Let's have a constructive debate on the role of the Reserve Bank

By Vishnu Padayachee

Vishnu Padayachee is Distinguished Professor and Derek Schrier and Cecily Cameron Chair in Development Economics, School of Economics and Finance, University of the Witwatersrand.

The Reserve Bank has ensured that South Africa has not had a general banking crisis in 100 years – but that impressive achievement should not insulate it from debate on what its role in the economy and society needs to be. Today, as coronavirus and climate change add to problems of inequality and limited development, Prof Vishnu Padayachee argues this debate is too important to be left to central bankers and economists alone.

I was asked to reflect on the rather unsatisfactory current political debate about South African Reserve Bank (SARB) independence and related issues in the context of the economic challenges that continue to face South Africa.[1] There is nothing wrong with debating a central bank's role in any country at any time but there are constructive ways to do this and many problematic ones. The noise about the SARB comes from the Economic Freedom Fighters (EFF) and some quarters of the ANC, such as the Radical Economic Transformation crowd. My assessment, however, is that neither the ANC nor the EFF has a clear enough sense of what changes they would like to make to the Bank, based on clear theoretical or policy and evidential arguments. What we have instead is posturing and the trading of insults. This is regrettable because a sensible, informed and respectful debate about the role, mandate and ownership of the SARB is well overdue.

The negotiations for a democratic South Africa in the 1990s did not give sufficient attention to determining the role and independence of the SARB and monetary policy in general (Padayachee and Van Niekerk, 2019). Significantly, there was no proper public participation on this matter at that time or since, compared for example to the process that led to increased Colombian central bank independence in the early 1990s (Clavijo, 2000). As a result post-apartheid South Africa has been saddled with a central Bank that is simply not playing the kind of developmental role in promoting growth and employment, and in reducing inequality, that all committed to social and economic justice in South Africa might have expected.

How did we get here?

DEBATING CENTRAL BANK INDEPENDENCE AND RELATED POLICY ISSUES

Central banks do not deserve nor require special protection from criticism. But here are some framing principles for such a public discussion.

First, I would contend that there is no such notion as central bank independence (CBI) in any real objective sense. Nominally independent central banks in modern economies have to interact in complex ways with a variety of stakeholders. The post-Keynesian economist, Randall Wray, states that, "the quaint notion that the central bank is above the fray, formulating policy in an objective manner, free of ideological considerations, is patently absurd given

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what we know about actual policy formation" (2007). As Gerald Epstein, an economist at the University of Massachusetts-Amherst, said more recently, central banks are a "contested terrain" over which major economic and political groups fight for control (2019).

Second, I contend that CBI, to the extent that it is a desirable goal, can best be buttressed by societal support and not just by legal prescripts. In his 2018 book, *Unelected Power,* Paul Tucker, who served more than 30 years as a central bank executive, argues that while legal underpinnings for CBI are of course crucial, for CBI to be sustainable, "society must support it ... that requires debate, and so scrutiny ... [W]hether we think of them as wise and virtuous or as purely self-interested, sensible central bankers will want to invest in reasoned debate and criticism of their policies" (2018: 422).

Central banks have evolved in the face of the enormous changes in the world since the first, the Bank of England, was set up in 1694. This evolution continues today at central banks all over the world as debates rage about their role, structure and functions. Contemporary concerns around wealth and income inequality as well as climate change have joined traditional concerns around price and financial stability (and in some cases) growth and employment within the broad objectives of central banks. Today (from the USA to India and Turkey) central banks are the subject of contestation (to put this mildly) – their very existence, independence, mandate and ownership are the subject of on-going public debate and the world has not come to an end. This is normal. And South Africans should not shy away from questioning their central bank and how it operates.

A BRIEF HISTORY OF THE SARB

The South African Reserve Bank was born in June 1921 in controversial circumstances. Sentiment within the then Union of South Africa was deeply divided about whether a typical (regulatory) central bank was needed as opposed to a more lending-focused state bank. Private banks had to that point had the right to issue coins and notes and they were reluctant to cede these functions to a new institution such as a reserve bank.

The SARB was a key actor in the international Gold Standard debates of the 1920s and early 1930s and it played an important role in contributing to the growth of the South African economy after World War II. It was a major force in the fight against inflation after 1971, but the Bank remained largely outside the political or policy limelight. It is important to emphasise that in the entire period since its establishment, right up to the present, the SARB was sub-ordinated to the government of the day. It has never had the degree of independence and autonomy that many central banks have today.

Like most other central banks formed in the inter-war years, the SARB was privately owned, and had its own board of directors which included both private shareholder representatives and government appointees. Most of these central banks were effectively nationalised over the course of the 20th century. South Africa has been an exception. The SARB remains one of a handful of central banks with private shareholders who fully own it.

The question of the 'independence' of the SARB, like most other central banks, hardly ever arose for most of the 20th century. Central banks operated with varying degree of practical autonomy within the ambit of the state, with the bank's executive being 'sub-ordinate' in one way or the other to the government of the day, reporting to government via the minister responsible for financial matters.

Central bank independence became a matter of debate in the context of the demise of Keynesianism, the sidelining of old style monetarism and the rise to dominance of new classical macroeconomics.[2] Academics first raised the fear of government interference in central bank decision-making for populist or electoral reasons. Then they pushed the debate onto the practical level, after the election of conservatives such as Ronald Reagan in the US, Margaret Thatcher in the UK and Helmut Kohl in West Germany, all around 1980. Their impact was to prove irresistible. During the course of the 1980s and 1990s, many central banks acquired one or other form of 'independence' at least at an operational level (what is called instrumental independence).

South Africa followed suit through the constitutional provisions of 1996 which required that the SARB act 'independently', subject to the requirement of regular consultation between the SARB and the minister responsible for financial matters (Section 224 of the Constitution).

The global financial crisis of 2008 (continuing) threw a massive spanner in the well-oiled machinery of central bank operations and independence. The crisis demonstrated painfully that traditional instruments of central bank practice, such as the manipulation of short-term interest rates, were simply useless in the face of the severity, depth and length of the crisis. As argued by Padayachee (2015) the SARB did fairly well in this cauldron of global chaos and uncertainty. But all over the world the old certainties, rules and traditions for central banks, established with such mathematical nicety and precision in the 1980s, disappeared out of the window.

SARB IN THE CONTEXT OF NEGOTIATIONS FOR A DEMOCRATIC SOUTH AFRICA

In the negotiations over a new constitution at the Convention for a Democratic South Africa (Codesa) in the early 1990s, the future of the SARB and its degree of independence was one of a handful of economic policy matters which came up for debate, or so it seems. We know little about what really happened during those negotiations as public records are scanty.[3]

Jason Hickel, an economic anthropologist now based at the London School of Economics has argued that:

> Knowing that the ANC were going to assume political power, the National Party wished to insulate economic policy as much as possible from their control ... An independent Reserve Bank with a low inflation mandate was central to this strategy. The National Party ... did not trust the ANC to wield this power, probably fearing that the latter would engage in "loose" monetary policy for populist ends which would undermine ... the white community whose interests the National Party sought to secure. This move to tie the hands of its successor government is recognised in the literature as a classic motive for enshrining central bank independence (2016: 4-5).

In a context described by former Governor Chris Stals as being more "by accident than by design" (see Rossouw and Padayachee, 2020) the SARB was granted constitutional independence. The failure to democratically debate this issue at the outset, including through public participation, continues to affect the current debate. The admittedly interrelated issues of ownership, independence and mandate are regularly confused in some circles.

It is necessary to consider some theoretical and historical context related to these three issues: CBI; ownership (should SARB be nationalised – taken into state ownership); and mandate (should its inflation targeting mandate be changed, and to what?).

THE CASE FOR AND AGAINST CBI

Between 1990 and 1995 at least 30 countries, spanning five continents, legislated for increased independence of their central banks (Maxfield, 1997: 3).

The usual argument for CBI is that governments might use monetary instruments to further their own electoral ends, or electorates might seek increases in public spending faster than the economy can afford (Bowles and White, 1994: 237). Both of these pressures can lead to greater inflation. The problem was one of credibility,[4] which would be overcome "by transferring the responsibility for anti-inflationary policy to a non-political independent central bank" (Snowdon et al., 1994: 211).

In apartheid South Africa a classic case in point is that of the Primrose by-election incident. The ruling National Party faced a crucial by-election in the Primrose constituency on 29 November 1984. Interest rates were at a new record high from August 1984 (the prime overdraft rate was at 25%) resulting in domestic unhappiness about economic conditions and

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monetary policy. The SARB Governor, (operating free of the disciplines now exercised by the SARB Monetary Policy Committee!) dropped interest rates 10 days before the by-election – and put them back at their previous level on 8 January 1985. Although the Bank denied that these movements in rates were politically induced, this incident eroded the ability of the Bank to conduct credible monetary policy. These and other factors clearly influenced the decision to grant SARB constitutional independence in 1996 (see e.g. Padayachee, 2015).

In short, it is a common argument that independent central banks are better at maintaining price stability than subservient central banks. The empirical evidence in support of this belief is not, however, overwhelming (Bowles and White, 1994: 238). Economics Nobel prize-winner and one time Chief Economist of the World Bank, Joseph Stiglitz, observed there was also little evidence to suggest that economies with more independent central banks had achieved more in the arguably more important areas of output and employment stabilisation and growth (1997: 16).[5]

The argument against central bank independence is that monetary policy should be subject to democratic political processes. The monetary policies central banks formulate and implement are a key determinant of a country's macroeconomic performance and of the economic well-being of the electorate. Democratically elected governments are held responsible for that performance. Why then should central banks not be held accountable in the same way? This point is especially relevant as budget stringency has reduced the extent to which fiscal policy instruments can be used to influence the economy, leaving monetary policy as the main instrument for affecting macroeconomic performance.

Decisions made by central banks are also not just technical decisions to be left up to a group of experts who will pursue what is optimal for society; they involve judgements about trade-offs – most fundamentally about whether inflation or unemployment is more of an economic priority in any particular society (Stiglitz, 1997: 13). Central bankers generally are not representative of society as a whole. They tend to be drawn from the ranks of the financial community and their policy prescriptions are likely to coincide narrowly with those of that community (Bowles and White, 1994: 247).

THE POST-APARTHEID ERA

In the post-apartheid era the South African central bank initially remained free of noticeable political interference, in part because of the strong stance of Governors, especially after 1999. However, in the post-Mbeki era signs of unhappiness with the SARB arose within some circles of the ruling party and its alliance partners. The 'lost years' of the Zuma administration saw the Bank coming in for repeated attacks from various factions within the ANC alliance. Deputy-Secretary General of the ANC Jesse Duarte attacked the SARB's stance towards a volatile rand, displaying on her part either total naivety or the beginning of a deliberate strategy on the part of the ANC to destabilise the SARB, arguably in line with the strategy of one faction of an increasingly ill-disciplined ruling party. The SARB Governor moved rapidly to reaffirm the Bank's mandate and he did so publicly and with justification.

There is a vigorous debate globally about CBI, but I would argue that whatever the formal legal or constitutional prescriptions, it is imperative that the mandate and the decisions of a central bank are understood and respected. As I have argued elsewhere a lot can be done to » democratise an independent central bank such as SARB without removing or threatening its independence (see Padayachee, 2015). These relate to the way that the Monetary Policy Committee (MPC) works, its composition, its transparency and its accountability, among other matters.

In December 2018, the ANC resolved at its National Conference to 'nationalise' the Reserve Bank. While it is not clear what the real motives for this change may be (as the debate is clouded in political double speak) there is a danger, likely to be seized upon by credit rating agencies and potential foreign investors, that this is possibly the first step in taking the SARB under executive control again, as was the case in the 1980s (Rossouw and Padayachee, 2020). Let's now look at the main issues in the debate.

THE TWO MAIN POLICY ISSUES

On ownership and independence

The 'ownership' of the SARB is not a matter to get ourselves into knots about. It is simply an anomaly of history that the SARB has private shareholders, even though this distinctively sets us apart from international practice as we are only one of a handful of central banks with private shareholders. The reality is that the private shareholders have no control whatsoever over the management, policy and operations of the SARB.

I would have no problem with (and in fact would support) taking the Bank into state ownership and control to bring it into line with the global norm, while retaining the operational independence of the Bank. But this has to be done at the right time under the right conditions and with due consideration of other priorities and the economic and political context. One final point worth emphasising is that most independent central banks are also state-owned. There is no contradiction between state ownership and independence of a central bank but, remarkably, this is not well appreciated among our political class. Yet we fear that those in a particular faction of the ANC and some other minor parties pushing for 'nationalisation' of the SARB may have a far more insidious agenda.

I want to make one possibly controversial point about CBI, especially in relation to post-apartheid developments around the SARB, which is seldom made and for which the Bank itself is not responsible.

I think it is a problem that there has been a kind of revolving door of senior executives between the National Treasury, private banks and other leading financial institutions and the SARB, which may not be good for ensuring true independence. There has been too much movement of senior executives between these institutions to make anyone comfortable. In addition to the obvious problem of possible conflicts of interest, there also may arise a certain amount of groupthink –"... the mode of thinking people engage in when they are deeply involved in a cohesive in-group, when the members striving for unanimity override their motivation to realistically appraise alternative courses of action".[6]

The common, shared economic ideology coming out of the cosy nexus of private banks and the Treasury/SARB may shut out new and fresh thinking.

Yale economist Robert Schiller, reflecting on why experts at the Fed (the central bank of the USA) did not respond to the many signs of the impending financial crisis before 2008, argues that groupthink tells us why panels of experts could make colossal mistakes. He also implicates central bankers in this self-censoring behaviour where 'mavericks' are put under intense pressure if they question the 'group consensus' (2008).

On the mandate

The Constitution, in section 224, instructs the SARB, as its primary objective, "to protect the value of the currency in the interest of balanced and sustainable growth".

The present Governor, Lesetja Kganyago, in a public lecture at the University of South Africa in 2019, explained that, "The Constitution tells us what to do, but it is not explicit about how we do it. We had to figure out a monetary policy framework for ourselves. In fact, it took us a few years to arrive at the approach we use now: the Constitution was passed in 1996, but we only started inflation targeting in 2000 – after a false start using the so-called 'eclectic approach' that included a failed attempt to control the exchange rate" (Kganyago: 2019).[7] (At present, the SARB is mandated to achieve an inflation rate within a band of 3-6 %.)

Also in 2019, *New Agenda* 74 reported on criticism that the SARB has been too focused on inflation targeting and has not been responding to the serious economic conditions in the country.

It is worth pointing out that a wide variety of countries at different stages of development have a dual or multiple central bank mandate, "that also covers the promotion or support of economic growth or development in addition to ensuring price stability" (Arnold: 2019). These include the USA, Australia and New Zealand, as well as Russia, Malaysia and the Philippines (Arnold: 2019).

The question arises in this context: What is so unique or exceptional about South Africa that suggests that we should not even have a sensible and responsible debate about the SARB mandate?

So what is the case for this? I will not pretend to have the answer, yet. Any case needs to be anchored in the reality of an unemployment rate around 40% (by the broad and much more realistic definition). While the Bank should not and cannot be expected to deal with such a major structural deficiency in the

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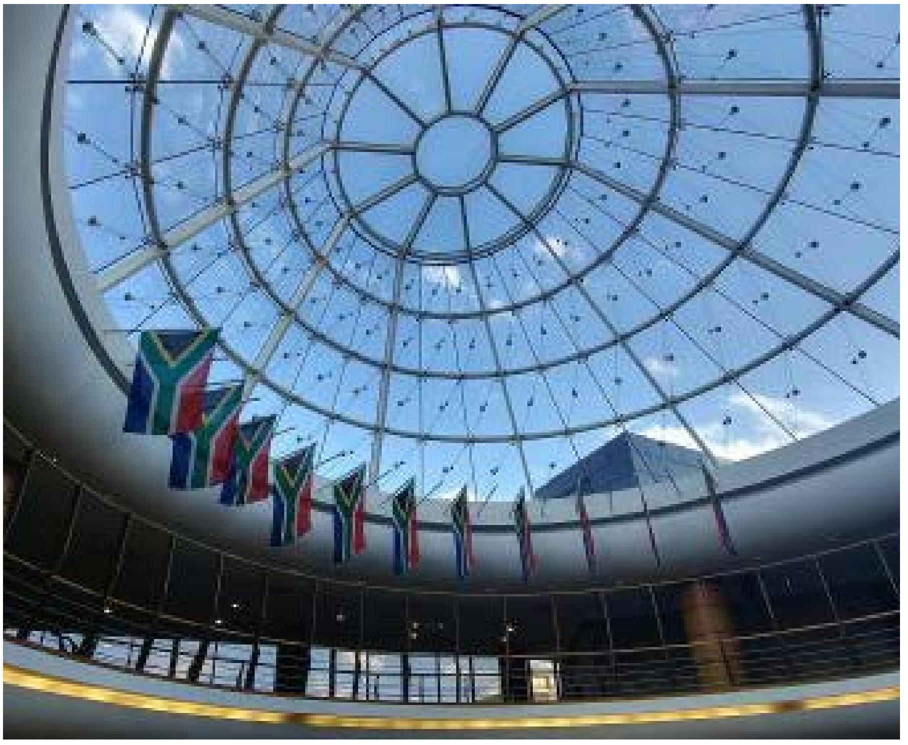

labour market on its own, it has to be prepared to line up and ask itself what role it can play to help alleviate this extreme social and economic distress which can have serious consequences for the economy and the stability of our young democracy. Price stability cannot, must not, be ignored (only the Public Protector appears to believe this is possible), but employment has to be elevated to at least equal status. Comparative cases and theory suggest that this is not rocket science; it needs political will (small p) and the building of the appropriate capabilities within the Bank.

Hasan Cömert (of the Middle East Technical University) and Gerald Epstein have argued that the SARB should set its interest rates, "to achieve an overall real growth rate consistent with the plan which has an employment target at its core. As part of its mandate, the Reserve Bank would try to reach an inflation constraint that is mutually decided upon [with the state] as part of the overall program" (Cömert and Epstein, 2011: 108).

Not everyone would concur, but we do need to start a debate somewhere, and where we are today is not the place to be. Let us find sensible, democratic mechanisms and respectful forums to move the debate forward before we get swallowed up in the 'dog eat dog' culture that has enveloped not only *our* national politics but the recent politics of the US and UK too, among others. Safeguarding the future of policy institutions such as central banks is far too important a task to be left to populist politicians of whatever hue. Every sensible economist, whether orthodox or heterodox, should support the task of defending this venerable institution, the South African Reserve Bank, now entering its centenary anniversary year.

CONCLUSION

The SARB has to be credited with ensuring that South Africa has not suffered a banking crisis in 100 years. That is an achievement worth celebrating, and recognition of the correctness of the stance that John Maynard Keynes took in his defence of the establishment of central banks as regulators in the inter-war years.

In thinking about the mandate of the SARB going forward, we need to be cognisant of two major issues that have the potential to lead to economic crises and subvert macroeconomic policy management down the line: one is sharply rising inequality of income and wealth; and the second is climate change, which overwhelming scientific evidence warns has the potential to destroy us all.

In 2015, the former Bank of England Governor, Mark Carney, warned that global warming could send the world economy spiralling into another 2008-like crisis. He called upon central banks to act "aggressively and immediately" to reduce the risk of climate-related catastrophe. He initially convened 33 central banks to investigate how to green the financial system. I understand that every major central bank agreed to work with him, except the Banco do Brasil and the US Fed, and that their ranks have swelled to 42 central banks. It is commendable, as I understand it, that the SARB has joined this network on greening the financial system and we wait to see how this will be operationalised and what implications this may have for its independence in the event (as expected) that it may be required in terms of such a policy to favour some sectors or industries or activities over others.

Adam Tooze has also urged policymakers to action. He is a University of Columbia economic historian and author of the award-winning 2018 book, *Crashed,* on the 2008 crisis and its aftermath. Tooze says: "… after their exertions in the 2008 financial crisis, central bankers, of all public officials, can't plausibly retreat into an insistence on the limits of their mandate". Faced with the threat of climate change, to indulge in the idea that central banks can limit themselves to worry only about price and financial stability is, Tooze argues, "its own form of denial" (2019).

These are big issues to grapple with now before it's too late. They are far more critical to our future than uninformed wrangling about nationalisation or the 'independence' of the SARB from some political quarters.

The issue of central bank independence and its role in the economy and society is too important to be left to central bankers and economists alone. Let's have a debate, let us make it participatory – which is feasible within a constitutional democracy –but most importantly, let that debate be sensible, and informed by what is best for the economy and the people of South Africa.

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ENDNOTES

1 My thanks for my friend, Wits colleague and former PhD student Professor Jannie Rossouw, with whom I have collaborated over a period of about 15 years on academic work in the area of central bank independence, including in South Africa. I have drawn liberally from Jannie's work and our recent joint paper (Rossouw and Padayachee, 2020) in assembling this paper for *New Agenda*.

2 The new classical macroeconomics approach was led by US academics such as Robert Lucas, Edward Prescott, Robert Barro and Thomas Sargent, among others.

3 See Padayachee and Van Niekerk (2019) for one of the few comprehensive accounts of the economic and social policy aspects of the negotiations.

4 This view was identified by Kydland and Prescott, and developed further by Gordon and Barro, and Backus and Driffill (see Snowdon et al., 1994: 204-14).

5 Stiglitz was Chief Economist and Senior Vice-President of the World Bank from 1997-2000.

6 Reference cited by Mitchell (2015): Janis, I.L. (1982).

7 Also see Padayachee (2015). NA