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Central Bank Independence in the Southern African Development Community: Legal Reform Progress and Prospects

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Public commitments by political leaders to fast-track economic integration in the Southern African Development Community (SADC) have been at variance with the extremely slow pace of domesticating the 2009 SADC Central Bank Model Law. This paper identifies specific legislative gaps in the national central bank laws that member states need to address in order to enhance institutional uniformity and promote central bank independence in the SADC region. Countries with recent amendments have made adjustments for more compliance, while others have not done so. The paper recommends that member states should speedily effect the needed legislative alignments if the frequently delayed economic integration agenda is to move apace.

1. Introduction

The Southern African Development Community (SADC) Central Bank Model Law (SADC, 2009) was adopted by the SADC Committee of Central Bank Governors in 2009 to promote closer cooperation among the region's central banks. The Model Law encourages the adoption of general codes to facilitate operational independence, establish transparency and accountability standards, and facilitate the harmonisation of legal and operational frameworks of SADC's central banks. Through the Model Law the SADC leadership are supporting the "independence of the central bank [as] (...) a condition sine qua non for the achievement of price stability" (SADC, 2011).

Worldwide central bank statutes make extensive use of the term 'independence'. In the literature however the label 'autonomy' is sometimes preferred seeing that it entails operational freedom, whereas the expression 'independence' may indicate freedom from institutional constraints (Mfunwa, 1998: 9). Henceforth this paper will adopt the term 'independence' because of its wider use in the region, even if both terms refer essentially to the same status. 'Price stability' describes an economic and financial environment where inflation is so low as not to be a factor in economic agents' decision making processes (Blinder, 1995).

Central bank independence (CBI) is defined in terms of a mixture of political, economic and informal factors. Political independence is largely determined by the relationship between the central bank and the government in monetary policy formulation,

including the authority to choose the final policy goal of a certain inflation rate or level of economic activity, and procedures for the appointment and removal of central bank head. Economic or financial independence refers to the financial and budgetary relationship between the central bank and government, including lending to the government (Mfunwa, 1998: 18). The informal factors are difficult to assess and include whether central bank governors serve their full terms of office, particularly when there is a change of government; personalities, educational and occupational background of principal officials within the central bank; and the quality of the central bank's research programme.

The need for price stability in the SADC region was brought to the fore when Zimbabwe's hyperinflation reached the 231 million percent rate in July 2008 (Reserve Bank of Zimbabwe, 2012). Secondly, when South Africa's public protector recently adjudged the central bank's price stability mandate as 'too narrow', the public reaction was visceral and negative. Besides lessons from Zimbabwe, South Africa's economy is about half of the region's total economy and several neighbours' currencies are linked to the Rand, especially in the context of the Southern African Customs Union. Therefore, price instability in South Africa would destabilise the entire SADC economy.

By understanding the mismatches between the SADC Model Law and individual country laws, this paper is commenting on the independence of country central banks. It is important to state upfront that this paper does not seek to assess the reliability and consistency of the SADC Model Law against the stricter elements of the CBI. With this caveat in mind, this paper's main objective is to ascertain the extent to which central bank laws among 12 countries in the SADC region comply with the new regional model law; it identifies areas requiring amendments.¹ The paper is structured as follows: Section 2 briefly reviews literature on the theoretical rationale for granting independence to regional and national central banks, from which the SADC Model Law draws its inspiration. Section 3 highlights the key elements of CBI that form part of the Model Law. Section 4 unpacks the various central bank laws in the SADC region and highlights areas of convergence with and divergence from the adopted regional model law. Section 5 provides recommendations and concludes.

2. Literature Review: Solving the Inflationary Bias of Monetary Policy

The theoretical foundations of the SADC Model Law are found in the Finn E. Kydland and Edward C. Prescott model (1977), which sought to solve the time-inconsistency problem of policy making. Titled 'Rules Rather than Discretion', the model argued that monetary authorities' policy decisions are often time-inconsistent; that is, monetary policy changes intended to remedy an immediate problem such as unemployment will often have

¹ Central bank laws of three other SADC member states (Madagascar, Democratic Republic of Congo and Mozambique) were not available in English, and therefore could not be reviewed due to language limitations of the authors.

unintended outcomes that work against the goal of reducing joblessness. When a government announces a remedy to a short-term problem, individuals and firms adjust their behaviour and make new decisions based on that information. Those decisions change the economic landscape, obviating the need for the government to fulfill its promise on policy changes. Thus, if a government has the discretion to pursue any policy it wants, given the particular economic situation on the ground, and cannot remain committed to the promises it makes, a credibility problem arises. To counter this, it is wiser for a central bank to focus on long-range goals and not interfere in the economy too aggressively by trying to boost employment or boost economic activity in the short run. The model underscored the critical importance of policy consistency over time rather than thinking about what is optimal right now.

The Kydland-Prescott model was followed by the work of Robert Barro and David Gordon (1983) who added a 'rational expectations' idea to the original model. The rational expectations theory argues that people make choices based on their rational outlook, available information and past experiences. In the Kydland-Prescott model the government policy could influence people's decisions in the short run, while no such influence exists in the Barro-Gordon model because the current expectations in the economy are the same as what people think the future state of the economy will become. Simply put, if government attempts to reduce unemployment or stimulate economic activity using monetary policy, this action can only lead to higher inflation without achieving the intended goal. In this regard, the attempt will only trigger inflation in wages and engender generalised inflation; the unemployment rate or economic activity will remain unchanged. As such, the monetary policy stimulus will have no real effects on the economy other than inducing price instability.

These models brought fundamental changes to how monetary policy is conducted worldwide. Institutionally, they have influenced how central bank frameworks are calibrated to enhance operational independence, thereby injecting credibility in the face of short-term changes in the economy. Many central banks around the world have committed themselves to a long-range policy of seeking price stability. Moreover, from the early 1990s countries such as New Zealand, Sweden, South Africa, Thailand and Argentina have adopted an inflation-targeting policy – a specific range for inflation that the central bank commits to pursuing (Central Bank News, 2017). To a very large degree, the SADC Model Law has adopted these models' principles for enhanced CBI. However, there are areas where this law is accommodating regional peculiarities that may therefore be less strict than other regions' regional laws, such as the European Union.

3. Determinants of Central Bank Independence

The determinants of CBI are theoretically and empirically well studied, among others in the work of Cukierman (1992), and Alesina and Summers (1993); whereas the studies by

Presnak (1996), Wessels (2004) and Wessels (2009) have offered insights on CBI in Southern African countries. This section discusses formal or *de jure* independence determinants and how the SADC Model Law incorporates them. This paper does not concern itself with informal determinants of CBI although these may be more important in practice than formal determinants.

Outlined below are key elements of CBI that charters or statutes of central banks should contain to entrench formal political and economic independence.

3.1 Political Elements of Central Bank Independence

Clarity of objective(s): The primary objective of the central bank should be to maintain price stability. If the act assigns multiple objectives such as promoting economic growth or employment creation, then price stability should be stated as the principal objective which should prevail in cases where policy conflicts arise (Alesina and Summers, 1993). Regional monetary authorities have embraced this element (for example, the European Central Bank ECB, 1997). In this regard, sections 4, 5 and 6 of the SADC Model Law state that while the national central bank may support general economic policies of the country, its primary monetary policy objective should be price stability. The central bank should pursue this objective independently and without fear, favour, prejudice or direction from any authority or institution.

Governing structure of the bank: Political appointments to the central bank board should be prohibited but if that is not the case, then the legislature should ratify such appointments. This is to shield the board from political manipulation (Alesina and Summers, 1993). The SADC Model Law embraces this principle, with sections 11 and 14 stipulating that the governors and directors of the central bank should be appointed by the Head of State. Alternatively, the Head of State can merely nominate these persons, and the legislature should ratify such nominations. Section 8 establishes the Board of Directors with a responsibility to determine the central bank governance policy, consisting, among others, of the governor as chairperson.

Governors and Board of Directors: The governors' tenure of office should exceed or straddle the term of office of politicians in the executive and legislative arms of governments (Alesina and Summers, 1993). This principle, which is contained in the SADC Model Law, seeks to ensure that governors are more impervious to undue political pressure and ensures the retention of a central bank's institutional memory. The Model Law further recommends that the governors should be appointed for a renewable six-year term. However, the governors' office terms should not coincide with parliamentary elections.

Coordination between monetary and fiscal policy: The SADC Model Law's section 43 states that without prejudice to the powers of the central bank to formulate and implement monetary policy and to any other provisions of the act, the central bank shall consult with the minister responsible for financial matters in areas necessary to ensure coordination between monetary and fiscal policies (Alesina and Summers, 1993).

Accountability and transparency: The Model Law's section 61 stipulates that the central bank should submit to the minister an annual report containing among other information, the annual accounts, the central bank's operations, report on the state of the economy and the conduct of monetary policy. The report should also be published. The minister shall table such annual report in parliament. Furthermore, Section 62 requires that the governor appear before parliament at least twice a year and at any other time as parliament or the governor may request, to report, among others, on the current operations and affairs of the bank, the state of the economy and the conduct of monetary policy (Alesina and Summers, 1993).

Absence of politicians and representatives of private banks on the Board: No politicians or private bank representatives should be allowed on the central bank board. Should government have a representative, then it should not have voting powers on monetary policy stances (Alesina and Summers, 1993). The SADC Model Law (section 17) directs that a person should not be appointed as or remain a board member if s/he becomes a member of cabinet, parliament, other executive or legislative authority; civil servants (except if they do not have voting rights); director, officer, employee or a shareholder in a bank or financial institution; or provides or is appointed to provide professional services to the central bank, or any financial institution.

3.2 Economic Components of Central Bank Independence

Financial independence: The SADC Model Law (sections 10, 65 and 66) embraces this principle. To avoid government interference, the central bank should have sufficient financial resources as well as full authority over its budget. Furthermore, the central bank should not be responsible for fiscal losses or conduct quasi-fiscal operations. Financial independence also entails that only realised net profits, after prudent provisioning by the central bank and allocations to general reserves, should be given to the fiscus. Such independence will also allow the central bank to operationally conduct timely and sufficient open market operations without financial constraints and in line with the set policy goals (Alesina and Summers, 1993).

Credit to government: The law should prohibit or severely limit demands on the central bank to finance government budget deficits. This principle, captured in the SADC Model

Law's section 40, argues that temporary advances and loans can be allowed if strict limits on the amount are clearly spelt out, and as long as the central bank has authority to determine the terms and rates of interest payable. Furthermore, such credit, including any indirect credit to the government should be guided by set monetary policy objectives and targets (Alesina and Summers, 1993).

Instrument independence: The central bank should have unimpeded authority to use all monetary policy instruments available in its toolbox, as and when it sees fit. Instrument independence shields the central bank from failure to achieve otherwise attainable objectives and targets due to interference from the government. To ensure that the central bank is not constrained over instruments in executing monetary policy, Section 10 empowers the board to determine policies applicable to the bank's administration and operations (Alesina and Summers, 1993).

4. Comparison of National Central Bank Acts with the SADC Model Law

The study by Wessels (2009) focused on legal independence of twelve SADC central banks by applying the international best practice CBI yardsticks to the statutes or charters of the relevant central banks. This study, however, explores *legal* CBI in the SADC region by examining the convergence or divergence between the SADC Central Bank Model Law and the existing central bank charters or acts of twelve of the fourteen SADC member states. The extent to which the central bank law goes beyond the leniency provided by the Model Law shows a shortfall in the national law and therefore weakens CBI. As in Wessels (2009) we examine the content of the central bank acts (with amendments up to the end of 2017) of Angola (2010), Botswana (1996), Lesotho (2000), Malawi (1989), Mauritius (2004), Namibia (1997), Seychelles (2011); South Africa (1989), Swaziland (1974); Tanzania (2006); Zambia (1996) and Zimbabwe (2004); and compare them with the CBI related elements of the SADC Central Bank Model Law. Results of this comparison across the Central Bank Acts of the 12 SADC member states are outlined in the table below:²

² As in other studies of a similar nature, the CBI elements contained in the SADC Model Law were treated with equal weights on a simple binary basis, i.e. *compliance* with the criteria was assigned 1 for 'Yes' and *non-compliance* was regarded as 0 for 'No'.

Table 1: National Central Banks and the SADC Model Law: Assessment of CBI Compliance and Identifying the Gaps

CBI Elements of the SADC Model Law	ANG	BOT	LES	MAL	MAU	NAM	SEY	SOU	SWA	TAN	ZAM	ZIM	Total
1. Single; clear price stability objective (s.4,5)	0	0	1	0	1	0	1	1	0	1	1	0	6
2. Governors appointed by Head of State, ratified by parliament (s.11)	1	1	1	1	1	1	1	1	1	1	1 (Ratify)	1	12
3. Tenure of Governors is 6 years; eligible for re-appointment (s.11)	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	1	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	0 (5-yr)	1
4. Term of Governors does NOT coincide with elections (s.11, note 17, 19)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0 (Unclear)	0
5. Absence of politicians or Govt. employees on Board (s.17, note 24)	0 (Unclear)	0 (Govt. officers)	1	1	1	0 (Govt. officers)	1	1	0 (Govt. officers)	1	1	0 (Unclear)	7
6. Grounds for removal of Governor; commission to investigate outlined (s.22)	0 (No Comm.)	1	1	0 (No Comm.)	0 (No Comm.)	0 (No Comm.)	1	0 (No Comm.)	0 (No Comm.)	0 (No Comm.)	0 (No Comm.)	0 (No Comm.)	3
7. Locus of decision making (formulating, implementing monetary policy) lies with Bank (s.5, 6, 44)	0 (Unclear)	0 (govt. intervene)	1	0 (govt. intervene)	1	0 (govt. intervene)	1	1	0 (govt. intervene)	1	0 (govt. intervene)	0 (govt. intervene)	5
8. Transparency & accountability (audited records made available to govt. & parliament in time (s.60-64)	1	1	1	1	1	1	1	1	1	1	1	1	12
9. Financial independence (including control over its policies, operations & budget) clearly stipulated: (s.10, 65-67)	1	0 (Unclear)	0 (Unclear)	1	1	0 (Unclear)	1	1	0 (Unclear)	1	0 (Unclear)	0 (Minister approves)	6
10. Strict limits on lending to Govt. (amounts & repayment period stipulated, i.e.	1	1	0 (7-year repayment)	1	0 (20-year govt. securit)	1	1	0 (Unspecified period)	1	1	1	0 (Intervene)	8

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only short term but best practice is to prohibit lending) V (s.41)					ies)								
11. Instrument independence (s.5,6,10)	0 (Unclear)	1	1	1	1	0 (Unclear)	1	1	1	1	1	0 (Unclear)	9
TOTAL	4	5	7	6	7	3	10	7	4	8	6	2	69

NB: Angola (ANG), Botswana (BOT), Lesotho (LES), Malawi (MAL), Mauritius (MAU), Namibia (NAM), Seychelles (SEY), South Africa (SOU), Swaziland (SWA), Tanzania (TAN), Zambia (ZAM), Zimbabwe (ZIM); Comm. = commission to investigate; govt. = government

In Table 1 above, 11 CBI related elements of the 2009 SADC Central Bank Model Law were applied to the central bank acts of twelve SADC member States to assess the extent of compliance with the regional Model Law. Although various CBI determinants could be more important than others, this paper uses a binary approach rather than assigning weights to each of the criteria. The limitation of this methodology is that it does not cover macroeconomic or monetary policy implementation, which could explain why relatively well performing central banks (in terms of price stability) may not have a correspondingly high score. Despite this limitation this approach nonetheless provides a general indication of the state of compliance by central bank laws to the SADC Model Law and by extension to the CBI principles.

Based on these criteria the 12 countries had a combined score of only 69 out of a possible 132 points, representing a 52 percent overall compliance. With a score of 10 out of a possible 12 points, Seychelles was the best performer, followed by Tanzania with 8 points. Namibia and Zimbabwe score lowest at 3 and 2 points, respectively. We observe a slight improvement in the overall scores in this study compared to the Wessels (2009) results. One reason is that a few countries such as Angola and Seychelles have since reviewed or amended their central bank acts for strengthened CBI. Furthermore, instead of employing the more stringent international best practice CBI criteria, in this study we used CBI elements as contained in the Model Law.

5. Key Recommendations and Concluding Remarks

Before countries can start using this work and adopting its recommendations a lot of work would be required to: (a) determine the reliability and consistency of the SADC Model Law; and (b) the compatibility of the Model Law with provisions for fiscal management in fiscal (public finance) laws. The results from the analysis of this paper show that some of the central bank charters fall short of meeting the critical elements of the regional model law. The paper therefore makes the following specific recommendations:

First, the central bank charters of Angola, Botswana, Malawi, Namibia, Swaziland and Zimbabwe should explicate that achieving and maintaining price stability is the primary objective of monetary policy, and any other objective is subsidiary to this.

Second, since in all countries the Head of State appoints governors as suggested by the SADC Model Law; therefore, parliament should ratify such appointments as in Zambia's case. Furthermore, countries should follow the example of Botswana, Lesotho and Seychelles by bestowing an independent body with powers to investigate and sanction any dismissals of the governors or directors by the executive. Beside Seychelles which has already done so, SADC countries should expound clearly that the governors are eligible for reappointment, and that the duration of each term is 6 years, thus avoiding coinciding with the usual 5-year political electoral cycles.

Third, Angola and Zimbabwe are silent on the participation of politicians and government officials on the central bank board. The central bank acts of Botswana, Malawi, Namibia and Swaziland provide for senior government officials to be part of the board with voting rights. All these countries need to effect the needed corrections.

Fourth, Botswana, Malawi, Namibia, Swaziland, Zambia and Zimbabwe should remove the provision allowing government to intervene in the conduct of monetary policy. Angola, which is mute on the matter, should clearly state that only the central bank has a right to conduct monetary policy.

Fifth, Lesotho and Mauritius should comply with the provision to restrict the repayment periods of central bank finance to government. South Africa should specify limits on repayment period and the credit amount that the central bank can provide to government. Finally, Zimbabwe should reconsider the stipulation giving government leeway to set its own credit limits from the central bank.

Finally, Botswana, Lesotho, Namibia, Swaziland and Zambia should clearly stipulate the bank's control over its budget. Zimbabwe should relax the need for the Minister of Finance to approve the central bank's budget. Angola, Namibia and Zimbabwe should explicitly allow central banks to exercise control over instruments used in executing monetary policy.

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