choice because of the *Sword of Damocles* of losing his or her job, which hangs over him or her.

Apart from the Bundesbank and the Reserve Bank of New Zealand, there is another institution, which is also well known for its independence, namely the European Central Bank, an overview of which is given below.

#### 2.1.6 The European Central Bank

In the late 1990s, a number of European Union countries formed a monetary union, creating a common currency called the euro and a new central bank called the European Central Bank (ECB).<sup>85</sup> The primary objective of the ECB is to maintain price stability. Its tools and its directives are similar to those of the Bundesbank and some experts have considered it an expansion of the Bundesbank for the entire EU.<sup>86</sup> Like the Bundesbank, the decision to uphold that independence is provided for in the Maastricht Treaty.<sup>87</sup> This Treaty has made legal central bank independence a *sine qua non* for participating in the European Monetary Union. It was further provided that 'in the discharge of its duty, the ECB does not take instruction from any quarter whatsoever within the Community'.<sup>88</sup> These provisions strengthen its legal independence.

Furthermore, that independence is laid down in the Treaty, member states are imperatively bound to bow to its provision. Like other countries, which adopted the independence of central banks in their constitutions, the main reason, as seen above, is the fact that they are hard to amend. In fact, to amend a multilateral treaty like the EC Treaty is as difficult as to amend any other constitutional provision.<sup>89</sup> As seen earlier, 'a constitution is the document in which the most important laws of the states are authoritatively ordained'.<sup>90</sup> This is one of the reasons why it was declared that 'the member states

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<sup>85</sup> Colander op cit (n 31) 684.

<sup>86</sup> See, Colander op cit (n 31) 22.

<sup>87</sup> The Maastricht Treaty is a Treaty on the European Economic Union agreed by the heads of governments of the twelve member states of the European Community (Rome Treaty of 1957) at a summit in Maastricht (the Netherlands) in December 1991; the ratification was completed in 1993 (Pearsall op cit (n 9) 635).

<sup>88</sup> Ibid.

<sup>89</sup> See, Cranston op cit (n 1) 123.

<sup>90</sup> Brentford op cit (n 44) at 76.

undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or the national central banks in the performance of their tasks'.<sup>91</sup>

Consequently, the Bank has no legal or moral obligation to heed any manipulative measure from the Community in compliance with Article 107 of the Treaty. According to this treaty, the ECB shall not seek or take instruction from the Community or bodies from any government.<sup>92</sup> Likewise, the member of state is requested not to try to impede the decision-making body, the ECB or the national bank in the performance of their duty.<sup>93</sup>

With regard to the structure and independence, the European Central Bank being a new institution, had older institutions from which, perhaps, to draw inspiration, such as the Bundesbank;<sup>94</sup> but also other leading central banks in the world, such as the Federal Reserve Bank in the United States of America or the Reserve Bank of South Africa.

Cranston, stressing the importance of independence of central banks remarked, *inter alia*, that a central bank is in a strong position if its independence is constitutionally guaranteed because constitutions are generally speaking less readily amendable than statutes;<sup>95</sup> and in support of this idea, referred to the South African Reserve Bank and the European Central Bank as examples.<sup>94</sup>

Concerning public financial management, the strictest limit on a central bank financing government is an absolute prohibition; this is contemplated in Article 104 of the EC Treaty for the European Union, where any form of credit to member states or any other dealings are not allowed.<sup>95</sup>

A part from the above described central banks, it has been indicated, right from the beginning, that the Reserve Bank of South Africa is among the first generation of central banks with an extra feature of being among the rarest institutions of this kind to have its independence entrenched in the Constitution. Therefore, its case will help enhance the comprehension of the topic under consideration as expressed in the following chapter.

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<sup>91</sup> Cranston op cit (n 1) 123.

<sup>92</sup> See, Cranston op cit (n 1) 122.

<sup>93</sup> Ibid.

<sup>94</sup> See, eg, Cranston (n 1) 122.

<sup>95</sup> Cranston op cit (n 1) 130.

## CHAPTER THREE

### 3.1 THE INDEPENDENCE OF THE SOUTH AFRICAN RESERVE BANK

#### 3.1.1 Brief overview of historical evolution

The discovery of gold on the Witwatersrand in 1886 brought huge inflows of foreign capital into South Africa.<sup>96</sup> This movement brought about a flourishing industry in the region. Because of this, and even before, there was a pressing need to organize a financial sector with at the centre, the creation of a central bank. The issue was raised several times in many and consecutive years, but every time, the Government would dismiss the claim as premature.<sup>97</sup>

In the long run, at the turn of the 20<sup>th</sup> century, gold mining around Johannesburg had brought about the creation of a great number of enterprises in various areas of economic activity. This situation led to the creation of a stock of exchange,<sup>98</sup> and the emergence of a fledging banking industry, which made many business people and a number of financial experts to make a fresh call for the creation of a central bank to ensure financial coordination. This claim was also based on the adverse effects of the financial and monetary crisis, which had arisen in the aftermath of the World War I.

During all those periods of unsuccessful petitions and discussions, one of the main arguments in favour of this claim was that 'a central bank would ensure note circulation, more stable interest rates; trade would be fostered and only in times of crisis, a strong bank could serve the State and the public'.<sup>98</sup> There were already other central banks, such as the Bank of Netherlands, the Bank of Java and the Federal Reserve Bank in the United States. The existence of these banks contributed to the encouragement of people to continue with their agitation to have a central bank; on the other hand, there was also a general observation that almost everywhere where central banks had been established, they had stimulated their economies and stabilised their currencies.

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<sup>96</sup> *Financial Mail* 30 August 1991 121 9 7.

<sup>97</sup> Gerhard de Kock *A History of the South African Reserve Bank (1920-1952)* (19 54) 3).

<sup>98</sup> *Ibid.*

Furthermore, at international level, a conference was held in Brussels in 1920 calling on all countries to establish a central bank to facilitate the restoration and maintenance of stability in their monetary and banking systems and to promote international cooperation.<sup>99</sup>

Finally, the Government decided to create a central bank, which came to be called the South African Reserve Bank.<sup>100</sup>

Because of this achievement, South Africa prided herself on being ahead of Australia, Canada and New Zealand, who had still not yet established their central banks. The legal framework was modelled on that of the US Federal Reserve System<sup>101</sup>, which had been founded seven years earlier, and on that of the Bank of Java.<sup>102</sup> An outline of the creation and structure of the SARB has more to tell.

### **3.1.2 Creation of the South African Reserve Bank**

The South African Reserve Bank was originally instituted by the Currency and Banking Act 120 (Act No 31 of 1920) with its seat of office in Pretoria where it commenced its business on 30 June 1921. This initial Act required commercial banks to subscribe to a total of 50 percent of the bank's initial capital.<sup>103</sup> In terms of the Currency and Banking Amendment Act 22 of 1923, however commercial banks were exempted from this obligation.<sup>104</sup> This Act was followed by a series of other Amendments, which culminated in the setting up of the South African Reserve Bank Act 89 (Act 90 of 1989), and which currently governs the Bank.

The interim constitution, which came into effect on 27 April 1994, deals with the constitutional role played by the South African Reserve Bank.<sup>105</sup> After a long debate on whether it was convenient to put the provisions dealing with the Bank in the new Constitution; or alternatively, if it was to be provided for in an ordinary statute. The decision of the Constituent Assembly was that it should be entrenched in the Constitution and should be independent.

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<sup>99</sup> Malan et al op cit (n 6) 308 para 194.

<sup>100</sup> The South African Reserve Bank also goes by its acronym the SARB and which for the sake of convenience, will sometimes be referred to as such or the Bank in the present dissertation .

<sup>101</sup> As indicated earlier, the selection of the central banks to be included in this short dissertation was randomly done, and the nature and volume of the work could not permit the review of all central banks. This is how the Fed was not included in this work.

<sup>102</sup> Ibid.

<sup>103</sup> Oelofse op cit (n 6) 235.

<sup>104</sup> Ibid.

<sup>105</sup> Olkers op cit (n 65) 37.

This is how 'the Constitution of the Republic of South Africa (Act 108 of 1996), which came into operation on 4 February 1996 (Procl R6 of 24 January 1997),<sup>106</sup> confirmed in s 223 that the South African Reserve Bank is the central bank of South Africa'.<sup>107</sup> The independence of the South African Reserve Bank is stipulated in s 234 (2), which proclaims that the South African Reserve Bank in pursuit of its primary objective 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 primary objective of the South African Reserve Bank, as expressed in the preceding paragraph, is laid down in s 234(1) of the Constitution, and is aimed at protecting the value of the currency in the interest of a balanced and sustainable economy. In this regard, it is suggested that this section should be read together with s 3 of the South African Reserve Bank Act 89 (Act 90 of 1989), in terms of which, the primary objective of the Reserve Bank is the promotion of monetary stability and balanced economic growth in the Republic.<sup>108</sup> The same source indicates that these two sections are essentially the same in the sense that both intend to promote monetary stability in the interest of economic growth.<sup>109</sup>

The reason of keeping intact the Reserve Bank Act lies in the fact that the Constitution describes the objectives and functions of the SARB in broad and general terms leaving the details to be dealt with in an Act of Parliament as provided for in s 225. In all likelihood, the enactment of that Act could have followed the promulgation of the Constitution; but it is a constitutional practice that when there is a new constitution, the laws, which were in force prior to its promulgation, remain in force unless expressly repealed by a provision in the constitution.

This is what happened with the South African Reserve Bank Act because s 242 of the Constitution makes provision for the preserving of all laws, which were in force immediately before the commencement of the Constitution. It also provides for an express abrogation contained in Schedule 7. Since the South African Reserve Bank Act was not in that Schedule, the proper construction is that: it was the intention of the framers of the Constitution to preserve its existence. This is why the new Constitution was put in place, but the missions and functions of the SARB remain the same.<sup>110</sup>

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<sup>106</sup> WG Schulze & ME M Kelly *Banking Law and Usage (LLM 407-U)* Tutorial Letter 202/3/2001; *Banking Law and Usage MBLW1-9(MBLW2-A0)* Tutorial Letter 102/3/2011 (2001) 1.

<sup>107</sup> Ibid.

<sup>108</sup> Ibid.

<sup>109</sup> Ibid.

<sup>110</sup> HE Formby & HT Cashmore 'The Central Bank in the New South Africa' 1994 *Financial Mail* 1333 96 5.

### 3.1.3 Mission, Powers and functions of the SARB

#### 3.1.3.1 Mission

The term mission also means goal, target or objective; if one looks at the Constitution, the mission of the South African Reserve Bank is provided for in s 234 (1). This was later reaffirmed in legal literature that in 1990, the Reserve Bank issued a mission statement declaring in unequivocal terms that the main objective of monetary policy in South Africa, at all times, is to protect the internal and external value of the rand. In this regard, it was further said that the achievement of the mission is carried out through monetary policy, which 'forms part of broader economic policy', and just as in the case of other policy measures, its ultimate objective is the creation of maximum economic growth in a financially stable environment to improve the economic welfare of the total population of the country'.<sup>111</sup>

With regard to the constitutional obligation to maintain sustainable economy as expressed above, it is said that an economic growth is sustainable if it lasts, an economy should not be designed to boom and subsequently collapse. The Reserve Bank should neither fuel nor suppress economic development but should try to lay sound foundation to protect growth.<sup>112</sup> In addition, it was also declared that the Reserve Bank's mission statement calls on the Bank to strive for financial stability as a medium term objective. Key element in such stability will indeed be a relative absence of both inflation and deflation of the general price level.<sup>113</sup> In addition, as a general rule, almost all central banks focus on promoting public goals, such as economic growth, low inflation and the smooth operation of financial markets.<sup>114</sup>

Applying the rule within the context of the South African Reserve Bank, it is suggested that focus should be on: a moderate rate of expansion credit and the money supply, an orderly and well functioning financial market, an orderly payment and money transmission system with built-in safeguards against

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<sup>111</sup> Ibid.

<sup>112</sup> See, eg, Olkers op cit (n 65) 40.

<sup>113</sup> HB Falkena, LJ Fourie & WJ Kok *The South African Financial System* (1995) 68.

<sup>114</sup> Robert H Frank & Ben Bernanke *Principles of Macroeconomics* 2 ed (2004) 268.

systemic risk, and a system of sound and well managed banks and other financial institutions that are well versed in the monitoring of risks and in risk management.<sup>115</sup>

### **3.1.3.2 Powers and Functions**

The powers and functions of the South African Reserve Bank are those customarily exercised and performed by central banks, which powers and functions must be determined by an Act of Parliament and must be exercised or performed subject to the conditions prescribed in terms of that Act as given in s 225 of the Constitution.

For the reason previously stated, the powers of the Bank were already determined and enumerated in s 10 of the South African Reserve Bank Act 89 (Act 90 of 1989) as amended, and thus, the preservation of this Act fulfils the conditions prescribed in s 225 with regard to the Act of Parliament therein ordained. Furthermore, apart from these powers, s (11) and s (12) confer on the Reserve Bank powers of inspection with respect to banks and mutual banks.<sup>116</sup>

### **3.1.4 The structure of the South African Reserve Bank**

The structure of the South African Reserve Bank indicates that there is no significant change in the status of its initial ownership. The Bank is still a corporate body with its own assets and the right to sue and to be sued in its own name. The Reserve Bank, which was created as a public entity from its inception, was meant to play a non profit maximizing public interest role, and was established as such under the Government of the Union of South Africa.

Contrary to some belief that the bank is privately owned, the fact that some commercial banks participated in its initial capital has not changed its status as a public entity. Even though at this stage, one could get the impression that the South African Reserve Bank was a semi autonomous or semi public institution, but what happened later, came to change the whole picture because, as indicated earlier, the obligation for commercial banks to participate in the capital was later relinquished, and the structure of the Board was modified as a result. In reality, keeping those commercial banks on the Board could have constituted an embarrassment to the Bank when it would try to discuss matters concerning them.

Furthermore, the public character of the South African Reserve Bank is also reflected in s 34 of the Reserve Bank Act with regards to the allocation of the Bank's surplus income after certain prescribed expenditures have been provided for and dividends from the net profits have been paid to the

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<sup>115</sup> HB Falkena et al op cit (n 113) 368.

<sup>116</sup> See, eg, Oelofse op cit (n 6) 238.

shareholders.<sup>117</sup> This surplus is divided by allocating 10% of it to the Bank's reserve fund and paying 90% of it to the Government.<sup>118</sup>

In addition, the Reserve Bank, which was once described as a relative rarity among central banks because its stock was listed at the Stock Exchange of Johannesburg,<sup>119</sup> is no longer active on this market because as from 2 May 2002, it has been delisted.

### 3.1.5 Administration of the Bank

The Bank is managed by a board of fourteen directors, consisting of a Governor, three Deputy Governors (one of whom is designed as a Deputy Governor) and three others who are all appointed by the Minister of Finance and seven Directors elected by the shareholders (sect 4(1)).<sup>120</sup> Of the elected directors, four represent commerce and finance, two industries, and one agriculture<sup>121</sup> in the sense that they should be, or should have been primarily and actively engaged in these various pursuits.<sup>122</sup> In this regard, it was further observed that 'the board represents a variety of interests, which will induce the Bank to take all those interests into consideration in the formation of its policy and the board does not merely function as an instrument of the government'.<sup>123</sup>

Furthermore, in terms of s 4(2) (a), the Governor must be a person of tested banking experience. However, nothing is said about the rest of the governors in relation to their competence and experience. It may probably be implied that they should have suitable qualifications.

To preserve the independence of the Bank, nobody may serve as a director if he is a director, officer or employee of a bank or a mutual bank, if he or she is not residing in the Republic, or if he or she is a Member of Parliament or a member of certain other government institutions as per s 4(2) (a) and s 4. It is also specified that no person shall be appointed or elected or remain a director if he or she is a Minister or a Deputy Minister in the Government of the Republic or if he or she is a Member of Parliament.

Furthermore, like the Bundesbank, s 35 of the Reserve Bank Act gives the Board a ruling power to avoid bureaucracy of state machinery<sup>2</sup>, and give the bank flexibility to adjust its operations to changing times.<sup>3</sup>

<sup>117</sup> See, eg, Oelofse op cit (n 6) 245.

<sup>118</sup> Ibid.

<sup>119</sup> Falkena et al op cit (n 113) 63.

<sup>120</sup> Oelofse op cit (n 6) 236.

<sup>121</sup> See, s 4(3) (a).

<sup>122</sup> Falkena et al op cit (n 113) 63.

<sup>123</sup> Ibid.

and also act swiftly in the light of circumstances. This is another way of strengthening its administrative independence.

Similarly, in order to achieve high performance in the discharge of its duties, the South African Reserve Bank is expected to apply modern techniques of corporate governance to make sure that the interests of all the stakeholders are accommodated, and are effectively protected in line with the theory of corporate law that 'directors must consider and balance the interest of several constituencies, such as customers, employees, creditors, suppliers and the environment, each of which has a legitimate stake in the company's development and activities'.<sup>124</sup>

### 3.1.6 Tenure and conditions of office of directors

The independence of the central bank is an abstraction; the reality is the people behind it. It is therefore the duty of the law to protect them, and determine how this independence will be translated into reality. One of the measures conceived is the security of tenure of the directors during the period of their office. As seen earlier, within the framework of the SARB, the Governor and the Deputy Governors hold office for a period of five years, and the other directors hold office for a period of three years as stipulated in s 5 of the South African Reserve Bank Act. A director is eligible for reappointment or re-election as the case may be after the expiry of his term of office (s 5(2)). This article read together with s 5(3) spells out that the directors (including the Governor and Deputy Governors) shall hold office upon such conditions of remuneration (including allowances) as may be determined by the Board, and upon such other conditions as may be prescribed by regulation. Some observers think that the security of tenure of the directors is still to be more clearly defined.

For example, in the case of the Bundesbank, it is clearly stipulated that the members of the Bundesbank Directorate cannot be removed from office before the end of their term; except for reasons which lie in their person and if the initiative comes from themselves or the Central Bank Council.<sup>125</sup> Concerning the period of tenure, the general observation is that 'a long period of office may induce a lethargic management of monetary policy'.<sup>126</sup> But, it is also thought that governors of central banks should enjoy certain stability because it is argued that 'rapid turnover of central bank governors indicates a lower level

<sup>124</sup> Michele Havenga 'Social Responsibility-Only a Company's Duty'? (2006) 47 *Codicillus* 1 64.

<sup>125</sup> Lastra op cit (n 2) at 485.

<sup>126</sup> Brentford op cit (n 44) at 93.

of independence'.<sup>127</sup> Therefore, it is not good to change central bank governors every time governments change.

The protection of the Board members of a central bank is favoured by many; for example, some experts take the view that to protect the independence of a central bank, the governor and the board of directors should be guaranteed a sufficiently long term of office.<sup>128</sup> Furthermore, it is also maintained that 'short terms of office could make them vulnerable to dim-sighted political pressure because of the uncertainty around the possible extension of their appointment'.<sup>129</sup>

Similarly, it is further observed that in some countries, there is a tendency for some political authorities to pick governors who will toe the line, and act according to their wishes, and fire those who dare to legitimately challenge their decisions. This would amount to what Lastra calls appointment on the basis of patronage, which according to her, undermines the purpose of independence of central banks.<sup>130</sup> If this situation were to be allowed to happen, the independence of central banks would remain a legal idealism while the situation is the other way round.

However, this issue has remained controversial; as some commentators take the view that 'the independence of the central bank will be enhanced: if the governor is not appointed by government, the governor is appointed for more than five years, the board is not appointed by government, or if more than half of the board members are appointed independently of government and the board is also appointed for more than five years'.<sup>131</sup>

While this general observation may sound correct in some respects, to be realistic, it may not always be possible to ignore totally the political aspect in the appointment of governors of central banks; as public institutions, most of time, they are anchored in constitutions or statutes of various countries; what is

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<sup>127</sup> Jacob de Haan & Willem J. Kooi 'Does central bank independence really matter? New evidence for developing countries using a new indicator' (2000) 24 *Journal of Banking & Finance* 644.

<sup>128</sup> Wessels op cit (n 26) 258.

<sup>129</sup> Ibid.

<sup>130</sup> See, eg, Lastra op cit (n 2) at 483.

<sup>131</sup> Ibid. With regard to this issue, a study, which has been conducted in 2004, indicates that in general, 'the executive branch of government is involved in the appointment of monetary policy authority decision makers in many countries, apart from Canada, where the central bank chooses the head of the Bank of Canada although the Minister of Finance must approve the board's decision. In Japan, and the United States, the Diet and Congress have statutory powers to veto the appointment. In the case of the European Central Bank Article 112(b) of the Treaty establishing the European Community states that 'the European Parliament needs to be consulted before the appointment of the ECB executive board members by Head of States and Governments. In other countries, parliaments do not possess such vetoes' (See, eg, Jonathan Lepper & Gabriel Stern *Parliamentary scrutiny of central banks in the United Kingdom and overseas*, [www.bankofengland.co.uk/qb020302.pdf](http://www.bankofengland.co.uk/qb020302.pdf) [visited on 22.10.2004]).

needed is the possibility of selecting and vetting candidates from within or from without political circles; and appoint credible people with tested experience, high ethical standards and academic qualifications.

### **3.1.7 Financial control and cooperation with the Minister of Finance**

As seen above, cooperation between the Reserve Bank and the Minister in charge of financial matters is a constitutional obligation, one of the duties of the latter is to ensure that the finances of the Bank are efficiently managed; to reach this target, the shareholders are entitled to elect two firms of public accountants to act as auditors of the Reserve Bank in terms of s 30(1) of the South African Reserve Bank Act; especially so because in terms of s 31 of the Act, the Reserve Bank also has a duty to inform the Minister of Finance about its financial standing. This is mainly carried out through its annual financial statements.

In this connection, it is further maintained that any imperfection noticed in the management of the Bank by the Minister of Finance may be drawn to the attention of the Reserve Bank and the Board, which are obliged to remedy the default. If the Board does not comply, the minister may apply to the Supreme Court for an order to compel the Reserve Bank to remedy the default in accordance with s 37 of the Reserve Bank Act 89 (Act 90 of 1989) as amended.

In addition, the Minister of Finance may, at any time, cause an investigation to be made into the affairs of the South African Reserve Bank by one or more officers of the Department of Finance as per s 30(2) of the South African Reserve Bank Act. The providing of the information constitutes a kind of accountability by the authorities of the Reserve Bank to the Executive Branch of the State.

### **3.1.8 Inflation targeting by the South African Reserve Bank**

The mainstream of experts in this area is in agreement that curbing inflation is not the only macroeconomic variable used to maintain growth and sustainable economy. However, they also recognize that it remains one of the major aspects of economic and financial stability. This is why many countries attach great importance on that. For example, the agreement between the Government of New Zealand and the Reserve Bank of New Zealand is premised on inflation targeting. Similarly, the granting of independence to the Bundesbank was an attempt to fight against hyperinflation, which prevailed in the country.

Furthermore, experts are also unanimous that inflation is a wild animal to be tamed by all means. Since central banks are generally entrusted with the carrying out of this task, it is therefore the duty of every governor with his or her team to meet the primary objective of their respective institutions. In this regard,

in the context of the SARB, it was declared that ‘within the framework of its anti inflationary strategy, the Bank has continued its practice of setting year to year target, now called guidelines’.<sup>132</sup> Although these guidelines were informal in their nature, it appears that ‘South Africa formally adopted an inflation target monetary policy on February 2000 when the Minister of Finance announced an inflation of three to six percent to be achieved by 2002’.<sup>133</sup>

The same source reveals that ‘this came as a result of a creeping inflation and an increase in external deficits that were to be brought under control through restrictive monetary policy’.<sup>134</sup> Even though this was a political statement, and not a legal enactment, nevertheless, it has had a positive impact at international level because currently ‘South Africa is categorized as an inflation targeting country’<sup>135</sup> and listed among the countries with full-fledged inflation policies’.<sup>136</sup>

### 3.1.9 Financing of deficit by the South African Reserve Bank

Financing deficit of governments by central banks has always been a vexed issue, some experts consider that it should be prohibited at all cost, others estimate that it should be tolerated, but their common view is that it should preferably be avoided or in the event of extreme necessity, when other means have proved impossible, it should be strictly regulated. Within the framework of the South Africa Reserve Bank, it was said that the adoption of a more market oriented approach in implementing monetary policy in the 1980s led to the extensive use of public debt management by the Bank in close cooperation with the Treasury.<sup>137</sup> In this connection, it was also declared that the objective of debt management operations is to finance “the so called “deficit before borrowing and debt repayment” of the Exchequer in a non-inflationary manner, as well as to exert better control over liquidity in the economy.”<sup>138</sup>

However, it is convenient to make it clear that funding deficit does not necessarily mean printing money because the general observation is that monetisation of government debt occurs when any deficit in a government budget is funded directly (normally by printing money) by the central bank. A deficit itself

<sup>132</sup> Falkena et al op cit (n 113) 369.

<sup>133</sup> Emmanuel Ating Onwioduokit West African Institute Options for a Common Monetary Policy in Conference Proceedings Monetary Policy in Framework Africa For the Second Monetary Zone in West Africa (2001) 260. Since inflation targeting was first introduced in 1990 in New Zealand; the framework has been adopted by a number of countries such as Canada (1991), the UK (1992) and Sweden (1993), Chile (1991), Israel (1999), and South Africa (2000). For further details, see also Anton Casteleijn *South Africa Monetary Policy, Framework in Conference Proceedings, Monetary Policy Framework Africa* (2001) 211.

<sup>134</sup> Ibid.

<sup>135</sup> See, Fraser op cit (n 38) at 8.

<sup>136</sup> Ibid.

<sup>137</sup> Falkena et al op cit (n 113) 59-60.

<sup>138</sup> See, eg, Falkena et al op cit (n 113) 60.

does not therefore imply monetisation of government debt. For example, the central bank may use its reserves or recommend recourse to other means of outsourcing of the required funds to plug the shortage.

In addition, the South African Reserve Bank holds current accounts for State departments and other government bodies and institutions.<sup>139</sup> In this capacity, 'it operates as a commercial bank for the State and its agencies. Instruments of payment from those institutions are collected and honoured by the Bank. The Bank grants loans and advances to the State'.<sup>140</sup> It derives this power from s 10(f) of the South Africa Reserve Bank Act. Furthermore, the South African Reserve Bank acts as an agent and an advisor to the government.<sup>141</sup> Therefore, it is expected that if the situation of funding deficit could arise, the Bank would be in a better position to advise the government to adopt proper financial structural adjustments in this sector.

One of the ways often suggested is the raising of money in the open market; this practice entails the buying and the selling of government securities by the Reserve Bank in the open market at the Bank's discretion in order to regulate the money supply or pattern of the interest rate.<sup>142</sup> It is further explained that these transactions are called open market operations because the Bank is prepared to deal with any interested party.<sup>143</sup> Although these transactions are generally [emphasis added] undertaken to achieve long term monetary objectives, a secondary objective may be to iron out temporary money market fluctuations caused for example, by agricultural crop financing, tax payment to the Exchequer or change in the net gold and other foreign reserves.<sup>144</sup>

Similarly, by way of comparison, in most industrialised countries, whether formally recognising the idea of the independence of central banks or not, it is said that 'government's access to borrowing from the central bank is governed both by central bank laws and regulations implementing them'.<sup>145</sup> A prohibition or limitation on financing the public sector's deficits or monetising public debt is a classic indication of the economic independence of central banks.<sup>146</sup> In addition, limiting the extent to which central banks can finance the government acts as a brake on the latter's budgetary policies, and encourages economic rectitude.<sup>147</sup>

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<sup>139</sup> Oelofse op cit (n 6) 242.

<sup>140</sup> Ibid.

<sup>141</sup> Ibid.

<sup>142</sup> Falkena et al op cit (n 113) 60.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

<sup>145</sup> Lastra op cit (n 2) at 490.

<sup>146</sup> Ibid.

<sup>147</sup> Cranston op cit (n 1) 130.

For example, in Germany, the Bundesbank can intervene when the government is confronted with a temporary shortage of liquidity and establish the ceiling beyond which the Bundesbank can grant credit to government. While financing a deficit is the sovereign decision of every country, it is clear that there has to be a legal framework defining this practice. This avoids situations where deficits have led some countries, such as Brazil and Mexico, to a structural inflation almost impossible to absorb.<sup>148</sup>

Furthermore, it is believed that one of the reasons that the International Monetary Fund (IMF) is pushing the cause of central banks independence among its member states is to encourage and maintain acceptable financial benchmarks and avoid funding inflationary budget deficits.<sup>149</sup>

### 3.1.10 External Cooperation and debt management

The South African Reserve Bank maintains internal relations with other central banks and international financial institutions especially the Institutions of Bretton Woods. For example, the Governor of the Reserve Bank is the South African representative on the Board of Governors of the International Bank for Reconstruction and Development (IBRD), commonly known as the World Bank. One of the objectives of this institution is the encouragement of capital formation and provision of technical assistance to the developing countries.<sup>150</sup> This may perhaps constitute another source of getting money in the form of subsidies or loans to face temporary shortages of cash,<sup>5</sup> or turn the economy around in times of crisis.

Likewise, it is also said that there is a close cooperation between the South African Reserve Bank and the International Monetary Fund (IMF), which is generally concerned with financial arrangement and assistance within state members. The South African Reserve Bank is actively involved in regular consultations conducted by the Fund's staff with South Africa as a part of their surveillance of member state economies. The Bank administers South Africa's accounts with the IMF.<sup>151</sup> The same grants or loans, like the ones expected from the World Bank, may be provided in case of necessity.

However, some critics have charged that the IMF has required recipients of its loans to follow economic policies, such as tight monetary policies and fiscal cut backs that have turned to be ill-advised.<sup>152</sup> Others have claimed that the IMF loans help foreign financial investors and the richest people in the countries

<sup>148</sup> See, eg, Etienne Douat *Finances Publiques* 1 ed (1999) 206.

<sup>149</sup> See, eg, Cranston op cit (n 1) 120.

<sup>150</sup> See, Falkena et al op cit (n 113) 64.

<sup>151</sup> Ibid.

<sup>152</sup> Frank & Bernanke op cit (n 114) 495.

receiving the loans, rather than the average person.<sup>153</sup> The loan granted in 1998 to Russia was referred to as an example.<sup>154</sup>

In the same breath, the South African Reserve Bank also became a member of the Bank of International Settlements (BIS) on June 1971. The BIS was established in order to increase the cooperation between central banks and to act as an agent in respect of international payments.<sup>155</sup> The importance of this institution as a centre of international monetary cooperation and research has increased considerably during recent years. Within this framework, central bank governors meet regularly to exchange ideas and discuss about monetary current issues. Those meetings may sometimes culminate in joint action and in assistance to cope with emergency where it arises.<sup>156</sup> This institution may also constitute another source of funding and a proper forum of exchange of ideas in the event of crisis.

### **3.1.11 The Financial and Fiscal Commission**

Generally, fiscal policy and monetary policy are two sides of the same coin. Although the Reserve Bank formulates and monitors money supply in the economy, the collection of taxes belongs to the Government. This is the reason why their harmonious cooperation helps combat inflation on several fronts, thereby preserving the integrity of the national currency and promoting economic growth as required by the Constitution.

The Constitution of South Africa recognises this in ss 220-222 by creating the Financial and Fiscal Commission in charge of making sure the two policies converge in the efficient handling of financial matters. 'It is also said that the Commission makes recommendations to both Parliament and the provincial legislatures. This removes the impression that people have that the South African Reserve Bank works in isolation from fiscal and other macroeconomic goals of government'.<sup>157</sup> The independence of the central bank in financing debt will depend on the outcome of the deliberations of the Commission.

### **3.1.12 Accountability and transparency**

#### **3.1.12.1 Accountability**

Before examining the accountability within the South African Reserve system, it is convenient to get a clear notion of the principle and see how it is applied in some other jurisdictions. In fact, accountability

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<sup>153</sup> Ibid.

<sup>154</sup> Ibid.

<sup>155</sup> Ibid.

<sup>156</sup> Falkena et al op cit (n 113) 64.

<sup>157</sup> Chris Stals *The Independence of the Central Bank and Monetary Policy* (1998) 1.

is the quality or state of having someone to report to, or of being answerable to somebody. Someone is accountable when he or she has been given a free hand to do what he or she is required to do, but is still expected to explain his actions and decisions to an accounting authority. Within the context of state officials, accountability is the ability of the public to hold government officials responsible for their actions.<sup>158</sup>

One of the aspects of accountability is the formal duty to justify what has been done. In its Code of Good practice on Transparency (Section IV), the International Monetary Fund (2000) argues that officials of the central bank should be available to appear before a designated public authority to report on the conduct of monetary policy, explain the policy objectives(s) of their institution, describe their performance in achieving their objectives and as appropriate, exchange views on the state of economy and financial system.<sup>159</sup>

Similarly, within the framework of the European Union, it is also observed that ‘although independence is one side of the coin, a central bank also must be accountable in a democratic state’.<sup>160</sup> It was further maintained that such accountability should be diversified, including both parliamentary control and control by the executive and judicial bodies.<sup>161</sup>

### **3.1.12.2 Accountability before executive organs of the state**

With regard to accountability to executive body, it is said that to avoid undemocratic state within a state, the central bank should provide certain information, reports and advice to the government upon demand.<sup>162</sup> There are a number of countries where such accountability is applied, such as Germany, the United States, and the European Union. For example, the Maastricht Treaty stipulates that the ECB shall provide quarterly and annual reports, as well as weekly consolidated financial statements to EC bodies. These reports are to be made available to interested parties free of charge.<sup>163</sup>

### **3.1.12.3 Accountability before legislative bodies**

Accountability to legislative body means that the central bank should provide an ex post justification of its actions. Parliament would not be allowed to change decisions that are made legally, and therefore, its

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<sup>158</sup> Patterson op cit (n 42) 448.

<sup>159</sup> Lepper & Stern op cit (n 131) at 279.

<sup>160</sup> Lastra op cit (n 2) at 497.

<sup>161</sup> Ibid.

<sup>162</sup> Ibid.

<sup>163</sup> Ibid.

supervision would mean that the central bank must simply account for its actions both before parliament and in front of the country.<sup>164</sup>

In the context of the Reserve Bank of South Africa, the exchange of ideas is generally carried out at the level of the Parliamentary Portfolio Committee acting on behalf of the House. It may ordinarily result in a praise to the Bank if the representatives of the people are satisfied by the work, or a reprimand if they are not. Corrective measures may be recommended by the House and the Governor (who bears administrative responsibility) and the Minister of Finance (who bears political responsibility) cannot ignore them with impunity.

#### 3.1.12.4 Accountability to judicial institutions

With regard to accountability before the judiciary, there is no Court of Auditors in South Africa, like it is the case in the European Union<sup>165</sup>; much of the Republic financial control is carried out by the Office of the Auditor General as per s 188 of the Constitution. Although there is no accountability before judicial institution, this does not weaken the capacity of control by Auditor General. In addition, in s 188 (2) (a) it

<sup>164</sup> Ibid.

<sup>165</sup> Within the context of the European central banking system, it is declared that 'the judiciary should control the lawlessness of the Central Bank's operations and decisions in the fulfillment of its functions. The Court of Auditors should control the accounts of the Central Bank in order to avoid lack of transparency, particularly if the Bank enjoys budgetary and financial autonomy (see, Lastra op cit (n 2) at 500). However, this does not mean that a judicial control system is necessarily better than the control effected by a General Auditor as it is applied in a great number of commonwealth countries; it is a matter of option, but at international level, institutions of control are coming closer; and in this regard, there is an effort of harmonization of international auditing standards within the framework of the International Organization of Supreme Audit Institutions (INTOSAI). In terms of Article 1 of the Statutes of the Institution, INTOSAI is an autonomous, independent and a non political organization established as a permanent institution in order to foster the exchange of ideas and experiences among the Supreme Audit Institutions on government auditing. Its Headquarters are in Vienna. Furthermore, in Article 2, it is specified that 'INTOSAI shall maintain its present link with the United Nations Organization' ([http://www.intosai.org/en/portal/about-us/statutes/index.php?article\\_pos=1](http://www.intosai.org/en/portal/about-us/statutes/index.php?article_pos=1)). [Visited on 29 June 27, 2009].

In addition, Article 1 (*supra*) also specifies, *inter alia*, that participation as a full member in its organs and exercise of functions are open to the Supreme Audit Institutions of all countries, which are members of the United States Organization or any Specialized Agencies; and the Supreme Audit Institutions of those supra national organizations, which are subject of international law; and endowed with a legal status and an appropriate degree of economic, technical/organization of financial integration (ibid). In countries where courts of auditors exist, central banks, like any other legal entity in which the state has full ownership or is a leading shareholder, are audited by those courts; and before the passing of the financial bills of the year, the reports of the Courts of Accounts are sent to Head of States or Governments; and then presented to parliaments with ample coverage by the media for the public to be informed about the overall management of public finance (see, eg, Maurice Duverger op cit (n 65) 415). Judges at those institutions are mostly highly qualified and experienced former civil servants from the Ministry of Finance, experienced accountants and lawyers specializing in financial law. On top of ensuring the auditing of public accounts, those courts are also empowered to judge all public accountants with regard to proper handling of the funds in various ministerial departments. For example, in France, the Court of Accounts is a prestigious institution and it is provided for in Article 47 of the Constitution of 1958 as amended, which proclaims, *inter alia*, that the Court of Accounts (*Court des Comptes*) assists Parliament and the Government in the control of the proper implementation of public budgets voted every year. The main duties of the Court are to conduct financial audits of accounts, conduct good governance audits, and provide information and advice to Parliament and Administration (ibid).

is said that the General Auditor has jurisdiction on any institution funded from the National Revenue Fund or a Provincial Revenue Fund or by a municipality; or (b) any institution that is authorized in terms of any law to receive money for a public purpose. Furthermore, in terms of s 188 (3), the Auditor-General must also submit audit reports to any legislature that has a direct interest in the audit, and to any other authority prescribed by national legislation. In view of this, there are many common features in the two systems, and the end result seems to be the providing of information to the legislatures that represent taxpayers. Therefore, the above exposition of the functioning of courts of accounts is simply given in comparative perspective.

### 3.1.12.5 Accountability and election of monetary authorities

Accountability and transparency are closely related to democratic doctrines stipulated in most constitutions. A constitution defines different organs of a State and their mode of cooperation in the best interest of the people. When people vote for their leaders, they expect better services and visionary leadership. A leadership that is capable of building up strategies of prudence, promotes good governance, and upholds the rule of law; if they do not, they should be brought to account before the relevant authority. As such, 'governments must first and foremost be held accountable by the people themselves in any given country'.<sup>166</sup> It is also maintained that 'people will have confidence in public institutions only if they can be assured of their honesty and of being served in a transparent manner, and if there are mechanisms through which they can hold governments accountable'.<sup>167</sup>

It is true to declare that in a representative democracy, the elected are responsible to the public, which holds them accountable, at least through the electoral process; a fact, which is not applied to monetary authorities. Consequently, there is a current opinion holding that those monetary authorities should also be elected and raise a number of issues; as one expert puts it 'can it be right that a bank governor not elected by the people and not answerable to voters at all, has so much power over them and their lives?'<sup>168</sup> It is not only in South Africa where the issue is raised; this was also the case in the European central banking system where it is reported that 'the main argument against central bank independence is that an institution, which is free from the direct effect of political control, lacks democratic legitimacy'.<sup>169</sup>

<sup>166</sup> Bience Ganawas 'The Role of the Ombudsman' The World Bank Comprehensive Legal and Judicial Development towards an Agenda for a Justice and Equitable Society in the 21<sup>st</sup> Century', in RV van Puymbroeck (ed) (2000) 45.

<sup>167</sup> Ibid.

<sup>168</sup> H Preece 'Central Questions Does SA Want a Reserve Bank Independent of Government?' (1991) 49 *Financial Week* 7 16.

<sup>169</sup> Lastra op cit (n 2) at 478.

In South Africa, this issue was in the air before the existence of the Constitution.<sup>170</sup> It still lingers even after the promulgation of the Constitution. This means that the issue still remains controversial, and every group provides its own reasons for supporting or opposing the idea. The South African monetary authorities are aware of the criticism.<sup>171</sup> The answer provided by some of them to justify their non-election is once again by way of analogy to the judiciary; in this connection, it has been said that 'some governmental agencies enjoy independence even though, in general, their members are not submitted to elections like politicians; there are plenty of other areas of national life where decision making is delegated to independent but unelected officials; the judiciary is a prime example'.<sup>172</sup>

Despite the legal independence of the Bank, the authorities are also aware that 'independence does not mean lack of accountability'. According to some of them, 'no central bank can totally be independent in the sense that it is not answerable to anyone';<sup>173</sup> it is further argued that 'even the most autonomous central bank has to report in some form or another to the legislature, which in any case has the ultimate power to change the laws governing the central bank'.<sup>174</sup> Another perceived danger by those who are against electing them is the fact that elected monetary authorities may be subservient to people who have funded their campaigns instead of acting independently and transparently.

Finally, while a country may make an option of a representative democracy in which the people participate in the decision making not directly but indirectly through the election of officials to represent their interests,<sup>175</sup> not all institutions are submitted to this process. For example, under the American Constitution, it is declared that 'the framers, after long debates over this issue, decided that federal judges and justices would rather be appointed than elected'.<sup>176</sup> They would be nominated by the President and confirmed through the approval of the Senate. Once confirmed, they would hold office during good behaviour. In effect, they would be allowed to hold office for life unless they committed a crime.<sup>177</sup> This is probably not the kind of guarantee sought for central bankers.

While some current opinion holds the view that central bankers should be appointed, not elected, and probably approved by parliaments, there is no example in the world where governors are allowed to hold their office for life like judges; rather, their tenure is of a limited duration; their professional guarantees

<sup>170</sup> There is a group opinion which thinks that 'all institutions controlling or influencing policy must be under democratic control, and is sharply opposed to the privatization of the SARB (see, eg, H Preece op cit (n 56) 57).

<sup>171</sup> Tito T Mboweni 'Central Bank Independence' (2004) *BIS Review* 88.

<sup>172</sup> Mboweni op cit (n 171) at 4.

<sup>173</sup> Ibid.

<sup>174</sup> Ibid.

<sup>175</sup> Patterson op cit (n 158) 50.

<sup>176</sup> Patterson op cit (n 158) 51.

<sup>177</sup> Ibid.

should therefore remain within that period. In the final analysis, it was also said that the judiciary should be more of a guardian institution.<sup>178</sup> Similarly, central banks may also be considered guardian institutions, with members probably not needing to be elected. Whether elected or not, what is expected from all of them is accountability and transparency as public trustees.

However, in general, there are some experts who think that there are still some shortcomings in the way the South African Reserve Bank is made accountable. In their opinion, the Bank should be given a legal framework that would lead to more accountability and transparency and that the South African Reserve Bank does not as yet prescribe a completely transparent framework for monetary policy<sup>179</sup> on the grounds that 'the Act does not specify what level of inflation offers sufficient price stability, and does not specify the benchmarks against which the performance of the South African Reserve Bank can be judged when called before Parliament'.<sup>180</sup> For them, the pronouncements of relevant monetary authorities on the level of inflation should be translated into statutory or administrative guidelines to give them a compelling character.

### 3.1.13 Transparency

In some financial or political literature, the terms accountability and transparency are used interchangeably, but while accountability compels fiduciary authorities to appear before relevant authorities and bodies, transparency is concerned with the reporting of essential information to the public so that people may know what is going on in their departments. The common perception is that people who are in charge of the implementation of monetary policies should not only keep account of their actions, but also provide some financial information. Within the framework of the South African Reserve Bank, the term transparency is a vital tool for fulfilling this accountability requirement. The rationale is that the essential actions and strategies of the South African Reserve Bank should be communicated to the public in general, and to its clientele in particular. In this way, it is thought that the South African Reserve Bank will be able to retain broader public support and will help the financial market operate more efficiently.

In this regard, as seen earlier, pursuant to s 31 and s 32 of the South African Reserve Bank Act, the Governor must submit an annual report relating to the implementation of monetary policy by the Bank to the Minister in charge of national financial matters; at the same time, he must furnish detailed information to the Department of Finance and to Parliament concerning the financial activities of the Bank. Some information, such as statements of assets and liabilities, must be sent on a monthly basis. The Department

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<sup>178</sup> Ibid.

<sup>179</sup> Casteleijnin op cit (n 133) 213.

<sup>180</sup> Ibid.

of Finance has a duty to publish every return received annually from the Bank in the Government Gazette. It is further stated that although the Governor sends his report to Parliament, the Minister must as well do so to Parliament; he must present a copy of the report sent annually to him by the Governor within fourteen days after its reception, if Parliament is then in ordinary session, or within fourteen days after the commencement of its next ordinary session as per s 32(3). By informing the people, the public can help shape up the formulation and implementation of delivery of monetary policy. This is a way to keep the public informed about the financial situation of the South African Reserve Bank and providing opportunity to the Government to monitor the activities of the Bank. The Government must make sure that the Bank acts within the limitation of the Reserve Bank Act.<sup>181</sup>

### **Conclusion**

This work has explored essential elements of the legal foundations of the independence of central banks in general, and the legal independence of the South African Reserve Bank in particular. The common denominator of the mission of central banks is to keep inflation under control. A central bank, also called reserve bank in some countries, is an institution in charge of monetary policy of a given country. The primary objective to achieve this is the maintenance of price stability; in other words, it is fight against inflation on a continuous basis. To allow central banks reach this goal, many countries have granted certain degree of autonomy by delegating some powers to them. In some others, such autonomy is reflected in constitutions, others in charters or statutes.

The main idea of the independence of central bank is to invite the relevant authorities to exercise self restraint. These institutions must also make sure that there are no reckless and fraudulent practices likely to affect the stability of currencies of their countries. Central banks must also make sure that the borrowing by governments follows certain and clear criteria, and guidelines to avoid unnecessary expenditure. An overview of some institutions, such as the European Central Bank, the Bundesbank, the Reserve Bank of New Zealand have been made,<sup>181</sup> and the maintenance of price stability is their main common denominator as well as the conduct of their activities with a certain degree of autonomy. But given the nature of the institution and state structure and functioning, the authorities of those institutions have a duty to cooperate with their respective governments for more coordination in this area.

With regard to the South African Reserve Bank, its independence is rooted in the Constitution. This means that the people of South Africa have found this independence to be a value to be protected at a higher level, that is, the Constitution. This is especially due to the fact that the Constitution is not easily

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<sup>181</sup> See, Oelofse op cit (n 6) 245.

amendable. In the event of any amendment, which is always possible due to the inherent constituent power of the people to change the Constitution as they think fit, there should be a compelling reason for doing so. In the same breath, the people should also make sure that the independence is effectively implemented and, at the other end of the spectrum, check whether the Bank has not abused that power. In order to make effective its independence, the Bank was given the power to formulate and implement monetary policy, while the Executive Branch of the State determines and implements fiscal policy. For harmonious functioning among monetary authorities, regular consultations are held between the Minister of Finance, the Governor and other relevant ministries. All these meetings on monetary and fiscal policies are coordinated and different opinions are taken into consideration for the smooth running of the overall economy. The legal independence of the South African Reserve Bank requires that the financial objectives should be clearly defined in law. The purpose of this clarity is to afford the South African Reserve Bank the opportunity to react efficiently when the economy sends wrong signals, and thereafter come up with appropriate solutions in due time. The legal independence of the South African Reserve Bank also means that the Bank has its own structures, and is allowed to cooperate with the government in setting up its monetary targets as well as having the instruments to achieve them. It also signifies that the Bank will not be forced to finance budget deficits without justification, and will be given latitude to screen and appoint highly qualified people to administer the Bank without any interference.

The independence means that the Governors and the Board should have security of tenure during their mandate so that they may feel little political pressure, if any, in the discharge of their duties. The work has also outlined that the Bank is not a power within a power; it should be considered a guardian institution for the life of the currency and for the sake of a healthy economy. Despite its legal independence, the Bank is also expected to account for its actions before Parliament, and it has a duty to report and communicate pertinent information to the public, bearing in mind that, in its capacity as a bank, it is also held to the banking duty of confidentiality in terms of s 33 of the Reserve Bank Act. It should not, however, hide behind this to withhold crucial information needed by different bodies. Although central banks are granted legal independence, the reality is that they do not operate in vacuum; they follow macroeconomic policies and targets set up by their governments; while the judiciary may take an independent position vis a vis the Government; it is not so easy for the Governor to take the same stand because the Constitution requires him or her to work in consultation with the government.

The independence of central banks may be understood within the concept of the division of labour for efficiency and effectiveness. The Government and the Bank should work as close allies because both of them act as agents; the real masters are the people they serve. It has been shown that the legal foundation of the independence of central banks is either in constitutions, in charters or in other contractual

arrangements. In this regard, it is said that however elegantly worded or drafted, the legal stipulation may be dead letters if the government's attitude or the general socio political climate do not support it. The (officially required) objective, recommendations and advice of the central bank will have no practical relevance if, in practice, they are not accepted by government. What is more important is a deeply rooted respect and a reputation for objectivity and technical competence on the part of the central bank to resist the pressure of political expedience.<sup>182</sup> But whether a bank is independent or not, the reality is that it is not severed from the executive branch, which assumes the ultimate responsibility of the nation.

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<sup>182</sup> See, Wessels op cit (n 26) at 262.

**Appendix One: List of main abbreviations used in the work**

SARB	The South African Reserve Bank.
ECB	The European Central Bank.

**Appendix Two: List of main statutes**

The Constitution of the Republic of South Africa Act No 106 of 1996.

The South African Reserve Bank Act No 90 of 1989 as amended.

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## INTRODUCTION

A central banking system is a crucial factor in the growth of every economy. Central banks play a pivotal role in the implementation of monetary policies. Initially, these banks were created as autonomous institutions, and designed to regulate payment systems. The power of running monetary policies was conferred on them only at a later stage. Their functioning was expressed, either in the charters that created them or in other legal arrangements. In the past, it has been observed that, in the discharge of their duties, some policymakers have tried to interfere with their activities in order to achieve their own objectives.

This method of operation has sometimes been reflected in monetary expansionary tendencies, which have caused harmful effects on the values of currencies, and several economies have been seriously affected as a result. This often occurred in periods of large spending by governments, such as general elections. In fact, during such periods, some governments do everything possible to meet the electoral pledges that they have been unable to implement during the period of their political mandate. After this trend had been discerned in some jurisdictions, efforts were made to address the issue. Although the main reason for pushing for the legal independence of central banks is to maintain sound monetary policies by avoiding expansionary measures to artificially stimulate economy; much of the economic and financial literature that prevailed twenty years ago had constantly continued to see 'politicians using monetary expansion as a means of stimulating the economy in the interest of short-term electoral popularity'.<sup>1</sup> Surprisingly, in present days, the same view still lingers, and it is still said that some 'governments and parliaments are tempted to use the printing press to meet their financial needs; thus neglecting the risks and detriments of inflation'.<sup>2</sup>

While this seems to be the essential motive put forward to substantiate the need for the separation of political and monetary authorities, some experts are sceptical about this generalization, and one of them holds the view that 'evidence that monetary policy follows the electoral cycle is thin'.<sup>3</sup> In other words, every case should be examined on its own merits, and empirical evidence shown that a government has actually indulged in such practices.

From the above, it may be inferred that when people express their views on this matter, they should exercise caution, and not try to consider expansionary money an evil that is always linked to the electoral process alone.

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<sup>1</sup> Ross Cranston *Principles of Banking Law* 1 ed (1979) 120.

<sup>2</sup> Rosa Maria Lastra 'Independence of the European System of Central Bank' (1992) 33 *Harvard International Law Review* 476.

<sup>3</sup> *Ibid.*

Unfortunately, in many jurisdictions around the world, there is a persistent suspicion that political undue influence is sometimes exerted on central banks to print money for illegitimate ends. If these allegations proved to be true, it would indeed amount to public financial malpractice with a negative impact on economy. In such situations, an independent central bank, it is said, would deprive those politicians of the temptation to take this easy path;<sup>4</sup> since printing of money<sup>5</sup> is a process that follows strict rules, and requires certain standards of macroeconomic variables, such as an increase in production or maintenance of full employment, otherwise, the purchasing value of the currency would depreciate; and the primary objective of central banks would miss its target.

In order to curb such a tendency and other undesirable practices in this area, a number of countries including South Africa have set up a series of safeguards; one of them being the inclusion of the independence of central banks in their constitutions. In so doing, they have recognised the role expected to be played by those institutions;<sup>6</sup> and decided to ensure that their protection is embedded in the highest law of the Land. (why caps?) In fact, a constitution has been considered by many as a social contract between the people themselves as to how they should be governed, on one hand, and the rulers who are expected to be limited in their power by that contract, on the other. The values cherished by the people are enshrined therein, and it is the duty of governments to uphold them. Therefore, respect for central bank independence is an obligation binding both governments and monetary authorities. However, despite the existence of that autonomy, central banks are also expected to work in consultation with governments; and account for their actions before relevant authorities.

The analysis of this concept is the main objective of this short dissertation. Its purpose is to explore the legal dimension of the independence of central banks, bearing in mind that the nature of the topic, and the areas in which these institutions operate are interdependent; this is why this study will build on the views of economists, financial experts and lawyers. In fact, both lawyers and economists play an important role in the economic regulatory process. Their close cooperation is useful in the formulation of wise and effective regulations.

Consequently, this dissertation will be tackled within an interdisciplinary perspective because mercantile law in general and banking law<sup>6</sup> in particular deals with legal aspects of finance, economics and business.

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<sup>4</sup> Ibid.

<sup>5</sup> A currency is a potent symbol of a polity's unity, integrity and perhaps strength. Governments interfere with it at their peril (Cranston op cit (n 1) 118).

<sup>6</sup> The law is usually subdivided into two categories, namely public and private law. Public law is that part of law which regulates the legal relationship between the State and a subject in which the State acts from a position of authority, whereas private law regulates the legal relationship between legal subjects acting on a basis of equality. Areas of the law, which in particular are related to trade and commerce, are classified as mercantile law. Some

In chapter one, a brief reference to the historical background of central banking in general will give an insight into the topic. In chapter two, the general theory of the independence of central banks will be considered. The third chapter will deal with the legal independence of the South African Reserve Bank (hereinafter called the SARB or the Bank). The concluding remarks will sum up the main ideas developed in the dissertation.

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mercantile subjects consist largely or entirely of private applied law, for example, the law of partnership and insurance law, while others such as tax law are mainly public; company law is an example of mercantile law comprising both public and private rules. Banking law is presented as a mercantile law subject and regulates both public and private relationships. Public banking law regulates the legal relationship between banks and organs of the State, which are in a position of authority, and comprises those legal rules which make provision for control by the State of money and activities of banks in particular (An Oelofse *UNISA Study Guide Mercantile Law LML-407-U LWB 7-9 Banking Law and Usage* (2002) 4-5).

With regard to public banking law, Cranston remarked that 'banking lawyers have taken little interest in central banks. Central banking law, at least in the common law countries, has been regarded as a specialized subject, mainly for public lawyers. But public lawyers have generally done little, although the debate about the European Central Bank is generating a great interest on their part. There is hardly any literature about central banking' (Cranston op cit (n 1) 117). This probably may explain the reason why a number of economists have ventured into dealing with the independence of central banks, some with wonderful contributions and others with economic bias. However, given the nature and object of central banks, it is also not easy for lawyers specializing in this area, not to borrow from economic history, economics and finance to substantiate some legal concepts. Similarly, it is not possible for a lawyer involved in banking supervision to ignore the concepts of corporate finance, financial engineering (financial innovation) and corporate governance. However, even though the language used in their writings may have a smack of economics; finance and commerce, the overall of their literature is expected to have a legal perspective.

Concerning the expansion of banking law, in South Africa, there is a significant literature on banking law in general, and an impressive development of private banking law both in academic writings and judge made law. This is probably due to the fact that many legal experts are in agreement with the opinion expressed by Schulze that among the phenomena influencing banking law, there is the fact that 'banking law is not an autonomous branch of the law; but rather an application of concepts and techniques of the general law of obligations'. (See, WG Schulze 'The Source of South African Banking law- A twenty first Century Perspective' (2001) 14 *SA MercLJ* Part I) 439). See also, FR Malan; JT Petrorius & SF du Toit Malan on *Bills of Exchange, Cheques and Promissory Notes in South African Law* 4 ed (2002) 335.

Therefore, the law of contracts being wide in scope, so becomes the law related to private banking law. Furthermore, Schulze, in describing the principles likely to exercise a decisive influence over the development of banking law, declared, *inter alia*, that other important considerations when studying banking law (...) are the fundamental changes taking place in the banking sphere which affect the economics of banking. Some of these economic changes, which may have an influence of the development of a future South African banking law, include the far greater competitiveness in the bank market and its products: increased asymmetric competition; excess capacity in the market and the far reaching impact of technology and financial innovation (ibid).

With regard to public banking law, as above described by ~~An (or simply, Oelofse, no initials or firstname is necessary when referring to an author for a second time, unless there is more than one author with the same surname.) Oelofse,~~ there are also a number of lawyers who have written on public banking law, mainly, in the area of banking supervision, money law, money laundering, legal aspects of financial institutions, etc. Therefore, the remarks of Cranston (*supra*), which were relevant some years ago, and which may still prevail in some other countries, may not necessarily apply to South Africa as such.

## CHAPTER ONE

### 1.1 A BRIEF HISTORY OF MONEY AND CENTRAL BANKING

#### 1.1.1 Role of money in society

Walter Rogers, an American humorist, once said ‘there have been three great inventions since the beginning of time: fire, the wheel and central banking’.<sup>7</sup> He certainly forgot the invention of money around which central banking systems revolve.<sup>8</sup> In fact, at all times, money has occupied a central stage in people’s lives. History tells us that money has been linked to religion and, in ancient times, the Romans banked in the temples of the goddess Juno, also called *Moneta*<sup>9</sup>, the Latin root of the word money.<sup>10</sup> This practice carried with it another religious dimension in that Roman coins were minted in temples,<sup>11</sup> and sanctified by the priests, an act that made the currency acceptable by society as a reality.<sup>11</sup> In this regard, Voet also declares that it is well known that ‘the Romans often deposited their things for safe keeping in a holy temple... sometimes with bankers and money changers’.<sup>12</sup> This is probably why banks have always been considered sacred institutions from the time of their creation to this day.

Similarly, money has become an object of almost universal veneration. Some people are convinced that money makes everything possible, and this is probably true if one considers its value of exchange and the material enjoyment it brings to those who own it. Consequently, the place it holds in social relations explains the need for societies to seek its protection and stability. In this regard, it has been said that ‘there are few things more important to society than stable money,<sup>13</sup> and efficient and reliable means of transferring it from one person to another’.<sup>13</sup>

<sup>7</sup> *The Economist* September 2000 80.

<sup>8</sup> In antiquity, money took the form of ornaments, household utensils and tools. In Egypt, circa 2000BC rings, anklets, necklaces and bracelets were used extensively as a common means of exchange. The legendary King Croesus of Lydia in Asia Minor is generally credited with the honour of introducing a formal and sovereign coinage system when official silver and gold coins were struck in his kingdom between the years 560 to 546 BC. In Athens, coins were apparently introduced by Solon (638-559) who fixed money payment for fines and dues formerly paid in cattle; probably before this time coins had been in use in China. (See, eg, Houston *The Fundamentals of Money* [1935]10; see also ‘Market Intelligence’ [2004] *The Nairobi Business and Financial Journal* 28).

<sup>9</sup> The most important goddess of the Roman state, wife of Jupiter; she was originally an ancient Italian goddess; the Greek equivalent is *Hera* (Jidy Pearsall & Patrick Hanks (eds) *The New Oxford Dictionary of English* [1998])

<sup>10</sup> *The Latin term moneta came to signify money; you have already mentioned this in the text to foot note 10*

<sup>11</sup> Robert W Kolb & Ricardo J Rodriguez *Financial Institutions and Markets* 2 ed (1996) 38.

<sup>12</sup> *Ibid.*

<sup>13</sup> Nigel Willis *Banking in South Africa* (1981) 184.

<sup>14</sup> Guy David ‘Money in Canadian Law’ (1986) *The Canadian Bar Review* 192.

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In effect, money is the common denominator in several human transactions, and the means of discharging the obligations thereby created.<sup>14</sup> From barter to counter-trade, its modern form, people use money as a medium of exchange to facilitate transactions,<sup>15</sup> as a unit of account which helps determine with precision the value of the goods exchanged, and the services delivered. Money is also a store of value equal to or near its face value.<sup>16</sup> In this regard, money is any medium, which in practice fulfils the function of exchange and which is accepted by those who use it.<sup>17</sup> This is why 'money has evolved from cowrie shells (in South Pacific Islands) to cattle (in Africa) to cigarettes (in prisoner-of-war camps) and then to gold'.<sup>18</sup> Among all these forms of money, only gold was easy to handle, divisible and durable; thus it was preferred to other kinds of money.

As history continues to say, the increase in the volume of trade transactions in ancient times gave rise to the need for people to have a safer place to keep their money other than in their homes. In this connection, it is said that 'recourse was hard to some individuals, such as priests, and wealthy merchants to keep it for them in the vaults they had for the safekeeping of their own gold'.<sup>19</sup> The movement led to various associations of individuals or legal entities to form banks. From the activities of those banks, which were commercial in nature, came the idea of a central banking system that is examined below.

### 1.1.2 Emergence of central banking

A central banking system is a recent phenomenon when compared to commercial banking system. Commercial banking system is believed to be much older. Its beginning may be traced back to somewhere in the Middle Ages, from the European institutions that provided depository safekeeping services when, as seen earlier, the goldsmiths and silversmiths having facilities in which to keep their own valuable inventories, found that 'they could earn additional income by storing valuables for a fee'.<sup>20</sup>

By contrast, the emergence of central banks is located somewhere in the 17<sup>th</sup> century.<sup>21</sup> These banks were essentially created to assist their governments with finances. For example, the Bank of England Act 1694

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<sup>14</sup> Ibid.

<sup>15</sup> David S Kidwell, Peterson & Blackwell *Financial Institutions, Markets and Money* 7 ed (2000) 5.

<sup>16</sup> Ibid.

<sup>17</sup> See, Guy op cit (n 13) at 205.

<sup>18</sup> Jerry Jordan 'Money, Central Banking and Monetary Policy in the Global Financial Arena' (2001) *FMF Mnograph* 27 15.

<sup>19</sup> See, Oelofse op cit (n 6) 22.

<sup>20</sup> Kolb et al op cit (n 10) 404.

<sup>21</sup> Sveriges Riskbank of Sweden was created in 1668; it was followed by the Bank of England in 1694, the Bank de France in 1800, the Bank of the Netherlands in 1814, the National Bank of Belgium in 1850, the Bank of Spain in 1856, the Bank of Russia in 1860, the Bank of Japan in 1882 (Rene du Plessis 'The Structure and Operations of the Reserve Bank and its Relationship with the Government' (1984) *BM* 86-93. See also Jeremy Leaman *The Bundesbank Myth Towards the Critique of Central Bank Independence* [2001] 52).

authorized the incorporation of the Bank by means of public subscription. Originally, the object of the Bank was to raise money required by the war with Louis XIV.<sup>22</sup> It is further said that ‘the Bank was prohibited from engaging in general trade but was authorized to deal in bills of exchange and in the equivalent of promissory notes’.<sup>23</sup> The duties of that bank included keeping the accounts of the government, issuing banknotes and were also allowed to trade in gold coins, bullion and silver.<sup>24</sup>

As private institutions, central banks were created as independent bodies. With time, a number of countries, which were satisfied with the way they were handling money, came to realise that they could also play a macroeconomic role.<sup>25</sup> As a result of this realisation, some of them have been entrusted with the handling and protection of currencies on behalf of governments. As their function grew in importance, central banks were also given the power to formulate monetary policies on behalf of governments. In addition to this, they received additional duties, such as supervision of banks and other financial institutions.

Furthermore, because of their expertise, they also began to serve as governments’ advisors on financial matters. With these new roles, central banks went from strength to strength, which is why it was said that ‘never before, have central banks reached the pinnacle position and obtained the widespread interest they now command’.<sup>26</sup> It is owing to their role in macroeconomic policy that they are now the focus of a great number of researchers in different fields.<sup>27</sup> This movement was probably due to financial global expansion.<sup>28</sup> In fact, since 1973, almost all the nations in the world have been operating fiat monetary systems<sup>29</sup> in which the goods and services value of a unit of money rises or falls with the parsimony or profligacy with which the central bank issues its money.<sup>30</sup>

<sup>22</sup> EP Ellinger, Eva Lomnica & Richard Hooley *Ellinger’s Modern Banking Law* 4 ed (2006) 29.

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

<sup>25</sup> When central banks were created, the notion of macro economy as such had not yet appeared.

<sup>26</sup> GM Wessels ‘Cycles in Central Bank independence’ (1997) 12 *The South African Journal of Economic History* 1 153.

<sup>27</sup> See, GM Wessels ‘On the Meaning of Central Bank Independence’ (1998) 1 *South African Journal of Economic and Management Sciences* 2 254.

<sup>28</sup> The global expansion was characterised by the expansion of the European Monetary Union, the former Eastern Bloc States, Chile, UK, France, New Zealand and a number of other countries where central banks statutes have been amended or completely revised in order to strengthen their independence. The independence of central banks received attention in South Africa during the constitution-making phase in that independence was debated and eventually included in the Constitution (Jordan *op cit* (n 18) 1).

<sup>29</sup> Fiat money is paper money that is backed only by the issuing government’s decree that it is acceptable as legal tender currency. Its value stems from public confidence rather than being convertible into gold or other hard currency (Thomas Fitch *Dictionary of Banking Law* 3 ed (1997) 182). Legal tender is the money recognised by law as acceptable payment for creditors also called lawful money (Fitch *op cit* (n 29) 261). It is the money people use in their daily businesses, such as banknotes and coins. For further details, see section 17 of the South African Reserve Bank Act 89 (Act 90 of 1989) as amended.

<sup>30</sup> Jordan *op cit* (n 18) 27.

This helps maintain the balance in the money supply.<sup>31</sup> Nations today no longer provide an anchor to their currencies by a legislative declaration of gold value. Therefore, central banks have themselves become anchors for the stability of their respective currencies.<sup>32</sup> It is on the basis of these considerations that, nowadays, a central banking system is entrusted with the duty of formulating and implementing financial policies with the ultimate end of protecting the value of the currency and fostering economy. This crucial role has resulted in central banks being included by the will of the peoples in the well-cherished values at the same level as national symbols, such as flags, national anthems, systems of governments and Bills of Rights in constitutional dispensations. It is also because of the claim of national ownership by central banks, in some countries, that the appointment of the leadership of those institutions is strictly scrutinised, and carried out by governments, sometimes, with the approval of parliaments. All these legal and administrative precautionary measures have been designed to avoid any subordination of those institutions to governments; because it could facilitate inflation and even hyperinflation,<sup>33</sup> which are considered a threat to the life of any currency. The theory of the independence of central banks highlights this concept even more.

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<sup>31</sup> The central banking wisdom is that there should be neither too much money in circulation nor too little (see, David Colander *Economics* 1 ed (1994) 278). Central bankers are expected to keep the balance according to the moods of the economy.

<sup>32</sup> Jordan op cit (n 18) 15.

<sup>33</sup> Inflation is a continual rise in price level. It is also a continuous decline in the value of the money. Inflation is an ongoing rise in the price level; a rise generates another rise in an exponential manner and the spiral is hard to stop. Once inflation hits 5 or 6% it is no longer insignificant, inflation of 10% (double digit) or more is significant and once it hits triple digits of 100 or more it is called hyperinflation (see, Colander op cit (n 31) 149).

## CHAPTER TWO

### 2.1 THEORY ON THE INDEPENDENCE OF CENTRAL BANKS

The term 'independence' is defined as a state of being free of influence, guidance or control of another or others. To be independent is a state of being free from outside control; not depending on another authority.<sup>34</sup> To be independent is also to act personally without external pressure. Within the context of a central banking system, this means autonomy from government.<sup>35</sup> It is a restriction made on governments against interfering with the handling of monetary policies. In fact, granting independence to central banks essentially represents elevating monetary policy to a more consecrated level beyond the fray of politics.<sup>36</sup> As noted previously, since some people think that political interference in the implementation of monetary policies weakens the credibility of central banks by restraining their ability to perform in a predictable and sound manner, their independence means freedom to execute monetary policies without fear of any political retaliation; otherwise, the entrenchment of that independence in constitutions would be meaningless. In this regard, it was said that 'empirical evidence has shown that countries with an independent central bank enjoy a low inflation rate and small budget deficit without at the same time exhibiting reduced economic growth'.<sup>37</sup>

In order to strengthen this independence, it has continuously been thought that the power to create ~~money~~ and the power to spend it should be separated for central banks to operate as a check on governments, particularly over its fiscal policies, and prohibiting the financing of government deficit. In this regard, the idea of separation between monetary authorities and governments was mooted in the 19<sup>th</sup> century even though its application has taken a long time to gain wide recognition. This will be explained in the following section.

<sup>34</sup> Pearsall op cit (n 9) 928.

<sup>35</sup> The anomaly of the independence of central banks is illustrated by Sayers, who states that the authority of the State over the central bank is always necessarily absolute. All that is open to question is the extent to which the sovereign body should detail its command to the central bank for the monetary laws are such a command (Gianni Tiniolo in Tiniolo (ed) *Central Banks' independence in Historical Perspective* (1988) 42). To make sure that this command will be obeyed, the Governor of the Central Bank of England and the government negotiated a deal of allegiance, which provides that 'as long as I am the Governor of the Bank, I shall do my utmost to work loyally and harmoniously with you and for you as a Chancellor of the Exchequer, and I shall continue if you allow me to tender you such advice as I consider it my duty to offer, fully realize that I must not attempt to impose my views on you' (ibid). This is an example of a bank, which really had its hands tied and was under the direction of a Government. However, according to Ellinger, the election of a Labour government in 1997 resulted in two momentous changes in banking regulation. First, the Bank of England Act 1998, as well as giving the Bank independence in determining monetary policy, also transferred its responsibility for banking regulation to the Financial Services Authority (the 'FSA'). (See, Ellinger et al op cit (n 22) 28). Therefore, the Bank, which was nationalized in 1946, and ever since subject to government control, has now recovered its independence.

<sup>36</sup> Ignacio Mass *Central Bank Independence, A Critical View from A Developing Country Perspective* (1994) 4-5.

<sup>37</sup> Markus Lusser 'Autonomous Monetary Policy in a Small Country' (1994) 13 *South African Journal of Economic and Management Sciences* 3.

### 2.1.1 Hallmark of central bank independence

A distinctive feature of independence of central banks, namely autonomy from governments and non-financing of budgets, was identified by one of the famous British economists in a paper on the establishment of a national bank in England in 1824 in which he stated that 'the government could not be entrusted with the power of issuing paper money that it would most certainly abuse it'.<sup>38</sup> For him, to avert the danger, commissioners should be allowed to control the use of public finance, and should not authorize the lending of money to governments without proper justification; on the other hand, governments should not try to use their dominant power to convince the commissioners to do so. He further stated that 'if the government wanted money, it should be obliged to raise it in the legitimate way',<sup>39</sup> such as applying wise fiscal policies or participating in financial markets like any other institution, but 'in no case, should it be allowed to borrow from those who have the power of creating money'.<sup>40</sup>

It is clear from the above that the speaker had in mind a system of checks and balances in the financial sector, but his vision that the representatives of the peoples should have a final say in public financial management is somehow blurred by the current view that 'although parliaments once exercised effective control of government budgets, today [in many countries], parliamentary control of government's budget is a mere formality rather than a real check'.<sup>41</sup> Because of this situation, the last hope of the people on these matters is placed in the role to be played by an independent central bank. Their expectation is that a central bank would not systematically finance deficits; rather, serious studies and consultations should be conducted to examine the merit of the requests of the government before any disbursement of funds is carried out.

The separation of monetary authorities will shed more light on this concept.

### 2.1.2 Separation of duties of governments and central banks

Although the independence of central banks is topical in many countries, it is still a controversial issue. Those who advocate the idea of that autonomy tend to compare the legal independence of central banks

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<sup>38</sup> BW Fraser *Reserve Bank of Australia Bulletin Central* (1994) 1 [www.rba.gov.au/publications](http://www.rba.gov.au/publications) and Research/Buttein/bu-dec94/bu 1294-1pdf. [Visited 4 May 2004]. This theory has been largely expounded by David Ricardo (1772-1823), a British economist and a successful stockbroker of Dutch-Jewish parentage who is also credited with several other economic theories, such as the theory of wages in the economy and the theory of comparative advantage in international trade (see, Colander op cit (n 31) 14, 113-114).

<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

<sup>41</sup> Lastra op cit (n 2) at 77.

with the independence of the judiciary. The attempt to use this analogy as an example to separate monetary authorities and governments is probably by reference to the traditional system of checks and balances between the three traditional branches of power, namely the executive power, the legislative power and the judicial power as featured in several constitutions around the world.

They probably view this mutual control where 'no one branch can exercise power decisively without the support or the acquiescence of the other'<sup>42</sup> as an efficient mode in the conduct of monetary policies and another way of fostering decentralisation and avoiding the abuse of power. Although the analogy may be somehow self understood because in some countries, independence of the judiciary, and independence of central banks are entrenched in their constitutions, the reality is that independence of the judiciary is an almost universally accepted concept. On the contrary, the idea of central banks' independence in constitutional systems is a new concept, which does not enjoy universal recognition. The reason being that there are still a number of countries in which the principle of independence of central banks is not yet recognised, and where the idea is not even on the agenda of their financial policies.

Another reason, which may lead one to think that the independence of the two institutions is different in their essence, is the fact that central banks are part of the executive branch of the state. This is still true even in those countries that have opted to enshrine the independence of their central banks in their fundamental laws. The framers of those constitutions perhaps never thought that their central banks were meant to be the fourth estate of power. Even the press itself has never managed to be elevated to the level of a fourth power despite the freedom it enjoys, and the role it plays in political orientation.

Therefore, it is not because the independence of central banks is provided for in some constitutions that central banks may consider themselves separate from governments. There are many other state agencies, the independence of which is written into constitutions, that are still considered administrative and advisory bodies, such as the Financial and Fiscal Commission or the Independent Authority to regulate Broadcasting as respectively stipulated in s 220 and s 192 of the Constitution of the Republic of South Africa Act 108 of 1996; as well as similar institutions in many other countries around the world.

Furthermore, it is true to say that the courts enjoy the authority of *res judicata*,<sup>43</sup> which gives final decisions of the courts a binding character. By contrast, the decisions of central banks do not enjoy the

<sup>42</sup> Thomas E Patterson *American Democracy* 5 ed (2001) 44.

<sup>43</sup> The complete expression is *res judicata pro veritate habetur* meaning that 'a judgment will have a binding effect on another' (Bryan A Garner (ed) *Black's Law Dictionary* 8 ed (2004) 1337); it also means that the judgment that has been definitely decided is held as a truth and has a binding character (see, eg, Raymond Gullien & Jean Vincent *Lexique de Termes Juridiques* 5 ed (1981) 373). It is also called 'judicial precedent' and by way of generalization, judicial precedent may be described as a judicial decision that serves as example and authority for

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same privileges because central banks, as administrative institutions, may be made to account to relevant institutions or seek consultation with pertinent administrative bodies. By contrast, the judges do not need such kind of consultation in their decision-making process.

The view that the two forms of independence are different is shared by many; this is why it was said that 'the definition referring to a relationship between central bank and government which is comparable to the relationship between the judiciary and the government ...' is not helpful<sup>44</sup> because this would entail a strict separation of powers in the traditional meaning of the word, which would amount to elevate the independence of central banks to a level of another power not recognized by law, the comparison simply 'suggests a degree of autonomy to be reserved to central banks'.<sup>45</sup>

From the above, it may be inferred that independence of central banks seems to be more administrative than political; administrative in the sense that its main objective is to reinforce the delegation of powers conferred on them in consistence with the principle of the division of labour, which consists of organising the financial sector into different constituencies to ensure greater efficiency and effectiveness in the management of the economy. However, as a general rule, governments retain the big role of conducting public affairs, and are primarily accountable for their actions to the peoples through institutions of control, such as parliaments in countries where the rule of law prevails; this is why it was said, 'viewed broadly, an elected government in a democratic society has the ultimate power to formulate and implement macroeconomic policy and is also responsible for it'.<sup>46</sup> In practice, however, it is hard for governments to carry out all these tasks alone. Some of them are entrusted to other institutions; or state agencies provided those governments retain control, because, as it is commonly said, 'delegation of power without control is improper'.

To achieve this end, there has to be a regulatory mechanism to avoid conflict and duplication of duties. This kind of delegation may be considered a routine matter in any administration or bureaucracy. It is sometimes discretionary, but in the case of central banks, the position is different because some of them derive their independence from constitutions or statutes of their respective countries. Thus, governments have no other alternative but to comply with law. The delegation is thus compulsory, but not

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deciding a later case, either by the same or by another court. In Latin concept of judicial precedent is embedded in the maxim of *stare decisis et non quieta movere*, meaning to stand by precedent and not to disturb settled points (see, Schulze op cit (n 6) at 447).

<sup>44</sup> Philip Brentford 'Constitutional Aspects of the Independence of the European Central Bank' (1998) 47 *International and Comparative Law Quarterly* 88.

<sup>45</sup> Ibid.

<sup>46</sup> Wessels op cit (n 26) at 255.

discretionary. However, this does not mean that central banks will cease to be closely associated with the general administration whatever their legal status and their degree of independence.

Furthermore, one of the legislature's motives in granting that independence is clearly to avoid the misuse of authority by governments by compelling central banks to adopt measures that may adversely affect their respective ~~currencies~~ ~~or~~ ~~currencies~~ or impact negatively on their overall economies.

It is beyond dispute that governments also have the interests of the people at heart; but they are comprised of human beings with all the weaknesses linked with human nature, for instance, the voters may pile pressure on them by claiming to cater for their needs at all costs, especially when elections are around the corner. In that event, when they cannot exercise self-restraint, and resist the temptation of succumbing to those pressures, they may act in panic, and use public finance as a vehicle to regain their electoral mandate. To avoid this temptation, it was suggested that governments should draw a lesson from Ulysses<sup>47</sup> of Greek mythology who decided to have his ears plugged with wax to avoid the temptation to hear the beautiful melodies of the sirens, which otherwise could have cost him his life.

Similarly, the legitimacy of independent institutions may also be understood by reference to the 'Robinson Crusoe' paradigm. Just as an individual imposes constraints on himself in order to channel his own expedient behaviour towards rationally selected norms,<sup>48</sup> so a government limits itself by allowing or creating autonomous or independent bodies, recognising its own weakness in the face of temptation.<sup>49</sup> Otherwise, it may tend to make decisions that exhibit inflationary biases, and thereby undermine the legal independence of central banks.

Where such a restraint proves impossible, governors of central banks and their teams should be able to voice their disagreement freely when pressure to print money is unjustifiably imposed on them. In case of conflict, the dispute should be resolved by the relevant state agencies in total adherence to due process of law.

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<sup>47</sup> Ulysses (also called Odysseus in Roman mythology) and his sailors plugged their ears with wax to be immune to the songs of the sirens which lured unwary sailors to their death. Ulysses asked the sailors to tie him to the mast to protect him from the temptation of removing the wax, and when they were in the middle of the voyage, he was tempted to hear the songs and asked the sailors to assist him; his sailors followed his instructions and refused to remove the wax from his ears or to release him from the mast. His life was saved because he recognised his weakness and protected himself from it. Furthermore, experience teaches that cherished values may be put in jeopardy by the passion of the moment. Ulysses tied his own hands but constitutions bind present and future generations; a constitution is an attempt by a society to tie its own hands to limit its ability to fall prey to weaknesses (see, Erwin Chemerinsky *Constitutional Law Principles and Policies* 1 ed (1997) 7).

<sup>48</sup> Lastra op cit (n 2) at 479.

<sup>49</sup> Ibid.

However, despite the autonomy of central banks, as observed earlier, it is also stressed that ‘an independent central bank is not an omnipotent institution devoid of supervision and accountability but a part of democratic society’.<sup>50</sup> As such, there are limits to its powers and restrictions on the scope of its discretionary policy.<sup>51</sup> Independence for a central bank does not therefore mean that the bank occupies the position of a state within a state; it is impossible to have two sovereign authorities in a single state.<sup>52</sup> The economic policy of a country cannot be anything but the policy of the elected people.<sup>53</sup>

In the same vein, it was also said that, ‘although governments have the final say in the management of their countries, and none has granted absolute independence to central banks, governments do grant or delegate monetary powers to central banks’.<sup>54</sup> As the argument goes ‘a mandated independence means that the bank is insulated from day to day political interference and short term affinity’.<sup>55</sup>

It is also useful to mention that, even in those countries where the independence of central banks is not provided for in constitutions, they are somehow granted charters giving them a certain autonomy allowing them to conduct monetary policies in a more relaxed atmosphere, and some of them have had impressive inflation records. In this regard, it may be said that the success of central banks depends much on an effective leadership. For example, Margaret Thatcher was persistently hostile to statutory independence for the Bank of England; but under her rule, inflation was kept at a reasonable level.<sup>56</sup> This happened when there were divergent points of view with her long-serving Chancellor Lord Nigel, who was a keen advocate of independence for the Bank of England.<sup>57</sup>

From a historical point of view and observation, some experts believe that the role of the legal independence of central banks rose and declined with the application of economic ideologies, which originated from England and expanded to some other parts of the world, as briefly expounded below.

### **2.1.3 Central bank independence with economic ideologies**

According to economic history, there are two important economic theories with regard to how the British government approached the conduct of economy in the past and contemporary period; namely classical

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<sup>50</sup> Wessels op cit (n 26) at 155.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> Ibid.

<sup>54</sup> Ibid.

<sup>55</sup> Ibid.

<sup>56</sup> H Preece ‘Right to be wrong’ (1993) 57 *Finance Week* 10 8.

<sup>57</sup> Ibid.

economy, spearheaded by Adam Smith (1723-1790) under the doctrine of *laissez faire*;<sup>58</sup> and interventionist economy developed by John Maynard Keynes (1883-1946).<sup>59</sup> These two concepts have had an impact on the legal independence in countries, which applied them beyond the United Kingdom.

From the above, the perception of many financial experts and economists is that there is no big difference between the doctrine of *laissez faire* long time considered the embodiment of the system of capitalism and the basis of freedom of contract and the economic philosophy of interventionism. Their conclusion is based on the fact that Smith does not totally rule out the intervention of government in the management of economy;<sup>5</sup> and Keynes also recognizes the interplay between the forces of the market; as well as a system of market oriented economy. However, there is a middle-of-the road theory, essentially developed by the so called classic economists,<sup>60</sup> and which, currently, is claimed by those who profess it to be the most suitable for the conduct of economy despite its being still controversial in the eyes of many others.

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<sup>58</sup> In economics and politics, *laissez faire* (let alone) is a doctrine that economic system functions best when there is no interference by government. It is based on the belief that the natural economic order tends, when undisturbed by artificial stimulus or regulation, to secure the maximum well being for the individual and therefore for the community as a whole (see, Paul Lagasse et al (eds) *The Columbia Encyclopedia* 6 ed (2000) 1574). Historically, *laissez faire* was a reaction against mercantilism, a system of commercial controls in which industry and trade, especially foreign trade, were merely seen as means of strengthening the state. Navigation laws, trade monopolies, taxes, paternalist regulations of all kinds bore heavily upon the rising class of merchants in the period of European colonial expansion. It was on behalf of this class that the French PHYSIOCRATS, pioneer economists in 18<sup>th</sup> century first formulated the principle of *laissez faire*. With the physiocrats, state non interference became a cardinal teaching; they especially opposed the taxation of commercial pursuits. Opposition to mercantilism and state paternalism also motivated Adam Smith, father of classical economics, whose name, more than any other, is connected with the British *laissez faire* doctrine, which he developed after his stay in France. Smith believes that individual welfare rather than national power was the correct goal; he thus advocated that trade should be free of government restrictions. When individuals were free to pursue self interest, the invisible hand of rivalry or competition would become more effective than the state as a regulator of economic life. Smith did not believe in *laissez faire* in an absolute sense; he found a place for government in public works, such as the building of canals and docks to facilitate trade and in the regulation of foreign commerce to protect certain home industry (ibid).

<sup>59</sup> Some centuries later, another English economist and monetary expert, Keynes John Maynard (*supra*) came up with another theory, which was perceived as departure from classical economy. His position dated from the mid 1920s, when he formulated the Liberal Party program to promote employment by a program of government spending on public works. Keynes came to believe that such a program would increase national purchasing power and foster employment in complementary industries. For the sake of full employment, Keynes also modifies the classical belief in international free trade. The basis of his doctrine is mainly based on large scale government economic planning and the intervention of government in the regulation of economic activities. His doctrine appealed to both practical politicians and theoretical economists with equal force; perhaps because he attacked the problem of employment and income while remaining faithful to the requirements of rigorous economic thought. Although he favored controlled investment and an active public sector, he never waived his faith in capitalist economy. In Keynesian theory, government action is designed to stimulate the market, not to eliminate it (see, eg, Lagasse op cit (n 58) 1524).

<sup>60</sup> Since the two ideologies exposed above have some convergent points of view, the economists who accept Smith's ideas;<sup>2</sup> and at the same also recognize some of the ideas of Keynes, are known as 'Neo Classic Economists' (see Colander op cit (n 31) 318).

With regard to independence of central banks, this brief exposition of economic ideologies will help the reader understand that the position of those who favour that concept have continued to believe that central banks prevailed under the influence of the doctrine of *laissez faire*; while others think that, nationalisation or centralisation of main economic institutions and thereby the subordination of central banks to governments, were much influenced by the doctrine of interventionism.

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In fact, a number of countries have been following these theories depending upon the party controlling the government of the day. To maintain financial stability, some of them have found that it was good to institutionalise a legal framework that permits governments and central banks to act in close cooperation.

In this regard, a few banks have been randomly selected, without any inclination whatsoever –towards anyone of the ideologies exposed above, but to simply highlight the importance of granting legal independence of central banks in the conduct of economic and financial affairs.

#### 2.1.4 The Bundesbank

In Germany, the Central Bank is called the Bundesbank. It has a reputation as a fierce inflation fighter,<sup>61</sup> in large part because of the historical legacy of the German hyperinflation of the late 1920s and early 1930s.<sup>62</sup> Commentators and policymakers are almost unanimous on the fact that ‘the Bundesbank is the bastion for price stability and a symbol of monetary discipline around the world’.<sup>63</sup> The anti-inflationary record of the Bundesbank is typically cited in literature as the quintessential example of the inverse relationship between inflation and central bank independence.<sup>64</sup>

The aim of stability, which became enshrined in the Bundesbank Act of 1957,<sup>65</sup> was coupled with the strong desire of the German people to put an end to a financial crisis that was worsened by the burden of the war reparation debt. In their effort to revamp their economies, a series of measures were put in place among which the independence of the Bundesbank was prominent.

<sup>61</sup> David Colander *Economics* 4 ed (2001) 684.

<sup>62</sup> Ibid.

<sup>63</sup> Maria Rosa Lastra & GP Miller ‘Central Bank in Ordinary and Extraordinary Times’ in Jan Kleineman (ed) *Central Bank Independence, The Economic Foundations, The Constitutional Implications and Democratic Accountability* (1999) 12.

<sup>64</sup> Ibid.

<sup>65</sup> The German Constitution includes some dispositions about the Bundesbank, but does not mention its legal status or whether it will be a private or a public body. (See, eg, Felix Olkers *Central Bank Law in German and South Africa*, unpublished LLM dissertation University of Cape Town (1992) 1).

The success of the German economy in the above-mentioned period is also largely attributed to the combined efforts of the Bundesbank and its predecessor, the Bank Deutscher, which led to a period hailed as the miracle years<sup>66</sup> during which stable high growth, low inflation, full employment and healthy external balances were realised and which was also called a magic square.<sup>67</sup>

This phenomenon is illustrated by the fact that from the lowest rate of growth in the 1950s, which hovered around 3.5 percent up to 1958, the year the Bundesbank Act came into force, the average growth for the decade was 8 percent and, for the sixteen years (1951-1966),<sup>68</sup> it was still an impressive 6.8 percent. Inflation averaged less than two percent in 1950 to just one percent in 1960 and the rate of unemployment fell.<sup>69</sup>

There was widespread belief that the success was not only due to the legal independence of the Bundesbank but also, particularly, to the teamwork of all political, economic and financial institutions in applying positive policies and using top talents to achieve those results.<sup>70</sup> This was further strengthened by German legislation on the monetary system, which included decisive measures to contain access by the state to central bank credit.

In this regard, it was declared that the Bundesbank could lend directly to the Federal and Lander governments only to a limited extent and only for a short period.<sup>71</sup> The credit lines thus granted could be used only for cash advances, that is, to bridge short-term cash deficits that arise during the implementation of the budget, but not to finance deficit budgets themselves.<sup>72</sup> This is reflected in s 20 of the Bundesbank Act, which sets a ceiling on the credit the Bank can grant to government.<sup>73</sup> Moreover, the Bundesbank may not acquire bonds issued by public authorities direct from the borrower but only in the open market on the terms ruling there.<sup>74</sup>

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<sup>66</sup> Leaman op cit (n 21) 114.

<sup>67</sup> In the United States, Humphrey & Hawkins Act on Full Employment and Balanced Growth (1978) translates this theory into reality. In fact, apart from the requirement of voting and implementing a balanced budget, the Act expressly requires the coordination of economic policy between the president, Congress and the Federal Reserve System, and the setting of 3 percent adult employment as the official target for public policy (see, Robert B Carson *Macroeconomic Issues Today Alternatives, Approaches* 4 ed (1987) 180-181). Furthermore, the Act, as it stood by that time, explicitly required the nation to aim at four ultimate goals: full employment, growth in production, price stability, balance of trade and budget (ibid).

<sup>68</sup> Leaman op cit (n 21) 114.

<sup>69</sup> Ibid.

<sup>70</sup> See, eg, Leaman op cit (n 21) 113.

<sup>71</sup> Ibid.

<sup>72</sup> Ibid.

<sup>73</sup> See, Lastra op cit (n 2) at 490.

<sup>74</sup> Ibid.

In this effort of economic revival, the Bundesbank was also given a rule-making power, that is, it was permitted to issue regulations with a binding character through the principle of delegated legislation. However, the by-laws passed by the Council of the Bundesbank are subject to the approval of the Federal Government, and are published in the Federal Gazette. Therefore, by law, the Bundesbank has both goal independence (formulation of monetary policy) and instrumental independence (freedom in the implementation of the monetary policy).

In order to strengthen teamwork, Germany has introduced an element, which is not common in many countries, that is, the cooperation between monetary authorities and the government in such a way that ministers who are in charge of economic and financial matters and monetary authorities are by statute obliged to act as close allies in the handling of economic and monetary policies. For example, the members of the Federal Government are entitled to attend meetings of the Central Bank's Council, even though they have no right to vote; they can nonetheless propose motions.<sup>75</sup> A reciprocal privilege is extended to the Governor of the Bundesbank.<sup>76</sup>

However, in this innovative style of seeking a synergetic action to achieve high results, 'there is no formal liaison or interchange of staff members, but the Bundesbank and the Ministry of Finance work together closely in national and international bodies, such as the International Monetary Fund'.<sup>77</sup> This *modus operandi* is in line with the German Central Banking Act of 1957, which provides that 'the Bundesbank is independent from the Government in the conduct of monetary policy; but it must cooperate with the Government'.<sup>78</sup> Moreover, 'the Bundesbank needs the Federal Government's approval in order to participate in institutions serving the purposes of supra national policy or international payments and lending'.<sup>79</sup>

In the same perspective, there is another central bank that has achieved success in its own right. This bank is the Reserve Bank of New Zealand.

### **2.1.5 The Reserve Bank of New Zealand**

The Reserve Bank of New Zealand was established in 1934.<sup>80</sup> At the time, it was under the tutelage of the Bank of England. The Reserve Bank was perceived as an essential tool in the economic development of the country and a subject of national pride. It was created as an independent institution under the

<sup>75</sup> Section 13 (2) of the Bundesbankgesetz.

<sup>76</sup> Section 13 (3) of the Bundesbankgesetz.

<sup>77</sup> Lastra & Miller op cit (n 63) 488.

<sup>78</sup> Lastra & Miller op cit (n 63) 45.

<sup>79</sup> Ibid.

<sup>80</sup> Geoffrey Wood 'Central Banks independence' in Jan Kleineman op cit (n 63) 10.

inspiration of the then Governor of the Bank of England.<sup>81</sup> His idea was presented before the New Zealand House of Representatives. Some of the elements of the report are still topical today. The recommendations to establish a Reserve Bank were subject to two fundamental conditions. In the first place, the bank must be entirely free from both the actual fact and the fear of political interference.<sup>82</sup>

The Bank would not be able to discharge its duty if its room for manoeuvre were limited. Best practice in banking management has shown that to allow a bank to work as a private entity with its own capital owned by individuals or corporations with an autonomous board of directors appointed by the shareholders would allow the central bank to attain its objectives and realise better performance.

The approximation to the framework of the advisor did not last long because of the advent of a new government. In 1936, the Bank was nationalised. The power of monetary policy as provided for in the Act creating the Bank Act of 1989 was put in the hands of the Government; the Bank had to execute the directives from the Minister of Finance. It was only in 1984 that the independence of the New Zealand Reserve Bank was revived. A series of reforms started to give the Bank back its lost powers. This was especially due to continued economic crises. In light of the German miracle, there was a general feeling that an independent central bank could better facilitate economic development in New Zealand.

The Reserve Bank of New Zealand is currently regulated by the Reserve Bank Act of 1989 No. 157 as amended. This new legislation requires the Governor of the Reserve Bank of New Zealand to negotiate a monetary policy agreement with the Minister of Finance. Under this arrangement, the agreement must be made public. Under previous law, this requirement was not present; the Governor could be directed to follow a particular policy without that directive being released publicly. Currently, 'the Reserve Bank of New Zealand has the very specific goal of pursuing an inflation target of between zero and two percent'.<sup>83</sup>

This has helped inflation decline from double-digit levels to lower than two percent. Owing to this achievement, 'the Reserve Bank of New Zealand is regarded as a forerunner in establishing institutional structures which ensure central bank independence with a formalized performance contract arrangement'.<sup>84</sup> In fact, its independence is in the form of a bilateral contract, in which the fight against inflation is the object. The Governor commits himself to meeting the targets agreed upon in the contract. If the set targets are not achieved, dismissal may occur.

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<sup>81</sup> Otto Nyeemer was the advisor of the Bank of England; he subsequently became director of the Bank (1938-1932).

<sup>82</sup> Ibid.

<sup>83</sup> Fraser op cit (n 38) 3.

<sup>84</sup> Jackson MKC 'Reserve Bank Independence A Post Keynesian Perspective' (2002) 70. *The South African Journal of Economics* 129.

To facilitate the execution of the agreement, the role assigned to the Reserve Bank of New Zealand is to maintain price stability; other economic objectives are set aside. The Governor, in the implementation of this obligation, agrees that he will direct those under him or her towards the achievement of goals stipulated in the contract. In fact, he or she has no other choice because of the *Sword of Damocles* of losing his or her job, which hangs over him or her.

Apart from the Bundesbank and the Reserve Bank of New Zealand, there is another institution, which is also well known for its independence, namely the European Central Bank, an overview of which is given below.

#### 2.1.6 The European Central Bank

In the late 1990s, a number of European Union countries formed a monetary union, creating a common currency called the euro and a new central bank called the European Central Bank (ECB).<sup>85</sup> The primary objective of the ECB is to maintain price stability. Its tools and its directives are similar to those of the Bundesbank and some experts have considered it an expansion of the Bundesbank for the entire EU.<sup>86</sup> Like the Bundesbank, the decision to uphold that independence is provided for in the Maastricht Treaty.<sup>87</sup> This Treaty has made legal central bank independence a *sine qua non* for participating in the European Monetary Union. It was further provided that 'in the discharge of its duty, the ECB does not take instruction from any quarter whatsoever within the Community'.<sup>88</sup> These provisions strengthen its legal independence.

Furthermore, that independence is laid down in the Treaty, member states are imperatively bound to bow to its provision. Like other countries, which adopted the independence of central banks in their constitutions, the main reason, as seen above, is the fact that they are hard to amend. In fact, to amend a multilateral treaty like the EC Treaty is as difficult as to amend any other constitutional provision.<sup>89</sup> As seen earlier, 'a constitution is the document in which the most important laws of the states are authoritatively ordained'.<sup>90</sup> This is one of the reasons why it was declared that 'the member states

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<sup>85</sup> Colander op cit (n 31) 684.

<sup>86</sup> See, Colander op cit (n 31) 22.

<sup>87</sup> The Maastricht Treaty is a Treaty on the European Economic Union agreed by the heads of governments of the twelve member states of the European Community (Rome Treaty of 1957) at a summit in Maastricht (the Netherlands) in December 1991; the ratification was completed in 1993 (Pearsall op cit (n 9) 635).

<sup>88</sup> Ibid.

<sup>89</sup> See, Cranston op cit (n 1) 123.

<sup>90</sup> Brentford op cit (n 44) at 76.

undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or the national central banks in the performance of their tasks'.<sup>91</sup>

Consequently, the Bank has no legal or moral obligation to heed any manipulative measure from the Community in compliance with Article 107 of the Treaty. According to this treaty, the ECB shall not seek or take instruction from the Community or bodies from any government.<sup>92</sup> Likewise, the member of state is requested not to try to impede the decision-making body, the ECB or the national bank in the performance of their duty.<sup>93</sup>

With regard to the structure and independence, the European Central Bank being a new institution, had older institutions from which, perhaps, to draw inspiration, such as the Bundesbank;<sup>94</sup> but also other leading central banks in the world, such as the Federal Reserve Bank in the United States of America or the Reserve Bank of South Africa.

Cranston, stressing the importance of independence of central banks remarked, *inter alia*, that a central bank is in a strong position if its independence is constitutionally guaranteed because constitutions are generally speaking less readily amendable than statutes;<sup>95</sup> and in support of this idea, referred to the South African Reserve Bank and the European Central Bank as examples.<sup>94</sup>

Concerning public financial management, the strictest limit on a central bank financing government is an absolute prohibition; this is contemplated in Article 104 of the EC Treaty for the European Union, where any form of credit to member states or any other dealings are not allowed.<sup>95</sup>

A part from the above described central banks, it has been indicated, right from the beginning, that the Reserve Bank of South Africa is among the first generation of central banks with an extra feature of being among the rarest institutions of this kind to have its independence entrenched in the Constitution. Therefore, its case will help enhance the comprehension of the topic under consideration as expressed in the following chapter.

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<sup>91</sup> Cranston op cit (n 1) 123.

<sup>92</sup> See, Cranston op cit (n 1) 122.

<sup>93</sup> Ibid.

<sup>94</sup> See, eg, Cranston (n 1) 122.

<sup>95</sup> Cranston op cit (n 1) 130.

## CHAPTER THREE

### 3.1 THE INDEPENDENCE OF THE SOUTH AFRICAN RESERVE BANK

#### 3.1.1 Brief overview of historical evolution

The discovery of gold on the Witwatersrand in 1886 brought huge inflows of foreign capital into South Africa.<sup>96</sup> This movement brought about a flourishing industry in the region. Because of this, and even before, there was a pressing need to organize a financial sector with at the centre, the creation of a central bank. The issue was raised several times in many and consecutive years, but every time, the Government would dismiss the claim as premature.<sup>97</sup>

In the long run, at the turn of the 20<sup>th</sup> century, gold mining around Johannesburg had brought about the creation of a great number of enterprises in various areas of economic activity. This situation led to the creation of a stock of exchange,<sup>98</sup> and the emergence of a fledging banking industry, which made many business people and a number of financial experts to make a fresh call for the creation of a central bank to ensure financial coordination. This claim was also based on the adverse effects of the financial and monetary crisis, which had arisen in the aftermath of the World War I.

During all those periods of unsuccessful petitions and discussions, one of the main arguments in favour of this claim was that 'a central bank would ensure note circulation, more stable interest rates; trade would be fostered and only in times of crisis, a strong bank could serve the State and the public'.<sup>98</sup> There were already other central banks, such as the Bank of Netherlands, the Bank of Java and the Federal Reserve Bank in the United States. The existence of these banks contributed to the encouragement of people to continue with their agitation to have a central bank; on the other hand, there was also a general observation that almost everywhere where central banks had been established, they had stimulated their economies and stabilised their currencies.

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<sup>96</sup> *Financial Mail* 30 August 1991 121 9 7.

<sup>97</sup> Gerhard de Kock *A History of the South African Reserve Bank (1920-1952)* (19 54) 3).

<sup>98</sup> *Ibid.*

Furthermore, at international level, a conference was held in Brussels in 1920 calling on all countries to establish a central bank to facilitate the restoration and maintenance of stability in their monetary and banking systems and to promote international cooperation.<sup>99</sup>

Finally, the Government decided to create a central bank, which came to be called the South African Reserve Bank.<sup>100</sup>

Because of this achievement, South Africa prided herself on being ahead of Australia, Canada and New Zealand, who had still not yet established their central banks. The legal framework was modelled on that of the US Federal Reserve System<sup>101</sup>, which had been founded seven years earlier, and on that of the Bank of Java.<sup>102</sup> An outline of the creation and structure of the SARB has more to tell.

### **3.1.2 Creation of the South African Reserve Bank**

The South African Reserve Bank was originally instituted by the Currency and Banking Act 120 (Act No 31 of 1920) with its seat of office in Pretoria where it commenced its business on 30 June 1921. This initial Act required commercial banks to subscribe to a total of 50 percent of the bank's initial capital.<sup>103</sup> In terms of the Currency and Banking Amendment Act 22 of 1923, however commercial banks were exempted from this obligation.<sup>104</sup> This Act was followed by a series of other Amendments, which culminated in the setting up of the South African Reserve Bank Act 89 (Act 90 of 1989), and which currently governs the Bank.

The interim constitution, which came into effect on 27 April 1994, deals with the constitutional role played by the South African Reserve Bank.<sup>105</sup> After a long debate on whether it was convenient to put the provisions dealing with the Bank in the new Constitution; or alternatively, if it was to be provided for in an ordinary statute. The decision of the Constituent Assembly was that it should be entrenched in the Constitution and should be independent.

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<sup>99</sup> Malan et al op cit (n 6) 308 para 194.

<sup>100</sup> The South African Reserve Bank also goes by its acronym the SARB and which for the sake of convenience, will sometimes be referred to as such or the Bank in the present dissertation .

<sup>101</sup> As indicated earlier, the selection of the central banks to be included in this short dissertation was randomly done, and the nature and volume of the work could not permit the review of all central banks. This is how the Fed was not included in this work.

<sup>102</sup> Ibid.

<sup>103</sup> Oelofse op cit (n 6) 235.

<sup>104</sup> Ibid.

<sup>105</sup> Olkers op cit (n 65) 37.

This is how 'the Constitution of the Republic of South Africa (Act 108 of 1996), which came into operation on 4 February 1996 (Procl R6 of 24 January 1997),<sup>106</sup> confirmed in s 223 that the South African Reserve Bank is the central bank of South Africa'.<sup>107</sup> The independence of the South African Reserve Bank is stipulated in s 234 (2), which proclaims that the South African Reserve Bank in pursuit of its primary objective 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 primary objective of the South African Reserve Bank, as expressed in the preceding paragraph, is laid down in s 234(1) of the Constitution,<sup>108</sup> and is aimed at protecting the value of the currency in the interest of a balanced and sustainable economy. In this regard, it is suggested that this section should be read together with s 3 of the South African Reserve Bank Act 89 (Act 90 of 1989), in terms of which, the primary objective of the Reserve Bank is the promotion of monetary stability and balanced economic growth in the Republic.<sup>108</sup> The same source indicates that these two sections are essentially the same in the sense that both intend to promote monetary stability in the interest of economic growth.<sup>109</sup>

The reason of keeping intact the Reserve Bank Act lies in the fact that the Constitution describes the objectives and functions of the SARB in broad and general terms leaving the details to be dealt with in an Act of Parliament as provided for in s 225. In all likelihood, the enactment of that Act could have followed the promulgation of the Constitution; but it is a constitutional practice that when there is a new constitution, the laws, which were in force prior to its promulgation, remain in force unless expressly repealed by a provision in the constitution.

This is what happened with the South African Reserve Bank Act because s 242 of the Constitution makes provision for the preserving of all laws, which were in force immediately before the commencement of the Constitution. It also provides for an express abrogation contained in Schedule 7. Since the South African Reserve Bank Act was not in that Schedule, the proper construction is that: it was the intention of the framers of the Constitution to preserve its existence. This is why the new Constitution was put in place, but the missions and functions of the SARB remain the same.<sup>110</sup>

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<sup>106</sup> WG Schulze & ME M Kelly *Banking Law and Usage (LLM 407-U)* Tutorial Letter 202/3/2001; *Banking Law and Usage MBLW1-9(MBLW2-A0)* Tutorial Letter 102/3/2011 (2001) 1.

<sup>107</sup> Ibid.

<sup>108</sup> Ibid.

<sup>109</sup> Ibid.

<sup>110</sup> HE Formby & HT Cashmore 'The Central Bank in the New South Africa' 1994 *Financial Mail* 1333 96 5.

### 3.1.3 Mission, Powers and functions of the SARB

#### 3.1.3.1 Mission

The term mission also means goal, target or objective; if one looks at the Constitution, the mission of the South African Reserve Bank is provided for in s 234 (1). This was later reaffirmed in legal literature that in 1990, the Reserve Bank issued a mission statement declaring in unequivocal terms that the main objective of monetary policy in South Africa, at all times, is to protect the internal and external value of the rand. In this regard, it was further said that the achievement of the mission is carried out through monetary policy, which 'forms part of broader economic policy', and just as in the case of other policy measures, its ultimate objective is the creation of maximum economic growth in a financially stable environment to improve the economic welfare of the total population of the country'.<sup>111</sup>

With regard to the constitutional obligation to maintain sustainable economy as expressed above, it is said that an economic growth is sustainable if it lasts, an economy should not be designed to boom and subsequently collapse. The Reserve Bank should neither fuel nor suppress economic development but should try to lay sound foundation to protect growth.<sup>112</sup> In addition, it was also declared that the Reserve Bank's mission statement calls on the Bank to strive for financial stability as a medium term objective. Key element in such stability will indeed be a relative absence of both inflation and deflation of the general price level.<sup>113</sup> In addition, as a general rule, almost all central banks focus on promoting public goals, such as economic growth, low inflation and the smooth operation of financial markets.<sup>114</sup>

Applying the rule within the context of the South African Reserve Bank, it is suggested that focus should be on: a moderate rate of expansion credit and the money supply, an orderly and well functioning financial market, an orderly payment and money transmission system with built-in safeguards against

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<sup>111</sup> Ibid.

<sup>112</sup> See, eg, Olkers op cit (n 65) 40.

<sup>113</sup> HB Falkena, LJ Fourie & WJ Kok *The South African Financial System* (1995) 68.

<sup>114</sup> Robert H Frank & Ben Bernanke *Principles of Macroeconomics* 2 ed (2004) 268.

systemic risk, and a system of sound and well managed banks and other financial institutions that are well versed in the monitoring of risks and in risk management.<sup>115</sup>

### **3.1.3.2 Powers and Functions**

The powers and functions of the South African Reserve Bank are those customarily exercised and performed by central banks, which powers and functions must be determined by an Act of Parliament and must be exercised or performed subject to the conditions prescribed in terms of that Act as given in s 225 of the Constitution.

For the reason previously stated, the powers of the Bank were already determined and enumerated in s 10 of the South African Reserve Bank Act 89 (Act 90 of 1989) as amended, and thus, the preservation of this Act fulfils the conditions prescribed in s 225 with regard to the Act of Parliament therein ordained. Furthermore, apart from these powers, s (11) and s (12) confer on the Reserve Bank powers of inspection with respect to banks and mutual banks.<sup>116</sup>

### **3.1.4 The structure of the South African Reserve Bank**

The structure of the South African Reserve Bank indicates that there is no significant change in the status of its initial ownership. The Bank is still a corporate body with its own assets and the right to sue and to be sued in its own name. The Reserve Bank, which was created as a public entity from its inception, was meant to play a non profit maximizing public interest role, and was established as such under the Government of the Union of South Africa.

Contrary to some belief that the bank is privately owned, the fact that some commercial banks participated in its initial capital has not changed its status as a public entity. Even though at this stage, one could get the impression that the South African Reserve Bank was a semi autonomous or semi public institution, but what happened later, came to change the whole picture because, as indicated earlier, the obligation for commercial banks to participate in the capital was later relinquished, and the structure of the Board was modified as a result. In reality, keeping those commercial banks on the Board could have constituted an embarrassment to the Bank when it would try to discuss matters concerning them.

Furthermore, the public character of the South African Reserve Bank is also reflected in s 34 of the Reserve Bank Act with regards to the allocation of the Bank's surplus income after certain prescribed expenditures have been provided for and dividends from the net profits have been paid to the

<sup>115</sup> HB Falkena et al op cit (n 113) 368.

<sup>116</sup> See, eg, Oelofse op cit (n 6) 238.

shareholders.<sup>117</sup> This surplus is divided by allocating 10% of it to the Bank's reserve fund and paying 90% of it to the Government.<sup>118</sup>

In addition, the Reserve Bank, which was once described as a relative rarity among central banks because its stock was listed at the Stock Exchange of Johannesburg,<sup>119</sup> is no longer active on this market because as from 2 May 2002, it has been delisted.

### 3.1.5 Administration of the Bank

The Bank is managed by a board of fourteen directors, consisting of a Governor, three Deputy Governors (one of whom is designed as a Deputy Governor) and three others who are all appointed by the Minister of Finance and seven Directors elected by the shareholders (sect 4(1)).<sup>120</sup> Of the elected directors, four represent commerce and finance, two industries, and one agriculture<sup>121</sup> in the sense that they should be, or should have been primarily and actively engaged in these various pursuits.<sup>122</sup> In this regard, it was further observed that 'the board represents a variety of interests, which will induce the Bank to take all those interests into consideration in the formation of its policy and the board does not merely function as an instrument of the government'.<sup>123</sup>

Furthermore, in terms of s 4(2) (a), the Governor must be a person of tested banking experience. However, nothing is said about the rest of the governors in relation to their competence and experience. It may probably be implied that they should have suitable qualifications.

To preserve the independence of the Bank, nobody may serve as a director if he is a director, officer or employee of a bank or a mutual bank, if he or she is not residing in the Republic, or if he or she is a Member of Parliament or a member of certain other government institutions as per s 4(2) (a) and s 4. It is also specified that no person shall be appointed or elected or remain a director if he or she is a Minister or a Deputy Minister in the Government of the Republic or if he or she is a Member of Parliament.

Furthermore, like the Bundesbank, s 35 of the Reserve Bank Act gives the Board a ruling power to avoid bureaucracy of state machinery<sup>2</sup>, and give the bank flexibility to adjust its operations to changing times.<sup>3</sup>

<sup>117</sup> See, eg, Oelofse op cit (n 6) 245.

<sup>118</sup> Ibid.

<sup>119</sup> Falkena et al op cit (n 113) 63.

<sup>120</sup> Oelofse op cit (n 6) 236.

<sup>121</sup> See, s 4(3) (a).

<sup>122</sup> Falkena et al op cit (n 113) 63.

<sup>123</sup> Ibid.

and also act swiftly in the light of circumstances. This is another way of strengthening its administrative independence.

Similarly, in order to achieve high performance in the discharge of its duties, the South African Reserve Bank is expected to apply modern techniques of corporate governance to make sure that the interests of all the stakeholders are accommodated, and are effectively protected in line with the theory of corporate law that 'directors must consider and balance the interest of several constituencies, such as customers, employees, creditors, suppliers and the environment, each of which has a legitimate stake in the company's development and activities'.<sup>124</sup>

### 3.1.6 Tenure and conditions of office of directors

The independence of the central bank is an abstraction; the reality is the people behind it. It is therefore the duty of the law to protect them, and determine how this independence will be translated into reality. One of the measures conceived is the security of tenure of the directors during the period of their office. As seen earlier, within the framework of the SARB, the Governor and the Deputy Governors hold office for a period of five years, and the other directors hold office for a period of three years as stipulated in s 5 of the South African Reserve Bank Act. A director is eligible for reappointment or re-election as the case may be after the expiry of his term of office (s 5(2)). This article read together with s 5(3) spells out that the directors (including the Governor and Deputy Governors) shall hold office upon such conditions of remuneration (including allowances) as may be determined by the Board, and upon such other conditions as may be prescribed by regulation. Some observers think that the security of tenure of the directors is still to be more clearly defined.

For example, in the case of the Bundesbank, it is clearly stipulated that the members of the Bundesbank Directorate cannot be removed from office before the end of their term; except for reasons which lie in their person and if the initiative comes from themselves or the Central Bank Council.<sup>125</sup> Concerning the period of tenure, the general observation is that 'a long period of office may induce a lethargic management of monetary policy'.<sup>126</sup> But, it is also thought that governors of central banks should enjoy certain stability because it is argued that 'rapid turnover of central bank governors indicates a lower level

<sup>124</sup> Michele Havenga 'Social Responsibility-Only a Company's Duty'? (2006) 47 *Codicillus* 1 64.

<sup>125</sup> Lastra op cit (n 2) at 485.

<sup>126</sup> Brentford op cit (n 44) at 93.

of independence'.<sup>127</sup> Therefore, it is not good to change central bank governors every time governments change.

The protection of the Board members of a central bank is favoured by many; for example, some experts take the view that to protect the independence of a central bank, the governor and the board of directors should be guaranteed a sufficiently long term of office.<sup>128</sup> Furthermore, it is also maintained that 'short terms of office could make them vulnerable to dim-sighted political pressure because of the uncertainty around the possible extension of their appointment'.<sup>129</sup>

Similarly, it is further observed that in some countries, there is a tendency for some political authorities to pick governors who will toe the line, and act according to their wishes, and fire those who dare to legitimately challenge their decisions. This would amount to what Lastra calls appointment on the basis of patronage, which according to her, undermines the purpose of independence of central banks.<sup>130</sup> If this situation were to be allowed to happen, the independence of central banks would remain a legal idealism while the situation is the other way round.

However, this issue has remained controversial; as some commentators take the view that 'the independence of the central bank will be enhanced: if the governor is not appointed by government, the governor is appointed for more than five years, the board is not appointed by government, or if more than half of the board members are appointed independently of government and the board is also appointed for more than five years'.<sup>131</sup>

While this general observation may sound correct in some respects, to be realistic, it may not always be possible to ignore totally the political aspect in the appointment of governors of central banks; as public institutions, most of time, they are anchored in constitutions or statutes of various countries; what is

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<sup>127</sup> Jacob de Haan & Willem J. Kooi 'Does central bank independence really matter? New evidence for developing countries using a new indicator' (2000) 24 *Journal of Banking & Finance* 644.

<sup>128</sup> Wessels op cit (n 26) 258.

<sup>129</sup> Ibid.

<sup>130</sup> See, eg, Lastra op cit (n 2) at 483.

<sup>131</sup> Ibid. With regard to this issue, a study, which has been conducted in 2004, indicates that in general, 'the executive branch of government is involved in the appointment of monetary policy authority decision makers in many countries, apart from Canada, where the central bank chooses the head of the Bank of Canada although the Minister of Finance must approve the board's decision. In Japan, and the United States, the Diet and Congress have statutory powers to veto the appointment. In the case of the European Central Bank Article 112(b) of the Treaty establishing the European Community states that 'the European Parliament needs to be consulted before the appointment of the ECB executive board members by Head of States and Governments. In other countries, parliaments do not possess such vetoes' (See, eg, Jonathan Lepper & Gabriel Stern *Parliamentary scrutiny of central banks in the United Kingdom and overseas*, [www.bankofengland.co.uk/qb020302.pdf](http://www.bankofengland.co.uk/qb020302.pdf) [visited on 22.10.2004]).

needed is the possibility of selecting and vetting candidates from within or from without political circles; and appoint credible people with tested experience, high ethical standards and academic qualifications.

### **3.1.7 Financial control and cooperation with the Minister of Finance**

As seen above, cooperation between the Reserve Bank and the Minister in charge of financial matters is a constitutional obligation, one of the duties of the latter is to ensure that the finances of the Bank are efficiently managed; to reach this target, the shareholders are entitled to elect two firms of public accountants to act as auditors of the Reserve Bank in terms of s 30(1) of the South African Reserve Bank Act; especially so because in terms of s 31 of the Act, the Reserve Bank also has a duty to inform the Minister of Finance about its financial standing. This is mainly carried out through its annual financial statements.

In this connection, it is further maintained that any imperfection noticed in the management of the Bank by the Minister of Finance may be drawn to the attention of the Reserve Bank and the Board, which are obliged to remedy the default. If the Board does not comply, the minister may apply to the Supreme Court for an order to compel the Reserve Bank to remedy the default in accordance with s 37 of the Reserve Bank Act 89 (Act 90 of 1989) as amended.

In addition, the Minister of Finance may, at any time, cause an investigation to be made into the affairs of the South African Reserve Bank by one or more officers of the Department of Finance as per s 30(2) of the South African Reserve Bank Act. The providing of the information constitutes a kind of accountability by the authorities of the Reserve Bank to the Executive Branch of the State.

### **3.1.8 Inflation targeting by the South African Reserve Bank**

The mainstream of experts in this area is in agreement that curbing inflation is not the only macroeconomic variable used to maintain growth and sustainable economy. However, they also recognize that it remains one of the major aspects of economic and financial stability. This is why many countries attach great importance on that. For example, the agreement between the Government of New Zealand and the Reserve Bank of New Zealand is premised on inflation targeting. Similarly, the granting of independence to the Bundesbank was an attempt to fight against hyperinflation, which prevailed in the country.

Furthermore, experts are also unanimous that inflation is a wild animal to be tamed by all means. Since central banks are generally entrusted with the carrying out of this task, it is therefore the duty of every governor with his or her team to meet the primary objective of their respective institutions. In this regard,

in the context of the SARB, it was declared that ‘within the framework of its anti inflationary strategy, the Bank has continued its practice of setting year to year target, now called guidelines’.<sup>132</sup> Although these guidelines were informal in their nature, it appears that ‘South Africa formally adopted an inflation target monetary policy on February 2000 when the Minister of Finance announced an inflation of three to six percent to be achieved by 2002’.<sup>133</sup>

The same source reveals that ‘this came as a result of a creeping inflation and an increase in external deficits that were to be brought under control through restrictive monetary policy’.<sup>134</sup> Even though this was a political statement, and not a legal enactment, nevertheless, it has had a positive impact at international level because currently ‘South Africa is categorized as an inflation targeting country’<sup>135</sup> and listed among the countries with full-fledged inflation policies’.<sup>136</sup>

### 3.1.9 Financing of deficit by the South African Reserve Bank

Financing deficit of governments by central banks has always been a vexed issue, some experts consider that it should be prohibited at all cost, others estimate that it should be tolerated, but their common view is that it should preferably be avoided or in the event of extreme necessity, when other means have proved impossible, it should be strictly regulated. Within the framework of the South Africa Reserve Bank, it was said that the adoption of a more market oriented approach in implementing monetary policy in the 1980s led to the extensive use of public debt management by the Bank in close cooperation with the Treasury.<sup>137</sup> In this connection, it was also declared that the objective of debt management operations is to finance “the so called “deficit before borrowing and debt repayment” of the Exchequer in a non-inflationary manner, as well as to exert better control over liquidity in the economy.”<sup>138</sup>

However, it is convenient to make it clear that funding deficit does not necessarily mean printing money because the general observation is that monetisation of government debt occurs when any deficit in a government budget is funded directly (normally by printing money) by the central bank. A deficit itself

<sup>132</sup> Falkena et al op cit (n 113) 369.

<sup>133</sup> Emmanuel Ating Onwioduokit West African Institute Options for a Common Monetary Policy in Conference Proceedings Monetary Policy in Framework Africa For the Second Monetary Zone in West Africa (2001) 260. Since inflation targeting was first introduced in 1990 in New Zealand; the framework has been adopted by a number of countries such as Canada (1991), the UK (1992) and Sweden (1993), Chile (1991), Israel (1999), and South Africa (2000). For further details, see also Anton Casteleijn *South Africa Monetary Policy, Framework in Conference Proceedings, Monetary Policy Framework Africa* (2001) 211.

<sup>134</sup> Ibid.

<sup>135</sup> See, Fraser op cit (n 38) at 8.

<sup>136</sup> Ibid.

<sup>137</sup> Falkena et al op cit (n 113) 59-60.

<sup>138</sup> See, eg, Falkena et al op cit (n 113) 60.

does not therefore imply monetisation of government debt. For example, the central bank may use its reserves or recommend recourse to other means of outsourcing of the required funds to plug the shortage.

In addition, the South African Reserve Bank holds current accounts for State departments and other government bodies and institutions.<sup>139</sup> In this capacity, 'it operates as a commercial bank for the State and its agencies. Instruments of payment from those institutions are collected and honoured by the Bank. The Bank grants loans and advances to the State'.<sup>140</sup> It derives this power from s 10(f) of the South Africa Reserve Bank Act. Furthermore, the South African Reserve Bank acts as an agent and an advisor to the government.<sup>141</sup> Therefore, it is expected that if the situation of funding deficit could arise, the Bank would be in a better position to advise the government to adopt proper financial structural adjustments in this sector.

One of the ways often suggested is the raising of money in the open market; this practice entails the buying and the selling of government securities by the Reserve Bank in the open market at the Bank's discretion in order to regulate the money supply or pattern of the interest rate.<sup>142</sup> It is further explained that these transactions are called open market operations because the Bank is prepared to deal with any interested party.<sup>143</sup> Although these transactions are generally [emphasis added] undertaken to achieve long term monetary objectives, a secondary objective may be to iron out temporary money market fluctuations caused for example, by agricultural crop financing, tax payment to the Exchequer or change in the net gold and other foreign reserves.<sup>144</sup>

Similarly, by way of comparison, in most industrialised countries, whether formally recognising the idea of the independence of central banks or not, it is said that 'government's access to borrowing from the central bank is governed both by central bank laws and regulations implementing them'.<sup>145</sup> A prohibition or limitation on financing the public sector's deficits or monetising public debt is a classic indication of the economic independence of central banks.<sup>146</sup> In addition, limiting the extent to which central banks can finance the government acts as a brake on the latter's budgetary policies, and encourages economic rectitude.<sup>147</sup>

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<sup>139</sup> Oelofse op cit (n 6) 242.

<sup>140</sup> Ibid.

<sup>141</sup> Ibid.

<sup>142</sup> Falkena et al op cit (n 113) 60.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

<sup>145</sup> Lastra op cit (n 2) at 490.

<sup>146</sup> Ibid.

<sup>147</sup> Cranston op cit (n 1) 130.

For example, in Germany, the Bundesbank can intervene when the government is confronted with a temporary shortage of liquidity and establish the ceiling beyond which the Bundesbank can grant credit to government. While financing a deficit is the sovereign decision of every country, it is clear that there has to be a legal framework defining this practice. This avoids situations where deficits have led some countries, such as Brazil and Mexico, to a structural inflation almost impossible to absorb.<sup>148</sup>

Furthermore, it is believed that one of the reasons that the International Monetary Fund (IMF) is pushing the cause of central banks independence among its member states is to encourage and maintain acceptable financial benchmarks and avoid funding inflationary budget deficits.<sup>149</sup>

### **3.1.10 External Cooperation and debt management**

The South African Reserve Bank maintains internal relations with other central banks and international financial institutions especially the Institutions of Bretton Woods. For example, the Governor of the Reserve Bank is the South African representative on the Board of Governors of the International Bank for Reconstruction and Development (IBRD), commonly known as the World Bank. One of the objectives of this institution is the encouragement of capital formation and provision of technical assistance to the developing countries.<sup>150</sup> This may perhaps constitute another source of getting money in the form of subsidies or loans to face temporary shortages of cash,<sup>5</sup> or turn the economy around in times of crisis.

Likewise, it is also said that there is a close cooperation between the South African Reserve Bank and the International Monetary Fund (IMF), which is generally concerned with financial arrangement and assistance within state members. The South African Reserve Bank is actively involved in regular consultations conducted by the Fund's staff with South Africa as a part of their surveillance of member state economies. The Bank administers South Africa's accounts with the IMF.<sup>151</sup> The same grants or loans, like the ones expected from the World Bank, may be provided in case of necessity.

However, some critics have charged that the IMF has required recipients of its loans to follow economic policies, such as tight monetary policies and fiscal cut backs that have turned to be ill-advised.<sup>152</sup> Others have claimed that the IMF loans help foreign financial investors and the richest people in the countries

<sup>148</sup> See, eg, Etienne Douat *Finances Publiques* 1 ed (1999) 206.

<sup>149</sup> See, eg, Cranston op cit (n 1) 120.

<sup>150</sup> See, Falkena et al op cit (n 113) 64.

<sup>151</sup> Ibid.

<sup>152</sup> Frank & Bernanke op cit (n 114) 495.

receiving the loans, rather than the average person.<sup>153</sup> The loan granted in 1998 to Russia was referred to as an example.<sup>154</sup>

In the same breath, the South African Reserve Bank also became a member of the Bank of International Settlements (BIS) on June 1971. The BIS was established in order to increase the cooperation between central banks and to act as an agent in respect of international payments.<sup>155</sup> The importance of this institution as a centre of international monetary cooperation and research has increased considerably during recent years. Within this framework, central bank governors meet regularly to exchange ideas and discuss about monetary current issues. Those meetings may sometimes culminate in joint action and in assistance to cope with emergency where it arises.<sup>156</sup> This institution may also constitute another source of funding and a proper forum of exchange of ideas in the event of crisis.

### **3.1.11 The Financial and Fiscal Commission**

Generally, fiscal policy and monetary policy are two sides of the same coin. Although the Reserve Bank formulates and monitors money supply in the economy, the collection of taxes belongs to the Government. This is the reason why their harmonious cooperation helps combat inflation on several fronts, thereby preserving the integrity of the national currency and promoting economic growth as required by the Constitution.

The Constitution of South Africa recognises this in ss 220-222 by creating the Financial and Fiscal Commission in charge of making sure the two policies converge in the efficient handling of financial matters. 'It is also said that the Commission makes recommendations to both Parliament and the provincial legislatures. This removes the impression that people have that the South African Reserve Bank works in isolation from fiscal and other macroeconomic goals of government'.<sup>157</sup> The independence of the central bank in financing debt will depend on the outcome of the deliberations of the Commission.

### **3.1.12 Accountability and transparency**

#### **3.1.12.1 Accountability**

Before examining the accountability within the South African Reserve system, it is convenient to get a clear notion of the principle and see how it is applied in some other jurisdictions. In fact, accountability

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<sup>153</sup> Ibid.

<sup>154</sup> Ibid.

<sup>155</sup> Ibid.

<sup>156</sup> Falkena et al op cit (n 113) 64.

<sup>157</sup> Chris Stals *The Independence of the Central Bank and Monetary Policy* (1998) 1.

is the quality or state of having someone to report to, or of being answerable to somebody. Someone is accountable when he or she has been given a free hand to do what he or she is required to do, but is still expected to explain his actions and decisions to an accounting authority. Within the context of state officials, accountability is the ability of the public to hold government officials responsible for their actions.<sup>158</sup>

One of the aspects of accountability is the formal duty to justify what has been done. In its Code of Good practice on Transparency (Section IV), the International Monetary Fund (2000) argues that officials of the central bank should be available to appear before a designated public authority to report on the conduct of monetary policy, explain the policy objectives(s) of their institution, describe their performance in achieving their objectives and as appropriate, exchange views on the state of economy and financial system.<sup>159</sup>

Similarly, within the framework of the European Union, it is also observed that 'although independence is one side of the coin, a central bank also must be accountable in a democratic state'.<sup>160</sup> It was further maintained that such accountability should be diversified, including both parliamentary control and control by the executive and judicial bodies.<sup>161</sup>

### **3.1.12.2 Accountability before executive organs of the state**

With regard to accountability to executive body, it is said that to avoid undemocratic state within a state, the central bank should provide certain information, reports and advice to the government upon demand.<sup>162</sup> There are a number of countries where such accountability is applied, such as Germany, the United States, and the European Union. For example, the Maastricht Treaty stipulates that the ECB shall provide quarterly and annual reports, as well as weekly consolidated financial statements to EC bodies. These reports are to be made available to interested parties free of charge.<sup>163</sup>

### **3.1.12.3 Accountability before legislative bodies**

Accountability to legislative body means that the central bank should provide an ex post justification of its actions. Parliament would not be allowed to change decisions that are made legally, and therefore, its

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<sup>158</sup> Patterson op cit (n 42) 448.

<sup>159</sup> Lepper & Stern op cit (n 131) at 279.

<sup>160</sup> Lastra op cit (n 2) at 497.

<sup>161</sup> Ibid.

<sup>162</sup> Ibid.

<sup>163</sup> Ibid.

supervision would mean that the central bank must simply account for its actions both before parliament and in front of the country.<sup>164</sup>

In the context of the Reserve Bank of South Africa, the exchange of ideas is generally carried out at the level of the Parliamentary Portfolio Committee acting on behalf of the House. It may ordinarily result in a praise to the Bank if the representatives of the people are satisfied by the work, or a reprimand if they are not. Corrective measures may be recommended by the House and the Governor (who bears administrative responsibility) and the Minister of Finance (who bears political responsibility) cannot ignore them with impunity.

#### 3.1.12.4 Accountability to judicial institutions

With regard to accountability before the judiciary, there is no Court of Auditors in South Africa, like it is the case in the European Union<sup>165</sup>; much of the Republic financial control is carried out by the Office of the Auditor General as per s 188 of the Constitution. Although there is no accountability before judicial institution, this does not weaken the capacity of control by Auditor General. In addition, in s 188 (2) (a) it

<sup>164</sup> Ibid.

<sup>165</sup> Within the context of the European central banking system, it is declared that 'the judiciary should control the lawlessness of the Central Bank's operations and decisions in the fulfillment of its functions. The Court of Auditors should control the accounts of the Central Bank in order to avoid lack of transparency, particularly if the Bank enjoys budgetary and financial autonomy (see, Lastra op cit (n 2) at 500). However, this does not mean that a judicial control system is necessarily better than the control effected by a General Auditor as it is applied in a great number of commonwealth countries; it is a matter of option, but at international level, institutions of control are coming closer; and in this regard, there is an effort of harmonization of international auditing standards within the framework of the International Organization of Supreme Audit Institutions (INTOSAI). In terms of Article 1 of the Statutes of the Institution, INTOSAI is an autonomous, independent and a non political organization established as a permanent institution in order to foster the exchange of ideas and experiences among the Supreme Audit Institutions on government auditing. Its Headquarters are in Vienna. Furthermore, in Article 2, it is specified that 'INTOSAI shall maintain its present link with the United Nations Organization' ([http://www.intosai.org/en/portal/about-us/statutes/index.php?article\\_pos=1](http://www.intosai.org/en/portal/about-us/statutes/index.php?article_pos=1)). [Visited on 29 June 27, 2009].

In addition, Article 1 (*supra*) also specifies, *inter alia*, that participation as a full member in its organs and exercise of functions are open to the Supreme Audit Institutions of all countries, which are members of the United States Organization or any Specialized Agencies; and the Supreme Audit Institutions of those supra national organizations, which are subject of international law; and endowed with a legal status and an appropriate degree of economic, technical/organization of financial integration (ibid). In countries where courts of auditors exist, central banks, like any other legal entity in which the state has full ownership or is a leading shareholder, are audited by those courts; and before the passing of the financial bills of the year, the reports of the Courts of Accounts are sent to Head of States or Governments; and then presented to parliaments with ample coverage by the media for the public to be informed about the overall management of public finance (see, eg, Maurice Duverger op cit (n 65) 415). Judges at those institutions are mostly highly qualified and experienced former civil servants from the Ministry of Finance, experienced accountants and lawyers specializing in financial law. On top of ensuring the auditing of public accounts, those courts are also empowered to judge all public accountants with regard to proper handling of the funds in various ministerial departments. For example, in France, the Court of Accounts is a prestigious institution and it is provided for in Article 47 of the Constitution of 1958 as amended, which proclaims, *inter alia*, that the Court of Accounts (*Court des Comptes*) assists Parliament and the Government in the control of the proper implementation of public budgets voted every year. The main duties of the Court are to conduct financial audits of accounts, conduct good governance audits, and provide information and advice to Parliament and Administration (ibid).

is said that the General Auditor has jurisdiction on any institution funded from the National Revenue Fund or a Provincial Revenue Fund or by a municipality; or (b) any institution that is authorized in terms of any law to receive money for a public purpose. Furthermore, in terms of s 188 (3), the Auditor-General must also submit audit reports to any legislature that has a direct interest in the audit, and to any other authority prescribed by national legislation. In view of this, there are many common features in the two systems, and the end result seems to be the providing of information to the legislatures that represent taxpayers. Therefore, the above exposition of the functioning of courts of accounts is simply given in comparative perspective.

### 3.1.12.5 Accountability and election of monetary authorities

Accountability and transparency are closely related to democratic doctrines stipulated in most constitutions. A constitution defines different organs of a State and their mode of cooperation in the best interest of the people. When people vote for their leaders, they expect better services and visionary leadership. A leadership that is capable of building up strategies of prudence, promotes good governance, and upholds the rule of law; if they do not, they should be brought to account before the relevant authority. As such, 'governments must first and foremost be held accountable by the people themselves in any given country'.<sup>166</sup> It is also maintained that 'people will have confidence in public institutions only if they can be assured of their honesty and of being served in a transparent manner, and if there are mechanisms through which they can hold governments accountable'.<sup>167</sup>

It is true to declare that in a representative democracy, the elected are responsible to the public, which holds them accountable, at least through the electoral process; a fact, which is not applied to monetary authorities. Consequently, there is a current opinion holding that those monetary authorities should also be elected and raise a number of issues; as one expert puts it 'can it be right that a bank governor not elected by the people and not answerable to voters at all, has so much power over them and their lives?'<sup>168</sup> It is not only in South Africa where the issue is raised; this was also the case in the European central banking system where it is reported that 'the main argument against central bank independence is that an institution, which is free from the direct effect of political control, lacks democratic legitimacy'.<sup>169</sup>

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<sup>166</sup> Bience Ganawas 'The Role of the Ombudsman' The World Bank Comprehensive Legal and Judicial Development towards an Agenda for a Justice and Equitable Society in the 21<sup>st</sup> Century', in RV van Puymbroeck (ed) (2000) 45.

<sup>167</sup> Ibid.

<sup>168</sup> H Preece 'Central Questions Does SA Want a Reserve Bank Independent of Government?' (1991) 49 *Financial Week* 7 16.

<sup>169</sup> Lastra op cit (n 2) at 478.

In South Africa, this issue was in the air before the existence of the Constitution.<sup>170</sup> It still lingers even after the promulgation of the Constitution. This means that the issue still remains controversial, and every group provides its own reasons for supporting or opposing the idea. The South African monetary authorities are aware of the criticism.<sup>171</sup> The answer provided by some of them to justify their non-election is once again by way of analogy to the judiciary; in this connection, it has been said that 'some governmental agencies enjoy independence even though, in general, their members are not submitted to elections like politicians; there are plenty of other areas of national life where decision making is delegated to independent but unelected officials; the judiciary is a prime example'.<sup>172</sup>

Despite the legal independence of the Bank, the authorities are also aware that 'independence does not mean lack of accountability'. According to some of them, 'no central bank can totally be independent in the sense that it is not answerable to anyone';<sup>173</sup> it is further argued that 'even the most autonomous central bank has to report in some form or another to the legislature, which in any case has the ultimate power to change the laws governing the central bank'.<sup>174</sup> Another perceived danger by those who are against electing them is the fact that elected monetary authorities may be subservient to people who have funded their campaigns instead of acting independently and transparently.

Finally, while a country may make an option of a representative democracy in which the people participate in the decision making not directly but indirectly through the election of officials to represent their interests,<sup>175</sup> not all institutions are submitted to this process. For example, under the American Constitution, it is declared that 'the framers, after long debates over this issue, decided that federal judges and justices would rather be appointed than elected'.<sup>176</sup> They would be nominated by the President and confirmed through the approval of the Senate. Once confirmed, they would hold office during good behaviour. In effect, they would be allowed to hold office for life unless they committed a crime.<sup>177</sup> This is probably not the kind of guarantee sought for central bankers.

While some current opinion holds the view that central bankers should be appointed, not elected, and probably approved by parliaments, there is no example in the world where governors are allowed to hold their office for life like judges; rather, their tenure is of a limited duration; their professional guarantees

<sup>170</sup> There is a group opinion which thinks that 'all institutions controlling or influencing policy must be under democratic control, and is sharply opposed to the privatization of the SARB (see, eg, H Preece op cit (n 56) 57).

<sup>171</sup> Tito T Mboweni 'Central Bank Independence' (2004) *BIS Review* 88.

<sup>172</sup> Mboweni op cit (n 171) at 4.

<sup>173</sup> Ibid.

<sup>174</sup> Ibid.

<sup>175</sup> Patterson op cit (n 158) 50.

<sup>176</sup> Patterson op cit (n 158) 51.

<sup>177</sup> Ibid.

should therefore remain within that period. In the final analysis, it was also said that the judiciary should be more of a guardian institution.<sup>178</sup> Similarly, central banks may also be considered guardian institutions, with members probably not needing to be elected. Whether elected or not, what is expected from all of them is accountability and transparency as public trustees.

However, in general, there are some experts who think that there are still some shortcomings in the way the South African Reserve Bank is made accountable. In their opinion, the Bank should be given a legal framework that would lead to more accountability and transparency and that the South African Reserve Bank does not as yet prescribe a completely transparent framework for monetary policy<sup>179</sup> on the grounds that 'the Act does not specify what level of inflation offers sufficient price stability, and does not specify the benchmarks against which the performance of the South African Reserve Bank can be judged when called before Parliament'.<sup>180</sup> For them, the pronouncements of relevant monetary authorities on the level of inflation should be translated into statutory or administrative guidelines to give them a compelling character.

### 3.1.13 Transparency

In some financial or political literature, the terms accountability and transparency are used interchangeably, but while accountability compels fiduciary authorities to appear before relevant authorities and bodies, transparency is concerned with the reporting of essential information to the public so that people may know what is going on in their departments. The common perception is that people who are in charge of the implementation of monetary policies should not only keep account of their actions, but also provide some financial information. Within the framework of the South African Reserve Bank, the term transparency is a vital tool for fulfilling this accountability requirement. The rationale is that the essential actions and strategies of the South African Reserve Bank should be communicated to the public in general, and to its clientele in particular. In this way, it is thought that the South African Reserve Bank will be able to retain broader public support and will help the financial market operate more efficiently.

In this regard, as seen earlier, pursuant to s 31 and s 32 of the South African Reserve Bank Act, the Governor must submit an annual report relating to the implementation of monetary policy by the Bank to the Minister in charge of national financial matters; at the same time, he must furnish detailed information to the Department of Finance and to Parliament concerning the financial activities of the Bank. Some information, such as statements of assets and liabilities, must be sent on a monthly basis. The Department

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<sup>178</sup> Ibid.

<sup>179</sup> Casteleijnin op cit (n 133) 213.

<sup>180</sup> Ibid.

of Finance has a duty to publish every return received annually from the Bank in the Government Gazette. It is further stated that although the Governor sends his report to Parliament, the Minister must as well do so to Parliament; he must present a copy of the report sent annually to him by the Governor within fourteen days after its reception, if Parliament is then in ordinary session, or within fourteen days after the commencement of its next ordinary session as per s 32(3). By informing the people, the public can help shape up the formulation and implementation of delivery of monetary policy. This is a way to keep the public informed about the financial situation of the South African Reserve Bank and providing opportunity to the Government to monitor the activities of the Bank. The Government must make sure that the Bank acts within the limitation of the Reserve Bank Act.<sup>181</sup>

### **Conclusion**

This work has explored essential elements of the legal foundations of the independence of central banks in general, and the legal independence of the South African Reserve Bank in particular. The common denominator of the mission of central banks is to keep inflation under control. A central bank, also called reserve bank in some countries, is an institution in charge of monetary policy of a given country. The primary objective to achieve this is the maintenance of price stability; in other words, it is fight against inflation on a continuous basis. To allow central banks reach this goal, many countries have granted certain degree of autonomy by delegating some powers to them. In some others, such autonomy is reflected in constitutions, others in charters or statutes.

The main idea of the independence of central bank is to invite the relevant authorities to exercise self restraint. These institutions must also make sure that there are no reckless and fraudulent practices likely to affect the stability of currencies of their countries. Central banks must also make sure that the borrowing by governments follows certain and clear criteria, and guidelines to avoid unnecessary expenditure. An overview of some institutions, such as the European Central Bank, the Bundesbank, the Reserve Bank of New Zealand have been made,<sup>181</sup> and the maintenance of price stability is their main common denominator as well as the conduct of their activities with a certain degree of autonomy. But given the nature of the institution and state structure and functioning, the authorities of those institutions have a duty to cooperate with their respective governments for more coordination in this area.

With regard to the South African Reserve Bank, its independence is rooted in the Constitution. This means that the people of South Africa have found this independence to be a value to be protected at a higher level, that is, the Constitution. This is especially due to the fact that the Constitution is not easily

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<sup>181</sup> See, Oelofse op cit (n 6) 245.

amendable. In the event of any amendment, which is always possible due to the inherent constituent power of the people to change the Constitution as they think fit, there should be a compelling reason for doing so. In the same breath, the people should also make sure that the independence is effectively implemented and, at the other end of the spectrum, check whether the Bank has not abused that power. In order to make effective its independence, the Bank was given the power to formulate and implement monetary policy, while the Executive Branch of the State determines and implements fiscal policy. For harmonious functioning among monetary authorities, regular consultations are held between the Minister of Finance, the Governor and other relevant ministries. All these meetings on monetary and fiscal policies are coordinated and different opinions are taken into consideration for the smooth running of the overall economy. The legal independence of the South African Reserve Bank requires that the financial objectives should be clearly defined in law. The purpose of this clarity is to afford the South African Reserve Bank the opportunity to react efficiently when the economy sends wrong signals, and thereafter come up with appropriate solutions in due time. The legal independence of the South African Reserve Bank also means that the Bank has its own structures, and is allowed to cooperate with the government in setting up its monetary targets as well as having the instruments to achieve them. It also signifies that the Bank will not be forced to finance budget deficits without justification, and will be given latitude to screen and appoint highly qualified people to administer the Bank without any interference.

The independence means that the Governors and the Board should have security of tenure during their mandate so that they may feel little political pressure, if any, in the discharge of their duties. The work has also outlined that the Bank is not a power within a power; it should be considered a guardian institution for the life of the currency and for the sake of a healthy economy. Despite its legal independence, the Bank is also expected to account for its actions before Parliament, and it has a duty to report and communicate pertinent information to the public, bearing in mind that, in its capacity as a bank, it is also held to the banking duty of confidentiality in terms of s 33 of the Reserve Bank Act. It should not, however, hide behind this to withhold crucial information needed by different bodies. Although central banks are granted legal independence, the reality is that they do not operate in vacuum; they follow macroeconomic policies and targets set up by their governments; while the judiciary may take an independent position vis a vis the Government; it is not so easy for the Governor to take the same stand because the Constitution requires him or her to work in consultation with the government.

The independence of central banks may be understood within the concept of the division of labour for efficiency and effectiveness. The Government and the Bank should work as close allies because both of them act as agents; the real masters are the people they serve. It has been shown that the legal foundation of the independence of central banks is either in constitutions, in charters or in other contractual

arrangements. In this regard, it is said that however elegantly worded or drafted, the legal stipulation may be dead letters if the government's attitude or the general socio political climate do not support it. The (officially required) objective, recommendations and advice of the central bank will have no practical relevance if, in practice, they are not accepted by government. What is more important is a deeply rooted respect and a reputation for objectivity and technical competence on the part of the central bank to resist the pressure of political expedience.<sup>182</sup> But whether a bank is independent or not, the reality is that it is not severed from the executive branch, which assumes the ultimate responsibility of the nation.

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<sup>182</sup> See, Wessels op cit (n 26) at 262.

**Appendix One: List of main abbreviations used in the work**

SARB	The South African Reserve Bank.
ECB	The European Central Bank.

**Appendix Two: List of main statutes**

The Constitution of the Republic of South Africa Act No 106 of 1996.

The South African Reserve Bank Act No 90 of 1989 as amended.

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