

A BRIEF NOTE ON NEL AND LEKALAKE:
MONETARY TRANSPARENCY IN SOUTH
AFRICA

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IN NEL AND LEKALAKE (2004), monetary policy transparency in South Africa is addressed, focusing on the SA Reserve Bank's compliance with the *Code of Good Practices on Transparency in Monetary Policy* (IMF, 2000) and assessing whether the Bank has been effective in introducing transparency in South Africa. The study also offers some recommendations on how monetary policy transparency could be improved.

Although the study by Nel and Lekalake offers a useful insight into monetary policy transparency based on the application of the codes of the IMF, it is argued in this brief note that the study took neither full cognisance of the Reserve Bank's unique ownership structure supporting monetary policy transparency, nor of the insights gained by the Bank from past experiences. This brief note therefore highlights the Bank's ownership structure and then comments on certain of the recommendations made by Nel and Lekalake.

1. UNIQUE OWNERSHIP STRUCTURE OF THE RESERVE BANK

Although the conclusion is reached by Nel and Lekalake "... that the Reserve Bank has been effective in creating a transparent monetary policy environment and that it complies with most

international standards in this regard" (2004:361), they do not point out the uniqueness of the general public's shareholding in the central bank as an important further factor contributing to transparency. Whereas most central banks established before the Great Depression of the early 1930s used to have private shareholding, this tendency changed after the Depression (De Kock, 1939:320-327). Today the Reserve Bank, the Belgium National Bank and the Swiss National Bank are the only central banks left with the public as shareholders.

This unique ownership structure makes an important contribution to the transparency of monetary policy, as it places on the Reserve Bank the obligation to arrange annually a general meeting of shareholders. At the general meeting shareholders do not only approve the *Annual Report and Financial Statements* of the Reserve Bank and elect shareholders' representatives to the Bank's Board, but the Governor also delivers a Chairperson's address, known as the *Governor's Address*. The *Address* highlights, *inter alia*, the conduct and successes (or otherwise) of the implementation of monetary policy. At the conclusion of the *Governor's Address*, the attendees at the meeting are provided an opportunity to question the Governor on matters covered in the *Address* or other matters related to the conduct of the affairs of the Reserve Bank. This arrangement adds a dimension of transparency to the implementation of monetary policy way beyond the formal reporting structures and analytical assessments of transparency suggested by the IMF: the public can question the Governor on monetary policy, who is under a legal obligation to respond to questions.

In the interest of the transparent implementation of monetary policy, it is important to retain this unique feature of the Reserve Bank. However, it might be put in jeopardy and be the subject of revision in view of the position taken by a majority of the Bank's shareholders at the time of the previous general meeting held on 26 August 2003.

Section 24 of the SA Reserve Bank Act, No 90 of 1989, as amended, states that the annual dividends payable to shareholders

are limited to 10 cents per share per annum. During July 2003 the Reserve Bank was informed by a shareholder of the intention to put before the next general meeting (*i.e.* on 26 August 2003) a resolution proposing an amendment to section 24 of the Act to provide for a dividend equal to 10 per cent of the annual profits of the Bank. As the regulations framed under the SA Reserve Bank Act permit any shareholder to introduce any matter related to the affairs of the Reserve Bank for consideration by shareholders, this matter had to be put to shareholders.

Despite the opposition of the management and Board of the Reserve Bank to the proposed amendment, the majority of shareholders still voted in favour of the resolution (De Jager, 2004:17). As the Reserve Bank cannot amend its own Act, the matter was raised with Government, stating clearly that it is not supported by the management and the Board, as any profit motive would not be reconcilable with the Bank's role as central bank. In accordance with the Bank's recommendation, Government has wisely decided to note but ignore the resolution.

The question remaining, however, is whether shareholders might put their shareholding in jeopardy by their conduct at the general meeting of 2003. De Jager (2004:17) concludes that "(t)he question arises whether the shareholder activism displayed by SARB shareholders ... signalled a need to end private shareholder participation in the governance of the central bank". As the Reserve Bank serves the public interest, rather than the narrow interests of its shareholders, this question deserves thorough further deliberation, although the removal of the shareholders will reduce the transparency of and reporting on monetary policy decisions.

2. COMMENTS ON CERTAIN RECOMMENDATIONS

Whilst the study of Nel and Lekalake offers for consideration recommendations aimed at improving the transparency of monetary policy, their recommendations pertaining to the position of the Governor of the Reserve Bank warrant comment. The specific recommendations are that "(i)t would also improve transparency to have formal rules for the removal from office of the governor and

directors. The Bank should also consider whether it would not be more appropriate in terms of good corporate governance to appoint someone other than the governor or his/her deputies as chairperson of the SARB board" (Nel and Lekalake, 2004:362).

The first of these recommendations might, *inter alia*, have been informed by the remark in a footnote by Nel and Lekalake (2004:361) that "(t)he Governor of the Reserve Bank of New Zealand is dismissed if the central bank is not adequately carrying out its functions". In the case of New Zealand, it is a legal requirement for the Minister of Finance and the Governor of the Central Bank to agree on a published *Policy Target Agreement* (PTA), which sets out specific inflation targets. The PTA can only be changed by agreement between the Governor and the Minister of Finance and such changes must also be made public. A new PTA must be negotiated every time a Governor is appointed or re-appointed, but it does not have to be renegotiated when a new Minister of Finance is appointed (Reserve Bank of New Zealand, 2004b). Although the Reserve Bank of New Zealand missed its inflation target in 1996 (Reserve Bank of New Zealand, 2004a), the PTA is worded in such a fashion that it allows the Governor sufficient opportunity to explain the reasons why the central bank did not achieve its targets. The use of the words "... is dismissed ..." by Nel and Lekalake (2004:361) is therefore too strong to describe the true state of affairs. At best they should make reference to "... could be dismissed ...", as no Governor of the Reserve Bank of New Zealand has ever been dismissed.

The use of this example as the basis to recommend "... formal rules for the removal from office of the governor and directors ..." (Nel and Lekalake, 2004:362) therefore warrants further discussion. It is of particular importance to note that "... the (New Zealand) Government has the power to override the PTA ... by directing the Reserve Bank to use monetary policy for a different economic objective altogether for a 12 month period, though ... it must make the instruction public. A new PTA must then be negotiated to cover the override period and another PTA must be negotiated when the override ends. In either case, if a new PTA cannot be negotiated, the Governor can be dismissed. So far, this override section has not been

used" (Reserve Bank of New Zealand, 2004b).

This puts both transparency of monetary policy in New Zealand and the possible dismissal of the Governor in a completely different perspective. The Reserve Bank of New Zealand (2004b) states that "(p)erhaps the most important feature of the PTA is that it is a public document. As a result, any attempt by a Government to use monetary policy to create a temporary surge in economic activity for electoral advantage would *probably* (own emphasis) fail. This is because a public announcement that inflation was going to be higher would immediately trigger higher interest rates, offsetting the temporary stimulatory effect of any induced inflation"; a clear target not providing for intervention by the government would be much more supportive of transparent monetary policy. Rather remove temptation altogether, than to suggest that it would *probably* not deliver the desired results and might lead to the dismissal of the Governor.

The appointments of the Governor and deputy governors of the Reserve Bank are governed by section 4 of the SA Reserve Bank Act. This section states, *inter alia*, that "(t)he Governor shall be a person of tested banking experience" and stipulates in section 4(4) that "(n)o person shall be appointed or elected as or remain a director (and therefore serve as Governor or a deputy governor): "if he or she is not resident in the Republic; or if he or she is a director, officer or employee of a bank or a mutual bank; or 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 or of a provincial legislature referred to in section 125 of the constitution" (SA Reserve Bank Act, 1989).

As these stipulations comprise the full conditions of service of Board members, the implication is that the SA Reserve Bank Act would have to be changed if it is considered necessary to dismiss the Governor (or any deputy governor). This corresponds with the position in Canada in the early 1960s, when an attempt was made to get approval in Parliament for a bill to remove Governor Coyne from office. During the late 1950s the Canadian government sought to ease monetary policy in order to support demand and reduce slack in the economy. Governor Coyne, the Governor of the Bank of Canada, resisted these attempts to change policy (Bank of Canada, 1999).

Owing to the policy dispute, the Canadian government requested the resignation of Governor Coyne on 30 May 1961, but the Governor refused to resign. On 20 June 1961 the Canadian Minister of Finance introduced a bill in Parliament to declare vacant the position of the Governor of the central bank. The House of Commons passed the bill, but, after testimony by Governor Coyne, the full Senate defeated the bill. Only after the defeat of the bill did Governor Coyne resign, hence allowing public debate on his position (Bank of Canada, 1999).

This seems to be a preferable position, rather than to provide for a dismissal procedure, as it will subject any dismissal process to public debate and scrutiny during a Parliamentary process, thereby adding to the transparency of debates on differences of opinion on monetary policy.

The SA Reserve Bank Act (1989) also stipulates in section 7 that "(t)he Governor shall preside at the meetings of the Board, ... (but) ... the Minister may designate any other director to act as chairman of the Board during the Minister's pleasure ...". The Minister of Finance at the time, Dr TE Donges, exercised this option in 1962 and during the latter part of that year and the most of 1963 the Governor did not serve as Chairperson of the Board of the Reserve Bank. After he stepped down as Governor of the Reserve Bank on 30 June 1962, Dr MH de Kock was appointed by the Minister of Finance as Chairperson of the Bank's Board, whereas Dr G Rissik was appointed as Governor with effect from 1 July 1962 (Meinng, 1993:56, SA Reserve Bank, 1971:47).

This decision to split the responsibilities was soon found not to be in the interest of the Reserve Bank and this practice was

hence ended in 1963. One complicating factor, for instance, was that the Chairperson, rather than the Governor, had to deliver the *Address* at the general meeting of shareholders. A similar split of responsibilities would raise questions of responsibility for the explanation of monetary policy decisions. Retaining the Governor as Chairperson is therefore the preferable position, particularly in a central bank with private shareholders that would wish to engage in discussion at the general meeting of shareholders. However, the option is still available to the Minister of Finance to designate another director as Chairperson of the Board of the Bank.

CONCLUSION

The study by Nel and Lekalake contributes to the debate on monetary policy transparency in South Africa, but stops short of recognising the uniqueness of the private shareholding of the Reserve Bank that deserves to be treasured and maintained, albeit with the necessary restraint exercised by the shareholders, as an important further dimension adding to transparency. Previous experiences in respect of some of the specific recommendations included in their study are also not taken sufficiently into consideration by Nel and Lekalake in the formulation of their recommendations.

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