

# The Role of a Modern Central Bank in Managing Consumer Bankruptcies and Corporate Failures: A South African Public-Law Angle of Incidence\*

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## 1 Introduction

Most people know little about their country's central bank; so far as they are concerned, a central bank is merely involved in determining the interest rate on their home loans and overdrafts. As recent events in the global financial markets have shown, however, there is more to a central bank than lending rates and signatures on banknotes. On Wednesday, 8 October 2008, world central banks intervened in an effort to alleviate clogged money markets and reestablish confidence in the panic-stricken international financial system and the global economy. Six central banks, including the United States Federal Reserve, the European Central Bank and the Bank of England, cut interest rates together. Other central banks that also cut interest rates included those of Canada, Sweden, and Switzerland. China also cut interest rates, though it did not join in the group statement. This was the first coordinated interest rate reduction since the terrorist attacks in the United States of America in September 2001.<sup>1</sup>

The global economy is showing clear signs of financial duress and distress. National and international media reports are dominated by references to higher energy prices, higher food prices, a slowdown in economic growth, monetary instability and the ever-present fear of uncontrollable inflation.<sup>2</sup> These concerns prevail not merely in one or two countries, but worldwide, involving some of the biggest economies and monetary role-players. Regular reference is made to the 'credit crunch' and sub-prime mortgage crises in the United States of America that have created extra-territorial financial losses in

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<sup>1</sup> See <http://www.cnn.com/> and <http://www.bbcnews.com/> (visited on 5 May 2008).

<sup>2</sup> See <http://www.cnn.com/> and <http://www.bbcnews.com/> (visited on 5 May 2008).

Europe and the United Kingdom in particular. There is a significant downturn in the United Kingdom housing market, whilst the European Union is experiencing a definite economic slowdown. The consequences of these issues are not only of concern to private companies, financial institutions and multinational corporations, but are equally important to all governments, public institutions, and ultimately every human being. As a result the turmoil in financial markets has a global impact, and quick and decisive steps would indeed be in the interest of both public and private sectors. Although often forgotten, the poorest people of the world are the hardest hit in troubled times. Every government has a responsibility to act, taking appropriate steps to protect its people and ensure that appropriate mechanisms are in place to aid them during difficult times.

The central bank is one of the most important institutions created to manage economic growth and fiscal stability in a country. It is customary for most states in the world to create and empower a specific institution to manage and oversee certain financial powers and functions. These institutions are of particular importance for financial markets and local economies because the proper fulfilment of their functions is directly attributable to economic growth, inflationary control and financial stability. Central banks were established throughout the world because of the realisation that under typical, normal conditions of banking and financial business, it was advantageous to have centralised monetary reserves, currency control and credit management that enjoyed the support of the state and were subject to some form of governmental supervision and participation.<sup>3</sup> A central bank should be created by legislative intervention as a core pillar within a particular financial system. Given the differences of circumstances and political structures, the central banks in each country have different constitutional positions. However, these banks not only act 'offensively' (pro-actively), but are often also called upon to act defensively in times of financial trouble and instability. Although it must be noted that the creation of central banks is no guarantee against financial crisis, their quick and committed fulfilment of their powers and functions should have an important impact on financial markets, with resultant benefits for consumer bankruptcies and corporate failures and liquidations.<sup>4</sup>

## 2 Overview of the Historical Development of the South African Reserve Bank

The South African Reserve Bank ('the Bank') dates back to 1921, when it was established in terms of a special Act of Parliament: the Currency and

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<sup>3</sup> See Johann de Jager 'The South African Reserve Bank: An Evaluation of the Origin, Evolution and Status of a Central Bank (Part 1)' (2006) 18 *SA Merc LJ* 159. Central banks function at the heart of any financial system, and their practices and activities directly influence the entire financial system. Initially, central banks developed from normal commercial banks but were given certain rights and privileges such as the issuing of bank notes and acting as the agent and banker of the government of a state.

<sup>4</sup> It should be noted that aspects such as inflation, interest rates and general economic growth are emotional issues important not only to central banks, but to all the inhabitants of a country.

Banking Act 31 of 1920. Prior to the establishment of this central bank, the issuing of banknotes to the public was done by commercial banks,<sup>5</sup> but there was no uniformity in the issuing of such banknotes. After the end of World War I, the price of gold in the United Kingdom rose above the price of gold in South Africa. This created the opportunity of profit-taking by converting banknotes into gold in the Union of South Africa, and then selling them in London.<sup>6</sup> In turn, commercial banks had to repurchase gold according to the London price as converted in South Africa. This 'obligation to trade at a loss' seriously threatened the ability of commercial banks to meet their obligations, and the banks subsequently requested the Government to release them from this obligation. At the Gold Conference in October 1919, a select committee recommended the establishment of a central bank for the Union of South Africa, with the purpose of, among other things, assuming the responsibility to issue banknotes and taking over the management of physical gold held by the commercial banks.<sup>7</sup> The Union Parliament accepted the recommendation of the committee and in December 1920 passed the Currency and Bank Act formally establishing the South African Reserve Bank. The Bank officially opened its doors for business on 30 June 1921.<sup>8</sup>

Originally, the main function of the Bank was the issuing of banknotes. This function was initially shared with other commercial banks, but in 1944 the Bank obtained the sole right to issue banknotes in South Africa. Banknotes issued were redeemable on demand in physical gold or gold certificates. Financial difficulties in the 1930s prompted a fresh investigation into the financial and banking sectors, and in December 1932 it was decided that banknotes could no longer be redeemed in gold. Other basic functions of the Bank included the following:<sup>9</sup>

- the making of loans or advances on current accounts to certain defined customers;
- becoming the custodian of cash reserves of all other banks in South Africa;
- becoming a lender of cash to other banks in the event of a shortage of financial liquidity;

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<sup>5</sup> Eg, the Standard Bank of South Africa.

<sup>6</sup> It should be noted that commercial banks at the time had to convert notes held by the public into gold when tendered.

<sup>7</sup> See the official website of the SA Reserve Bank at <http://www.reservebank.co.za> (visited on 30 April 2008).

<sup>8</sup> See De Jager op cit note 3 at 160. He points out that owing to the relatively early establishment of the SA Reserve Bank, the SA authorities were unable to turn to examples of other central banks' status with similar financial conditions. Only a few central banks existed in Europe, the UK and the USA. The consequence was that SA Reserve Bank statutes were in many respects modelled on the laws relating to the US Federal Reserve. It is also reported that as a consequence of the International Financial Conference in Brussels in 1920, a resolution was passed that all countries that had not established central banking systems should do so as soon as possible, in order (among other things) to maintain stability in their monetary and banking systems and in the interest of world co-operation. See also Esmé du Plessis 'The Structure and Operation of the Reserve Bank and Its Relationship to the Government' (1980) 2 *Modern Business Law* 86 at 87.

<sup>9</sup> See again <http://www.reservebank.co.za> (as visited on 30 April 2008).

- performing the clearance and settling of financial claims between commercial (private) banks; and
- becoming the custodian of the majority of South Africa's gold and foreign exchange reserves.

In 1927 another important development took place when all government accounts were formally transferred to the Bank, which became the official banker of the South African Government. From its inception the Bank was given a degree of autonomy for the execution of its duties, and this autonomy and institutional independence is today entrenched in the Constitution of the Republic of South Africa, 1996 ('the Constitution'), the highest law of the Republic of South Africa.<sup>10</sup> In 1944 the Currency and Banking Act 1920 was replaced by the South African Reserve Bank Act 29 of 1944, itself later substituted by the South African Reserve Bank Act 90 of 1989 (the 'SARB Act'). Currently the SARB Act 1989 and regulations made under the Act, as well as certain provisions of the Constitution, constitute the enabling legislative framework for the Bank's operations and its powers and functions.<sup>11</sup>

### 3 The Statutory Foundations of the South African Reserve Bank

#### 3.1 Introduction

The last decade or so in South Africa has seen the liberalisation and deregulation of many sectors in society, including the financial-market sector and the banking sector. Most of the fundamental changes coincided with the political emancipation of all citizens and the commencement of a new and supreme Constitution (which entrenched fundamental rights and created constitutionally protected institutions such as an independent and impartial central bank).<sup>12</sup> In view of the historical developments, it has become customary for central banks to have a say in and oversight over the financial system and institutions in a state. For this reason, and since central banks significantly affect local economies, the drafters of the South African Constitution opted to protect such an important institution directly in the supreme law of the land. Although an Act of Parliament is authorised to regulate the activities and overall functions of the Bank, it is the Constitution that establishes the foundational provisions of this central financial institution.<sup>13</sup>

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<sup>10</sup> Section 224(2) of the Constitution of the Republic of South Africa, 1996.

<sup>11</sup> In terms of s 239 of the Constitution, the South African Reserve Bank Act 90 of 1989 is categorised as 'old-order legislation'.

<sup>12</sup> In particular, see chapters 1, 2 and 13 of the Constitution, and FR Malan & JT Pretorius 'The Reserve Bank, Banks and Clearing Houses in South African Law (Part 1)' (2001) *SA Merc LJ* 13 at 55.

<sup>13</sup> Cf Du Plessis op cit note 8 at 86, where the author states that: '[t]here can be no doubt that central banking has developed into an entirely separate and autonomous branch of banking . . .'. In general, a central bank is recognised as the bank that constitutes the apex of the monetary and banking structure of its country.

The Bank is a legal rarity: not only is it a constitutionally protected<sup>14</sup> independent<sup>15</sup> organ of state<sup>16</sup> and a public-law creature of statute,<sup>17</sup> but it is also a directly incorporated domestic corporation<sup>18</sup> privately owned by shareholders!

### 3.2 The Constitutional Framework of the SA Reserve Bank

With its commencement on 4 February 1997, chapter 13 of the Constitution of the Republic of South Africa – dealing with the financial matters of the South African state – specifically recognised and confirmed the Bank as the central bank of the Republic.<sup>19</sup> Section 223 states: ‘The South African Reserve Bank is the central bank of the Republic and is regulated in terms of an Act of Parliament.’<sup>20</sup>

Apart from confirming the Bank as the official banker of the South African Government, the Constitution then continues by stating that the primary object of the Bank is to protect the value of the South African currency (which is rand (R)) in the interest of balanced and sustainable economic growth in the Republic.<sup>21</sup> In pursuit of its primary object, the Bank is constitutionally obliged – and protected – to perform its functions independently and without fear, favour or prejudice. But the Constitution requires regular consultation between the Bank and the Cabinet member responsible for national financial matters.<sup>22</sup> Finally, the Constitution confirms that the powers and functions of the Bank are those customarily exercised and performed by central banks. However, such powers and functions must be determined by an Act of

<sup>14</sup> Section 224(1) of the Constitution.

<sup>15</sup> In *Ex parte Chairperson of the Constitutional Assembly: In re Certification of the Constitution of the Republic of South Africa*, 1996 1996 (4) SA 744 (CC) in pars 166-9 at 825, the Constitutional Court held that the text of the Constitution relating to the Reserve Bank did comply with Constitutional Principle XXIX (dealing, among other things, with the independence of the Reserve Bank).

<sup>16</sup> Section 239 read with s 33 of the Constitution. In terms of s 1 of the Institution of Legal Proceedings against Certain Organs of State Act 40 of 2002, an organ of state includes ‘any functionary or institution exercising a power or performing a function in terms of the Constitution . . .’. The nature of an organ of state is discussed in *Hoffmann v South African Airways* 2001 (1) SA 1 (CC) in par 23 at 15.

<sup>17</sup> Section 239(b)(ii) of the Constitution read with the SARB Act.

<sup>18</sup> See *Herbstein & Van Winsen The Civil Practice of the Supreme Court of South Africa (now the High Courts and the Supreme Court of Appeal)* 4 ed (1997) by Louis de Villiers van Winsen, Andries Charl Cilliers & Cheryl Loots (edited by Mervyn Dendy) at 68 (under the heading ‘Domestic corporations’):

‘For present purposes, the term “domestic corporations” includes all those bodies that are directly or indirectly incorporated in the Republic. A number of bodies are directly incorporated by legislative enactment, for example the universities, industrial concerns like Iscor and Eskom, the Reserve Bank, the Land Bank and the SA Broadcasting Corporation. Others are indirectly incorporated under a general legislative enactment, for example companies and commercial banks.’

<sup>19</sup> Section 195 of the Constitution of the Republic of South Africa Act 200 of 1993 (hence ‘the interim Constitution’) was very similar to s 223 of the Constitution of the Republic of South Africa, 1996.

<sup>20</sup> See also the SARB Act.

<sup>21</sup> See s 224(1) of the Constitution. The Bank’s main role is the protection of the value of the SA currency. When the value of the local currency depreciates and the country’s current account deficit increases, inflation rises and economic growth is stifled. There is a strong link between the value of a local currency and the rate of inflation in a particular economy.

<sup>22</sup> Section 224(2) of the Constitution. The relevant Cabinet member is the Minister of Finance.

Parliament and must be exercised or performed subject to the conditions prescribed in terms of such an Act of Parliament.<sup>23</sup>

Upon a more general evaluation of the Constitution's impact and importance, the following interesting aspects should be highlighted:

- Although the Constitution does not directly confirm the juristic nature of the Bank, the SARB Act states that the Bank is a public-law juristic person with the associated consequences.<sup>24</sup>
- According to Constitutional Principle XXIX of the interim Constitution, the 1996 Constitution had to provide for a central bank that was both independent and impartial. This requirement was complied with in ss 223 to 224 of the final Constitution.<sup>25</sup> During the negotiations in the Constitutional Assembly there was some controversy about the Bank's independence. Organised labour apparently held the view that such independence would deprive the Government of meaningful control over the fiscal policy determined by the Bank, which in turn could have a negative impact on meaningful delivery to the South African poor. This argument eventually subsided, and agreement was reached on the current independence of the Bank.<sup>26</sup>
- According to s 2 of the Constitution, the Constitution is the supreme law of the Republic of South Africa and any law or conduct inconsistent with the Constitution is invalid. This provision obviously refers not only to the sections relating to the Bank directly, but also to all other provisions – including the fundamental rights in the Bill of Rights. It is important to remember that the Constitution provides for a new constitutional ethos and legal dispensation in which particular fundamental rights and values are entrenched, and as a result the business of the South African central bank cannot only concern interest rates and market trends.<sup>27</sup> Both the founding provisions and the Bill of Rights have a fundamental impact on

<sup>23</sup> See s 225 of the Constitution.

<sup>24</sup> See s 2 of the SARB Act and Felix Oelkers 'The South African Reserve Bank under the Interim Constitution (Part 2)' 1996 *Tydskrif vir die Suid-Afrikaanse Reg* 701 at 701. See also Malan & Pretorius op cit note 12 at 36, where the authors comment that the Reserve Bank is organised as a corporate entity.

<sup>25</sup> *Ex parte Chairperson of the Constitutional Assembly: In re Certification of the Constitution of the Republic of South Africa, 1996* supra note 15 in pars 166-9 at 825, where the Constitutional Court held that the text of the Constitution relating to the Reserve Bank complied with Constitutional Principle XXIX, which provided as follows:

'The independence and impartiality of a Public Service Commission, a Reserve Bank, an Auditor-General and a Public Protector shall be provided for and safeguarded by the Constitution in the interests of the maintenance of effective public finance and administration and a high standard of professional ethics in the public service.'

<sup>26</sup> Note George Devenish 'Constitutional Law' in: WA Joubert (founding editor) *The Law of South Africa* vol 5 part 3 2 ed (2004) in par 370 at 399-400. Some commentators have highlighted the fact that control over financial institutions and central banks in particular has always been a controversial issue. There is always tension between capitalism on the one hand, and socialism on the other. See Malan & Pretorius op cit note 12 at 56-7.

<sup>27</sup> See the preamble to, and s 1 and chapter 2 of, the Constitution in particular. The three core values of equality, human dignity and freedom are specifically emphasised in the new constitutional order. With regard to the new normative constitutional framework and social justice, see (amongst others) Sachs J in *Port Elizabeth Municipality v Various Occupiers* 2005 (1) SA 217 (CC) in par 18 at 227-8, who remarked as follows:

the way in which even the central bank of the state functions and acts. Apart from the fact that the Constitution is supreme, constitutional issues are dealt with according to a value-orientated approach, which means that the underlying values and rights of the system must be practically enforced, promoted and protected.<sup>28</sup>

- In the new legal order, the Bank is a constitutionally protected organ of state, which in turn has significant implications for the enforcement of the principles of administrative law and administrative action.<sup>29</sup> The Bank is an institution that exercises a public power or performs a public function in terms of legislation.<sup>30</sup> Some commentators have indicated that the Bank should be regarded as an executive organ of state that acts both in the public-law domain and in the private-law domain. When the Bank sets its monetary policy and rates policy, it is said to act within the public-law sphere. When it interacts with other commercial banks, it then acts within the private-law sphere.<sup>31</sup>
- It seems clear from the Constitution that the Bank is not only a creature of statute, but that it does not possess any common-law powers. All its

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‘It is not only the dignity of the poor that is assailed when homeless people are driven from pillar to post in a desperate quest for a place where they and their families can rest their heads. Our society as a whole is demeaned when State action intensifies, rather than mitigates, their marginalisation. The integrity of the rights-based vision of the Constitution is punctured when governmental action augments, rather than reduces, denial of the claims of the desperately poor to the basic elements of a decent existence.’

Horn AJ in *Port Elizabeth Municipality v Peoples Dialogue on Land and Shelter & Others* 2000 (2) SA 1074 (SE) at 1081F-G pointed out that ‘a court, when having to decide a matter of this nature, would be obliged to break away from a purely legalistic approach and have regard to extraneous factors such as morality, fairness, social values and implications and any other circumstances which would necessitate bringing out an equitably principled judgment’. In *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs & Others* 2004 (4) SA 490 (CC) in par 73 at 522, Ngcobo J held:

‘South Africa is a country in transition. It is a transition from a society based on inequality to one based on equality. This transition was introduced by the interim Constitution, which was designed

“to create a new order . . . [based on equality] in which there is equality between men and women and people of all races so that all citizens shall be able to enjoy and exercise their fundamental rights and freedoms”.

This commitment to the transformation of our society was affirmed and reinforced in 1997, when the Constitution came into force. The Preamble to the Constitution “recognises the injustices of our past” and makes a commitment to establishing “a society based on democratic values, social justice and fundamental human rights”. This society is to be built on the foundation of the values entrenched in the very first provision of the Constitution. These values include human dignity, the achievement of equality and the advancement of human rights and freedoms.’

<sup>28</sup> See ss 2, 7 and 39(2) of the Constitution. It should be noted that the preamble to the Constitution expressly refers to the pursuit of social justice in a new democratic South Africa.

<sup>29</sup> Section 239 read with s 33 of the Constitution.

<sup>30</sup> Section 239(b)(ii) of the Constitution read with the SARB Act. Note that the Bank is regulated by the Constitution and the SARB Act. It does not have its own memorandum and articles of association like a normal company. It is not profit orientated but acts in the public interest by controlling inflation (see Oelkers op cit note 24 at 704).

<sup>31</sup> See Malan & Pretorius op cit note 12 at 40 and Oelkers op cit note 24 at 702-4. The relationship between the SA Reserve Bank and the state was accordingly prima facie the relationship of a bank and customer as ordinarily understood in the laws of banking and bills of exchange (see *The Godfather v Commissioner for Inland Revenue* 1993 (2) SA 426 (N)).

powers and functions are now statutory.<sup>32</sup> Apart from the statutory powers and functions set out in the Constitution and the SARB Act, the Bank does not have any other functions. This position is comparable with the powers and functions of the South African President: under the new constitutional dispensation, the President also does not have any common-law powers.

### 3.3 The South African Reserve Bank Act 1989

As was indicated above, the South African Reserve Bank Act is specifically authorised by the Constitution.<sup>33</sup> Although the Constitution refers to ‘an Act of Parliament’, the SARB Act – the primary law – is not the only national law that affects the functioning of the Bank. Many other national laws are also important.<sup>34</sup>

The SARB Act commenced on 1 August 1989. Its main purpose is to consolidate the laws relating to the Bank and the monetary system of the Republic of South Africa, and to provide for matters connected therewith. The Act determines that the Bank is a juristic person, and that the Minister of Finance is the responsible member of Cabinet under the Act.<sup>35</sup> According to s 3, the primary object of the Bank – emphasising its constitutional foundation – is to protect the value of the South African currency in the interest of balanced and sustainable economic growth. To achieve its object, the Bank is authorised to regulate the prime lending interest rate at which it lends money to other banks, which must in turn follow this rate.<sup>36</sup> The SARB is managed by a Board of 14 directors. The Governor of the Bank, who is appointed by the President, presides over meetings of the Board and, together with his or her deputy governors, is responsible for the day-to-day management and affairs of the Bank.<sup>37</sup> The current Governor, Mr Tito Mboweni, is only the eighth Governor of the Bank since its creation in 1921, and assumed office on

<sup>32</sup> See again s 225, which states that ‘[t]he powers and functions of the South African Reserve Bank are those [which are] customarily exercised and performed by central banks, which . . . *must* be determined by an Act of Parliament’ (emphasis supplied).

<sup>33</sup> Section 223 of the Constitution. From the Constitution it is clear that the Bank is a creature of statute and that its powers and functions are determined by national legislation. The Bank is also not regarded as a ‘normal’ bank that is subject, among other things, to the South African Companies Act 61 of 1973. Some features of the Bank, such as its legal personality, share capital, shareholders and board of directors, make it useful to turn to the requirements of company law for guidelines on Reserve Bank governance, but since the Bank does not act solely for the benefit of shareholders but rather for the country and public as a whole, it is not a normal commercial institution (see De Jager op cit note 3 at 168 et seq).

<sup>34</sup> Eg, the Financial Institutions (Protection of Funds) Act 28 of 2001; the South African Reserve Bank, Banking Institutions, Mutual Building Societies and Building Societies Amendment Act 96 of 1988; the Extension of the Powers of the South African Reserve Bank Act 95 of 1990; and the National Payment System Act 78 of 1998.

<sup>35</sup> See the long title of the Act read with s 1 (definitions section).

<sup>36</sup> The Bank is in a superior position compared to other banks. The Bank can also impose certain requirements on other banks, either in its capacity as monetary policy maker or as financial institutions supervisor.

<sup>37</sup> According to s 7 of the SARB Act, the Governor presides at meetings of the Board, and a quorum of at least seven directors of the Board is required. Decisions of the Board are taken by majority vote of the directors present that have constituted a quorum. If seven members are present, at least 50% plus 1 (ie, 3 + 1 = 4) must vote in favour or against a particular issue, to resolve the issue. Note s 7(4) of the SARB Act.



8 August 1999. The Bank publishes monthly statements of its assets and liabilities, and must also submit an annual report to Parliament to which it is accountable. Finally, it should be noted that the Bank is privately owned and that the shares of the Bank are traded Over-the-Counter (OTC). Shareholders receive a fixed dividend per share, and all surplus earnings are paid over to the Government. The Bank is not profit driven, but is aimed at serving the best interests of all South African people.<sup>38</sup>

Following on the basic constitutional aim of the Bank, the SARB Act specifically authorises and determines a number of powers and duties of the Bank. These powers and duties are important because they form the statutory foundation of the so-called common powers and functions of the Bank, and because they are very similar to the functions of most central banks of the world.<sup>39</sup> Under s 10 of the SARB Act, the Bank is specifically authorised to exercise and perform the following powers and duties:<sup>40</sup>

- make or cause banknotes and coins to be made, issue them or destroy or have them destroyed;<sup>41</sup>
- perform functions or implement rules and procedures to establish, conduct, monitor, regulate and supervise payment, clearing or settlement systems;<sup>42</sup>
- acquire shares in limited companies if the Board is of opinion that such acquisition will be conducive to the attainment of the objects of the Act;<sup>43</sup>
- accept money on deposit, allow interest on such deposits and collect money for other persons;<sup>44</sup>
- grant loans and advances, even unsecured loans and advances in specified circumstances;<sup>45</sup>
- buy, sell, discount or re-discount bills of exchange drawn or promissory notes issued for commercial, industrial or agricultural purposes, or exchequer bills of the Government of the Republic of South Africa or of

<sup>38</sup> See <http://www.reservebank.co.za> (visited on 30 April 2008). Central banks are non-commercial, non-competitive, non-profit-maximising institutions. They must manage the banking system, maintain liquidity and exercise control over other financial institutions (mainly commercial banks) in overall system. Central banks have a particular place – with special powers, privilege and responsibilities. They must not compete with other commercial banks but should focus on their public-interest role – the economic growth and health of financial systems in the country (see De Jager op cit note 3 at 163).

<sup>39</sup> According to Johann de Jager 'The South African Reserve Bank: An Evaluation of the Origin, Evolution and Status of a Central Bank (Part 2)' (2006) 18 *SA Merc LJ* 274, in practice it is difficult to single out any particular function of a central bank. Central banks have a variety of functions, mostly relating to the financial stability of the particular system.

<sup>40</sup> See s 10(1)(a)-(u) of the SARB Act. According to Frans Malan 'Banks, the Reserve Bank and the Bills of Exchange Act 34 of 1964: *Big Dutchman v Commissioner for Inland Revenue* 1993 2 SA 426 (N)' (1993) *Tydskrif vir die Suid-Afrikaanse Reg* 755 at 758, s 10 of the SARB Act contains wide provisions, but not all the powers and duties given by the Act are 'objects' of the Bank. They should rather be regarded as powers given to the Bank to achieve its objects and thus its primary objectives.

<sup>41</sup> Section 10(1)(a)(i)-(v).

<sup>42</sup> Section 10(1)(c)(i)-(iv).

<sup>43</sup> Section 10(1)(d).

<sup>44</sup> Section 10(1)(e).

<sup>45</sup> Section 10(1)(f)(i)-(ii).

- the government of any other country, or securities of a local authority in the Republic of South Africa;<sup>46</sup>
- buy, sell or deal in financial instruments and hold them in safe custody;<sup>47</sup>
  - issue its own interest-bearing securities for the purposes of monetary policy, and buy and sell or grant loans and advances against such securities;<sup>48</sup>
  - buy, sell or deal in precious metals and hold in safe custody for itself or other persons or institutions gold, securities or other articles of value;<sup>49</sup>
  - buy and sell foreign currencies, accept or deal in special drawing rights, open credits and issue guarantees;<sup>50</sup>
  - effect transfers, sell drafts, establish branches or appoint agents in or outside South Africa;<sup>51</sup>
  - open accounts in foreign countries and act as agents and correspondents of any bank doing business in or outside South Africa;<sup>52</sup>
  - make agreements in foreign countries to borrow foreign currency;<sup>53</sup>
  - perform such other functions of bankers and financial agents as central banks customarily may perform. The Bank may also lend or advance money on security of a mortgage of immovable property to employees of banks to acquire a dwelling;<sup>54</sup>
  - perform the functions assigned to the Bank by the Banks Act 94 of 1990 and the Mutual Banks Act 124 of 1993, including
    - exercising the authority created under the Banks Act, namely to oversee and monitor certain aspects relating to the authority to establish banks, their functioning, registration and deregistration as well as certain other prudential requirements. It should be noted that the main purpose of the Banks Act is to provide for the regulation and supervision of the business of public companies that take deposits from the public;<sup>55</sup>
    - exercising the authority created under the Mutual Banks Act, namely, to oversee and monitor certain aspects relating to the regulation and supervision of the activities of juristic persons that are doing business

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<sup>46</sup> Section 10(1)(g).

<sup>47</sup> Section 10(1)(h).

<sup>48</sup> Section 10(1)(i)-(j).

<sup>49</sup> Section 10(1)(k).

<sup>50</sup> Section 10(1)(e)-(n). In general, a central bank must also exercise careful control over a country's foreign exchange reserves. Such reserves are helpful tools when currency weakness is experienced. In certain instances, currency weakness can be countered by selling foreign currency or gold reserves.

<sup>51</sup> Section 10(1)(o)-(p).

<sup>52</sup> Section 10(1)(q).

<sup>53</sup> Section 10(1)(r).

<sup>54</sup> Section 10(1)(s)-(t). The Bank may also acquire property for itself (s 10(1)(u)).

<sup>55</sup> See the long title of the Act read with (among other things) ss 3-4. The Act specifically creates an Office for Banks, as well as a Registrar of Banks, both of which have direct links with the SA Reserve Bank. The exercise of control by a central bank over other banking and financial institutions is a very important role because such institutions are major suppliers of money to the public and business communities.

as mutual banks in South Africa. Again, the Bank is authorised through its representative, the Registrar of Banks, to oversee and monitor the activities of mutual banks.<sup>56</sup>

Apart from these functions mentioned above, the Bank is also empowered to maintain accounts by banks of the minimum reserve amounts that those banks must keep with the Bank.<sup>57</sup> The Bank is also permitted to appoint inspectors to inspect the affairs of other (commercial) banks.<sup>58</sup> Under s 14 of the SARB Act, the Bank has the sole right to issue banknotes and coins in the Republic, as approved by the Department of Finance.<sup>59</sup> The Act also determines that the monetary unit of the Republic of South Africa shall be Rand and cents, abbreviated as R and c. One cent is one hundredth of a Rand.<sup>60</sup> Annually the Governor of the Bank has to submit a report on the implementation of the Bank's Monetary Policy to the Minister of Finance.<sup>61</sup> In essence, this monetary policy comprises the Bank's strategy and policies to achieve its aim and objectives.<sup>62</sup> Finally, it is interesting to note that the Bank itself may not be placed in liquidation, except if such liquidation is authorised in terms of an Act of Parliament.<sup>63</sup>

### 3.4 Some General Comments on the Role and Functions of the South African Reserve Bank

In the world of central banking there seems to be consensus that the main objective of central banks is to ensure stable financial conditions, thus protecting the value of local currencies. This situation is often achieved through the formulation and implementation of an effective monetary policy. Monetary policies are widely regarded as a useful instrument to depress demand for cash in times of excessive expenditure, and to stimulate such demand in times of recessionary conditions. By controlling financial expenditure, an effective monetary policy should create an environment of

<sup>56</sup> See ss 2-5 of the SARB Act. Under the Act, a bank is an institution as defined in s 1 of the Banks Act 94 of 1990, whilst a mutual bank means a mutual bank as defined in s 1(1) of the Mutual Banks Act 124 of 1993, ie, a juristic person: (a) of which the members qualify as members by virtue of being shareholders of that juristic person and are entitled to participate in the exercise of control in a general meeting of that juristic person; and (b) that is registered as a mutual bank in terms of the Mutual Banks Act.

<sup>57</sup> The rate of borrowing is not the only tool to control inflation in a particular economy. Central banks can also employ other mechanisms to manage inflation and financial stability. A good example is for central banks to increase the minimum reserve amount that other commercial banks or financial institutions must have deposited with the central bank. By increasing this amount, central banks can decrease the financial resources of other banks that they can then lend to consumers. Financial liquidity is thus extracted from the market before it reaches the lender.

<sup>58</sup> See s 10A of the SARB Act and the regulations made under the Act. See also s 11(1)-(2) of the SARB Act read together with the Inspection of Financial Institutions Act 80 of 1998.

<sup>59</sup> Section 14(1)-(2) of the SARB Act.

<sup>60</sup> Section 15(1) of the SARB Act.

<sup>61</sup> Again, one should remember that a primary function of a central bank is to act as the government's banker, financial agent and advisor (see Du Plessis *op cit* note 8 at 91).

<sup>62</sup> See s 31 of the SARB Act, as well as the Extension of the Powers of the South African Reserve Bank Act 1990, which allows the Bank to perform functions in relation to certain other countries.

<sup>63</sup> Section 38 of the SARB Act.

continuous and sustainable economic growth, and overall financial stability. For any monetary policy to be successful, it must be accepted by and be credible for all stakeholders. Central banks should therefore seek to establish partnerships between government institutions, on the one hand, and corporate and private institutions and individuals, on the other. However, these partnerships can be created only through regular consultation and communication.<sup>64</sup> It is also important to emphasise that central banks must communicate and co-operate with each other. Within the global economy, many vociferous critics acknowledge that there is an important need for reducing poverty and for ensuring regional and international integration and co-operation.<sup>65</sup> All in all, a central bank must seek to balance inflation and economic growth. Low inflation generally results in maximum economic growth. Inflationary control cannot be achieved in isolation; in particular, emerging economies must stay in touch with what is happening in the major economies of the world.<sup>66</sup>

### 3.5 The Role of a Central Bank in Protecting Local Consumers

It was mentioned above that a central bank plays an important role in a particular local economy, and that the actions of any central bank have a direct impact on local consumers. Through its monetary policy a central bank has a direct impact on consumer spending and corporate viability. In essence, a central bank should aim to control and limit inflation, thus achieving price and financial stability. Increased inflation lowers the value of money, in turn eroding the buying power of consumers.<sup>67</sup> If inflation spirals out of control, the poor of a country are more at risk. Whereas affluent people can to some

<sup>64</sup> See <http://www.reservebank.co.za> (visited on 30 April 2008).

<sup>65</sup> South Africa is generally regarded as the strongest economy in the Southern African Development Community (SADC), and the SA Reserve Bank plays an important role in ensuring inter-country co-operation, training and anti-money laundering initiatives. South Africa has an approximately R2 trillion economy, and is an important regional role-player in the Southern African economic environment. Note the statement of Mr TT Mboweni, Governor of the SA Reserve Bank (entitled 'The Role of the South African Reserve Bank in Economic Integration in the Southern African Development Community') (21 September 1999) available at <http://www.reservebank.co.za/internet/publication.nsf/WCEV/AEBA616E52DB5A3A42256B41002F1671/?opendocument> (visited on 30 April 2008) at 1. Examples of international and regional monetary institutions are the International Monetary Fund (IMF), which was created with the aim of restoring the world economy after World War II and international monetary co-operation and global liquidity; the World Bank, which lends funds to member states for various developmental purposes; and the African Development Bank, which provides monetary assistance for the development of African countries. For more on these institutions, see Izelde van Jaarsveld 'International Banking: the World Bank and Other Financial Institutions' (2000) 8 *Juta's Business Law* 159 at 161.

<sup>66</sup> See the address by Dr C Stals, former Governor of the SA Reserve Bank (entitled 'The Role of Central Banks in Today's Economies: The Experience of South Africa'), at the Conference on Current Economic Policy Issues (25 April 1997) in Durban, South (available at <http://www.reservebank.co.za/internet/publication.nsf/WCEV/B4DBD3D6F858E42942256B2F004C86A2/?opendocument>) at 1.

<sup>67</sup> In 2000 South Africa adopted an Inflation Targeting Framework (ITF) policy in which an inflation target of between 3-6% was determined by the Government. According to this policy the SA Reserve Bank, through interest-rate control, must try to keep CPIX inflation (headline consumer price inflation excluding mortgage interest costs) between 3-6% per year (see also the occasional paper no 19 by EJ van der Merwe 'Inflation Targeting in South Africa', July 2004 at [http://www2.resbank.co.za/internet/Publication.nsf/LADV/EIBAD4FBC856AE9042256EF4004DEBB/\\$File/OCCNo19.pdf](http://www2.resbank.co.za/internet/Publication.nsf/LADV/EIBAD4FBC856AE9042256EF4004DEBB/$File/OCCNo19.pdf) at 10 (visited on 28 April 2008)).

extent hedge themselves against higher inflation, the poor are hit directly by price increases and any downturn in economic growth. As a result, it is crucial for any central bank to ensure that inflation is controlled and managed within acceptable boundaries.<sup>68</sup> However, all central banks are faced with the financial irony that in order to protect the consumer from high inflation, the banks must often determine higher lending rates that in turn have negative consequences for consumer spending and credit supply. Central banks should seek to achieve a balance between financial and inflationary control and supervision, and consumer protection and economic growth and prosperity.<sup>69</sup> So a central bank must act as the guardian of the national economy. An appropriate balance will be achieved only when central banks act quickly, decisively and consistently.<sup>70</sup> In South Africa, the recent increases in the prime bank lending rate have been controversial. Many stakeholders argue that the main crisis is due not to inflation but to external factors such as high prices of food, energy and other commodities.

Recently the Governor of the Bank reiterated that the mandate and overall function of the Bank is to fight inflation, and that its only effective tool for doing so is the interest rate policy. The Governor added that the Bank must not give in to populist pressure by certain groups in society in order to change the macro-economic policy of the Bank and the state. Such actions would have negative consequences for international investors who would lose confidence in the South African economy as a possible destination for investment. The Bank must create and ensure a stable and credible financial and economic environment. There seems to be consensus that the central aim of all central banks is to control and minimise inflation. Low inflation means that money will lose value only slowly. As money is a means of payment, a measuring unit for the value of goods and services, and a store value for the savings of a community, it is essential that its value should remain as stable as possible. On the other hand, inflation is a continuous decline in the value of money that is reflected in the ever-increasing prices of goods and services. It is obvious that inflation should be contained. It is also a fact that prices in a market economy will always change in response to changes in relative scarcities. A serious problem occurs when all prices rise continuously.

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<sup>68</sup> See the address by Mr TT Mboweni, Governor of the SA Reserve Bank, 'The Role of the South African Reserve Bank in the Protection of Consumers', presented at the National Consumer Forum conference in Johannesburg on 15 March 2007 (available at <http://www.reservebank.co.za/Internet/publication.nsf/WCEV/87DAAC936B17945A4225729F00392D89/?opendocument> (visited on 28/04/2008)). Arguably, the best tool of a central bank to manage inflation is its interest-rate policy. Most central banks are authorised to determine the repo rate (the rate at which other banks borrow money from the central bank). The higher the repo rate, the higher the lending rate of banks on borrowed money.

<sup>69</sup> South Africa is generally recognised as a growing economy based on the principles of a free market and effective competition. The Bank must therefore help to foster a financial environment in which the local economy can thrive for the benefit of all.

<sup>70</sup> Much can be said for consumer education and training. Consumers also have a part to play. Inflation targeting is not only the role of a central bank. All role-players in a local economy must work together constructively to keep inflation as low as possible. Even ordinary people must take appropriate steps to ensure that inflation is maintained. Excessive borrowing, luxurious lifestyles and a careless approach to savings should be guarded against. Basic mechanisms to save energy and scarce resources will help to lower inflation.

Producers and consumers can then easily take wrong decisions because they cannot distinguish properly between the changes in relative prices and price increases that form part of a period of a high inflationary cycle. High rates of inflation lead inevitably to a decline in the working of a market economy and the growth of the economy, and to fewer opportunities of employment. Central banks should therefore aim to keep inflation under control.<sup>71</sup> Although economic difficult times create hardship – especially for the poor – an externally pressurised adjustment to the monetary and inflation policy of the Bank would harm the country's financial credibility. Some respite in the short term can then easily lead to long-term disadvantages. It is argued that the Bank must stick to its monetary and inflation policy, even in difficult times. Weak points must be identified and addressed, but a sound policy should not be sacrificed in the face of financial pressures.<sup>72</sup>

#### 4 A Brief Comparison of the Functions of Major Central Banks in the World

Most developed countries in the world have a central bank with broadly similar functions and powers. The oldest central bank is Sweden's Riksbank, which dates back to 1668, followed by the Bank of England in 1694.<sup>73</sup> In 1800 Napoleon I established the Banque de France. The German Bundesbank was re-established after World War II. More recently, some functions of central banks of European countries have been assumed by the European Central Bank, established in 1998.

##### 4.1 The Bank of England

The Bank of England is the central bank of the United Kingdom. The bank was founded in 1694 and nationalised in 1946 and it gained independence in 1997. The bank is at the centre of the United Kingdom's financial system, and as such it is committed to the promotion and maintenance of monetary and financial stability in order to ensure a healthy economy. In pursuing its goal of maintaining a stable and efficient monetary and financial framework, the Bank has two core purposes:<sup>74</sup>

##### 4.1.1 Core Purpose 1 – Monetary Stability

Monetary stability means stable prices and confidence in the currency. Stable prices are defined by the Government's inflation target, which the Bank

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<sup>71</sup> See <http://www.reservebank.co.za/internet/publication.nst/WSNCLV/96641B4A656B2A4E> (visited on 9 June 2008).

<sup>72</sup> See T Lund 'Inflation Targets' *Finweek* 10 April 2008 at 22. It is said that the Bank normally follows a market-orientated approach to implementing monetary policy. This approach technically refers to intervention in the various financial markets in a country. Intervention is often achieved by the Bank's buying and selling financial instruments to influence prices, by regulating the cash reserve requirement of banks, or by adjusting the prime bank lending rate (see De Jager op cit note 39 at 274-5).

<sup>73</sup> See Du Plessis op cit note 8 at 86.

<sup>74</sup> See <http://www.bankofengland.co.uk/about/corepurposes> (visited on 2 April 2008).

seeks to meet through the decisions on interest rates taken by the Monetary Policy Committee, explaining those decisions transparently and implementing them effectively in the money markets.

#### 4.1.2 Core Purpose 2 – Financial Stability

Financial stability entails the detection and reduction of threats to the financial system as a whole. Such threats are detected through the Bank's surveillance and market intelligence functions. They are reduced by strengthening infrastructure, and by financial and other operations – both at home and abroad – including, in exceptional circumstances, by acting as the lender of last resort.<sup>75</sup>

In pursuit of both purposes, the bank works closely with other institutions such as other central banks, the United Kingdom Treasury and international organisations. Finally, the bank has determined certain strategic priorities in order to fulfil its overall role and responsibilities. Some of these strategic priorities include:<sup>76</sup>

- achieving and managing a predetermined inflation target;
- ensuring a stable interest rate;
- ensuring monetary and financial stability;
- designing, producing and maintaining banknotes and guarding against counterfeiting;
- being on the lookout for major risks to the United Kingdom's financial system, and managing financial crises; and
- promoting safe and efficient payment and settlement systems.

#### 4.2 The United States Federal Reserve

The Federal Reserve System is the central bank of the United States of America. It was founded by Congress in 1913 to provide the United States with a safer, more flexible and more stable monetary and financial system. Over time, the bank's role and the economy have expanded greatly, and many other duties of the Federal Reserve have developed. In modern times, such duties are divided into four general areas:<sup>77</sup>

- conducting the nation's monetary policy by influencing the monetary and

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<sup>75</sup> Although not specifically mentioned in the SARB Act, this is also a function that the SA central bank should be able to perform. It is important to recognise that the SA Reserve Bank, like all central banks, has an invaluable role to play in rescuing banks and other financial institutions that have encountered financial and liquidity problems. See, eg, the actions in 2008 of the US Federal Reserve in saving some American banks from bankruptcy and the intervention of the Bank of England in the Northern Rock crisis. However, some commentators consider that rescue operations are not part of a central bank's primary functions and that a central bank should only be a lender of last resort; central banks should not be an easy bailout for insolvent or poorly managed financial institutions (see Oelkers op cit note 24 at 715).

<sup>76</sup> See <http://www.bankofengland.co.uk/about/strategy> (as visited on 2 June 2008).

<sup>77</sup> See <http://www.federalreserve.gov/generalinfo/mission> (visited on 2 June 2008).

- credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates;
- supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system, and to protect the credit rights of consumers;
  - maintaining the stability of the financial system and containing systemic risk that may arise in financial markets; and
  - providing financial services to depository institutions, the United States Government, and foreign official institutions, including playing a major role in operating the nation's payments system.

In essence, the overall objectives of the United States Federal Reserve include managing economic growth, advancing employment in the United States, ensuring stable prices with special reference to the purchasing power of the dollar, and moderating long-term interest rates. The Federal Reserve System is considered an independent central bank, because its decisions do not have to be ratified by the President or the executive branch of government. But the System is subject to oversight by the United States Congress.<sup>78</sup> According to its structure, the Federal Reserve System comprises a central, governmental agency, the Board of Governors, and twelve other regional Federal Reserve Banks. The Board and the Regional Reserve Banks share responsibility for supervising and regulating certain financial institutions and activities, providing banking services to depository institutions and the federal government, and ensuring that consumers receive adequate information and fair treatment in their business dealings with the United States banking system.

### 4.3 The European Central Bank

The European Central Bank (ECB) – as well as the European System of Central Banks (ESCB) – was established on 1 June 1998. The ECB is the central bank for Europe's single currency, the Euro. Within the Euro system, both the ECB and the national central banks of those countries that have adopted the Euro have a role to play in order to achieve the tasks of the ESCB. The tasks of the ESCB are laid down in the Treaty establishing the European Community. Both the ESCB and the ECB are specified in the statute of the ESCB and ECB, which is a protocol to the EU Treaty. The primary objectives of the ESCB are to maintain price stability, the purchasing power of the Euro, economic growth, and both employment and sustainable non-inflationary growth.<sup>79</sup> Apart from the ESCB's primary objectives, the ECB has the following additional tasks:<sup>80</sup>

- defining and implementing a monetary policy for the Euro area;

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<sup>78</sup> See <http://www.federalreserve.gov/general> (visited on 2 June 2008).

<sup>79</sup> Refer to <http://www.ecb.int/tasks> (visited on 1 June 2008).

<sup>80</sup> Note also <http://www.ecb.int/ecb/orga/tasks/html/index.en.html> (visited on 2 June 2008).



- conducting foreign exchange operations;
- holding and managing foreign reserves;
- promoting a smooth payment system;
- issuing banknotes in the Euro area;
- collecting statistics on economic data;
- ensuring financial stability and supervision; and
- facilitating international and European financial cooperation.

## 5 Summary and Concluding Remarks

The global economy is in a dangerous phase of unfolding financial horrors. Almost all countries are experiencing severe price increases in energy (oil and electricity) and food, as well as inflationary pressures and economic slowdowns. Many factors have been identified as the catalyst for these current problems: they include enormous population growth, concerns about global warming, and relentless competition for scarce resources.<sup>81</sup> It is submitted that if the current conditions signal a new trend in world markets, most world economies will soon find themselves in dire financial straits.

All central banks are challenged to achieve a balance between low inflation, a stable and strong local currency, and positive economic growth. Although currency weakness can be advantageous to local exporters, it is obviously detrimental to local importers.

No clear and universal formula exists to predict future economic challenges and to forecast preventive economic measures. So it is not surprising that economists all over the world hold different views on which steps must be taken and how central banks must fulfil their roles and responsibilities. What is certain, however, is that if central banks do not fulfil their roles or follow a haphazard approach to doing so, then consumer bankruptcies and corporate failures that could otherwise have been avoided will be exacerbated. It has been mentioned that central banks worldwide share more or less the same outlook on monetary and banking matters. These banks usually constitute monetary authorities capable of influencing the cost and availability of credit in the economy (the local and sometimes the global economy), and thus they can and must determine a particular monetary policy for their respective jurisdictions. This monetary policy represents only one pillar of the total macro-economic policy, and is generally aimed at achieving the highest possible rate of economic growth, price and financial stability and the value of the domestic currency, thus aiming at low inflation. To achieve the above-mentioned object central banks conduct monetary policy within an inflation-targeting framework – it endeavours to maintain the Consumer Price

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<sup>81</sup> Other factors are energy and food prices, political instability, regional and international conflict, and concerns about climate change.

Index excluding interest rates on mortgage bonds (CPIX) within a designated target range.<sup>82</sup>

To summarise: there should be no doubt that a country's central bank has an indispensable role to play in a particular local economy. Certain central banks (the United States Federal Reserve, the European Central Bank, and the Bank of England), though, have an even greater responsibility and impact because many local financial markets are driven and influenced by the major economies of the world.<sup>83</sup> It is fundamentally important that central banks take note of their vital roles and important responsibilities.

Central banks must ensure that steps are taken pro-actively to ensure a local economic environment with stable financial markets, and a balance between manageable inflation and economic growth.<sup>84</sup> These banks are not 'crowd-pleasers' but must ensure that appropriate steps are taken to achieve the main aim of the creation of such institutions. If central banks fail to fulfil their duties and responsibilities, the number of consumer bankruptcies and corporate failures will be much higher than could have been avoided in the first place.

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<sup>82</sup> According to De Jager op cit note 3 at 164-5 n38, the central banks of about 49 countries worldwide have either the preservation of the value of their respective currencies or price stability as their primary objective. According to some commentators, it is generally accepted today that the main objective of a central bank should be to achieve and maintain price stability. Price stability focuses on the domestic value of a currency and connotes low inflation. In South Africa, a floating exchange-rate policy is followed. The external value of the SA currency is therefore not determined by the SA Reserve Bank, but by the international market. For this reason, De Jager mentions that it is somewhat unfortunate that the protection of the value of the SA currency is stated as the primary objective of the SA Reserve Bank. Some commentators contend that it would be better for the Bank to achieve and maintain price stability in South Africa (see also De Jager op cit note 39 at 289).

<sup>83</sup> Recently the world has witnessed unprecedented action by some central banks. The US Federal Reserve has arguably lead the way by aggressively cutting interest rates and pumping billions of dollars into the financial system, thereby stimulating the local economy, seeking financial stability and increasing financial liquidity.

<sup>84</sup> Most developing countries, such as South Africa, have severe shortages on their current accounts. A country's current account refers to the balance of all trades between that country and the rest of the world. When a country imports more goods than it exports and when its local currency is weak in comparison with its trading partners, it would normally have a significant deficit (negative balance) on its current account. Countries with high current account deficits are then often perceived as risky investment destinations, with the result that international investment is limited and economic growth is restricted.