

OCCASIONAL
PAPERS
Number 20

**THE INDEPENDENCE OF
THE CENTRAL BANK:
IS IT FEASIBLE ?**

S.K. Apea

THE INSTITUTE OF
ECONOMIC AFFAIRS
ACCRA, GHANA

The Institute of Economic Affairs (IEA) Ghana was founded in October 1989 as an independent, non-governmental Institution dedicated to the establishment and strengthening of a market economy and a democratic, free and open society. It considers *improvements in the legal, social and political institutions* as necessary conditions for sustained economic growth and human development.

The IEA supports research, and promotes and publishes studies on important economic, socio-political and legal issues in order to enhance understanding of public policy.

Further information may be obtained from Dr. Charles Mensa the Executive Director, Institute of Economic Affairs, P. O. Box 01936, Christiansborg, Accra, Ghana

Tel: 233-21-244716/7 & 7010714

Fax: 233-21-222313

ISBN: 9988-584-03-2

ISSN: 0855-3238

THE INDEPENDENCE OF THE CENTRAL BANK: IS IT FEASIBLE ?

S.K. Apea



An Institute of Economic Affairs Publication

© 1999 Copyright by Institute of Economic Affairs

Printed in Ghana. All rights reserved. No part of this work may be published, used or reproduced in any manner without written permission of the publisher except in the case of brief quotations in critical articles and reviews.

The findings, interpretations and conclusions of this paper are however, entirely those of the author, and should not be attributed to the Institute of Economic Affairs or any organizations that support it

PREFACE

This paper by S.K. Apea examines the characteristics of an independent Central Bank. It begins by outlining what the features of a *statutorily* independent Central Bank should be, by drawing on the experiences of the New Zealand Reserve Bank, the German Bundesbank, the US Federal Reserve, and the European Central Bank. It also states why de-jure independence is necessary for monetary policy credibility, especially for countries with poor inflation history and governments who do not have a good track record for financial restraint.

The shortcomings of the existing legal arrangements forming the basis of Ghana's central bank, namely the Bank of Ghana, are next identified. To remedy the shortcomings, improvements in the legislative arrangements are proposed. These cover:

- (a) Transparency of the Central Bank's Objectives;
- (b) Appointment of Board Members;
- (c) Tenure of Office of the Board and Governors;
- (d) The Central Bank's Capitalisation and the Funding of its Budget;
- (e) Determination of the Exchange Rate of the Cedi; and
- (f) Accountability of Governor and the Board of the Central Bank.

The paper, in conclusion, points out that actual independence is what is required to promote monetary policy credibility. This requires that de-jure independence should be translated into de-factor independence. In order to achieve this, the operational relationship between the political authorities and

the Central Bank should be desirable and realistic to both the Government and the public at large, whose price and wage decisions tend to be informed by their inflationary expectations.

I am delighted to place on record, the gratitude of the Institute of Economic Affairs to the Danish Government, through the Royal Danish Embassy in Accra and DANIDA, and the Friedrich-Naumann Foundation, whose generous assistance made the publication of this Occasional Paper possible.

Dr. George A. Apenteng
Executive Director
Institute of Economic Affairs

Accra. October 1999

ABOUT THE AUTHOR

Mr. Samuel Kye Apea was born on 24 May, 1934 at Abetifi, Kwahu in the Eastern Region of Ghana. He was educated at the University of Ghana, Legon, where he earned a B.Sc. (Econs) 2nd Class Upper Degree in 1964; and at University College, London where he was awarded a M.Sc. (Econs) Degree in 1969.

For the greater part his working life, he was employed in Ghana's public service, and held numerous positions mostly in the financial sector. He was Deputy Governor of the Bank of Ghana from November 1985 to December 1989, and Deputy PNDC Secretary, Ministry of Finance and Economic Planning from January 1990 to March 1993. While holding the two positions, he was directly involved in, and supervised, implementation of financial sector reforms.

After leaving Ghana's public service in November 1993, Mr. Apea took up in December 1993 the position of Managing Director, ECOWAS Fund. During his administration, which ended in February 1998, the Fund was restructured with the help of the World Bank and other international institutions.

Other positions which he has held include: Acting Chairmanship of Statistical Service of Ghana (1991-1994), Chairmanship of Ghana Commercial Bank (1990-March 31, 1998) and Second Vice Presidency of Ecobank Transnational Incorporated (1994-1998).

Mr. Apea is currently an economic consultant and Fellow of the Institute of Economic Affairs, Ghana. He is married with five children, and his hobbies are reading, current world affairs and table tennis.

TABLE OF CONTENTS

	Page
Introduction	1
Formal or Statutory Independence	2
The Need for Informal Operational Arrangements	6
The Ghanaian Situation	8
The Bank of Ghana's Monetary Policy Performance	13
Graph (Inflation and M2+ Lagged 1 Year)	15
Official Hints at Improvement	16
Suggested Improvements	17
Conclusion	23

• INTRODUCTION

'Central Bank Independence' is about the relationship that exists between the Central Bank and the Government. A desirable relationship does not allow the Central Bank and its Board of Directors to be subjected to political pressures or orders. Such a relationship is expected to place the Central Bank in a better position to assist government to maximize the rate of economic development. Conceptually, it has been argued that Central Bank independence can bolster the credibility of a country's monetary policy, and consequently facilitate monetary policy implementation. This view has persuaded many governments, especially since 1972 when the US dollar was allowed to float, to grant their Central Banks greater autonomy, particularly in their pursuit of sound monetary policy.

Depending on the inflation history and/or the government's attitude to financial restraint, Central Bank independence may be secured statutorily, or may evolve in large measure from convention and practice. Examples of Central Banks with statutorily backed independence are the Reserve Bank of New Zealand, the Bundesbank of Germany, the European Central Bank, the Swiss National Bank (SNB), the United States Federal Reserve Bank and the Bank of Ghana.

However, it is important to note that the formal legal arrangements forming the basis of the Central Banks' independence are not always good indicators of actual independence. In other words, it will be a mistake to equate legal independence with actual independence.

• FORMAL OR STATUTORY INDEPENDENCE

Usually the laws establishing Central Banks determine the degree of formal independence that a Central Bank possesses. The relevant characteristics covered in such laws are broadly the following:-

(i) *The Central Bank's Objects -*

The narrower the macro-economic objective, the less the chances of monetary authorities having shifting objectives. There is no doubt, at least conceptually, that a clear statutory objective makes for the promotion of monetary policy credibility if the monetary authorities are seen to be committed to it. 'Price stability' is generally regarded as a sine-qua-non for the maintenance of the value of the currencies issued by the various Central Banks; hence the tendency by an increasing number of countries to adopt 'price stability' as Central Banks' statutory objective. This also explains why since 1989 a country like New Zealand has gone to the extent of adopting what amounts to a performance contract known as 'Policy Target Agreement' (PTA), signed by the Governor of the Reserve Bank of New Zealand and the country's Minister of Finance. Under this agreement, an inflation target of 0-2% is set for the Governor of the Reserve Bank of New Zealand.

Incidentally the European Union has also adopted a 'Harmonized Index of Consumer Prices' (HICP) of below 2%, set by the European Central Bank for countries in the Euro Zone. It is interesting to note, in this connection, that a country like the United Kingdom, noted for its reliance on custom and practice for its governance, has since 1997 adopted an explicit inflation targeting, and entrusted the responsibility of setting the key element of monetary policy – namely, interest rates – to an unelected committee. It

must however be noted that doubts have been expressed in some quarters about the feasibility of 'inflation targeting' by developing countries. The doubts are based on the premise that the scope of monetary policy operations for developing countries tends to be hampered by fiscal dominance, priority often accorded to foreign exchange policy, and undeveloped financial system. To counter this, one may argue that what is required of developing countries' governments is action to improve their own fiscal performance, to revamp the banking and financial systems, and to increase market orientation, especially with respect to foreign exchange transactions.

(ii) *Capitalisation and Financing of Central Bank's Budget -*

Adequate capitalisation and budgetary financing ensures financial independence. It is therefore important that legislative arrangements forming the basis of Central Bank independence contain funding clauses purported to avoid the necessity of the Central Bank board applying to the Treasury or the Ministry of Finance every now and then or annually for operating funds. One way a country like New Zealand has dealt with this issue is to provide in the Central Bank's establishment law, a five-year budget for the Central Bank's operations.

(iii) *Appointment and Removal of the Board and Governors-*

The composition and role of Central Bank Boards, including governors, can have an important influence on the nature of the relationship between Central Banks and governments. The reason is that governments may use Boards as channels for exerting direct influence on Central Bank decisions. One way of getting around this is to get a good number of non-government appointees on the board. Another is by making approval of a non-Executive body like the United States Senate necessary for such appointments, as is done in the case of the U.S.

Federal Reserve Board. To ensure that the Central Bank commands the confidence of the financial system, the Government in particular must possess the following qualities: strong academic and professional background, strong personality and ability to influence opinions through persuasive argument.

As regards dismissal or removal, the conditions and procedures are usually spelt out in unambiguous terms. Desirable conditions and procedures are those that seek to avoid capricious exercise of Executive power.

(iv) *Terms of Office of Board Members -*

Since security of tenure is crucial to the independence of operation of the Board, the terms of office need not only be long enough; they should also be staggered. When Directors' terms are relatively long and staggered, the scope of governments to load Central Bank Boards with malleable appointees tends to be reduced. In addition, the chances of Directors' terms of office coinciding with those of the political authorities will be greatly reduced. In this connection, it is instructive to note that the United States Federal Reserve Board of Governors have a 14 year staggered term each. The Directorate of the German Bundesbank has 8 year terms for each member, compared with the Board of the Bank Ghana whose Executive Directors have 4 years, and Non-Executive Directors 3 years.

(v) *Accountability of the Board of Directors -*

It is generally acceptable that political and financial independence should go with accountability. To achieve monetary credibility, therefore, requires that the performance of the statutorily defined policy be monitored by the public. This is where explicit formal inflation targets like

New Zealand's 0-2% and the Euro Area's below 2% have advantage of over the informal ones in terms of observable measures of performance. Accountability in the case of the United States of America Federal Reserve, for example, takes the form of bi-annual reports to Congress before which the Chairman is required to testify. These arrangements are particularly important for a country desiring to make a break with its inflationary past and to promote greater monetary policy credibility. One should, however, not lose sight of the possibility that explicit inflation targets that do not allow any flexibility, may be counter-productive in terms of growth and employment. Such a price may be too high to pay in the case of developing countries generally, and the policy may not be a prudent one for developed countries who may be near their full employment level. On balance, it appears that the better option may be that which has an in-built flexibility. In that regard, one option could be that of the United States, which gives the Federal Reserve Board discretionary powers in the formulation and implementation of monetary policy. Another possible alternative may be one that allows change of target in line with a clearly laid down procedure involving Parliament in the process.

(vi) *Financing Government -*

The extent of the legal constraint on Central Bank funding of the government's budget is an important aspect of monetary policy independence. Usually the relevant legislative arrangements set limits on direct Central Bank credit to government in terms of size of the amount and repayment period. The relevant laws however, allow government securities to be acquired in the course of open market operations. One may add that such a limitation can serve a useful purpose in promoting monetary restraint even in the case of a non-independent Central Bank in a country with relatively less-developed financial markets.

THE NEED FOR INFORMAL OPERATIONAL ARRANGEMENTS

It is an indisputable fact that formal legal arrangements forming the basis of the Central Bank's independence are not always good indicators of actual independence. Certain countries have Central Banks with similar levels of, or relatively less, formal autonomy, but have been known to perform exemplarily well as far as price stability is concerned. Until recently, Japan could be cited as a good example. This has led to the view held by researchers¹, including Adam Posen of Harvard and James Forder of Oxford, who through empirical studies have cast doubt on the causal relationship between Central Bank independence and monetary policy credibility, as well as reduction in the cost of disinflation.

The effectiveness of the informal operating arrangements depends, to a large extent, on the cooperation and the goodwill of the political authorities on the one hand, and on the Governor of the Central Bank who has the qualities described above, on the other. It also depends on such factors as:

- (a) checks and balances in the political system,
- (b) the level of public economic awareness and debate, and
- (c) the state of development of the country's financial sector

Even though there is a common feature, which is the duty of Central Banks to consult the political authorities in the conduct of monetary policies, in practice one can observe varying degrees

¹Notable among the researchers on the subject are:

1. **Jame Forder**, Balliol College, Oxford
2. **Michael Parkin**, University of Western Ontario
3. **Alberto Alesina**, harvard University
4. **Adam Posen**, Harvard University, Institute of International Economics

of Independence in operational arrangements. Examples to illustrate this point are:

- (a) **The Bank of England which, until 1997 played the role of an advisor and implementor of government monetary policy;**
- (b) **The United States Federal Reserve whose monetary policy decisions do not require Executive approval; and**
- (c) **The New Zealand case, where the Central Bank has substantial monetary policy autonomy, having a duty to pursue a formally set inflation target which can be varied by government only through Parliament. This, incidentally, imposes an effective disciplinary check on the government. At the same time, it explicitly recognizes government as having ultimate responsibility for monetary policy.**

• THE GHANAIAN SITUATION

1. *The Bank of Ghana Statutes*

In Ghana, the Central Bank is known as the Bank of Ghana (BOG). The BOG's existence, objects, capital, organization and functions can be found in the BOG Law (PNDC 291, 1992), together with Articles 146, 183 and 184 of the Fourth Republic's Constitution promulgated on January 7, 1993. The Central Bank is further aided in its supervision of the banking institutions by Banking Law 225 of 1992, and of the Non-Bank Financial Institutions by Law 328 of 1993. For purposes of this paper, the Bank of Ghana Law, i.e. PNDCL 291 of 1992 and the relevant provisions of the Fourth Republic's Constitution are what would be deemed applicable.

2. *The Bank of Ghana's Objects*

The principal objects of the Bank of Ghana have been spelt out in Section 3 of PNDCL 291 as follows:

- (a) to issue and redeem bank notes and coins;
- (b) to administer, regulate and direct the currency system;
- (c) to regulate and direct the credit and banking system in accordance with the economic policy of the Government and the provisions of the Law;
- (d) to promote by monetary measures the stabilisation of the value of the currency within and outside Ghana;
- (e) to propose to the government measures which are likely to have a favourable effect on the bal-

ance of payments, movement of prices, the state of public finances and the general development of the national economy and monetary stability;

- (f) to ensure effective maintenance and management of Ghana's external reserves;
- (g) to promote and maintain relations with international banking and financial institutions;
- (h) to act as banker and financial advisor to the government; and
- (i) to do all such things as are incidental or conducive to the efficient performance of its functions under this or any other enactment.

These objects are essentially no different from those of other Central Banks. The similarity to the objects of banks like the United States Federal Reserve and Bundesbank becomes clearer when one refers to the BOG's Mission Statement as boldly printed on page 1 of the Bank's 1997 Annual Report. In that statement the BOG sees its Mission as 'To pursue sound monetary and financial policies aimed at price stability so as to create an enabling macro-economic environment for the promotion of sustainable economic growth'. This summary of the Bank's objects in its Mission Statement brings the objectives of the BOG into a focus narrow enough to potentially facilitate the promotion of monetary policy credibility. The ideal situation would be where there is a coincidence of monetary policy objective between the Central Bank and the country's political authorities. That would be an edifying development in a country that has found inflation an enemy which for an unduly long time has defied all attempts to defeat it.

3. *The Bank of Ghana's Administrative Structure*

The appointment, terms of office, mode of operations, dismissal or removal of members of the Board of Directors, including the Governor and his two Deputies, have been provided for in Sections 7 to 19 of the 1992 Bank of Ghana Law (PNDCL 291, 1992) and in Articles 146, 183 and 184 of the 1992 Constitution. According to the relevant statutory provisions, the Board of Directors has a maximum membership of twelve made up of the Governor, who is also the Board Chairman, two Deputy Governors, one representative from the Ministry of Finance, and eight others. It is instructive to note that the relevant 1992 Constitutional provisions in terms of appointment, tenure of office and removal, concern only the Governor, while the BOG Law caters for the other Board members, including the Deputy Governors.

Article 183, 4(a) of the 1992 Constitution which governs the Governor's appointment provides that the Governor 'shall be appointed by the President in consultation with the Council of State'. The appointment of the Deputy Governors, on the other hand, is dealt with by Section 16 (1) of the BOG Law 291, which states that the Deputy Governors 'shall be appointed by the Government on the recommendations of the Secretary' (i.e. Minister of Finance). The appointment of the representative of the Ministry of Finance can be presumed to be also on the recommendation of the Finance Minister. The appointment of the eight other Board members is 'by the Government' as simply stated in Section 7 (2) of the 1992 BOG Law.

Section 9 (1) of the 1992 BOG Law provides for a **renewable three-year term of office** for the members of the Bank's Board other than the Governor and the Deputy Governors. For the Governor, Article 183(4) stipulates 'periods of four years each'. However, for the Deputy Governors, Section 16(2) of the 1992 BOG Law,

the only relevant statutory provision, stipulates a renewable term of five years.

Two points relating to the Board members' terms of office call for comments. The first is the anomalous situation where the Governor who had the same five-year renewable term of office as the two Deputies under Section 16(2) of the 1992 BOG Law was later given reduced periods of 'four-years each' under Article 183(a) of the 1992 Constitution, while the five-year tenure for the Deputy Governors has been left unaltered. The second point is that the relevant statutory provisions make the various periods of office renewable, but they do not indicate the number of times that the appointments can be renewed. This surely needs clarification.

It is worthy of note that, for purposes of assuring the Governor of security of tenure, Article 183(d) of the 1992 Constitution states that Governors 'shall not be removed from office except on the same grounds and in the same manner as a Justice of the Superior Court of the Judicature other than the Chief Justice.' The grounds for, and the manner of, removal a Justice of the Superior Court of Judicature are spelt out in the entrenched provisions of Article 146 of the 1992 Constitution. Section (1) of Article 146 states that 'a Justice of the Superior Court or a Chairman of a Regional Tribunal shall not be removed from office except for stated misbehaviour or incompetence or on the ground of inability to perform the functions of his office arising from infirmity of body or mind'. A detailed removal procedure has been provided for in Sections (3) to (5) of Article 146 of the 1992 Constitution. These provisions are yet to be put to the test in the case of a Governor of the Central Bank.

4. **The Capitalisation and the Financing of BOG's Budget**

This appears to be adequate, at least for the time being. One is led to this conclusion by the fact that Section 4 of the 1992 BOG Law makes provision for the distribution of profits made by the Bank. The BOG Law is however silent on a possible situation where, as a result of the divestiture of its subsidiaries and a much reduced scale of the Bank's participation in buying and holding of Government paper, the Bank's budget is in deficit.

5. ***The Bank of Ghana's Lending to Government***

As the Government's banker, the Central Bank serves not only as the depository of Government's accounts; it also advances credit to the Government occasionally. Section 27 of the 1992 BOG Law limits the amount that the Bank can make available to the Government in any budget year. The period of the advance to Government is also limited: repayment should be made no later than 3 months after the end of the relevant year.

● **THE BANK OF GHANA'S MONETARY
POLICY PERFORMANCE**

The foregoing supports the view that even though the Bank of Ghana has the legal backing that gives it some degree of autonomy, it cannot be said to have the degree of political and financial independence that the United States Federal Reserve or others like the Bundesbank, the New Zealand Reserve Bank and the Swiss National Bank are generally reputed to possess. This may be part of the explanation for BOG's poor monetary policy performance as shown in the Table Below. In the Table under reference, Actual Monetary Outturn overshoot Monetary Targets, expressed as annual rates of increase, in all but only one – the last – of the 10 years from 1989 to 1998.

MONETARY TARGETS VRS ACTUAL OUTTURNS

YEAR	TARGET	ACTUAL
1989	22.9%	26.9%
1990	17.5%	18.0%
1991	15.1%	19.9%
1992	9.6%	52.9%
1993	8.2%	27.4%
1994	5.0%	46.2%
1995	14.9%	37.4%
1996	5.0%	34.2%
1997	25.0%	42.0%
1998	18.0%	17.6%

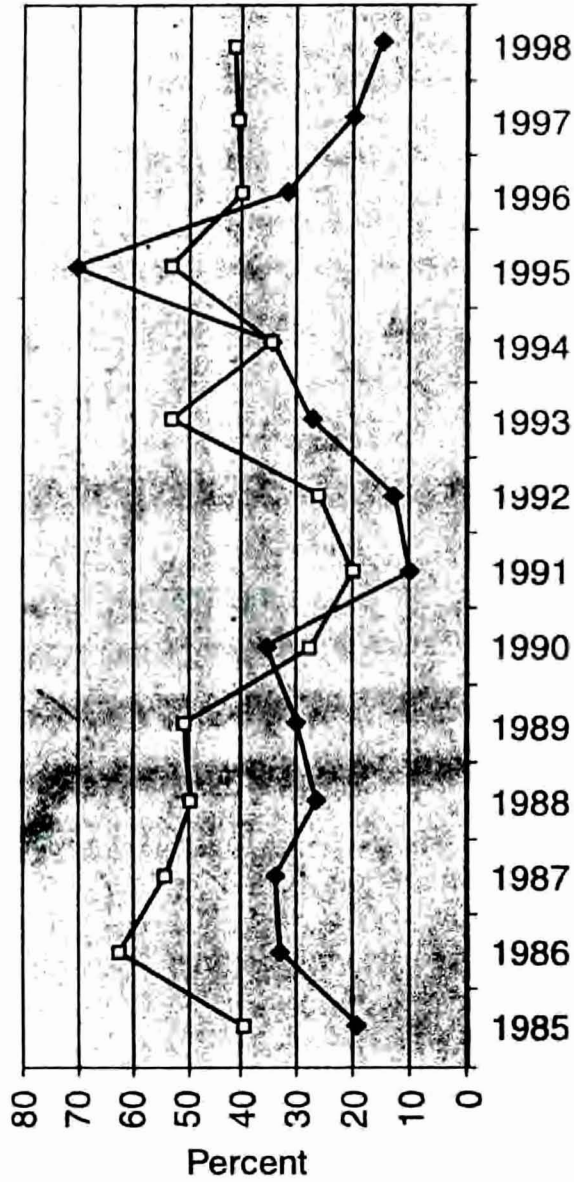
Notes: (1) From 1997 Money Supply = M2+
(2) M2+ includes foreign exchange deposits
Source: Bank of Ghana

As hinted at earlier on, the possibility that BoG's inadequate statutory and operational independence may have contributed to its poor monetary performance over the past several years cannot be ruled out. This is so since it cannot be denied that, despite Ghana's relatively underdeveloped financial sector, monetary policy can, and does, influence inflation through its impact on money supply. Even though the line graph below cannot be regarded as demonstrating a perfect fit, it does show a fairly close relationship between inflation and money supply growth lagged one year ($M2_{t-1}$). It thus lends credence to the view expressed above. It can be concluded from the foregoing that whatever the source of inflationary pressures, money supply growth should not be allowed to reinforce them. The reason is that money supply in excess does accommodate such pressures. The importance of a sound monetary policy can therefore not be over-emphasised.

One may also refer to the National Economic Forum held on September 2-3, 1997 at the Accra International Conference Centre. The aim of the Forum was the 'reduction in the rates of inflation and unemployment'² and major pre-occupation was 'regaining and sustaining macro-economic stability'. The broad topics covered under this key policy issue were Government fiscal restraint, aggregate savings and investment, monetary policy and the role of the Central Bank. The Syndicate Group that handled the key policy issue quoted above recommended, inter alia, that 'The Bank of Ghana Law, 1992 (PNDC Law 291) must be made consistent with conditions that will guarantee the independence of the Central Bank.

²Section 1.2 of the Report on the National Economic Forum at Accra International Conference Centre - September 2-3, 1997

Inflation and M2+ Lagged 1 Year



• OFFICIAL HINTS AT IMPROVEMENT

In the light of the monetary policy performance record of Ghana, it came as no surprise, but rather was heartening, when in the 1999 Government Budget Statement, Section 324 announced that 'The Government will place before the House a new Bank of Ghana Draft Bill that will strengthen the independence of the Bank of Ghana in the formulation and implementation of monetary policies. The bill will also aim at strengthening the authority of the Bank as a supervisor of the entire financial system. In return for the greater autonomy, the Bank of Ghana will be expected to continue to pursue sound and transparent policies. It will also be expected to be more accountable for the results of its policies'.

It is also encouraging to note that within two months after the budget announcement, a Chief Manager of the Bank of Ghana was reported by the local Financial Post of April 12 – 18, 1999, as having said in a public speech that 'a draft Bill seeking to strengthen and foster the independence of the Bank of Ghana has been submitted to Government for approval'.

It is important to note that the legislative backing is meant to make the independence of the Central Bank rule-based. This takes into consideration the rather poor track record of Ghana as far as inflation, public finance and monetary policy are concerned. It is also noteworthy that even though men of the right calibre abound in this country, getting such individuals to accept the Governorship has often been difficult. Moreover, many of the best-qualified individuals who, in the past quarter of a century, did accept to be Governors with the best of intentions, have had to prematurely leave office in circumstances that cannot be described as pleasant.

• SUGGESTED IMPROVEMENTS

In suggesting improvements to the existing legislative arrangements forming the basis of BOG's independence, the paper takes a long-term view of the Ghanaian situation. It also assumes that the trend towards good governance, though rather slow, will continue. It is therefore expected that the present relatively weak non-executive arms of government will become more effective with time as organs that can be relied on to provide the needed checks and balances.

As a basis for suggested improvements discussed below, the relevant provisions of the existing Bank of Ghana Law, PNDCL 291, 1992, together with Articles 146, and 183 of the 1992 Constitution, are compared with the characteristic features of independent Central Banks outlined earlier on. The relevant aspects are as follows:

(i) *Transparency Objective*

For effective performance monitoring, it is important that the Central Bank's monetary policy objective is narrowly focused and clearly defined. It will be a healthy development if the political authorities will see the Central Bank's monetary policy as coinciding with the Bank's Mission as stated on page one of the Bank's 1997 Annual Report. It is pertinent to note, in this connection, that the Bank of Ghana has, over the years, been involved in 'Quasi-lending' to its subsidiaries and other institutions.

Section 48, Sub-section 1(b) of the 1992 Bank of Ghana Law, gives the Bank power to 'lend money or grant short-term credits to any institutions' with the prior written approval of the Secretary (Minister) of Finance. Sub-section 2 also stipulates that 'The Bank may, at the written request of the Secretary, guarantee a loan granted to the Government or to any person in Ghana by a

foreign institution'. The danger with the guarantees is that they may turn into loans payable by the Bank, as in the past. These and other development promotion activities may complicate the conduct of sound monetary policy aimed at achieving price stability. The implicit multiple objectives may make it easier for the Bank to excuse one policy failure for another.

(ii) *Appointment of Board Members*

There is no doubt that the Board of Directors can be a channel for government's direct influence on the Bank's decisions. Sound monetary policy decisions therefore require that political considerations are relegated to the background. Consequently, in making appointments to the Board, competence, honesty and integrity should be the primary criteria. These qualities as listed on page 4, particularly in the case of the Governor, should be reflected in the appointee's educational and career background as well as professional standing. It will be desirable to choose some of the Board members from the business and professional associations. Such an approach may ensure that more independent opinions are brought to bear upon the Board's decisions.

(iii) *Tenure of Office of the Board and Governors*

A term of 3 years each for the non-Executive Directors is rather short. This may be compared with 8 years each for the German Bundesbank Directors, and 14 years each for the Governors of the Federal Reserve of the United States of America.

As regards the Governor of the Bank of Ghana and his two Deputies, the 1992 Constitution reduces their tenure of office from 5 years (as provided for in the PNDCL 291) to 4 years. These rather short terms surely do not engender a feeling of security of tenure, and may therefore weaken the

Bank's sense of independence. Moreover, it is possible that the Parliamentary and/or Presidential term may coincide with the Governor's term of office. Under such circumstance, depending on the stature of the individuals, there will be the likelihood that the Board in general, and the Governor in particular, may want to avoid conflict with the political authorities that have power to influence the Bank's status.

(iv) *Bank of Ghana's Capitalisation and the Funding of Its Budget*

Political independence needs to be supplemented by financial independence. A situation where the Central Bank has to appeal annually to the Minister of Finance for funding, will definitely undermine whatever political independence the Bank's Law may provide. The present financial situation of the Bank gives the impression that the institution is comfortably funded. The relevant provisions of the Bank's Law may, for that reason, be regarded as appropriate, at least, for the time being. Section 4 of the applicable BOG Law states: 'The Authorised Capital of the bank shall be one hundred billion cedis which shall be taken up from time to time and may be increased from time to time'. The phrase 'from time to time' relating to the payment of the unpaid portion of the authorized capital and the absence of any triggering mechanism for such payments and necessary capital increases can be a source of uncertainty that may undermine the independence of the Central Bank.

The uncertainty is aggravated by the fact that there are no statutory provisions for the funding of the Bank's budget. Instead, Section 5 of the BOG Law spells out in detail the distribution of the Bank's operational net profits between the Bank's General Reserve Fund and the Government's Consolidated Fund at the end of each year. The net profit is arrived at after 'allowing for the opera-

tional expenses and provision has been made for bad and doubtful debts, depreciation of assets, replacement of currency, development fund, contributions to staff and superannuation fund and other contingencies'.

What appears to be a comfortable financial situation of the BOG now, is likely to change in the not-too-distant future. Already evidence of a loss-making scenario occurring in future has started emerging. In December, 1997, the Central Bank's Capital and Reserves amounted to ~432.96 billion cedis. That amount exceeded the Bank's Authorised Capital of ~100 billion cedis by ~332.96 cedis. By end-December, 1998, the figure had dropped by 3.59% to ~417.6 billion cedis.

In anticipation of the likelihood that the Central Bank's income-earning sources, mainly fiscal deficit financing and other quasi-lending activities, may dry up, it is necessary that the provision of adequate working capital is given due consideration in any move to strengthen the autonomy of the Central Bank.

(v) *Determination of Exchange Rate of the Cedi*

Section 49 of the 1992 Bank of Ghana Law gives the Minister of Finance the power to determine the Cedi Exchange Rate in relation to external currencies. Under this Section of the Bank's Law, the Minister of Finance 'may in consultation with the Board take such decisions as he may deem fit for the determination of the exchange rate of the cedi in relation to external currencies'. The Law, as quoted, still recognizes the Minister of Finance as the Exchange Controller, and the Governor of the Central bank as the Deputy Exchange Controller. This is a carry-over from the era of exchange controls. For an independent Central Bank this relationship is an anachronism and must therefore be changed by amending the Bank of Ghana Law accordingly.

(vi) *Accountability*

It is important that greater autonomy is accompanied by meaningful accountability. Article 184 of the 1992 Constitution provides for accountability to Parliament only in respect of 'foreign exchange receipts and payments'. Sections 54, 55 and 56 of the 1992 BOG Law are the relevant provisions in this regard. Section 54 of the Bank's Law gives the Secretary (Minister) of Finance power 'to request the Auditor-General to make an examination of the accounts of the Bank and submit a report on the accounts' to the Secretary (Minister). Section 55 (1) of the Bank's Law enjoins the Bank 'to transmit a copy of the annual accounts certified by its external auditors to the Secretary (Minister) of Finance' within three months from the end of each year. Under the same Sub-section 1 of Section 55 of the Bank's Law, the BOG is also required 'to submit to the Secretary (Minister), an annual report of the Board on its working during the financial year in question'. Sub-section 3 of Section 55 also requires that the BOG should prepare and publish a bi-monthly return of its assets and liabilities, and transmit a copy of such return to the Secretary (Minister) of Finance for publication in the Gazette. Section 56 also enjoins the Bank to submit to the Auditor-General bi-annually, its foreign exchange receipts and payments on which the latter shall in turn report to the Government. It is noteworthy that only Article 184 of the 1992 Constitution provides for accountability to Parliament, and only in respect of foreign exchange receipts and payments.

For meaningful accountability, it is suggested that Parliament should be given the responsibility of examining at least twice a year, reports not only on the Bank's foreign exchange receipts and payments, but also on the Bank's monetary policy performance. In other words, at least bi-annual reports on the Bank's operations including the impact of monetary policy on the economy as a whole, should be submitted to Parliament. In addition, the

Governor might be required to testify before the appropriate Select Committee of Parliament on such reports.

If in fact the legal arrangements forming the basis of the Bank of Ghana's independence are duly strengthened, it will be a major step towards promoting the credibility of the Bank's monetary policy. It can also be assumed that a government that is not only sufficiently determined to grant, but actually grants greater statutory autonomy to its Central Bank, is most likely to be favourably disposed towards low inflation by balancing its budget, among other things. However, it needs to be remembered that getting de-jure Central Bank independence translated into de-facto independence demands a lot of effort from the Government – particularly in the form of cooperation between the Finance Ministry or the Treasury, and the Central Bank.

• CONCLUSION

The upshot of all these is that what statutory independence is capable of, is to give the public a sense of a more or less binding commitment on the part of the political authorities to the pursuit of sound monetary policies aimed at the achievement and maintenance of price stability. To this end, it has been suggested that the legal arrangements forming the basis of the Bank of Ghana's independence be improved in the following aspects:

- a. The **Objective** of monetary policy should be focused narrowly enough to facilitate monitoring. At the same time, the conduct of monetary policy should be transparent enough to aid meaningful accountability. Both the literature on the subject and the practice suggest price stability as the generally accepted objective. It is therefore suggested that price stability be adopted as the objective of monetary policy. However, the conduct of monetary policy should involve the degree of flexibility that will enable the Bank to cope with extraordinary circumstances in the conduct of monetary policy.
- b. The **Tenure of Office** of the Central Bank's Board should be longer than those of the Executive and Parliament, and should also be staggered. Each term should be at least 5 years.
- c. The **Funding of the Bank's Budget** should make provision for a loss-making eventuality.
- d. The conduct of **Foreign Exchange Policy** should be the responsibility of the Central Bank, who should normally consult the Minister of Finance – not the other way round as is now the case.
- e. The Board of the Bank should be made meaningfully **accountable** for the conduct of monetary policy to the

public through Parliament. Bi-annual reports on monetary policy performance and its impact on the economy are recommended.

Finally it needs to be stressed, however, that legal independence is only a necessary condition for actual independence. In practice, a sufficient condition is provided by the informal operational relationship that must be observed to exist between the Central Bank and the political authorities. Both the legal and the operational relationship should be desirable and realistic not only to the politicians, but also, and more importantly, to the society at large whose inflationary expectation is the key target.

OCCASIONAL PAPERS

Also Available

The Survival of Multi party Democracy in Ghana and the Politics of Accommodation in the Fourth Republic

B. J. Da Rocha

Democratic Governance in Ghana Under the 1992 Constitution

Kwame Karikari et al.

Strategies Towards African Monetary Integration: Issues and Options

M.I. Mahmoud

Intellectuals and Government: A Tale of Uneasy Partnership

Kwasi Yankah

Democracy, Adjustment and the "Internationalization of the State" in Ghana

Daniel Green

Science and Technology Policy: Sub-Saharan African Countries in the Context of Global Trends

Titus Adebayo

Financing the 1997 Budget

Jones Ofori-Atta

Education and Democracy in Africa: Preliminary Thoughts on a Neglected Linkage

Cyril K. Daddieh

Towards Judicial Independence and Accountability in an Emerging Democracy: The Courts and the Consolidation of Democracy in Ghana

H. Kwasi Prempeh

Dynamics of Conflict Management in Liberia

Amos Sawyer

Some Issues in Higher Education: A Management Perspective

G.F. Daniel

The Criminal Law and the Health Professional in Ghana

H.J.A.N Mensa-Bonsu

Ghana's Timber Industry: Perspectives of the Processing Sector

Fosuaba A. Mensah Banahene

Is There a Place for the State Media in a Constitutional Democracy?

Audrey Gadzekpo

The Right To Information, And Freedom Of The Media in Ghana's Fourth Republic

B.J. Da Rocha et al.

The Right To Information Bill 1999 (Draft)

Justice P.D. Anin

INSTITUTE OF ECONOMIC AFFAIRS

IEA

ISBN 9988-584-03-2



P. O. Box 01936
Christiansborg, Accra
Ghana

ISBN 9988-584-03-2