The Independence of Twelve Central Banks in the Southern African Development Community

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Abstract: The 14 countries of the Southern African Development Community (SADC) endeavour the establishment of a respected and independent regional central bank as a key precondition for the envisaged monetary union. Because the member of the central banks will also have to comply with the criteria of independence, the question arises as to their progress in this direction. This chapter analyses the economic and political independence from government of 12 of these central banks. The results reveal a clear lack of independence in the majority of cases, thus indicating the pressing need for significant steps to amend the charters of these central banks.

Keywords: Central Bank Independence, Southern African Development Community, Central Bank Statutes

1 Introduction

Debates and research regarding monetary policy-making normally focus on the technical and pure economic aspects of this branch of monetary science. Topics such as the instruments of monetary policy, the transmission mechanisms regarding monetary impulses and the lags in the effects of monetary policy are intensively researched. This might lead to the spurious idea that monetary policy-making is an apolitical or a political neutral affair void of partisan influences and subjective political manipulation. Such a one-dimensional view of monetary policy neglects the practical reality that monetary management has important socioeconomic influences that affect the daily lives of a multitude of people who happen to be voters in political elections. Globally politicians, therefore, have a natural inclination to manipulate monetary policy-makers and events in their favour to get elected or re-elected to parliament or congress. This brings monetary policy right into the midst of political gaming strategies. However, politicians most often have short-term policy horizons spanning only the duration of the election cycle. If the monetary policy domain is indeed allowed to be influenced by subjective political manipulations, it will consequently erode sustainable and prudent monetary policy-making, thereby leading to sub-optimal and misguided long-run economic outcomes. The latter phenomenon underlines the fact that monetary policy failures often do not have an economic basis, but a political origin. History provides ample examples of hyperinflations, the roots of which are grounded in the excessive creation of money spurred by political profligacy. It normally takes the form of an explosive fiscal deficit run up by incumbent politicians before a political election, which deficit is then financed by the monetisation of government debt, which amounts to an enormous oversupply of money.

The foregoing malignant course of events was already recognised at the dawn of the central bank history. Indeed, Bagehot, the father of central bank thought forcefully stated that ‘no result could be worse than that the conduct of the Bank (of England) and the management should be made a matter of party politics and men of all parties would agree in this, even if they agreed in almost nothing else’ (Bagehot, 1915, p. 218). Overtime statements like this have contributed to the realisation that economic policy-making is very much a politico-economic affair. Lately, it has caused an upsurge in interest and research in the field of central banking, focussing to a large extent on the degree of independence according to central banks (see Grilli et al., 1991). This research constitutes an extension of the renewed interest in political economy as well as renewed interest in the working and driving forces behind policy bureaucracies. The significance of the research on central bank independence (CBI) is supported by the argument that the power to create money should be separated from the power to spend it to defend the purchasing power of a country’s currency. Indeed, at an early stage, various studies already indicated lower inflation in those countries where independence of their central banks is the strongest (see De Haan and Sturm, 1992, p. 321).

The above arguments are also relevant for the central banks in the Southern African Development Community (SADC) and underline the urgency to assess the independence of the central banks in this region. The SADC consist of 14 member countries, namely South Africa, Angola, Botswana, the Democratic Republic of the Congo (DRC), Lesotho, Malawi, Mauritius, Seychelles, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe. These countries aim to establish a monetary and economic union by 2016, which implies that they will have a common, single currency and a common regional central bank. Except for setting and achieving common targets for the convergence of inflation, budget deficits, foreign exchange reserves and other important economic aggregates, the statutes of the planned regional central bank will also have to converge to global best practices regarding their central banks' independence.

This chapter compares and rates the degree of independence of the central banks of the aforementioned SADC countries.[1] It derives its impetus from the fact that one of the many necessary institutional designs for such an intended union is the establishment of a respected and independent central bank, as was the case with the establishment of the European Central Bank in the EMU. In pursuing this aim, Section 2 first develops criteria for assessing *legal* CBI. Political as well as economic yardsticks of the concept will be discussed, emanating from the flood of research on CBI since the 1980s and 1990s, continuing into the 21st century. Section 3 focusses on the evaluation of the CBI of the central banks in the SADC by applying the political and economic yardsticks to the statutes or charters of the relevant central banks. The section presents the CBI results in a tabulated format to simplify comparison between the countries. Section 4 concludes the chapter.

2 Criteria for Assessing CBI

Because the appearance of the path-breaking research by Bade and Parkin (1988), Cukierman (1992) and Cukierman (1994), many other supplementary efforts (e.g. MAE, 1998) have been made to compile suitable criteria for measuring CBI. At first the criteria were general in nature and applied only to developed countries, but later they got separated into political and economic criteria, which were also applied to emerging countries. A further distinction followed when *actual* and *legal* CBI assessment criteria were introduced. The latter refers to those criteria that are embedded in legal documents such as the statute or charter of the central bank. These criteria are more clear and definable and are therefore easier to apply than *actual* ones. This chapter will focus only on *legal* criteria of a political and economic nature.

2.1 Political Criteria for Assessing CBI

Political criteria developed by scholars in the area for measuring CBI consist primarily of the following (see Alesina and Summers, 1993; Cukierman, 1992; Cukierman et al., 1992; Eijffinger and de Haan, 1996; Eijffinger and Schaling, 1993; Fischer, 1995; Luis, 2001; Lybek and Morris, 2004):

- The primary policy objective;
- Governing structure of the bank;
- Tenure of the governor and the board;
- Absence of politicians on the board of the central bank;
- Locus of decision-making;
- Fixity of independence;
- Accountability.

The aforementioned criteria are explicated below and subsequently applied to the aforementioned 12 central banks in the SADC region to assess their CBI.

2.1.1 The Primary Policy Objective

It is imperative for a central bank to have a clear, single or primary objective, which should be stated in terms of maintaining price stability. Stating multiple policy objectives, e.g. promoting economic growth, creating

1 Despite several attempts English versions of the statutes of the central banks of the DRC and Mozambique could not be obtained and they are consequently excluded from the research.

employment, stabilising the balance of payments or a favourable distribution of income, might compromise the bank and invite political interference. The latter becomes especially relevant and pressing just before an election period or during intense political jockeying aimed at increased political popularity. Moreover, central banks' monetary policy instruments and their primary policy skills do not capacitate them to directly promote employment, create economic growth and redistribute income, but rather to curb inflation and inflationary expectations. Achieving the latter objective will anyhow contribute to the attainment of the others.

2.1.2 The Governing Structure of the Board and the Tenure of Officials

Ideally the board and top officials (such as the Governor and Deputy Governors) of a central bank must not be appointed by politicians or political bodies, and even if so, there should be another body that must be consulted. It must also not be possible for government or political office-holders to remove the Governor of a central bank in an arbitrary way, or likewise change their remuneration. Save for reasons of personal misconduct, the Governor must have certainty that tainted political motives will not interfere with his/her term of office. This allows him/her to focus single-mindedly and persistently on the required monetary policy responsibilities. It also contributes towards policy consistency and long-term stability in policy programming. Such fixity of position can be enhanced, if fixed legal procedures and transparent and fair methods are available for settling disputes between government and the Governor, and if the legislature (and not the government alone) has the final decision in the removal of a Governor. Also important is that no government office bearer or politician with voting rights should be present on the board of the central bank.

2.1.3 Locus of Decision-Making

Central bank independence requires that a central bank should have the sole authority to devise and implement monetary policy. This does not rule out any consultation between the central bank and the Treasury. However, a clear distinction should be made regarding the meaning of the term 'consultation'. If any law prescribes compulsory consultation with and approval by the Minster of Finance prior to the implementation of monetary policy by the central bank, it deprives the bank of independent actions and opens the way for political interference. On the other hand, if mere consultation is suggested without a possible political override, the Bank's independence is untouched.

2.1.4 Accountability

Central banks are creations of their respective governments and can therefore never function in complete isolation from parliament. The sound operation of a democracy requires central banks to be accountable to government and therefore to report to parliament. It is important for government as well as the wider public to be informed of the monetary strategy that a central bank is following. This contributes to the required transparency expected of such a bank, thereby also lifting the veil of secrecy that shrouds certain central banks' policy-making. Not only the bank's policy priorities, but also its applied instruments should be explained retroactively as well as proactively in public so that economic agents can form expectations accordingly. Consequently, central banks must be required to publish annual reports and lay it before parliament, and also issue monetary policy reports encompassing current and expected future policy strategies. Accountability is also promoted, if the Governor of a central bank can be summoned to a specially elected finance committee of parliament to explain the bank's policy success or lack of it.

2.2 Economic Independence

This type of independence can be measured primarily according to the following criteria (see references under Section 2 earlier):

- Financial independence
- Financing government
- Instrument independence

2.2.1 Financial independence

To be free of government interference, a central bank needs to have full authority over its internal budgetary matters. If it is not the case, government may have a powerful handle to manipulate the central bank into expedient political policies. As long as the central bank can otherwise manage its own internal financial affairs, it is removed from such interference. Furthermore, if central banks are not encumbered with the liability to conduct quasi-fiscal and development operations that might lead to losses for the bank, financial independence is further secured.

2.2.2 Financing Government

It is crucial for central banks to avoid direct financing of government budget deficits because it constrains their ability to curb the monetisation of government debt and subsequent inflation in the long run. There is ample historical evidence of countries experiencing runaway inflations stemming from the malpractice of central banks being pressurised by governments into financing their profligate fiscal deficits. However, the monetisation of government debt can be curbed by setting strict limits to the amount of finance a central bank may grant to the government. Such limits can range from a total prohibition on any direct or indirect central bank credit to government on the one hand, to more liberal or profligate credit granting dispensations on the other. Not only should the amount of central bank credit to government be restricted to manageable proportions, but the central bank must also have the authority to determine the term or maturity of the loan (the shorter the term the better) and the rate of interest on the loan. The latter should be market related and thus flexible.

2.2.3 Instrument Independence

It is of cardinal importance for CBI that a central bank has full instrument independence. This entails full command over its arsenal of monetary policy instruments. Instrument independence shields a central bank from the frustration of not reaching otherwise attainable objectives due to political interference in the execution of its technical affairs.

3 Application of the Criteria

The political and economic criteria for assessing the *legal* independence of a central bank in the foregoing sections are subsequently applied to 12 central banks in the SADC and summarised in the three tables in the following sections. Asterisks indicate compliance with CBI criteria and are added to signify the achieved number of compliances out of a possible total of 12. The information for applying the CBI criteria to the twelve central banks were obtained from their charters, namely: Banco Nacional de Angola, Organic Law, 4/91; Bank of Namibia, Act 15 of 1997; Central Bank of Lesotho, Act No.2 of 2000; Central Bank of Seychelles, Act 12 of 2004; Reserve Bank of Malawi, Act 1989; Reserve Bank of Zimbabwe, Act 22 of 2001; South African Reserve Bank, Act 90 of 1989; The Bank of Botswana, Act no.19 of 1996; The Bank of Mauritius, Act no.34 of 2004; The Bank of Tanzania, Act of 2006; The Bank of Zambia, Act no. 43 of 1996; The Central Bank of Swaziland, Order no. 6 of 1974 and Amendments.

It is important to note that no weights are attached to the relative importance of the relevant criteria, and also that some of the criteria do not lend themselves to a clear-cut definition or description. Despite an inevitable shade of subjectivism, the criteria outlined in the table nevertheless convey a general picture of the CBI in the SADC. The table clearly portrays a sad picture of the reality in these banks. The majority of the central banks do not even come close to meeting the CBI requirements, and some of them do not come close to satisfying even the most basic features of a respected central bank. This is especially true for the central banks of Zimbabwe, Malawi, Namibia, Swaziland and Angola. According to the tables mentioned in the following section, these institutions should thoroughly redraft and amend their charters as soon as possible to gain respect in the eyes of not only the central bank fraternity, but also the world at large.

Table 1 CBI in the SADC countries

Country/criteria	Angola	Botswana	Lesotho	Malawi
1. Single, clear price stability objective	No single price objective	No: monetary, not price stability	Sole, clear price objective	No: multiple, broad range of objectives
2. Governor not appointed by government	No; president appoints for 5 years	No; president appoints for 5 years	No; king appoints for 5 years	No; president appoints for 5 years
3. All Board members not appointed by government	No, government appoints most/all	No, government appoints most/all	No, government appoints most/all	No, government appoints most/all
4. More than half of the Board not appointed by government	No, less than half	No, less than half	No, less than half	No, less than half
5. Absence of government or politicians on board	Unclear	No, government official has voting power	Yes	No, government official on board of bank
6. Fixity of office term/conflict resolution	Fixed, but no democratic process	Yes, fixed, and democratic process	Yes/Yes, democratic	No democratic procedures or resolutions
7. Locus of decision-making with Bank	Government can intervene and prescribe	Government can intervene if justified	Yes (yet partly unclear)	No, government can intervene
8. Accountability	Unclear (n/a)	Yes: AR; and regular statements	Yes: AR and pre- and post-overview	No: AR, but no pre- or post-overviews
9. Financial independence	Yes, control over budget	No clear stipulation	No clear stipulation	Yes, control over budget
10. Finance to government not allowed	No, allowed	No, allowed	No, allowed	No, allowed
11. Strict limits on c/bank loans to government	No, fund full deficit. Unacceptable stipulations.	Yes, 5% of government av. 3 year revenue, repay at market rate within 6 months. 5% can be mutually waived	Limit of 5% of government revenue, repay at market rate in 93 days. But can finance government projects up to 7 years	No, finance to economic development and government corps. Loans of 20% of government revenue.
12. Instrument independence	No	Yes, command over measures	Yes, command over measures	Yes, command over measures
Total	1	4	6	2

Table 2 CBI in the SADC

Country/criteria	Mauritius	Namibia	Seychelles	South Africa
1. Single, clear price stability objective	Single, clear price objective	No single price objective	Multiple objectives	Price stability as objective
2. Governor not appointed by government	No president appoints for 5 years	No president appoints for 5 years	No, president appoints for 6 years	No, president appoints for 5 years
3. All Board members not appointed by government	No, government appoints most/all	No, government appoints most/all	No, government appoints most/all	No, government appoints half of board
4. More than half of Board not appointed by government	No, less than half	No, less than half	No, less than half	No, less than half
5. Absence of government or politicians on board	Yes, not external intervention	No, government and public service officials on board.	Yes	Yes
6. Fixity of office term/conflict resolution	Fixity, but no democratic procedures	No/no open democratic procedures	Fixity, but no democratic process	Yes/no democratic procedures
7. Locus of decision-making with c/bank	Yes, clearly stipulated	No, government can issue motivated directive	Yes, clear locus with Bank	Yes, Bank decides policy
8. Accountability	Yes: AR and pre- and post-overview	No: AR but not pre-overviews	No: AR but no pre-overviews	Yes: AR and pre- and post-overview
9. Financial independence	Yes, control over budget	No clear stipulation	Yes, very clear budget control	Yes, control over internal budget
10. Finance to government not allowed	No, allowed	No, allowed	No, allowed	No, allowed
11. Strict limits on government loans	No, 25% of government revenue, at government rate for long run. Loans for government corps and development	No, 25–35% of government revenue, at government's rates, repay 6 months.	Yes, c/bank decides rates, loan limits, etc. 6 months term	Yes, bank determines rate and limit of 12.5% of revenue.
12. Instrument independence	Yes, command over measures	No/unclear	Yes, command over measures	Yes, command over measures
Total	6	0	5	7

Table 3 CBI in the SADC

Country/criteria	Swaziland	Tanzania	Zambia	Zimbabwe
1. Single, clear price stability objective	No single price stability objective	Clear price stability objective	Price stability as objective	Multiple objectives
2. Governor not appointed by government	No, king appoints for 5 years	No president appoints for 5 years	No, president appoints for 5 years	No, president appoints for 5 years
3. All Board members not appointed by government	No, government appoints most/all	No, government appoints most/all	No, government appoints most/all	No, government appoints most/all
4. > half of Board not appointed by government	No, less than half	No, less than half	No, less than half	No, less than half
5. Absence of government or politicians on board	No, government official on board	Government officials, but no voting power	Government officials, but no voting rights	Not mentioned
6. Fixity of office term/conflict resolution	No/ No democratic process provided	Yes/ Yes, clear procedure	No/Undemocratic procedure	No/Autocratic procedure
7. Locus of de-cision-making with Bank	No, government can issue policy directive	Yes, Bank alone decides	No, government can interfere with policy	No, Minister can issue directive
8. Accountability	No: AR but no pre and post overview	Yes: AR and pre, post overview	Yes: AR and pre and post overview	Yes: A/Ac and pre and post overview
9. Financial independence	No clear stipulation	Yes, control over budget	No clear stipulation	No, government controls
10. Finance to government not allowed	No, allowed	No, allowed	No, allowed	No, allowed
11. Strict limits on government loans	No, 20% of government revenue, repay in 6 months at c/bank's rate. C/bank invests in shares of stat. bodies and instit's.	No, 12.5% of government revenue, repay in 6 months at neg.d rate. No quasi-government loans.	No, 15% of government revenue; govern-ment determines terms & conditions	No, 20% of government revenue, repay in 12 months. Government dominates bank in section 8
12. Instrument independence	Yes, command over measures	Yes, command over measures	Yes, command over measures	No, directives by government
Total	1	8	4	1

4 Conclusion

This chapter applied a collection of 12 *legal* CBI criteria to assess 12 central banks in the SADC region. Of a possible score of 144 for meeting all the requirements of CBI, a total score of only 46 is achieved by the 12 SADC central banks. Together, six of the central banks meet only 10 of a possible total of 72 criteria. What is especially worrisome is that the latter banks fall short of meeting not only the total requirements, but especially the primary or more crucial ones such as criteria 1, 5, 6 and 11. Some of the banks like Mauritius and Tanzania have updated statutes closely satisfying the requirements for modern day central bank independence. Others, especially the central bank of Zimbabwe, Namibia, Swaziland, Angola and Malawi, fail to meet even the most basic requirements for independence. For them, serious and wide-ranging amendments should be brought about as soon as possible. Others, such as Botswana, South Africa and Lesotho already have some important requirements in place and should progress with relative ease to an adequately revised draft of their statutes. However, the overall picture for the entire SADC area is not encouraging and the CBI of these central banks lags significantly behind that of comparable central banks in other parts of the world.

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