

**UNDERSTANDING THE LEVELS OF CENTRAL BANK
INDEPENDENCE IN THE SADC AND THEIR IMPACT ON POLICY
DECISION MAKING**

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Declaration

I declare that:

UNDERSTANDING THE INFLUENCE OF CENTRAL BANK INDEPENDENCE ON POLICY DECISION MAKING IN THE SADC.

Is my own independent work, that all the resources quoted have been indicated and acknowledged by means of complete references, and that I have not previously submitted this dissertation for a degree at any university.

Hermann Davin Bosch

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Abstract

The aim of this study was to understand the influence of Central Bank Independence on policy decision making in the SADC. The study made use of an interpretivistic research paradigm and followed a mixed method approach using an interpretative-Quantitative methodology. A literature review based on books, articles, previous research projects and the internet was done in order to gain a better understanding of central bank independence. Secondly the various central bank acts of the SADC member countries were studied in order to determine the level of independence that each central Bank have.

It was found that most of the SADC Central banks do not have a high degree of independence. Various indexes were used to quantify the levels of independence among the various central banks. Substantial differences exist in the level of independence among the various central banks. This makes the feasibility of successful monetary policy convergence within the SADC very unlikely. Any monetary convergence would have to include a unified legal framework within which monetary policy will be executed. The ultimate aim of monetary convergence is a single currency and a single central bank.

In order for the process of monetary policy convergence to move forward within the SADC reforms to the current central bank legislation will have to be undertaken. Legislation will have to ensure central bank independence within member countries. It is suggested that central bank independence also be entrenched in the constitutions of the various countries.

Opsomming

Die doel van hierdie studie was om te verstaan wat die invloed van sentrale bank onafhanklikheid is op beleids besluitneming in die SAOG. Die studie het gebruik gemaak van 'n interpretivistiese navorsings paradigma en 'n gemengde metodiek is gevolg. Daar is gebruik gemaak van 'n interpretatiewe-kwantitatiewe metodologie. Eerstens is 'n literatuurstudie gebaseer op boeke, artikels, vorige navorsing werke en die internet gedoen met die doel sentrale banke onafhanklikheid beter te kan verstaan. Tweedens is die verskillende sentrale banke se wetgewing bestudeer ten einde die vlak van onafhanklikheid van die bank te bepaal.

Daar is gevind dat die meeste SAOG sentrale banke nie hoë vlakke van onafhanklikheid het nie. Verskeie indekse is gebruik om die vlak van onafhanklikheid te kwantifiseer. Daar is substansiele verskille gevind in die vlakke van onafhanklikheid van die onderskeie sentrale banke. Dit maak die uitvoerbaarheid van suksessvolle monetaire integrasie binne die SAOG baie onwaarskynlik. Enige monetaire beleid integrasie sal moet geskied binne 'n gesamentlike regs raamwerk waarbinne monetaire beleid toegepas kan word. Die eindoel van monetaire integrasie is 'n gesamentlike geldeenheid en sentrale bank.

Die proses van monetaire beleid integrasie binne die SAOG sal net kan vorentoe beweeg indien hervormings aangebring word aan die huidige sentrale bank wetgewing. Wetgewing moet verseker dat sentrale bank onafhanklikheid gewaarborg word. Dit word ook voorgestel dat sentrale banke se onafhanklikheid in die grondwet gewaarborg moet word.

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List of Abbreviations

ADB	African Development Bank
CBI	Central Bank Independence
CCBG	Committee of Central Bank Governors
CEO	Chief Executive Officer
CB	Central Bank
CM	Common Market
CMA	Common Monetary Area
CU	Customs Union
CWN Index	Cukierman, Webb Neyapti Index
EEC	European Economic Community
ECB	European Central Bank
EU	European Union
FTA	Free Trade Area
GMT Index	Grilli, Masciandaro & Tabellini Index
IMF	International Monetary Fund
SADC	Southern African Development Community
SADCC	Southern African development Coordination Conference

Chapter 1 Introduction and Background to the Study

1.1 Introduction

During the 1990's a host of countries implemented structures to increase Central Bank Independence (CBI) (Kibner & Wagner, 1998:1). The shift towards CBI brought with it a number of empirical studies regarding the issue of CBI. Walsh (2005:1) defines CBI as the "*freedom of monetary policy authorities from government and political control in the implementation of macroeconomic policy*". Eijffinger & De Haan (1996:2) defines CBI in relation to three operational aspects namely personnel independence, financial independence and policy independence.

Personnel independence refers to the influence that government has in appointing members to the board of the Central Bank. If government appoints members with the intention of supporting government policies on the board, the bank will be less independent.

Financial independence can be seen as the government's ability to finance government expenditure and deficits directly or indirectly through Central Bank operations or lending. If government enjoys the ability to directly finance expenditure and deficits through Central Bank operations, the bank, and thus monetary policy, is seen as being influenced by fiscal policy and is therefore less independent.

Policy independence refers to the level of control granted to the Central Bank in the implementation of monetary instruments and policy, independent from any government coercion or influence (Eijffinger & De Haan, 1996:10).

The move towards a more independent Central Bank by many countries was necessitated by sustained periods of high inflation and stagflation during the 1970's and 1980's (Walsh, 2005:1). One explanation for these inflationary periods can be

found in the Keynesian policy revolution in the preceding years where the accepted theory was that a mild degree of inflation was acceptable in that it promoted faster economic growth (Cukierman, 2008:722).

The need for more independent Central Banks was also supported by various empirical studies that found a negative correlation between CBI and inflation (Pollard, 1993:22). This may have been due to the perception that in many countries government control of the Central Bank may influence the monetary policy environment in such a way as to favour higher economic growth and output and lower unemployment at the cost of higher inflation.

While inflation contributed on a large scale to the shift towards CBI, the role of globalisation needs to be considered. Globalisation resulted in an increase in free capital flows and growth in the scope and operations of global capital markets. Globalisation requires greater focus on price stability, which was believed to be achievable with greater levels of CBI (Cukierman, 2008:726). Price stability is one of the primary goals of the European Central Bank (ECB) through the Maastricht Treaty criteria (Eijffinger, Van Rooij & Schaling, 1996:163), with the current inflation target of 2% or less.

However, the idea of price stability through an independent Central Bank is nothing new. As long ago as 1932 John Maynard Keynes advocated a more independent Central Bank or monetary policy that is aimed at maintaining a given level of output and stable prices (Sawyer, 2006:644). Thus, price stability is one of the primary contributions that an independent Central Bank can make towards economic prosperity (Swanepoel, 2004:731).

From the above discussions, it is clear that CBI could have a significant impact on financial stability by lowering inflation and increasing price stability. The next question would be whether this is true for developed and developing countries.

It is clear that the political pressure and influence on the Central Bank can differ between developed and developing countries. This political pressure and influence could contribute to the possible conflict of monetary and fiscal policy given that the Central Bank may have higher or lower levels of independence. This study will examine developing countries within the SADC, but reference will also be made to developed countries, specifically in the European Union (EU).

Pollard (1993:31) describes a scenario where possible conflict may arise between an independent Central Bank and fiscal authorities. When government controls fiscal policy and the Central Bank controls monetary policy, conflict may arise when both parties set policy targets for the economy that may not be supportive of each other. Both parties will implement what instruments is available to them in order to reach the set goals. When these goals are not supportive of one another, the consequences to the economy may be negative and counterproductive. For example, government may for political reasons favour lower interest rates and or a weaker currency, hoping that this will stimulate exports and growth. The Central Bank may oppose this viewpoint as such a policy may result in higher inflation.

This study will concentrate on CBI within the Southern African Development Community (SADC). The SADC has been in existence since 1980, when it was formed in Lusaka, Zambia. The current member states are: Angola, Botswana, the Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, the United Republic of Tanzania, Zambia and Zimbabwe. Madagascar was suspended from the SADC following a military coup in 2009 (SADC, 2010).

The South African Reserve Bank was established by Section 9 of the Currency and Banking Act, 1920 (South Africa,1920) and is governed by the South African Reserve Bank Act, 1989 (South Africa, 1989), as amended. The SARB also conducts monetary policy for all members of the Common Monetary Area (CMA) namely Lesotho, Swaziland and Namibia. Botswana was a member of the Rand

Monetary Union, the predecessor of the CMA, from 1960, but withdrew in 1975 (Tjirongo, 1995).

The SADC common agenda includes the following (Tjirongo, 1995):

- The promotion of sustainable and equitable economic growth and socio-economic development that will insure poverty alleviation, with the ultimate objective of its eradication;
- Promotion of common political values, systems and other shared values transmitted through institutions that are democratic, legitimate and effective; and
- The consolidation and maintenance of democracy, peace and security (SADC, 2010).

On April 1, 1986, the Trilateral Monetary Agreement among the governments of the Kingdom of Lesotho, the Kingdom of Swaziland, and the Republic of South Africa came into force, establishing the Common Monetary Area (CMA). Namibia joined the CMA after gaining independence from South Africa in 1990.

It is the aim of this study to determine whether the currency union can be expanded into the rest of the SADC, and what role Central Banks and their governance will play in such a process. Specific attention will be given to current levels of Central Bank Independence within the SADC countries and whether a currency union with one Central Bank within the SADC would be possible.

1.2 Research Problem and Importance of Study

The SADC has the stated policy objective in the SADC Regional Indicative Strategic Development (SADC, 2003) of establishing an all-inclusive monetary union by 2016 incorporating all SADC member countries.

This study aims to examine the levels of Central Bank independence within the SADC, as well the influence of CBI on monetary policy decisions. No comprehensive study has been done of the levels of CBI in all the SADC countries. A study has been done on the levels of independence of only 5 of the SADC Central Banks (Wessels, 2008). It is the aim of this study to expand the scope of the previous study by Wessels by including all the SADC member countries' Central Banks in the sample. The study will also be expanded by incorporating the criteria for measuring CBI set out by the Cukierman Webb Nyapti (CWN) index of Central Bank independence (Cukierman, Webb & Nyapti, 1992).

1.3 Research Approach

This study will follow a mixed method approach using an interpretative-Quantitative methodology. A study will be made of the various Central Bank Acts and Charters and from this certain conclusions will be drawn. The study does not have a specific hypothesis. Certain research questions will be answered in order for the researcher to arrive at a theory regarding the primary objective. In this study a deductive methodology will be used where the data is used to make observations and draw conclusions in order to formulate opinions.

An interpretivistic research paradigm, conscious of the ontological assumption of realism, with some positivistic methodology is used to enhance understanding. The aim of the researcher is to understand the phenomenon of Central Bank independence within the SADC. In order to do this the researcher will within the interpretivistic paradigm make personal interpretations and observations as well as conclusions regarding the research objectives. The empirical studies will be used to lend credibility to the interpretations, observations and conclusions made by the researcher.

1.4 Research Questions

- How operationally independent are the 15 SADC Central Banks?
- How much policy independence do the 15 SADC Central Banks have?
- What are the levels of monetary policy convergence within the SADC?

1.5 Objectives of the Study

1.5.1 Primary Objective

The primary objective of the study is to determine the levels of Central Bank independence within the Southern African Development Community and the influence on policy decision making.

1.5.2 Theoretical Objectives

- Define the role and function of Central Banks;
- Explore the historical background, as well as the current and future roles of the SADC;
- Define what Central Bank independence is, as well as the existing criteria in the literature used to measure and define CBI; and
- Explore the literature regarding Quantitative measurements of CBI.

1.5.3 Empirical Objectives

- To understand how operationally independent each of the 15 Central Banks in the SADC are;
- To investigate how much policy independence each of the 15 Central Banks in the SADC have;
- To investigate how much CBI convergence there are between the various SADC Central Banks; and
- To determine what influence the level of independence of the proposed SADC Central Bank could have on monetary policy.

1.6 Research Methodology

The primary objective of this study is to analyse the levels of independence of Central Banks in the SADC. The research methodology used is based on the interpretive research paradigm.

A hermeneutical approach will be used in this study, iteration between the interdependent meaning of parts and the whole that these parts form will be analysed. The different components that determine the levels of CBI will be analysed and correlated to determine their overall impact on levels of independence of the various Central Banks. Contextualisation will be used to provide a critical reflection on the social and historical background of the SADC and Central Banking, in order for the reader to understand the current situation (Goede *et al.*, 2013:246).

1.6.1 Literature Study

A literature study will be conducted. To acquire the information in this study a wide range of sources will be used. Relevant textbooks, academic journals, magazines, newspapers, magazines, published reports, the Internet and previous studies on the subject will be used. The various SADC treaties and protocols will be studied, and specific attention will be given to the annual reports of the various national Central Banks as well as their constituent acts.

1.6.2 Empirical and Hermeneutical Study

The empirical and hermeneutical portion of this study comprises the following methodology dimensions. Empirical data drawn from the various SADC Central Banks through the secretariat of the SADC Committee of Central Bank Governors (CCBG) will be used within an interpretivistic research paradigm to make observations and draw conclusions in order to form opinions regarding the research question.

A country by country analysis will be done to determine the extent of Central Bank independence within the SADC, which will then be analysed against the stated policy aims of the SADC Committee of Central Bank Governors (CCBG) regarding the desired levels of CBI. Conclusions will then be drawn regarding the feasibility of monetary policy convergence in the SADC. Existing indices of CBI such as the Cukierman Webb Nyapti index (Cukierman, Webb & Nyapti, 1992) will be used for this comparison.

1.6.3 Target Population

A census of Central Banks of all 15 current member countries of the SADC will be used in the study.

1.6.4 Data collection method

A literature study of the various policies, protocols and acts that govern the various Central Banks will be conducted. Interviews will be done with both the SA Reserve Bank and the Committee of Central Bank Governors of the SADC (CCBG), both of which are located in Pretoria. Special attention will be given to the legal subcommittee of the CCBG, which is tasked with formulating the legal and legislative framework for the proposed SADC monetary union.

1.6.5 Data analysis

A mixed method interpretative-Quantitative approach will be followed. A content analysis will be done of a variety of sources such as the various Central Bank statutes, policy documents and protocols, annual reports as well as statistical releases by the various Central Banks regarding monetary policy variables such as inflation or lending to government

1.7 Chapter layout

Chapter 1 Introduction and Background to Study

In Chapter 1 the research problem, the objectives of the study, study area and the research methodology are outlined.

Chapter 2 Research Paradigm

In Chapter 2 various research paradigms are discussed, explaining why this research is based on a mixed method interpretative-Quantitative approach research methodology.

Chapter 3 Central Bank Independence

In Chapter 3 an overview is given of the literature regarding the role of monetary policy and Central Banks. The role of Central Banks in the economy is discussed as well as the goals and objectives of Central Banks. Central Bank Independence is defined and the literature as well as historical background to Central Bank Independence is discussed.

Chapter 4 Economic Integration

In Chapter 4 various forms of economic integration is discussed. Current policy and practises within the SADC and European Union (EU) is examined. An overview is given of the Southern African development community, its history, policies as well as its goals and objectives.

Chapter 5 SADC Central Banks Levels of Independence

In Chapter 5 a mixed method methodology will be used to determine the levels of Central Bank Independence within the SADC. A study of the existing protocols, policies and legislative frameworks of the various Central Banks will be done. Interviews will be conducted with both the SA Reserve Bank and the secretariat of the Committee of Central Bank Governors in order to obtain data for the study.

Chapter 6 Summary and Conclusion

In Chapter 6 a summary is made of all the findings of the study and a number of conclusions are made. The policy implications of the results as well as areas of weakness in the study and opportunities for future research will be identified.

Chapter 2 Research Paradigm

2.1 Introduction

The three main typical research paradigms are Positivism, Interpretivism and Critical Social Theory. Any of these three research paradigms, or a combination of them, are used in academic research to solve relevant research questions. It is the aim of this chapter to describe how the author applied specific research methodologies, as well as the reasons for using that specific methodology and paradigm.

The choice of which research paradigm to use is of crucial importance. Factors such as the problem environment, the research objectives, as well as constraints that research may face will determine what paradigm is used. A brief introduction to the various research approaches or paradigms are given in order to elucidate the research methodology used in this study.

2.2 Background

Research methodologies have traditionally been divided between Qualitative and Quantitative research. Authors such as Bryman, Becker & Sempik (2008) have used the terms Qualitative and Quantitative to refer to different research approaches while others such as Myers (1997) have used these terms to differentiate between the types of data that was used in the research used

Authors such as Kuhn (1970) and Johnson & Onwuegbuzie (2004) that focus on research approaches believe Quantitative research is where the observer remains objective and independent from the entities or events that are being studied. The observers are emotionally unattached and not involved in the process. This is found within the positivism paradigm.

Qualitative research according to authors such as Schultz (1962) and Lee (1999) aim for idealism, humanism and hermeneutics. The researcher should not be

detached and should be involved in the process. Detailed and descriptive writing is used. This is found within the interpretative paradigm.

Authors such as Myers (1997) and Oates (2006) that focus on the nature of the data believe Quantitative research is used in the study of natural phenomena and is conducted using experimentation and numerical or statistical methods. The data is based on numbers or values and is derived from experiments or observations. Quantitative research is mainly used in the positivism paradigm, but can be used in interpretivism or Critical Social Theory. Qualitative research uses Quantitative data that is used to explain certain social occurrences. Various methods for example documents, observations, and both individual and group interviews, are used in this process. The results and their interpretation cannot always be measured in empirical or mathematical terms.

In this study Qualitative will refer to textual data and Quantitative will refer to numerical data. The Qualitative data will be mainly derived from the various statutes that govern the Central Banks within the SADC, while Quantitative data will be derived using Central Bank Independence (CBI) indexes

A short introduction to the various research paradigms is provided in the next session.

2.3 Research paradigms

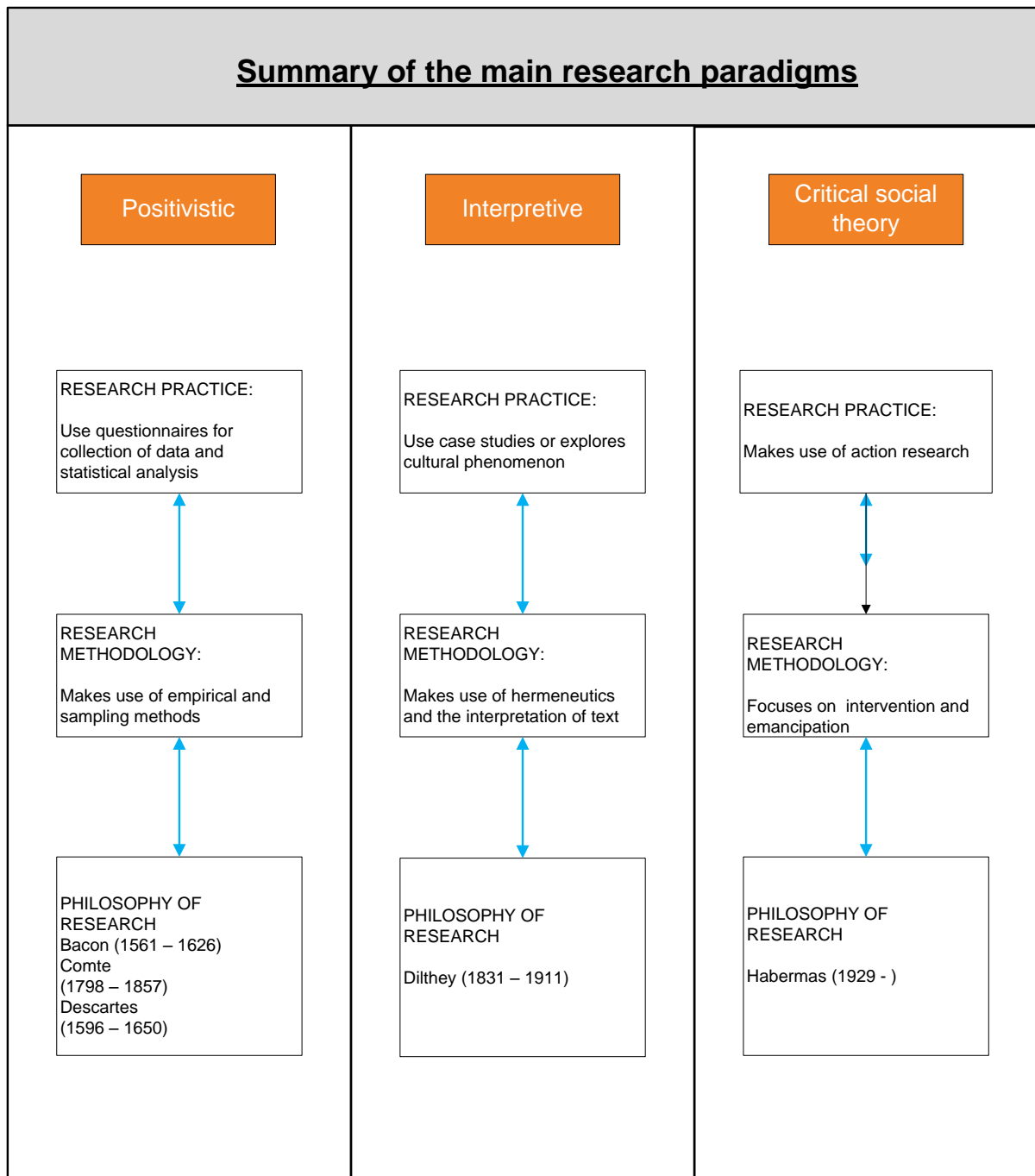
Research methodologies and paradigms are guided by philosophical assumptions. According to Hughes (1990) all research tools and procedures are linked to a particular world view. The philosophical assumptions that a researcher makes will determine what research methods is used.

A research paradigm is a description of the specific assumptions that the researcher made about their world view and the research methodology that is used within that assumptions. Taylor *et al* (2007:5) describe a research paradigm as “*a broad view or perspective of something*”

According to Mingers (2001) a paradigm is a “*construct that specifies a general set of philosophical assumptions covering, for example, ontology (what is assumed to exist), epistemology (the nature of valid knowledge), ethics or axiology (what is valued or considered right) and methodology* “. Researchers who share the same research paradigm will use the same principles, rules and standards in their research. These researchers agree on what is considered research of a high standard and quality, based on their use and interpretation of a certain research paradigm.

The three main paradigms (Positivism, Interpretivism, and Critical Social Theory) can be explained according to their underlying philosophies, methodologies, and practise as described in Figure 2.1.

Figure 2.1 Main research paradigms



Source: Goede, Taylor & Van Aardt 2013:246

2.4 Philosophical level

At the philosophical level the epistemological as well as ontological assumptions are investigated. Ontology refers to the form and nature of reality and more importantly what can be observed and measured of this reality (Goede, Taylor & Van Aardt, 2013). Epistemology refers to the relationship between the researcher and the research topic. The level of independence the researcher have from the research and the research topic will vary depending on which research paradigm is being used (Ponterotto, 2005)

2.4.1 Positivism

Positivism is based on realism and facts rather than values or opinions are investigated. Positivistic research is often used to determine the impact changes in specific variables may have on a certain scenario. This paradigm is often used in econometric research and is based on the following perspectives (Giddens, 1974)

- Reality consists of what can be observed by using the various senses;
- Any form of knowledge can be acquired through science;
- Human and natural sciences share common logical and methodological foundations. Methodologies from natural sciences can therefore for example be applied to social sciences and vice versa;
- There is a clear and fundamental difference between a fact and a value. Facts are used in science while values are used beyond the scope of science.

2.4.2 Interpretivism

Interpretivistic researchers create their own meanings and understanding of the world and the behaviour patterns that are observed in the world. Interpretivism is based on the ontological viewpoint of relativism (Lee,1999). In this research paradigm the aim is to understand the phenomenon that is being studied. This method studies the actions and events from within human life and is not based on

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observations regarding the impact of an external variable on the subject (Hughes, 1990).

2.4.3 Critical Social Theory

Critical Social research is based on a critical-dialectic perspective. The aim is to understand certain historical oppressive social structures. This could be for example racial, class or gender discrimination or oppression. The primary aim of critical social research is emancipation or changing of the suppressive behaviour (Lee, 1999).

2.5 Methodological Level

The methodological level comprises of the various principles that guide the practise of the various methodologies.

2.5.1 Positivism

Positivism methodology describes the various scientific methods that is used and is focused on ensuring repeatability, reliability, objectivity and the relationship between the various variables. The field of econometrics is an example of a positivistic research methodology.

Interpretative methodology is based on the following principles (Klein & Myers, 1999)

- The hermeneutic circle principle suggests that human understanding is gained by the study of interaction between the meaning of the individual interdependent parts and the whole they form;
- The contextualisation principle provides a social and historical background to the research setting. This is done so that the reader can have a better understanding of how the existing research environment and research problem came about;
- The interaction principle where the researcher and the subjects, through their interaction with each other, created the research data;

- The abstraction and generalisation principle requires relating the idiographic detail that was obtained through data interpretation using the hermeneutical and contextualisation principles to the theoretical concepts that describe human behaviour and understanding;
- The dialogical reasoning principle principles indicate that cognisance must be taken of possible contradictions between what the theoretical assumptions regarding a research question and the findings and conclusions that are made from the data. Data that are inconsistent with theory needs to be carefully revised and analysed, including the variables and methodologies used;
- The multiple interpretations principle indicates that of possibility of different interpretations by participants. This is exemplified in the example of various witnesses to the same even giving different or even contradictory accounts of a specific event; and
- The suspicion principle indicates that care must be taken to ensure that certain biases or preconceptions of the participants do not unduly influence the findings.

The above principles are guided by the hermeneutic circle (Goede, Taylor & Van Aardt, 2013). The hermeneutic circle principle entails looking at the parts in order to understand the whole, and vice versa. This would for example mean switching from understanding of individual words to understanding the words in context of a sentence and vice versa. The hermeneutic circle principle can be expanded beyond words, to for example understanding the specific response of a participant to a question within the whole interview process and vice versa.

2.5.2 Critical Social Theory

Critical social theory research is guided by emancipation. The aim of the research is to identify and address the oppressing structures that are found in a problem scenario.

Harvey (1990) identifies the following principles for Critical Social Theory:

- The abstraction principle refers to revealing and understanding the underlying structures that may have been overlooked or taken for granted. These structures define the nature of the abstract concepts that are studied;
- Totality principle that refers to the viewpoint that all social phenomena are interrelated and form a whole. These social phenomena should be studied in a specific context and not in isolation;
- The essence principle is used in Critical social research to unlock the deconstructive process. This is the fundamental element of the process of analysing the research problem;
- Praxis is the practical reflective activity. The aim is not only to understand the world; it is also to bring emancipation and change. The actions that can bring about this social transformation are of interest to the researcher;
- The nature of ideology needs to be revealed through the study of social relations and the identification of the core aspects or essence of these relations. This essence can be, through a process of dialectical deconstruction and reconstruction, be separated of the essence from the structural forms. This implies for example that the group dynamics within a family can be identified and studied independently from the structural form, for example the family;
- Structure is seen by the researcher in a holistic manner where a number on interrelated but independent elements are studied. These elements can only be understood as part of a complete structure. The structure is more than the sum of the various elements;
- Critical research history focuses on the context in which certain historical events took place, not necessarily in the events or facts themselves. Factors such as the social, political, economic environment and context are taken into account, as well as the circumstances and environment of the researcher;

- The aim of critical social research is to deconstruct the scenario into abstract concepts that can be studied. The interrelationships between these concepts are then studied with the aim of understanding the structure of the scenario. The core concepts are then used to reconstruct the situation, with the aim of understanding the ideology behind the oppression.

2.6 Practical level

2.6.1 Positivistic

Positivistic research uses methods such as questionnaires and experimentation in order to gather data. Various statistical and econometrical methods such as regressions are used to analyse and interpret the data (Behr, 1983).

2.6.2 Interpretative

Interpretative research uses methods such as ethnography, interviews and case studies in order to gather data. The aim of the data is to broaden understanding of the research topic. The aim of the research is to gather as much information as possible about the situation that is being studied and the world view of the participants. Saturation point is reached when no new deductions can be made from additional data, it can already be deduced from the existing data (Glaser & Strauss, 1999).

2.6.3 Critical social theory

Critical social theory use action research as a method to intervene in an environment. Action research is a cyclic research process where the oppressive structures are identified and a solution is designed and implemented. The success of the solution is investigated after it had been implemented and the cycle is repeated until emancipation from the identified oppression is achieved (Baskerville, 1999).

It is important to note the fundamental differences between the positivistic paradigm on the one hand and the interpretive and critical social theory on the other hand. The first major difference lies with the role of the researcher.

In the positivistic approach the researcher is required to be objective while conducting research. The researcher may not influence the research environment while data is being collected. Interpretive research is based on the personal

observations and interpretations of the researcher. The researcher aims to gather as much information from the research environment as possible in order to draw conclusions after interpreting the data. Critical researchers fulfil two roles, they interpret the data from the environment, they are also designing and implementing measures that changes the environment such as a organisation or social group.

The second major difference between interpretive and critical social research on the one hand and positivist research on the other hand lies with the use of sampling to reduce the problem area. In positivistic research the sample is assumed to be representative of the population as a whole and that statistical sampling methods can be used to analyse characteristics of the population using sampling. Interpretivistic and critical methods study the situation in its whole without deconstructing it.

2.7 Mixed Method

This study will use a mixed method approach, which is the combination of different research paradigms in a single research endeavour (Symonds & Gorard, 2010)

The underlying assumptions of the various paradigms are not changed; the aim is' as explained by Mingers (2001), to gather as much data as possible in order to have a better understanding of the research problem. A research problem can often be broken down into various phases, which will require different research methodologies.

According to Teddlie & Tashakkori (2009) there are a number of clear advantages to using a mixed method approach namely:

- Triangulation whereby it is possible to validate research results by combining different results obtained from various methods, sources and researchers;
- Creativity in which new or paradoxical aspects may be uncovered that can lead to further research;

- Expansion whereby aspects that may have been considered outside the research project be explored;

In this study the interpretivistic methodology will be dominant, and will be used together with the positivistic methodology to achieve the research objectives and answer the various research questions.

2.8 Quality

Of crucial importance is the issue of quality in research. Within the mixed method research the following approaches can be used to ensure quality (Bryman, 2009)

- Convergent criteria where the same criteria is used in the Quantitative (positivistic) and the Qualitative (interpretive) parts of the research;
- Separate criteria where separate criteria are used for the Quantitative (positivistic) and the Qualitative (interpretive) parts of the research; and
- Bespoke criteria where new criteria are devised for the mixed method research project.

2.9 Conclusion

This study will follow a mixed method approach using an interpretative-Quantitative methodology. The reason for this methodology is that the real world behaviour of Central Banks within the SADC will be studied and used to draw conclusions. The study does not have a specific hypothesis regarding the behaviour of Central Banks within the SADC. Certain research questions will be answered in order for the researcher to arrive at a theory regarding the primary objective of understanding how policy decision making is done within SADC Central Banks. The observations will be strengthened by using certain positivistic methodology to quantify aspects such as the level of Central Bank Independence and levels of convergence of certain macro-economic indicators such as inflation within the SADC. In this study a deductive methodology will be used where the data is used to make observations and draw conclusions in order to formulate opinions.

The above objectives can best be achieved by using a mixed positivistic-interpretive research paradigm. For example the legislative framework within which Central Banks operate can be studied within a interpretivistic approach, while an index of CBI can be studied using a positivistic approach.

Chapter 3 Central Bank Independence

3.1 Introduction

The concept of Central Bank Independence (CBI) refers to the extent that a Central Bank can conduct monetary policy independently from government (Walsh, 2005). This implies that the Central Bank will have autonomy or at least a very large degree of freedom when formulating and implementing monetary policy. There has been a substantial increase in focus on CBI since the 1990s. The main reason for this has been a belief that increased CBI will reduce inappropriate interference in monetary policy decision making (Goodman, 1992). Increased CBI has been seen as part of the process of globalisation, with greater convergence in how monetary policy is conducted. This should in turn lead to a more credible monetary policy environment (Arnone *et al* , 2008). Of crucial importance in an environment of high fiscal deficits is the ability of Central Banks to resist calls from central government to fund fiscal deficits by printing money.

As Lavezollo (2006) points out the literature around CBI has been built around foundations laid by the articles by Kydland & Prescott (1977) and Barro & Gordon (1983). The time-inconsistency model of inflation has been used as the analytical framework. The concept is based upon the ancient story Ulysses tying his hands in order to prevent the Siren songs from tempting him into steering his ship onto the rocks. An unbound government will not be seen as credible in its handling of monetary and fiscal policy. Such a government will adapt its policies to whatever is relevant within a particular time frame. Any promises of following prudent policies will not be credible, as politicians aiming for re-election are likely to use expansionary monetary policy in order to address both inflation and unemployment in the run-up to elections.

Such unpredictable unbounded behavior by governments means that other social actors such as consumers and workers cannot depend on self-constrained behavior from government. Government will have strong political incentives to deviate from its

stated policies. As Barro & Gordon (1983) points out government discretion provides no guarantee about the future behavior of government. Social actors will therefore adopt their own inflation expectations in order to maintain stable real wages. This would for example imply that unions ask for above inflation wage increases, in anticipation of the effects of expansionary monetary policy by government.

The effect of this will be to nullify the effect of monetary policy expansion on employment. This “neutrality of money” environment will create a sub-optimal inflation rate at the same level of inflation, resulting in a welfare loss for the whole society (Lavezollo, 2006).

In order to overcome this credibility problem a set of fixed rules and institutional arrangements regarding the conduct of monetary policy is required. The purpose is to “tie the hands” of government in order to commit government to not misuse monetary policy instruments. The delegation of monetary policy to an independent monetary authority is an example of this. According to Rogoff (1985) the purpose of delegating monetary policy to an independent Central Bank that follows a conservative or “hawkish” policy is to reduce inflationary bias. Rogoff points out that Central Banks are far more inflation averse than governments, and will have a greater focus on price stability. As Elster (1984) points out the role of the CB is to be a repository of reason that counteracts the “short term claim of passion”. Therefore the delegation of monetary policy to an independent Central Bank has been presented as an effective method to solve the time-inconsistency problem (Alesina & Tabellini, 1988).

The international focus on CBI has been motivated by a viewpoint that in order for a country to have a credible monetary policy framework, there must be guaranteed independence of the monetary authority from government (Arnone *et al*, 2008). The conduct and policy formulation of the Central Bank is considered of crucial importance to various stakeholders. These include national creditors, ratings agencies, private international banks, as well as bilateral as well as multilateral lending institutions such as the International Monetary Fund (IMF), the World Bank and regional development agencies such as the African Development Bank.

Countries with high levels of CBI are seen as having credible monetary policies (Maxfield, 1997).

There are literature that suggest that increased CBI can lead to improved macroeconomic performance (Alesina & Summers, 1993); (Arnone *et al*, 2008); (Nordhaus, 1975); (Dehaan & Klomp, 2009); (DeHaan & Kooi, 1997). This is based on the suggestion that higher levels of CBI will lead to a more stable monetary policy environment, lower inflation, foster greater fiscal policy discipline and reduce the impact of political business cycles on the economy.

The counter argument is presented by DeBelle and Fischer (1994) that increased CBI may not necessarily lead to improved macro economic performance in the economy. High CBI may lead to a widening in the inflation-output tradeoff, and that the sacrifice ratio would be higher with increased CBI. The sacrifice ratio is the cumulative increase in the yearly unemployment rate that is due to the disinflation effort of the Central Bank, divided by the total increase in the rate of inflation (Cukierman, 2002). Excessive efforts by the Central Bank to contain inflation could reduce economic growth, and thereby lead to a higher unemployment rate.

Walsh (1993) argues that high levels of CBI may actually weaken the levels of transparency and accountability of Central Banks. This is especially true in countries where the monitoring and enforcement mechanisms are weak, as which is the case in most third world and African countries. In order to overcome this most countries split responsibility between goal independence and instrument independence (DeBelle & Fischer, 1994). Macro economic goals such as Inflation targets are set by the legislature, but it is up to the Central Bank to determine which instruments should be used to attain those goals

A number of countries worldwide have introduced a system of inflation targeting (IT), including a number of African countries. On the African continent South Africa introduced IT in 2000, and Ghana in 2007 (Jefferis, 2007). CBI is seen as a prerequisite for the establishment of inflation targeting, as certain specific institutional arrangements need to be in place. Central Banks with a high level of CBI is more

likely to resist calls from central government to monetise public debts (Hayo, 1998) and (Pollard, 1993).

In this study the level of CBI in the SADC member countries will be measured. The approach developed by Cukierman, Webb & Neyapti (1992) and Grilli, Masciandaroand & Tabellini (1991) will be used. As the two approaches have a substantial amount of overlap, the focus in this study will be on the approach used by Cukierman, Webb & Neyapti (1992).

3.2 Policy Objective of Central Banks

Central Banks have as their main, but not only, function the conduct of monetary policy. The secondary function of ensuring financial stability has become more prominent since the global financial crisis. How these roles are structured and the functions are assigned to the Central Bank varies from country to country (Lippi 1999:3); (Rogoff, 1985).

The main policy issues that must be decided areas follows (Arnone *et al*, 2008):

- How independent will the Central Bank be from government and the executive? How much independent authority to formulate and implement monetary policy is afforded to the Central Bank. This issue also relates to the degree of independence Central Banks have in formulating exchange rate policy;
- To what degree is the Central Bank responsible for ensuring stability in the financial system? Is the Central Bank entrusted with supervision of financial institutions and does it have the powers and instruments available to successfully fulfil its supervisory goal;
- The Central Bank is responsible for ensuring there is an efficient, reliable and dependable system for payment and settlement in the financial sector. Does the Central Bank own and operate the various settlement mechanisms and institutions and how does that relate to the Central Banks oversight and supervision role? and

- What other functions and responsibilities may be assigned to the Central Bank? Are these functions in conflict with the stated aims of monetary policy and financial stability? For example a goal of full employment may be in conflict with a goal of price stability.

3.2.1 Functions of Central Banks

Central Banks have historically had a number of core functions, which developed over time. The monetary policy function has dominated the public perception of the role and function of Central Banks. The functions regarding ensuring efficient financial systems and provisioning the core financial infrastructure has come to the fore in recent times due to the global financial crises. The functions of Central banks are as follows (Miles & Scott, 2002:430):

- The Central Bank is the issuer of banknotes. It usually owns or at least supervises the national mint and is the only legal authority that can issue banknotes. There are a few exceptions such as Hong Kong where selected commercial banks have the authority to issue banknotes within a currency board;
- The Central Bank is responsible for the providing of the core financial infrastructure such as the monetary system and the banking system. The Central Bank is responsible for oversight of the national payment system. The Central Bank provides a public good that links the various banks' payment systems and the Central Banks account settlement system. For example a cheque issued by a Standard Bank client and deposited with First National bank is processed through the Central Bank settlement account system;
- The Central Bank is the banker to government. It usually provides banking services to government similar to those provided by a commercial bank to a business;
- The Central Bank is responsible for monetary policy and ensuring there is price stability. In modern time the monetary policy function is conducted within a framework of inflation targeting in a lot of countries. The Central Bank uses

a number of policy instruments such as interest rates, open market operations, and moral persuasion to achieve this objective;

- Economic advisory services are provided by Central Banks. In most cases this is an informal arrangement, there are however a number of banks in countries such as Israel where the Central Bank Governor is an ex officio advisor to the government on economic issues;
- The Central Bank acts as lender of last resort to the banking system. The Central Bank may also have an economic oversight and regulation role and is responsible for ensuring the stability of the banking sector, as stated above;
- Central Banks may have a regulatory and oversight role of the banking system, or its regulatory authority may lie with an independent institution such as the Federal Deposit Insurance Corporation (FDIC) in the USA; and the Central Bank only has a supporting role;
- Central Banks are custodians of the official reserves of the country. The Central Bank may choose to use these reserves to intervene in the foreign exchange market in order to achieve certain policy objectives;
- Some Central Banks have in the past acted as the debt management agency to government. The recent trend however is for the creation of specialised sovereign debt management units, usually within the Treasury/Department of Finance;
- An increased focus on the role of governments in the economy has led to Central Banks having an economic development role. Both directly and through the national banking system, many Central Banks have started to subsidise sectors of the economy that government saw as important for economic development. This preferential treatment is usually aimed at rapid industrialisation or to develop specifically targeted sectors of the economy.
- Central Banks conduct economic research on a wide range of macroeconomic variables. The result of this data is usually published, such as the Quarterly Bulletin of the SA Reserve Bank

3.2.2 Monetary policy objectives of Central Banks

Most modern Central Banks have a clearly defined policy objective of price stability. This implies that the Central Bank is mainly focused on combatting inflation. This is usually stipulated in the legislation that created the Central Bank. A number of countries may combine this objective with other macroeconomic objectives such as full employment. This combination of objectives such as those found in the USA and Malaysia creates a potential conflict for the monetary authority. In contrast the South African and Chinese Central Banks set out stability in the value of the currency as the main objective of the Central Bank (Van der Merwe & Mollentze, 2010).

The existence of multiple or even conflicting objectives is particularly relevant in a number third world and African countries, and this phenomenon will be investigated in Chapter 5 as it applies to the SADC Central Banks.

These potential conflicts can be addressed in a number of ways (Van der Merwe & Mollentze, 2010); (Cukierman, 1992):

- Clearly specify the order of precedence of the various objectives. The Maastricht treaty of 1992 that set up the EU clearly specify a hierarchy of objectives;
- Governments may use lower order legislation in order to clarify and assist in the interpretation of higher order legislation. For example the Central Bank may only be briefly mentioned in the constitution of a country. The legislature may in the act that governs the Central Bank provide far more detailed guidelines and procedures for the conduct of monetary policy, including clarification on the priority given to various objectives;
- Governments may use additional agreements or policy documents that assist the Central Bank in interpreting its mandate and objectives. The use of inflation targeting in countries such as Australia, South Africa, Brazil, United Kingdom and the Philippines are examples of this approach. These numerical targets may be set jointly or independently by either the Central Bank or the Government/Department of Finance. The SA Reserve Bank is responsible for

setting inflation targets while in the UK it is set by the Chancellor of the Exchequer; and

- The technical feasibility of each policy objective is assessed. It is not for example technically feasible to use monetary policy to improve economic growth beyond a point where it may start impacting on macroeconomic and price stability. The sacrifice ratio would imply that conservative monetary policy may lead to higher unemployment, while a loose monetary policy may lead to higher inflation. It can therefore be assumed that price stability is the dominant objective of the Central Bank.

3.2.3 Financial stability objective of Central Banks

Very few Central Banks have an explicitly stated financial stability objective. Most Central Banks however operate under a presumption that the Central Bank is responsible for financial stability (Van der Merwe & Mollentze, 2010). This is mainly derived from the oversight and regulation function of Central Banks. The Zambian Central Bank for example has a stated objective of “formulate and implement monetary and bank supervisory policies that will ensure the maintenance of price and financial systems stability” A number of Central Banks such as Nigeria and Zimbabwe place a more conditional responsibility for financial stability on the Central Bank. The Central Bank is tasked with “promoting” financial stability or a sound economic and financial system. (Van der Merwe & Mollentze, 2010)

With the exception of the lender of last resort functions, there are no clear policy instruments that can be used specifically to ensure financial stability. The instruments that may be used have other primary functions, for example interest rates are used for monetary policy objectives and financial regulations are used for institutional stability and market efficiency. The use of these policy instruments outside their normal functional framework can lead to potential conflicts (Barro & Gordon, 1983).

For example when the financial crisis materialised in 2007 the reduction of interest rates were at the risk of creating inflationary pressures. The current policies of

Quantitative easing (QE) in the United States of America and record low, even negative, interest rates were seen as essential in ensuring stability in the financial sector. There has not been a large increase in inflation, so the conflict between monetary policy objectives and financial stability has been limited. An effective response to the crisis was seen as paramount. There are however potential for substantial policy conflict in future. Premature Ending of Quantitative easing may hamper the resumption of normality in the financial markets, while removing QE at a too late date may see a rise in inflation (Bernanke, 2012).

3.2.4 Payment system objective of Central Banks

The oversight and supervision of the payment system is found as an objective in a number of Central Banks. This is usually written in general terms such as the Central Bank must “supervise the smooth operation of the clearing and payment system” found in the European Central Bank Acts (European Union, 2008). There are trade-offs among the various objectives, with robustness of the system versus efficiency being the most obvious. The risk exists that the Central Bank may over regulate the payment system, and in the process reduces its efficiency (Cukierman, 1992).

International cooperation have played an important role in clarifying the issues involved and helped set down clear criteria and standards that assist in balancing the robustness and efficiency objectives. These so called Lamfalussy principles have involved international agencies such as the Committee on Payment and Settlement systems (CPSS) and the International Organisation of Securities Commissions (IOSCO) (European Union, 2000).

3.3 Central Bank Independence

The four main components of Central Bank Independence are (Loungani & Sheets, (1997):

- The criteria for the appointment, term in office and dismissal procedures of the Central Bank Governor and other board members;

- The degree of freedom that the Central Bank has in formulating and implementing monetary policy free from government interference;
- The extent to which the Central Bank focuses on price stability as its main policy objective; and
- The lending criteria of the Central Bank. What is of crucial importance is the level to which the Central Bank is required to fund government deficits?

Kydland & Prescott (1977) refer to the dynamic inconsistency theory of monetary policy. The theory suggests that central government will try to abuse the Central Bank in order to finance fiscal deficits. This is based on political considerations and will be in conflict with the stated aims of a Central Bank which is price stability. Governments may try and use monetary authorities to mitigate the political business cycle, without considering the impact on monetary policy and price stability (Nordhaus, 1975).

In order to prevent any conflicts of interest proponents of CBI suggest that there should be a clear distinction between the Central Bank and government. The entity that creates money (Central Bank) must be independent from the entity that spends the money (Government) (Mangano, 1998). There must in other words be clear independence of the Central Bank from the National Treasury/Department of Finance. This is especially true in African countries where in many cases there are substantial fiscal deficits coupled with weak internal institutions. For example a country with an underperforming receiver of revenue where a lot of taxes are not collected may be tempted to simply instruct the Central Bank to print money in order to finance the shortfall in government revenue. This will ultimately lead to depreciation in the value of the currency and higher inflation.

3.3.1 Theoretical basis for CBI

The theoretical basis for CBI is primarily derived from three models namely:

- The political business cycle model as developed by Nordhaus (1975);

- The dynamic inconsistency problem of monetary policy developed by Kydland & Prescott (1977); and
- The delegation of monetary policy developed by Rogoff (1985).

These theories are based on the claim that governments have an incentive to misuse the money printing ability of the Central Bank. Political authorities may want to achieve certain short term political or economic objectives, or use the Central Bank to monetise debt. In order to counter this tendency, greater levels of CBI are called for. There should be a clear separation of power between the monetary policy authority (Central Bank) and the political and fiscal authorities (Government) (Nordhaus, 1975).

3.3.1.2 Political Business Cycle Model

Governments ultimately have as their main objective to win elections and remain in power. This will be done even if there is a trade off or opportunity cost to this objective. For example a government may introduce tax cuts before an election that may lead to a higher fiscal deficit later on. Government would then instruct the Central Bank to monetise the debt, despite the potential negative impact that such a policy may have on the economy. The focus however is on short term partisan political goals, not the long term economic impact of policies. Nordhaus refers to this phenomenon as the “Sirens of partisan politics” (Nordhaus, 1975). In order to counter this an independent Central Bank is seen as essential. Political cycles refer to changes in governments and government policies. For example a newly elected government may choose to follow different economic policies than their predecessors. In order to prevent the Central Bank from becoming involved in partisan politics where it is instructed to implement policies of whichever party is in power, a high degree of CBI is required. This will ensure that monetary policy remains free of the “sirens” mentioned earlier.

3.3.1.3 Dynamic inconsistency problem of monetary policy

Kydland & Prescott (1977) argue that CBI contributes to effective monetary policy and will lead to better macroeconomic performance. This is due to the fact that an independent Central Bank will be more consistent and transparent in its operations. If monetary authorities are not able to adjust policy as and when required the economic outcomes will not be optimal. This can be seen in the trade-off between unemployment and inflation. Monetary authorities must be able to independently implement policy. If there is an expectation that government may interfere in the setting of policy the Central Bank will not be seen as credible and will undermine its efforts towards price stability

3.3.1.4 Delegation of monetary policy

Monetary policy should be conducted by an independent and conservative Central Bank (Rogoff, 1985). There should be a clear and definitive delegation of monetary policy authority to an independent Central Bank. The Governor of the Central Bank should have different objectives and aims from politicians who concentrate on short term partisan political objectives.

The Central Bank should focus on building its credibility and ensure that it gains the confidence of the markets. The focus should be on price stability, even if the society at large is more focused on economic growth. As former US Federal Reserve Governor William McChesny Martin, Jr (Martin, 1955) stated it is the job of the Federal Reserve Governor to *“take away the punch bowl just as the party is getting good”*

Rogoff (1985) indicates that the Central Bank should have both goal and instrument independence. The focus of the Central Bank on price stability as well as high level of CBI should lead to macroeconomic stability due to higher policy certainty. The Central Bank will be able to remove political considerations from monetary policy which will lead to a more predictable and credible monetary policy environment (Romer & Romer, 1989).

3.3.2 Types of Central Bank Independence

There is a complex relationship between government and the Central Bank. The government appoints the Central Bank Governor and board members, but at the same time the board is considered independent from government.

Henning (1994) defined CBI as “*the ability of a Central Bank to use its instruments of monetary control without instruction, guidance or interference from the government*” Measuring the level of CBI can be done using a number of criteria or dimensions. Grilli *et al* (1991) identified six primary dimensions that can be used to identify the level of Central Bank Independence.

3.3.2.1 Political Independence

Political independence refers to the institutional features built into the statutes that govern the Central Bank in order to shield the Central Bank from partisan political influence from the national government. The Central Bank should be able to define and formulate its policy objectives independent from any outside coercion or influence (Grilli *et al* , 1991).

3.3.2.2 Economic Independence

Economic independence refers to the ability of the Central Bank to independently and objectively implement its monetary policy goals, strategies and objectives. This relates to both goal and instrument independence as discussed below. Grilli *et al* , (1991).

3.3.2.3 Goal Independence

Goal independence refers to the ability of the Central Bank to determine its own goals and objectives with minimum interference from central government (Fischer &

Debelle 1994). The setting of inflation targets is an example of this phenomenon. The US Federal Reserve has broad goal independence in that, although its objectives are set out in legislation, those objectives very broadly defined and it is up to the Federal Reserve to set its own goals (United States, 1913). In contrast the Bank of England (UK Central Bank) has limited goal independence; its inflation targets are determined by the UK government through the Chancellor of the Exchequer (United Kingdom, 1998). In South Africa the SA Reserve bank (SARB) has similar limitations on goal independence as its own inflation targets are set by government (South Africa, 1989).

3.3.2.4 Instrument Independence

Instrument independence refers to the amount of freedom a Central Bank has to adjust its policy instruments without interference or instruction from government. The Central Bank should have the ability to freely use its monetary policy tools in order to meet its stated policy goals and objectives. The Bank of England as well as the US Federal Reserve and the South African Reserve Bank have instrument independence; it can set interest rates without interference from government (Cukierman, 2005).

3.3.2.5 Legal Independence

Formal CBI is legally enshrined and guaranteed in the legislation of a country. The Central Bank Act of the relevant country should grant staff and financial autonomy to the Central Bank. In other words the Central Bank is free to appoint its own staff and manage its own budget. There are also specific guarantees regarding goal and instrument independence present (Wessels, 2008).

There is however a number of drawbacks to this method. Central Banks acts do not always clearly indicate the separation of powers between the government and Central Bank. Secondly the implementation of the act in practise may be lacking. A

bank may on paper be legally independent but in practise it has far lower levels of independence.

3.3.2.6 Actual Independence

For an Central Bank to be independent both the legal and other factors such as memorandums of understanding between government and the Central Banks, policy documents, and dispute resolution mechanisms need to guarantee CBI (Wessels, 2008). The actual level of CBI within a country will be determined by a number of factors. These factors fall outside the scope of the legal definition of CBI, as they are heavily influenced by the internal political climate of a country.

The following factors determine the levels of actual Central Bank Independence (Schwödiauer, Komarov & Akimova, 2006):

- The level of openness of the economy;
- The type of political system in the country and its internal arrangements;
- The levels of and mechanisms for supervision of financial Institutions;
- The level of financial sector opposition to inflation; and
- The level of public opposition to inflation.

3.4 The Importance of Central Bank Independence

The actions and policies of Central Banks are closely watched by various stakeholders such as national creditors, potential investors, and holders of government debt, international lending agencies, and credit agencies. Ratings and lending organizations such as the International Monetary Fund (IMF) and the World Bank use the CBI ratings of a country as part of the criteria for determining the credit rating of a country. According to Maxfield (1997), international creditors see a countries' commitment to CBI as a vital indicator of the ability of the country to have sustainable economic growth and the ability to successfully repay external debts.

3.4.1 International Factors

The experience of stagflation and poor economic growth in the 1970s prompted a number of countries to revisit their monetary policy frameworks. Hyperinflation in a number of Latin American countries coupled with historically very high inflation turned the focus on those countries that did not have those problems. Countries such as Japan and Germany were seen as being successful in controlling inflation while their economies outperformed their peers. Both the German Bundesbank and the Bank of Japan have high levels of Central Bank Independence, which prompted a move in a number of countries to try and copy their success by increasing the independence of their own Central Banks. (Cukierman, 2005).

International experience seemed to indicate that CBI is an effective tool to prevent undue political interference in the setting and conduct of monetary policy. An independent Central Bank will be far less likely to consider political considerations such as elections when conducting monetary policy. In cases where the Central Bank is not independent from government, government may well put undue political pressure on the Central Bank to implement monetary policy that will be of political benefit to government (Woolley , 1984) (Goodman, 1992).

3.4.2 Regional factors

A number of regional factors lead to an increase in Central Bank Independence. The collapse of the Bretton Woods system in the early 1970s , as well as the European Monetary System crisis of the early 1990s lead to a desire for a more stable institutional framework (Alesina & Tabellini, 1988). The German Bundesbank had a very good track record of both price stability and very good economic performance. The Bundesbank was also seen as having a high degree of CBI and when the European Economic Community (EEC) adopted the Maastricht Treaty that lead to European monetary union, the Bundesbank was seen as the benchmark to which other Central Banks should aspire. Potential EU member countries started a number

of reforms to bring their Central Banks in line with the levels of Central Bank Independence required for membership (Arnone *et al*, 2008).

The SADC has a stated policy goal of moving toward closer monetary union and macroeconomic convergence. The SADC has a goal of a monetary union by 2016 and the introduction of a single SADC wide currency by 2018. The establishment of a single SADC Central Bank with the legal powers to issue a single SADC currency, consolidate all foreign exchange reserves, and set a common monetary policy for the entire SADC is an essential step towards monetary union (Khamfula & Tesfayohannes, 2004)

The SADC has established a Committee of Central Bank Governors (CCBG) comprising the Governors of the various SADC Central Banks. The CCBG is responsible for monitoring and facilitating macro-economic convergence within the SADC. As part of this process a model SADC Central Bank Act has been published, which includes criteria regarding the level of CBI that SADC Central Banks must have. Prospective SADC monetary union members must, as was the case with the European Union, meet these criteria in order to qualify for membership (SADC Bankers, 2013)

3.5 Measuring Central Bank Independence

Cukierman, Webb & Neyapti (1992) developed an index of Central Bank Independence that is based on a number of criteria. The authors concentrated on a number of narrow but legally precise characteristics, and it is possible to gather this data from the various Central Bank acts and charters. This approach made it possible to objectively rank the various Central Banks by their level of CBI without having to make a large number of subjective value judgments. This index will be applied to the various SADC Central Banks in order to calculate the level of CBI in each of the member countries of the SADC.

Grilli, Masciandaroand & Tabellini (1991) (GMT) developed a legal independence index using political and economic criteria. The methodology used is similar to that

found in CWN in that the authors concentrated on a number of legally precise characteristics that can be sourced from the various Central Bank Acts.

This study will use the CWN index to the various SADC Central Banks in order to calculate the level of CBI in each of the member countries of the SADC. The reason for this is twofold. Firstly the CWN index is more comprehensive and provides a broader framework within CBI can be measured, and secondly the CWN index has been more widely used in the literature.

3.5.1 CWN Index of Central Bank Independence

3.5.1.1 Aggregate CWN Index

The aggregate legal Cukierman Webb Nyapti (CWN) index is compiled as follows (Cukierman, Webb & Neyapti, 1992):

$$CWN_{i,t} = 0.2 * CBGC_{i,t} + 0.15 * CBPO_{i,t} + 0.15 * PFAA_{i,t} + 0.5 * CBLC_{i,t} \quad (3.1)$$

Where $CWN_{i,t}$ indicates the aggregate level of CBI for country i for period t ;

Where $CBGC_{i,t}$ Indicates the characteristics of the CB Governor for country i for period t . This is a measurement of the level of personal independence that the Central Bank Governor of the country has. Among the indicators are the appointment and dismissal procedures and conditions of the Governor, The legal term of office of the Governor, and level of independence from other state institutions.;

Where $CBPO_{i,t}$ indicates the legal policy objectives of country i for period t . This measures the goal independence of the Central Bank ;

Where $PFAA_{i,t}$ indicates the locus of monetary policy formulation, in other words where are policy decisions taken. This is the measure the level of policy formulation independence that the Central Bank has;

Where $CBLC_{i,t}$ indicates the financial independence of the Central Bank. This is the measure of the level of restrictions placed on the Central Bank making loans to government.

The coefficients in equation 3.1 are the various weights of the various variables that are found in the CWN index. The CWN index is a weighted average of the 16 CBI variables that were placed into 4 sub-indices.. Each of the variables are awarded a value of 0 – 1, and the higher the index value, the greater the CBI level of a country, and vice versa.

The 4 sub-indices can be broken down further into their various components.

3.5.1.2 Central Governor sub-index (CBGC)

The first sub index can be defined as (Cukierman, Webb & Neyapti, 1992):

$$CBGC_{i,t} + \frac{GTOF_{i,t} + GAAT_{i,t} + GDAT_{i,t} + GOOF_{i,t}}{4} \quad (3.2)$$

Where $GTOF_{i,t}$ indicates the Governors legal term in office in country i for period t ;

Where $GAAT_{i,t}$ indicates the executive or legislative authority empowered to appoint the Governor;

Where $GDAT_{i,t}$ indicates the procedures for dismissal of the Governor

Where $GOOF_{i,t}$ is an indicator of other offices that the Governor may be able to hold over the period.

The $CBGC_{i,t}$ sub index is the average of the above 4 variables.

3.5.1.3 Policy Objective sub index (CBPO)

The second sub-index can be defined as follows (Cukierman, Webb & Neyapti, 1992):

$$CBPO_{i,t} = PSOP_{i,t} \quad (3.3)$$

$PSOB_{i,t}$ is the only component of $CBPO_{i,t}$. It indicates the Central Bank price stability objective in country i for period t , which is generally considered to be the primary objective of a Central Bank.

3.5.1.4 Locus of policy control sub index (PFAA)

The third sub-index can be defined as follows (Cukierman, Webb & Neyapti, 1992):

$$PFAA_{i,t} = 0.25 * MPFA_{i,t} + 0.5 * CFRM_{i,t} + 0.25 * CCBG_{i,t} \quad (3.4)$$

Where $MPFA_{i,t}$ indicates the monetary policy formulation authority in country i for period t ;

Where $CFRM_{i,t}$ indicates the conflict resolution mechanism in cases where there are policy conflicts in country i for period t ; and

Where $CCBG_{i,t}$ indicates the role that the Central Bank plays in formulating the national budget.

3.5.1.5 Financial Independence Sub Section (CBLC)

The fourth sub-index can be defined as follows (Cukierman, Webb & Neyapti, 1992):

$$CBLC_{i,t} = 0.15 * CBGA_{i,t} + 0.1 * CLGL_{i,t} + 0.1 * CLGT_{i,t} + 0.5 * COBF_{i,t} + 0.025 * CBTL_{i,t} + 0.025 * CLGM_{i,t} + 0.25 * CLRR_{i,t} + 0.025 * CBPM_{i,t} \quad (3.5)$$

Where $CBGA_{i,t}$ indicates the level of stringency placed on advances to the government by the Central Bank in country i for period t ;

Where $CLGL_{i,t}$ indicates the stringency of limits in Central Bank loans to the government in country i for period t ;

Where $CLGT_{i,t}$ indicates the authority that determines the terms placed on lending to government in country i for period t ;

Where $COBF_{i,t}$ indicate the various beneficiaries of Central Bank funds in country i for period t ;

$CBTL_{i,t}$ indicates the types of limits placed on lending out Central Bank funds in country i for period t ;

Where $CLGM_{i,t}$ indicates the maturity profile of Central Bank loans in country i for period t ;

Where $CLRR_{i,t}$ indicates the restrictions placed on interest rates in country i for period t , and

Where $CBPM_{i,t}$ indicates the presence of an explicit ban on the Central Bank participating in the primary government securities market in country i for period t .

3.5.1.6 Using the CWN Index

The limits stated in the above indexes can be either a percentage or an absolute value. The various characteristics that were considered when compiling the index can be organised into four groups or clusters namely:

- The term in office as well as appointment and dismissal procedures of the Governor or chief executive officer of the Central Bank;
- The policy formulation cluster, which includes the mechanisms for resolving conflicts between the Central Bank and the government regarding monetary policy' as well as the degree of involvement by the Central Bank in the fiscal policy and budget processes of government;
- The policy objectives of the Central Bank; and
- The degree to which lending by the Central Bank to the public sector is restricted. For example limitations on the amount, volume, interest rates and lending conditions from the Central Bank to the public sector.

The various clusters were created from 16 different legal variables, each of which had a value of 0 (low independence) or 1 (high independence). A high numerical result will therefore indicate a greater level of CBI and more freedom and autonomy in setting and implementing monetary policy. Table 1 contains the various variables as well as their numerical coding used in the CWN index of Central Bank Independence

Table 3.1 Cukierman Webb & Neyapti Index

Variable	Description of variable	Weight	Numerical Coding
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Number			
1	Chief executive officer	0.2	
	<i>a) Term in office</i>		
	Over 8 years		1.00
	6 – 8 years		0.75
	5 years		0.5
	4 years		0.25
	Under 4 years or at discretion of appointer		0.00
	<i>b) Who appoints CEO</i>		
	Board of Central Bank		1.00
	Council of CB board, executive branch and legislature		0.75
	Legislature		0.5
	Executive collectively (e.g. cabinet)		0.25
	1 or 2 members of executive		0.00
	<i>c) Dismissal</i>		
	No provision for dismissal		1.00
	Only for reasons unrelated to policy		0.83
	At direction of CB board		0.67
	At legislature discretion		0.5

	Unconditional dismissal possible by legislature		0.33
	At executive discretion		0.17
	Unconditional dismissal possible by executive		0.00
	<i>d) May CEO hold other positions in government</i>		
	No		1.00
	Only with permission from executive		0.5
	No rule against CEO holding another office		0.00
2	Policy Formulation	0.15	
	<i>a) Who formulates monetary policy</i>		
	Bank alone		1.00
	Bank participates but has little influence		0.67
	Bank only advises government		0.33
	Bank has no say		0.00
	<i>b) Who has final word in resolution of conflict</i>		
	The bank, on issues clearly defined in the law as its objectives		1.00
	Government, on policy issues not clearly defined as the goals of the bank or in a case of conflict with the bank		0.80
	A council of the Central Bank, executive branch and legislative branch		0.60
	The legislature, on policy issues		0.40
	The executive branch on policy issues, subject to due process and possible		0.20

	protest by the bank		
	The executive has unconditional priority		0.00
	c) Role in government budget process		
	Central Bank active		1.00
	Central Bank has no influence		0.00
3	Objectives	0.15	
	Price stability is the major or only objective in the charter, and the Central Bank has the final word in case of conflict with other government objectives		1.00
	Price stability is the only objective		0.80
	Price stability is one goal, with other comparable objectives such as a stable banking system		0.60
	Price stability is one goal, with potentially conflicting objectives such as full employment		0.40
	No objectives stated in the charter		0.20
	Stated objectives do not include price stability		0.00
4	Limitations on Lending to Government		
	<i>a) Advances (limitations on non-securitized lending</i>	0.15	
	No advances permitted		1.00
	Advances permitted, but with strict limits (e.g. up to 15% of government revenue		0.67
	Advances permitted, and the limits are loose (e.g. over 15% of government revenue		0.33
	No legal limits on lending		0.00

	<i>b) Securitised lending</i>	0.10	
	Not permitted		1.00
	Permitted, but with strict limits (e.g. up to 15% of government revenue)		0.67
	Permitted, and the limits are loose (e.g. over 15% of government revenue)		0.33
	No legal limit on lending		0
	<i>c) Terms of lending (maturity, interest, amount)</i>	0.10	
	Controlled by the bank		1.00
	Specified by the bank charter		0.67
	Agreed between the Central Bank and executive		0.33
	Decided by the Central Bank alone		0.00
	<i>d) Potential borrowers from the bank</i>		
	Only the central government	0.05	1.00
	All levels of government (state as well as central)		0.67
	Those mentioned above and public enterprises		0.33
	Public and private sector		0.00
	<i>e) Limits on Central Bank lending defined in</i>	0.025	
	Currency amounts		1.00
	Shares of Central Bank demand liabilities or capital		0.67
	Shares of government revenue		0.33

	Shares of government expenditure		0.00
	f) <i>Maturity of loans</i>	0.025	
	Within 6 months		1.00
	Within 1 year		0.67
	More than 1 year		0.33
	No mention of maturity in the law		0.00
	g) <i>Interest on loans must be</i>	0.025	
	Above minimum rates		1.00
	At market rates		0.75
	Below maximum rates		0.50
	Interest rate is not mentioned		0.25
	No interest on government borrowing from Central Bank		0.00
	h) Central Bank prohibited from buying or selling government securities in the primary market?	0.025	
	Yes		1.00
	No		0.00

Source: Cukierman, Webb & Neyapti 1992

The following criteria were used in coding the various Central Banks by their level of independence:

Those Central Banks where the chief executive officer (usually the Governor) has a longer legal term in office and where the executive branch do not have a lot of legal

authority in appointing or dismissing the chief executive officer are considered more independent in the chief executive officer cluster. This is indicated Criteria 1 in Table 3.1 above.

Central Banks with the authority to independently formulate monetary policy without interference from the executive are considered as being more independent. The higher the ability the Central Bank to resist interference from the executive in cases of conflict or disagreement the more independent the Central Bank is. This is indicated in Criteria 2 in Table 3.1 above.

The Central Bank policy objectives are divided into 6 possible ratings, according to the degree that price stability is seen as the primary objective of the Central Bank. The price stability objective may be in conflict with other objectives, such as full employment, and a Central Bank that has price stability as its primary or only goal is seen as being more independent. The objectives criterion is aimed to reflect the legal mandate of the Central Bank and the focus on price stability. Rogoff (1985) describes the objectives criteria as measuring the “*conservative bias*” of the Central Bank. This is not strictly speaking an indicator of independence from government, such as in the CEO and policy criteria, it does however indicate the primary focus and *raison d'être* of the Central Bank. This is indicated in Criteria 3 in Table 3.1 above.

Central Banks with stricter limitations on its ability to lend funds to the public sector are considered more independent from government. Central Banks with strict limitations will be for example more resistant to calls from government to monetise debt. The limitations are quantified in a number of specific variables, such as limitations on non-securitised lending, terms of lending, qualified lenders, maturity and interest rates. The limitations are specified either as specific cash amounts or as a percentage of central government revenue. The stricter the terms of lending specified the higher the rating of independence of the Central Bank. The limitations on lending are considered to be stricter the closer the interest rates paid by government are to market rates, and the shorter the maturities are of public sector debt.

3.5.2 GMT Legal Independence Index

3.5.2.1 Aggregate GMT Index

The first sub-index namely political CBI has 8 separate variables and the economic CBI has 7 variables (Grilli, Masciandaro & Tabellini, 1991). Each variable has an absolute binary number of 0 or 1. The GMT index is the aggregate of the various variables.

The legal CBI index (GMT) is defined as follows: $GMT_{i,t} = POLCBI_{i,t} + ECO CBI_{i,t}$

Where $POLCBI_{i,t}$ refers to the political CBI in country i for period t ; and

Where $ECO CBI_{i,t}$ refers to economic CBI in country i for period t .

3.5.2.2 Political Sub Section (POLCBI)

The first sub-index namely political CBI has 8 separate variables and the economic CBI has 7 variables (Grilli, Masciandaro & Tabellini, 1991). Each variable has an absolute binary number of 0 or 1. The GMT index is the aggregate of the various variables. If the variable is true a 1 is assigned if not a 0 is assigned

$POLCBI_{i,t}$ can be defined as follows: $POLCBI_{i,t} = CBGA_{i,t} + CBGT_{i,t} + CBBA_{i,t} + CBBT_{i,t} + CBBG_{i,t} + MPFA_{i,t} + PSSO_{i,t} + LDCR_{i,t}$.

Where $CBGA_{i,t}$ indicates the Government does not appoint the Central Bank Governor in country i for period t ;

Where $CBGT_{i,t}$ indicates the Central Bank Governor has a term of office of more than 5 years in country i for period t ;

Where $CBBA_{i,t}$ indicates that the government does not appoint the majority of reserve bank Governors in country i for period t ;

Where $CBBT_{i,t}$ indicates that the Central Bank board has a term of office of 5 or more years in in country i for period t ;

Where $CBBG_{i,t}$ indicates that a representative of government participates in Central Bank policy meetings in country i for period t ;

Where $MPFA_{i,t}$ indicates that government does not approve monetary policy in country i for period t ;

Where $PSSO_{i,t}$ indicates that there is a legal mandate given to the Central Bank to ensure price stability in country i for period t ;

Where $LDCR_{i,t}$ indicates that there is a mechanism in case to resolve policy conflicts between government and the Central Bank.

3.5.2.3 Economic Independence Sub Section (ECOCBI)

Economic CBI is defined as follows: $ECOCBI_{i,t} = CLGA_{i,t} + CLGT_{i,t} + CLGL_{i,t} + CLGM_{i,t} + OGD P_{i,t} + DRSA_{i,t} + CBSR_{i,t}$ (Grilli, Masciandaro & Tabellini, 1991)

Where $CLGA_{i,t}$ indicates that the granting of direct credit to government is not automatic in country i for period t ;

Where $CLGT_{i,t}$ indicates that Central Bank credit is granted at current market interest rates in country i for period t ;

Where $CLGL_{i,t}$ indicates that there are temporary limits in place to the amount that the Central Bank can lend in country i for period t ;

Where $CLGM_{i,t}$ indicates that there is a maturity limit on Central Bank loans in country i for period t ;

Where $OGDP_{i,t}$ indicates that the Central Bank participated in the primary government securities market in country i for period t ;

Where $DRSA_{i,t}$ indicates that discount rates are set by the Central Bank in country i for period t ; and

Where $CBSR_{i,t}$ indicates that the Central Bank plays a role in bank supervision in country i for period t .

3.5.2.4 Using the GMT index

Table 3.2 Grilli, Masciandaro & Tabellini Index

Index of Political Independence	POLCBI	Value (0 or 1)
Government does not appoint the CB Governor	CBGA	
CB Governor term of office is more than 5 years	CBGT	
Government does not appoint CB Board members	CBBA	
CB Board term of office is more than 5 years	CBBT	
Government participation in Board meetings	CBBG	
Government does not approve monetary policy	MPFA	
Primary legal mandate of price stability	PSSO	
Conflict resolution mechanisms in place	LDCR	
Index of Economic Independence	ECOCBI	
Direct CB credit not granted automatically	CLGA	
Markets interest rates apply to CB credit	CLGI	
Temporary limited amount on CB credit	CLGL	
Maturity of loans restricted	CLGM	
CB participates in primary market	OGDP	
CB alone sets discount rate	DRSA	
Banking supervision responsibility of CB	CBSR	

The criteria used in coding the GMT index are based on binary numbers 0 and 1. For each variable the relevant Central Bank Act is evaluated and a value of 0 or 1 is assigned to each variable. If the Central Bank complies with the criteria a 1 is assigned, else a 0 is assigned.

The CWN index will primarily be used, with the GMT methodology used to supplement the findings. The GMT index is based on a binary system, and assigns different weights to the variables than the CWN index.

3.5.3 Factual Central Bank Independence

In certain countries, especially developing ones, the legal CBI indicators may not necessarily give a true reflection of the relations between the Central Bank and government. This is especially true in countries where the rule of law is not always respected and legal CBI provisions may be loosely interpreted in certain circumstances (Cukierman, Webb & Neyapti, 1992) (Forder, 1996) (Mangano, 1998).

Factual CBI covers a number of aspects, including the term of office of the CB Governor, their political vulnerability, their role in monetary policy as well as their personal styles and charisma (Radzyner & Riesinger, 1997).

It must be stated that a long serving CB Governor may also be indicative of a subservient incumbent, which government is leaving in place for political reasons. For this reason the actual amount of time in office of the various Governors were not considered for this study, as it is impossible to determine the reasons why a Governor may have a particular long tenure in office.

3.6 Central Bank Independence and Transparency

Central Bank transparency refers to the degree to which the Central Bank communicates and explains monetary policy decisions to outside stakeholders (Issing, 1999). Geraats (2002) describes transparency as a necessary component of

CBI. Transparency and accountability must be present in order for a Central Bank to be seen as both credible and independent. Five distinctive aspects are identified that determine the level of transparency that a Central Bank has. These are as follows (Geraats, 2002):

- Political transparency that relates to whether the role, functions and objectives of the Central Bank should be published. The role and responsibilities of the Central Bank vs the executive authority should be laid down in statute and be publicly available;
- Economic transparency relates to the publishing of economic information , including projections and forecasts by the Central Bank as well as the ability of outside parties in the private sector to analyse and comment on the information;
- Procedural transparency refers to Central Bank policy regarding publishing of internal documents relating to policy decisions. For example the publishing of the minutes of monetary policy committee meetings, including voting records;
- Policy transparency relates to the release to the public of policy decisions after they have been made. For example how is interest rate decisions communicated to the public? Are the reasoning and motives behind the policy decisions communicated to the public? How are the practical implications of the policy explained to the public? ; and
- Operational transparency relates to whether the Central Bank published information relating to the functioning of monetary transmission mechanism. Are data analysis relating to the accuracy of past data forecasts published for comment? (Geraats, 2002).

3.7 Conclusion

Central Bank Independence has in the past few decades become a crucial indicator of the level commitment by the government to price stability and prudent monetary and macroeconomic policies. This includes the level of credibility and independence

of the Central Bank, and its ability to independently conduct monetary policy without interference from government.

It is the aim of this study to determine to what extent the Central Banks of the various SADC member countries are able to act in an independent manner “and without fear, favour or prejudice or direction from any authority or institution” , as is envisioned in the model Central Bank law

Chapter 4 Economic Integration

4.1 Introduction

Globalisation has had a significant and growing impact on the world economy over the past few decades. The impact for developing countries has been more visible from the late 1980s onwards (Kabundi & Loots, 2005). There has therefore been a concerted effort towards regional economic and political integration. The establishment of the European Union (EU) and the African Union (AU) are prime examples of this. While the EU has already completed the process of creating a monetary union, the AU is in the preparation phases of such an endeavour.

The AU has agreed in principle to create a monetary union, with a single currency, by 2021 (Jefferis, 2007). This would however be dependent upon, and preceded by the formation of regional monetary unions within Africa (Jefferis, 2007). The SADC is one of the 16 regional economic structures in Africa, and is the largest economic bloc in Africa, mainly due to the membership of South Africa (Rossouw & Breytenbach, 2011).

The origins of the SADC can be traced back to the struggle against apartheid. The so called Frontline states formed the Southern African Development Coordination Conference (SADCC) in Lusaka on 1 April 1980. The stated aim was closer cooperation towards the liberation of South Africa. The SADC was created at a meeting in Windhoek, Namibia on 17 August 1992 (Amos, 2010).

The mission statement of the SADC is as follows: *“to promote sustainable and equitable economic growth and socioeconomic development through efficient production systems, deeper cooperation and integration, good governance, and durable peace and security, so that the region emerges as a competitive and effective player in international relations and the world economy”* (Amos, 2010)

The SADC treaty of 1992 established a total of 21 cooperation clusters, and various member states were given the task of coordinating SADC functions and activities in

each of the clusters. South Africa was assigned the finance, investment and health portfolios (Amos, 2010). Stemming from its responsibility for the finance portfolio South Africa assumed the responsibility of monetary policy coordination. The governor of the SARB chairs the Committee of Central Bank Governors (CCGB), which is responsible for the coordination and convergence of monetary policy within SADC (Rossouw, 2006). The SADC 15 year plan called for a Free Trade Area (FTA) by 2008, a Customs Union by 2010, Common Market by 2015, Monetary Union by 2016, and a SADC currency by 2018 (Amos, 2010).

4.2 Stages of Economic Integration

Economic integration can be defined as '*both a process and a state of affairs*'. The process entails the set of political and economic measures aimed at reducing or elimination the barriers or discrimination between economic units of different states. It can be seen as a state of affairs where certain discriminatory practices are absent. This can include for example the absence of passport or visa control or tariffs and quotas between countries (Balassa, 1987:43)

Economic integration will by definition lead to closer economic policy convergence between member countries (Cardoso & Ferreira, 2000). This may entail the loss of sovereignty as certain policy decisions are henceforth taken at regional level. The loss of national currency in a monetary union. The main types of economic integration identified is discussed below.

4.2.1 Free Trade Areas (FTAs)

The member countries of a FTA take steps to eliminate all internal trade barriers between members of the FTA. Each individual country does however maintain their national trade barriers with regard to external third parties who are not members of the FTA. This is the most common type of economic integration (Appleyard & Field, 2001:351).

4.2.2 Customs Unions (CUs)

The members of a customs union expand the provisions of a FTA by removing all internal trade barriers and introducing a set of common tariffs that apply to all external third parties. The members of the CU jointly conduct trade negotiations and enter into trade agreements with non members as a group (Appleyard & Field, 2001)

4.2.3 Common Markets (CMs)

The members of a common market expand the provisions of a CU by adding provisions that allow for complete mobility of all factors of production. This would imply the free movement of goods, services, capital as well as labour between the members of the CM. The members of the CM will jointly negotiate a set of common policies regarding production factor flows to and from non member countries. The free movement of production factors can imply a significant loss of sovereignty for member countries, and domestic policy harmonisation between member countries may be required to prevent distortions (Appleyard & Field, 2001) ; (Jefferis, 2007).

4.2.4 Monetary Unions (MUs)

An Monetary Union can be seen as the most comprehensive form of economic integration between member states possible, short of forming a federation. A monetary union expands on the provisions of a common market by including provisions for the harmonisation of various aspects of national policies. This may include fiscal, monetary, social, justice, immigration and foreign policies. The member countries also adopt a common currency, with a common Central Bank. The European Union is a practical example of a monetary union. (Appleyard & Field, 2001); (Maruping, 2005).

4.3 Stages of Monetary Integration

Jefferis (2007:85-86) identifies four primary stages of monetary integration. The primary goal of the SADC is to move towards a monetary union by 2018, and the stages of integration will help to elucidate the processes that are involved. As Maruping (2005) points out the African Union (AU) has a similar vision of a continent wide monetary union and common currency by 2025. The various stylised stages are mainly characterised by the exchange rate policy in each stage, and the implications for monetary and other policies that entails.

4.3.1 Stage 1

During this stage there are no aspects of monetary integration present. There is no coordination between the monetary policy authorities of the various countries. There may be convergence in monetary policies if countries experience similar economic conditions and external shocks. Each country has its own independent monetary policy regime with a free floating exchange rate (Jefferis, 2007:86).

4.3.2 Stage 2

The member countries try and link their currencies within a managed floating exchange rate regime. The currencies either fluctuate within a pre-determined range, or follow a crawling peg arrangement. There is a degree of monetary policy integration between member countries, but this will be to a large degree be determined by the levels of capital mobility of member countries. A country that maintains capital controls will be able to maintain a certain degree of autonomy in monetary policy (Jefferis, 2007:86). At present the members of the Common Monetary Area (CMA) namely Lesotho, South Africa, Swaziland and Namibia operate under a currency peg with the SA Rand acting as the anchor currency. Botswana as well as the 4 CMA members forms the Southern African Customs Union (Aziakpono, 2006)

4.3.3 Stage 3

There is a high degree of monetary policy integration between member countries present. The currencies of the various members are pegged to each other. In an environment of full capital mobility, backed by well-developed national capital markets, it is possible that a common monetary policy regime be put in place for all members. It is important to note that if monetary policy is not effectively coordinated the result may be unsustainable capital outflows that may undermine the exchange rate peg. The experience of the UK and the European exchange rate mechanism in 1992 is an example of this (Jefferis, 2007:86).

4.3.4 Stage 4

There is a full monetary union in place between members. An Example of this is the EU, and this is also the ultimate aim of the SADC. All member states are committed towards the adoption of a single currency with a common Central Bank and monetary policy environment. The individual member countries would have given up a large degree of sovereignty and autonomy, in particular regarding the conduct of monetary and to a certain degree fiscal policy (Jefferis, 2007:87)

4.4 Costs and benefits of economic integration

The process of economic integration and the eventual creation of a monetary union will entail certain clear advantages or benefits as well as disadvantages or costs for the countries involved. The literature contains a number of studies (Glick, 1991); (Kaufmann, 1996); (Afxentiou, 2000); (Maruping, 2005); (Jefferis, 2007) and (Tavlas, 2007) conducted regarding the experience of the Europe and the process of forming the European Monetary Union. This is the best “real world” case study available regarding the costs and benefits of creating a monetary union.

4.4.1. Potential benefits of monetary integration

The following primary benefits of forming a monetary union have been identified:

- Eliminating the risk of associated with exchange rate volatility. Member countries in a monetary union share a common currency. The fact that there is no convertibility required in cross border transactions has clear benefits, especially for small scale transactions and services such as tourism (Afxentiou, 2000:251). The removal of exchange rate fluctuations and the associated uncertainty and risk should increase the levels of cross border trade and investment. This should in turn lead to better macroeconomic performance and economic growth (Tavlas, 2007);
- Reduction in transaction costs. A common currency will significantly reduce or even completely remove the costs associated with cross border trade. The costs associated with conversion of different currencies as well as the accounting of multi-currency transactions are eliminated. Goods will have a common uniform price, which will provide better information to consumers, as well as reducing administrative costs of retailers operating in multiple countries (Maruping, 2005). Kaufmann (1996) states that the reduced direct as well as indirect transaction costs may add up to 1-2 percent to the GDP of member states;
- Economies of scale benefits. Tavlas (2007) indicates that there are certain clear advantages arising out of economies of scale when monetary integration occurs. The most obvious is benefits arising out of the consolidated and expanded foreign exchange market. Both the volatility of the currency and the vulnerability to speculators is reduced. The various member countries do not have to hold reserves in order to conduct intra-area transactions. The need for reserve holdings should lead to more efficient allocation of financial resources within the region, which should lead to more efficient investment choices in terms of both risk and duration (Tavlas, 2007); and

- Acting as an “agency of restraint”. The process of economic and monetary integration leads to a reduction in sovereignty in a number of areas, such as the conduct of monetary policy. This factor has important implications for the SADC in particular, where certain countries have a history of irresponsible or even reckless monetary and fiscal policy management. This has mainly been done in the past in certain SADC countries to make short term political gains, without considering the long term economic impact. CBI is an important factor in ensuring that prudent and responsible policies are followed by member countries. The move towards monetary policy convergence and the creation of a single SADC Central Bank should act as an agency of restraint on monetary policy decision making (Jefferis 2007:90).

The creation of a monetary union would further help ensure that exchange rate policy adjustments are not used as “quick fixes” by governments looking to achieve short term political benefits. A centralised system of policy formulation and implementation will prevent countries from engaging in short term exchange rate manipulation (Jefferis, 2007).

(Buigot 2006:301) suggests that a currency peg with a low inflation currency is essential in strengthening the anti inflationary credibility of the countries’ monetary policy framework. The same benefits would arise through the creation of a single supranational monetary authority. It is however important to point out that a large degree of political commitment is required, as the real and or perceived losses of national sovereignty may have political implications (Maruping, 2005).

4.4.2 Potential costs of monetary Integration

Although there are certain clear benefits to economic integration, there are also certain costs involved. Despite these costs, a growing number of countries around

the world are joining or applying to join various monetary unions. (Saville, Bader & Spindler, 2005)

- The loss of monetary and fiscal policy authority. The primary cost involved in joining a monetary union may arise at a macro level. In the absence of floating exchange rates, and with strict fiscal policy guidelines regarding public debt and budget deficits, the individual members of the monetary union loses a number of important macroeconomic policy tools. The member country will not be able to counteract the business cycle with monetary policy interventions specific to that country alone. The country will not be able to take counter cyclical policy actions, as all monetary policy decisions is taken for the whole monetary union as a whole by a single Central Bank (Tethalova 2004). The experience of Greece during 2011 – 2013 clearly illustrates this point. The cost impact of the loss of monetary authority will be least if all countries are at the same stage of the business cycle and experience the same exogenous shock. This is most likely to happen if there is a high degree of macroeconomic convergence among the member countries (Glick 1991). If, like in the case of Greece, the country experiences problems that are unique or more severe than other members, the lack of control over monetary, fiscal and exchange rate problems may very well exasperate the problem (Jefferis 2007). The EU has specific fiscal policy rules regarding deficits, for example a cap on budget deficits of 3% of GDP. According to Jefferis (2007) this may in fact be counter to the literature regarding Optimum Currency Areas (OCA). Members should be granted more fiscal policy autonomy in order to compensate for the loss of monetary and exchange rate policy autonomy, especially in cases of external shocks.

This argument is not generally accepted for 2 practical reasons. The sustainability of individual countries' public debt may result in negative externalities for other countries. The current sovereign debt crisis within certain EU countries has had the potential to damage all members of the EU. Secondly increased budget deficits and the associated borrowing on capital markets may lead to increases in interest rates across the monetary union. It

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is therefor essential that common external shocks be resolved using a common union wide response using monetary and exchange rate policies (Jefferis 2007).

- The loss of revenue from seignorage. Granting monetary policy control to a single Central Bank will deprive the individual member countries of the revenues gained from seignorage, especially in countries with high levels of inflation (Afxentiou 2000). High inflation countries will also tend to be countries that print money in order to fund their budget defecits, instead of borrowing money from the financial markets. . For this reason the inflation rates of potential member countries are an important criteria for membership of a monetary union.

4.5 Convergence Criteria

The Maastricht criteria, which were the criteria on which European Monetary Union was formed, has had implications for other regions striving to form monetary unions, including the SADC. There are however consideration given to specific regional macroeconomic factors when the convergence criteria for the region is formulated (Jefferis, 2007).

4.5.1 Maastricht Criteria

The 1993 Treaty of Maastricht formed the basis for the final stages of European monetary integration. The treaty contained the various convergence criteria that guided the European Monetary Institute (EMI) and the European Commission (EC) in determining the eligibility of the various candidate countries of the EU (Springer 1996:281). The Maastricht treaty criteria are mainly used to ensure that the monetary union will enjoy price and fiscal stability (Afxentiou, 2000).

According to Afxentiou (2000) the 5 Maastricht criteria are as follows:

- i) A country must have an inflation rate no more than 1.5 percentage points above the average of the three countries with the lowest inflation rates;
- ii) A country must have nominal long-term interest rates not exceeding 2 percentage points of those of the three countries with the lowest inflation rates;
- iii) A country may have no exchange rate realignment for at least two years;
- iv) A country may not have a government budget deficit not in excess of 3 percent of the country's GDP; and
- v) A country may not have a gross debt to GDP ratio that does not exceed 60 percent of GDP.

4.5.2 SADC Convergence Criteria

The SADC has created a set of criteria regarding macroeconomic convergence. These criteria will be used as guidelines towards closer economic integration and the creation of a monetary union and single Central Bank (Rossouw, 2006).

According to Rossouw (2006) the 2008 SADC convergence criteria are as follows:

- i) SADC countries should have single-digit inflation rates;
- ii) SADC countries should have budget deficits of less than 5% of GDP;
- iii) SADC countries should public and publicly guaranteed debt, as a ratio of GDP of not more than 60%;
- iv) SADC countries should have foreign reserves should be equal to three months imports; and
- v) Central Bank credit to the government should not exceed 10% of the previous year's tax income.

The process of regional economic cooperation and macroeconomic convergence within the SADC is strengthened by the harmonisation of the legal and operational frameworks of the various SADC Central Banks (Gaolathe, 2004). The CCBG has

been given the task of monitoring the compliance of the various member states with the convergence criteria as set out by the SADC. The effective monitoring and compliance with this process is of crucial importance in achieving the goal of macroeconomic convergence and the establishment of a monetary union and single Central Bank and currency within the SADC (Jefferis, 2007); (Rossouw, 2006).

The SADC has set further milestones towards the establishment of a monetary union by 2016. These included the elimination of all exchange controls by 2005; the establishment of a SADC free trade area by 2006; the establishment of a SADC customs union by 2010, and a SADC common market by 2012. It must be pointed out that serious challenges remain in the achievement of these aims, and the timetable may well need revision (Maruping, 2005).

4.6 Conclusion

Of particular importance for this study is the role of Central Banks and Central Bank independence within the SADC. The degree of legal and actual independence of the various SADC Central Banks must converge to a point where a single SADC wide Central Bank can be formed. This implies that there must be a clear process of integration and convergence with clearly set out guidelines and criteria that the various Central Banks must comply with. It is the aim of this study to understand how policy decisions are made among the various SADC Central Banks, and to what degree convergence is taking place.

Chapter 5 Independence of SADC Central Banks

5.1 Introduction

The Southern African development Community (SADC) has a stated aim of creating a monetary union by 2016 and the issue of CBI is seen as one of the pre requisites for an effective monetary union (Jefferis, 2007). The African Union (AU) has a stated objective of creating a African continent wide monetary union by 2016 and a single currency by 2018. It must however be pointed out that these dates have been subject to change, and is very much in the discussion stage. The proposed African Central Bank (ACB) requires that monetary policy as directed by the ACB will be conducted independently free from political interference. The European Central Bank (ECB) has similar provisions that guarantee that the ECB operates independently (Afxentiou, 2000).

A number of African countries, including South Africa, use a system of inflation targeting in order to better coordinate and focus monetary policy (Wessels, 2008). A Central Bank can only effectively implement an inflation targeting policy if it has a substantial level of CBI. The monetary authority must be able to resist any calls from government to monetise government fiscal deficits as this would have a detrimental effect on the inflationary environment. The Central Bank must also be able to independently develop and implement the monetary policies required to meet the inflation targets.

In order to improve monetary policy coordination and to lay the grounds for possible further monetary policy integration, the Committee of Central Bank Governors in SADC (CCBG) was proposed by SADC Finance Ministers in 1995, and adopted at the August 1995 meeting of the SADC council. The CCBG plays a crucial role in promoting economic and financial development as well as macroeconomic and financial stability. (SADC Bankers, 2013).

The CCBG secretariat is based in Pretoria, inside the International Relations Unit of the Research Department of the South African Reserve Bank (SARB). The

Governor of the SARB (currently in 2013 Me Gill Marcus) serves as chairperson of the CCBG. The CCBG meet twice yearly, and meetings are normally held in April and September (SADC Bankers, 2013).

In 2002 the SADC member states signed a memorandum of understanding that obtained specific agreed upon targets for macroeconomic convergence (Jeffries, 2007). A peer review mechanism would be set up with a Performance and surveillance unit who was tasked with monitoring compliance with the convergence targets. The specific convergence targets are as follows:

Table 5.1 SADC Convergence Targets

	Target 2008	Target 2012	Target 2018
Inflation	Below 10%	Below 5%	3%
Budget Defecit as % of GDP	Below 5%	Below 3%	Below 3%
Public Debt as % of GDP	Below 60%	Below 60%	Below 60%
Current account balance as % of GDP	9%	9%	9%

Source: Jefferis, 2007

The CCBG, as approved by the SADC council, produced a model Central Bank act (SADC Bankers, 2013) with the aim of assisting in the establishment of a framework for convergence of legal and operational frameworks of the SADC Central Banks. The act defines a number of principles and standards that will ensure the independence of SADC Central Banks; and create clear standards of accountability and transparency in the legal and operational frameworks of SADC Central Banks.

Section 5 of the Act specifically states that:

- (1) *“The Bank, in pursuit of its primary objective, and in the performance of its functions under this Act, shall act independently and without fear, favour or prejudice or direction from any authority or institution.*

- (2) *The independence of the Bank shall be observed and*
- (a) *no person shall seek to improperly influence any member of the Board, management or staff of the Bank in the discharge of his or her duties towards the Bank, or otherwise interfere in the lawful activities of the Bank as provided for under this Act”*
- (b) *no member of the Board, management or staff shall seek to be influenced in the conduct of his or her duties towards the Bank.*

The SADC countries have a stated aim of creating a Monetary union by 2016. This implies that there will be a single regional SADC Central Bank. The SADC Central Bank will have to be widely respected and credible. In other words it must be independent and perceived to be independent as well have very good procedural and governance structures. The various Central Banks of the SADC monetary union member countries will have to comply with these criteria (Wessels 2008).

The question arises to what degree are the Central Banks at the moment (2013) in compliance with best practice and independence. It is the aim of this Chapter to assess the various SADC Central Banks, and specifically their level of independence from Central government.

A number of criteria are used to measure CBI of each Central Bank, and these conclusions are supplemented by using the CWN CBI index, as discussed in Chapter 3. The criteria focusing on the legal definition of CBI, as well as the political, statutory and economic climate in which the specific Bank operates is derived from the GMT index. In line with the interpretive paradigm as described in Chapter 2, conclusions are made based on the charters or statutes of the various Central Banks.

For each of the Central Banks in the SADC a study was made of the Central Bank Act or Charter and observations conclusions were made. These conclusions were captured in the relevant index in order to determine the level of CBI of the relevant Central Bank.

5.2 Angola

5.2.1 CWN Variable 1 Appointment of CEO/Governor and board

The BNA is a public company owned by the government (Angola, 1991). According to the BNA Act the president appoints the governor and deputy governor for periods of five years. The rest of the board consists of three to five general directors, appointed by Cabinet for five year terms on recommendation of the governor. The governors can only be dismissed for “serious” reasons. It is important to note that, although they are not Cabinet members, the Governor and Deputy Governor attends Cabinet meetings. Far greater levels of operational independence need to be established between government and the BNA.

5.2.2 CWN Variable 2 Policy Formulation

The BNA Act states that the Central Bank has a guarantee of financial and administrative independence (Angola, 1991). This must however be measured against the various criteria discussed in this chapter. As was pointed out Central Bank governors attend Cabinet meetings and are expected to “respect” the economic policy of the Government. The Act states that the Central Bank must coordinate with the Ministries of Planning and Finance when determining foreign exchange and monetary policies. According to the BNA Act the Bank uses direct as well as indirect monetary policy instruments. A section stating that the BNA has instrument independence is lacking in the statute.

5.2.3 CWN Variable 3 Clear Policy Objectives

The Angolan Central Bank, the Banco Nacional de Angola (BNA) is empowered in its statute, Organic Law 4/91 to promote and maintain monetary and fiscal stability (Angola, 1991) The fact that the BNA is mandated to also ensure fiscal stability may lead to conflicts of interest. It is therefore suggested that the BNA should focus solely on the maintaining of monetary and price stability

5.2.4 CWN Variable 4 Limitations on Lending to Government

The BNA Act stipulates that the Bank must grant credit to the government up to the amount of budget deficit as approved by Parliament (Angola, 1991). The Treasury issues treasury bills to finance the budget and remit the amount to the Bank. The Bank is in addition allowed to grant credit to government up to 10% of its ordinary revenue of the previous year. The credits must be repaid in the same fiscal year.

Table 5.2 Angola CWN Index

	Description of variable	Angola
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.29
	a) Who formulates monetary policy	0.67
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.4
4	Limitations on lending to government	0.48
	a) Advances	0.67
	b) Securitised lending	0.67
	c) Terms of lending	0.67
	d) Potential borrowers from the bank	0
	e) Limits on central bank lending defined	0.67
	f) Maturity of loans	0.67
	g) Interest on loans must be	0.5
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.44

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.3 Botswana

5.3.1 CWN Variable 1 Appointment of CEO/Governor and board

The BOB is a public company with all capital exclusively owned by the government (Botswana, 1996). The board consists of a Governor and Deputy Governors

appointed by the President and 8 other members. The Permanent Secretary of Finance is an ex officio member. Other Directors are appointed by the Minister of Finance for 4 year terms, and not more than 2 may be public servants. The President appoints the Governor and as many Deputy Governors as he wished for renewable 5 year terms.

A member of the board may only be removed for “inability to perform the functions of his office” or in cases of gross misconduct. A tribunal headed by a current or former Judge must investigate any allegations and make recommendations to the President.

5.3.2 CWN Variable 2 Policy Formulation

Article 65 of the BOB Act (Botswana, 1996) states that the Minister may if he/she is of the opinion that the BOB policies are not adequate or conducive to the achievement of the Bank’s objectives (See 5.3.3) submit a recommendation to the President, who may the issue a policy directive to the Bank. The Minister must inform the Bank in writing of the policy, and the bank must then implement the said policy directives. This policy directive must be published in parliament within 15 days, as well as any statements from the Bank as well as Government. The BOB Act empowers the Bank to use various monetary policy instruments when dealing with Financial institutions (Section 38), including the setting of rates for discounts and advances (Section 39). Section 40 empowers the Bank to set primary reserve requirements. All these instruments can be used independent of government.

5.3.3 CWN Variable 3 Clear Policy Objectives

The Bank of Botswana (BOB) is mandated in its statute (Act 19 of 1996) to have as its “first and foremost” priority to promote and maintain monetary stability, an efficient payments mechanism and the liquidity, solvency and proper functioning of a soundly based monetary, credit and financial system in Botswana (Botswana, 1996). A secondary objective of promoting economic development is listed, as long as it does not interfere with the primary objectives. The BOB is also tasked with, as long as it

does not interfere with the primary and secondary objectives, to assist with the attainment of national economic goals. The BOB Act empowers the Bank to use various monetary policy instruments when dealing with Financial institutions (Section 38), including the setting of rates for discounts and advances (Section 39). Section 40 empowers the Bank to set primary reserve requirements. All these instruments can be used independent of government.

The BOB has a clear primary objective of monetary and financial stability. The other secondary objectives may not interfere with the primary objective, and are subordinate to it. The BOB satisfies the stated CBI criteria of having a single clear policy objective.

5.3.4 CWN Variable 4 Limitations on Lending to Government

The BOB is empowered in Section 60 of the Act to grant temporary advances to government, at an interest rate agreed upon between the Bank and the Minister. These advances must be repaid within 6 months. Section 61 of the Act that states the BOB may purchase and sell securities issued or guaranteed by government which form part of a public issue. The Act stipulates in Section 62 that the total outstanding advances and credit to government, including the purchase of securities in terms of section 61 may not exceed 5% of the Governments average annual revenue for the previous 3 financial years. Subsection (4) of Section 62 of the Act allows for the Minister and the Bank to, in writing temporarily waiver the 5% limit if it is deemed “in the national interest” (Botswana, 1996).

Table 5.3 Botswana CWN Index

	Description of variable	Botswana
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.29
	a) Who formulates monetary policy	0.67
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.6
4	Limitations on lending to government	0.44
	a) Advances	0.67
	b) Securitised lending	0.67
	c) Terms of lending	0.33
	d) Potential borrowers from the bank	0.67
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	0.33
	g) Interest on loans must be	0.5
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.45

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.4 Democratic Republic of Congo

No information could be found regarding the DRC Central Bank statutes in either French or English

5.5 Lesotho

5.5.1 CWN Variable 1 Appointment of CEO/Governor and board

According to the Bank of Lesotho (BOL) Act (Lesotho, 2000) the board consists of a Governor, two deputy governors, as well as five other directors. All of the aforementioned are appointed by the King on recommendation from the Prime Minister for terms of office of five years in the case of governors and three years for the directors. Members of Parliament and Civil servants are not eligible for appointment as Governor or Deputy Governor. The terms of office of the incumbents may not be altered to their disadvantage during their term in office. Members may not be removed from office before the expiry of their term in office, except for certain clearly stated non-political reasons. A special *ad hoc* committee of

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knowledgeable persons must hold an inquiry into the matter and make recommendations to the appointing authority. Only on recommendation of the committee may a member of the board be removed. The BOL is unique in having this stipulations, they are absent from most of the other SADC Central Banks.

5.5.2 CWN Variable 2 Policy Formulation

The BOL Act states in Section 6(c) (Lesotho, 2000) that the Bank has the sole mandate to formulate, adopt, and execute the monetary policy of the country. The Act is silent regarding any government interference or instructions to the Bank.. No government directive, intervention or approval is mentioned in this regard. Section 39 further empowers the Bank to determine the discount as well as interest rates on lending. . Section 48 empowers the Bank to determine the prescribed reserve requirements of Banks, and Section 49 allows it to set credit ceilings as a temporary monetary policy measure.

5.5.3 CWN Variable 3 Clear Policy Objectives

The Central Bank of Lesotho (BOL) is mandated in its statute (Lesotho, 2000) to have as its primary objective to achieve and maintain price stability. There are no other multiple objectives mentioned.

5.5.4 CWN Variable 4 Limitations on Lending to Government

The BOL Act states in Section 7(f) (Lesotho 2000) that the Bank can buy ordinary government securities as well other self-amortising securities that are used to fund government projects not exceeding 7 years. The Board and not government determine the terms and conditions of advances made to government, including the market related interest rate. Section 42 of the Act states that total advances shall not exceed 5% of the Actual government revenue of the previous annual budget. Any advances must be paid back within 90 days from the end of the financial year. Although the 5% limit on advances is prudent, the role in development project financing does not augur well for the independence of the Bank.

Table 5.4 Lesotho CWN Index

	Description of variable	Lesotho
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.67
	a) Who formulates monetary policy	1
	b) Final word in resolution of conflict	1
	c) Role in government budget process	0
3	Objectives	0.8
4	Limitations on lending to government	0.63
	a) Advances	0.67
	b) Securitised lending	0.67
	c) Terms of lending	1
	d) Potential borrowers from the bank	0.33
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	0.67
	g) Interest on loans must be	0.75
	h) CB prohibited buying/selling govt securities	
	Aggregate CBI	0.59

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.6 Malawi

5.6.1 CWN Variable 1 Appointment of CEO/Governor and board

According to the BOM Act (Malawi, 1989) the board consists of a Governor, Deputy Governor and 5 other Directors. A member of parliament is ineligible for appointment. The Governor and Deputy Governor are appointed by the President for renewable 5 year terms. The terms and conditions of appointment of the Governors are set by government. The directors may include the Secretary to the Treasury, the Accountant General and the Secretary for Economic Planning. The Directors are appointed by the President for renewable two year terms, and their conditions of service must be approved by the Finance Minister. The fact that the terms and conditions of appointment are set by government, and can be changed at will by government, points to a lack of operational independence from government. . The BOM does not meet the CBI criteria of having and independent Governor and board.

5.6.2 CWN Variable 2 Policy Formulation

The BOM Act states in Section 4(2) (Malawi, 1989) that the Bank must Act with due regard to the interest of the economic policies of the government. This can imply that the locus of decision making does not exclusively lie with the Bank, but that there may be undue government influence. The BOM Act empowers in Section 32 (Malawi, 1989) the Bank to issue promissory notes and other securities as it sees fit. The Bank has the sole discretion to determine its rediscount as well as other rates, as well as the power to prescribe reserve and minimum cash requirements.

5.6.3 CWN Variable 3 Clear Policy Objectives

The Reserve Bank of Malawi (BOM) is mandated in its statute (Malawi, 1989), with a number of broad policy objectives. There is no clear singular objective mentioned, but a number of secondary objectives are listed, some of whom are contradictory in nature. Among the stated objectives are influencing the money supply and interest and exchange rates. The aims of these objectives are to promote economic growth, stable prices, employment and a sustainable balance of payment.

5.6.4 CWN Variable 4 Limitations on Lending to Government

The BON Act states in Section 28 and Section 40 (Malawi, 1989) that the Bank may grant short term loans to government. The amount loaned may not exceed 20% of the annual government budget revenues. The Bank may further, according to Section 28, hold shares not exceeding 10% of its total capital, in any corporation set up to government with the purpose of promoting economic development. The Bank may also, with the consent of the minister, make loans to any statutory body as it sees fit.

Table 5.5 Malawi CWN Index

	Description of variable	Malawi
1	Chief executive officer	0.33
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	
	d) Other positions in government	0.5
2	Policy Formulation	0.18
	a) Who formulates monetary policy	0.33
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.4
4	Limitations on lending to government	0.36
	a) Advances	0.33
	b) Securitised lending	0.33
	c) Terms of lending	0.33
	d) Potential borrowers from the bank	0.33
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	1
	g) Interest on loans must be	0.25
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.27

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.7 Mauritius

5.7.1 CWN Variable 1 Appointment of CEO/Governor and board

The Board of the BMA consists of the Governor, Deputy Governor and between 5 and 7 Directors (Mauritius, 2004). The Governor and Deputy Governors are appointed by the President, on recommendation of the Prime Minister for terms of up to 5 years. The Directors are appointed by the Minister of Finance for terms not exceeding 3 years. These Directors must be of “recognised experience in the field of economics banking finance, business or law” and may not be involved in politics. Director’s conditions of service are determined by government and set out in their letter of appointment. It is at the sole prerogative of the President or Minister according to Section 17 (c) to decide if alleged misconduct by a person warrants dismissal from office. There are no provisions for any independent tribunal or review.

5.7.2 CWN Variable 2 Policy Formulation

The BMA Act is silent regarding any government policy instructions to the Bank (Mauritius, 2004). As indicated in 5.7.3 the Bank is mandated with “promoting orderly and balanced economic development”, as well as monetary policy stability. There are however no indications that the locus of policy decision making does not lie with the Bank, which implies that the Bank can implement the economic development objective as it sees fit. The BMA Act empowers the Bank in Section 6 to engage in buying and selling of government securities, and issue promissory notes and other securities at its own discretion. The Bank is further empowered to set interest rates as well as various reserve and cash requirements for the banking sector.

5.7.3 CWN Variable 3 Clear Policy Objectives

The Bank of Mauritius Act, (Mauritius, 2004) mandates the Bank of Mauritius (BMA) with the primary objective of maintaining price stability and to promote orderly and balanced economic development. Other objectives listed include regulation of credit and currency, and ensuring the stability and soundness of the financial system. The primary objectives may be even be contradictory, while “*maintaining price stability*” is a clear and measurable monetary policy outcome “*orderly and balanced economic development*” is not.

5.7.4 CWN Variable 4 Limitations on Lending to Government

Section 58 of the Act (Mauritius, 2004) states that the Bank may grant advances to the government to cover negative net cash flows of the government at such rate as may be agreed with the government. The total of all such advances and other government securities owned by the Bank may not exceed 10% of the government revenue excluding grants and capital receipts for the current year, and are repayable within 4 months.

Table 5.6 Mauritius CWN Index

	Description of variable	Mauritius
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.29
	a) Who formulates monetary policy	0.67
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.6
4	Limitations on lending to government	0.27
	a) Advances	0.33
	b) Securitised lending	0.33
	c) Terms of lending	0.33
	d) Potential borrowers from the bank	0
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	0.33
	g) Interest on loans must be	0.5
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.38

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.8 Mozambique

5.8.1 CWN Variable 1 Appointment of CEO/Governor and board

The Bank of Mozambique (BMOZ) Act (Mozambique, 1992) states in Article 45 that the President may appoint and dismiss the Governor and Deputy Governor of the Bank, and that the Prime Minister appoints and can dismiss four to six Directors. According to Section 6 the members of the board may only be dismissed if there is “just cause”. No criteria are set, nor is there an independent tribunal to determine if “just cause” is present that would warrant dismissal of any board member. It is implied that it is the President or Prime Minister that determines whether there is cause for dismissal at his/her own discretion.

5.8.2 CWN Variable 2 Policy Formulation

The BMOZ Act is silent regarding the issuing of government instructions to the Bank (Mozambique, 1992). As is the case with Mauritius above (5.7) there are broad additional social and economic developmental objectives assigned to the Banks, in addition to monetary policy objectives. There are however no indications that the locus of policy decision making does not lie with the Bank, which implies that the Bank can implement the economic development objective as it sees fit. The BMOZ Act state in Article 23 that the Bank has the power to determine the discount rate, as well as regulations, limits and other conditions regarding rediscount operations. The Bank is empowered in Section 27 to set minimum reserve requirements for financial institutions. Article 41 empowers the Bank to trade in securities as well as enter into discounting and rediscounting operations.

5.8.3 CWN Variable 3 Clear Policy Objectives

The Bank of Mozambique Act (Mozambique, 1992) mandated the Bank in Article 3 with the main objective of preservation of the value of the national currency. A number of additional purposes including the conduct of the correct monetary policy; and advancing credit policies that promote the growth and economic and social development of the country, and the regulation of the banking system and the maintenance of enough foreign reserves to cover foreign trade. These objectives regarding protecting the value of the currency and credit policies that promote development can be contradictory.

5.8.4 CWN Variable 4 Limitations on Lending to Government

Article 18 of the Act (Mozambique, 1992) states that the Bank may grant the state interest free credit up to a maximum of 10% of the ordinary revenue collected in the previous year. All credit must be repaid by the end of the financial year. The fact that these advances are interest free is a clear violation of the criteria regarding CBI.

Table 5.7 Mozambique CWN Index

	Description of variable	Mozambique
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.29
	a) Who formulates monetary policy	0.67
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.8
4	Limitations on lending to government	0.46
	a) Advances	0.67
	b) Securitised lending	0.67
	c) Terms of lending	1
	d) Potential borrowers from the bank	0
	e) Limits on central bank lending defined	0.67
	f) Maturity of loans	0.67
	g) Interest on loans must be	0
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.48

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.9 Namibia

5.9.1 CWN Variable 1 Appointment of CEO/Governor and board

The Bank of Namibia (BON) Act (Namibia, 1997) states that the president appoints all members of the board. This includes the Governor, Deputy Governor, Permanent Finance Secretary, One Public servant recommended by the Minister, and four other member appointed after consultations with the Minister. The Governor and Deputy Governor serve for renewable five year terms, but the President in consultation with the Minister sets the terms and conditions of service of all the board members. This implies that the government has an undue amount of influence in the appointment process of board members. The fact that there are a number of state officials on the board also seems to undermine the independence of the board. The President can, in consultation with the Finance Minister, remove any board member including Governors on grounds of misconduct or “inability to efficiently discharge the duties of

his or her office". This is a very arbitrary and subjective clause, and can seriously undermine the independence of board members.

5.9.2 CWN Variable 2 Policy Formulation

The BON Act states in Section 49 (Namibia, 1997) that Cabinet may issue policy directives to the Bank. The Minister may, after consulting with the Bank, recommend to Cabinet that a policy directive be issued to the Bank. This may be done when the Minister is of the opinion that the Banks' policies are not conducive to the achievement of governments' economic objectives. The directive must mention the reasons as well as time period for the directive. The Bank is then compelled to give effect to the directive regarding the conduct of monetary policy. The Bank can within 30 days object to the minister and provide reasons for its objection. The Minister will then table the objections, together with his recommendations in the National Assembly. According to the Bank of Namibia Act in Section 34 and 35 (Namibia, 1997) the Bank is empowered to determine the discount and rediscount rates. The Bank also determines the minimum reserve requirements of the financial sector. Section 42(2) empowers the Bank to engage in buying and selling of government securities. Section 55 states that the Bank may, with the approval of the minister, issue and publicly trade in its own securities.

5.9.3 CWN Variable 3 Clear Policy Objectives

The Bank of Namibia (BON) is mandated in its statute (Namibia, 1997) with a number of policy objectives. Section 3 (b) includes as an objective promoting and maintaining internal as well as external monetary stability and an efficient payment system. Section 3 (e) states as an objective the achievement of national economic goals, without clear guidelines as to what those goals are. Section 53 is particularly problematic. It empowers the BON to, in concurrence with the Minister of Finance, to finance the economic development goals of the country. This opens the door to undue political interference from government, as it is government's discretion to determine what those national economic goals are.

5.9.4 CWN Variable 4 Limitations on Lending to Government

The BON Act states in Section 43 (Namibia, 1997) that the Bank may grant loans to the government on terms agreed by the Minister. These loans must be repaid within six months. Section 45 of the Act limits these loans to a maximum of 25% of annual government revenue of the three preceding budgets. There are provisions that the limit may be increased to 35%. If the limit is about to be reached the Bank must inform the Minister and make recommendations how the situation can be rectified.

Table 5.8 Namibia CWN Index

	Description of variable	Namibia
1	Chief executive officer	0.29
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.17
	d) Other positions in government	0.5
2	Policy Formulation	0.29
	a) Who formulates monetary policy	0.67
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.4
4	Limitations on lending to government	0.36
	a) Advances	0.33
	b) Securitised lending	0.33
	c) Terms of lending	0.33
	d) Potential borrowers from the bank	0.33
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	1
	g) Interest on loans must be	0.25
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.31

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.10 Seychelles

5.10.1 CWN Variable 1 Appointment of CEO/Governor and board

Part II of the Bank of Seychelles (BSE) Act (Seychelles, 2004) state that the Board consist of a Governor, Deputy Governors, the Attorney general who is an ex officio member, and four other members, all appointed for 6 year terms. It is important to

note that the Attorney General does not have voting rights, thereby preventing a possible conflict of interest. The Governor, Deputy Governors and rest of the Board members are appointed by the President on such terms and conditions as the President may determine. Section 2 of the act specifically states that the Bank must act independently and that no person shall seek to try and improperly influence the bank. Section 7 indicates clear guidelines and limitations for the removal of members of the board, and it is specifically stated that any removal from office of a board member shall be subject to judicial review. This is an important safeguard against abuse.

5.10.2 CWN Variable 2 Policy Formulation

Section 37 of the BSE Act (Seychelles, 2004) requires consultations between the Government and the Bank, with the important provision that it may not be prejudicial to any other provisions of the Act. There are no further provisions in the Act regarding government interference in the conduct of monetary policy. As stated in Section 5.10.1 the BSE Act requires the Bank to operate independent of any undue influence Section 41 of the BSE Act empowers the Bank to purchase treasury bills and other government securities for the purpose of conducting monetary policy. Section 42 empowers the bank to in its own name issue short term securities for monetary policy purposes. Section 43 empowers the Bank to conduct market operations including repurchase agreements. Section 31 empowers the Bank to set reserve ratios for the banking sector.

5.10.3 CWN Variable 3 Clear Policy Objectives

The Central Bank of Seychelles Act (Seychelles, 2004) states in Part II Section 4 that the bank has as its primary objective the promotion of domestic price stability. Secondary objectives include provide advisory services to the government, and the promotion of a sound financial system.

5.10.4 CWN Variable 4 Limitations on Lending to Government

Section 44 of the BSE Act (Seychelles, 2004) prohibits the granting of advances of loans to government or government agencies, except as provided for in the Act. Section 40 empowers the Bank to make temporary advances to the government. The limit on the total amount of loans and advances, expressed as a percentage of Government revenue from the previous year, is determined by the bank in consultation with the Minister of Finance. All advances must be repaid within 6 months, the Bank can however grant a temporary repayment waiver of no longer than 3 months. A temporary waiver may only be granted if it is consistent with the monetary policy of the Bank, and with the approval of the President.

Table 5.9 Seychelles CWN Index

	Description of variable	Seychelles
1	Chief executive officer	0.52
	a) Term in office	0.75
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.67
	a) Who formulates monetary policy	1
	b) Final word in resolution of conflict	1
	c) Role in government budget process	0
3	Objectives	0.6
4	Limitations on lending to government	0.59
	a) Advances	0.67
	b) Securitised lending	0.67
	c) Terms of lending	0.33
	d) Potential borrowers from the bank	1
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	1
	g) Interest on loans must be	0.75
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.58

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.11 South Africa

5.11.1 CWN Variable 1 Appointment of CEO/Governor and board

According to the South African Reserve Bank (SARB) Act (South Africa, 1989) the board consists of fourteen members. The SARB is unique within SADC in being a privately owned company. These private shareholders elect seven of the board members, and the SA government appoints the other seven. The Governor as well as the three Deputy Governors are appointed by the President for renewable five years terms in office. All other Directors are appointed to three year terms. The governor has a casting vote within meetings. Beside the four Governors the government appoints three other part time directors. The SARB Act does not provide clear guidelines regarding the dismissal of governors.

5.11.2 CWN Variable 2 Policy Formulation

The Constitution of South Africa in Section 224 as well as the SARB Act ensures that there is no undue influence on monetary policy from government. The

Constitution states that the SARB must perform its functions independently and without fear, favour or prejudice. There is however also a provision in Section 224(2) that regular consultations must take place between the government and the Minister of Finance. The Constitution can only be amended with a 2/3 majority, so the provisions ensuring an independent SARB carries more weight than ordinary legislation.

5.11.3 CWN Variable 3 Clear Policy Objectives

The South African Reserve Bank (SARB) is mandated in its statute, the South African Reserve Bank Act (South Africa, 1989) with the primary objective of safeguarding the value of the Currency (Rand) in the interest of balanced and sustainable economic growth. The SARB primary objective is further enhanced with an inflation targeting regime (3 – 6%) that is set by government in consultation with the SARB.

5.11.4 CWN Variable 4 Limitations on Lending to Government

The SARB Act constrains in Section 13(f) (South Africa, 1989) the Banks' ability to directly finance government. It states that the Bank may not hold government stock which has been acquired directly from the Treasury by subscription to new issues, or the conversion of existing ones that exceed its paid-up capital and reserve funds plus one-third of its liabilities to the public.

Table 5.10 South Africa CWN Index

	Description of variable	South Africa
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.40
	a) Who formulates monetary policy	1
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	1
4	Limitations on lending to government	0.57
	a) Advances	0.67
	b) Securitised lending	0.67
	c) Terms of lending	0.33
	d) Potential borrowers from the bank	1
	e) Limits on central bank lending defined	0.67
	f) Maturity of loans	1
	g) Interest on loans must be	0.25
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.52

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.12 Swaziland

5.12.1 CWN Variable 1 Appointment of CEO/Governor and board

The Bank of Swaziland (BOS) Act (Swaziland, 1974) states that the board comprises of a Governor, Deputy Governor and seven other directors. Included is a Civil servant from the Department of Finance. The Governor and Deputy Governors are appointed by the King in consultation with the Prime Minister for terms of five and three years respectively. The other directors are appointed for renewable three year terms in office. The terms and conditions of service of the Governor and Deputy Governor are determined independently of the board, while the conditions of service of the other members are approved by the Minister. There is a very high degree of government interference in the board as well as the conditions of service of the members. .

5.12.2 CWN Variable 2 Policy Formulation

The Bank of Swaziland (BOS) Act (Swaziland, 1974) state in Section 54 that government has the power to issue a directive to the Bank. If the Finance Minister is of the opinion that the Bank is not adequately performing its duties, or that the Bank is not achieving its objectives, the minister can recommend to the prime Minister that a directive be issued compelling the BOS to follow a specific policy. The Minister will set the policy and the Bank plays a subordinate role. The amended BOS Act states in Section 37 that the Bank is empowered to engage in open market operations through the buying and selling of eligible paper. Section 38 empowers the bank to set the discount and rediscount rates. Section 40 empowers the Bank to set the reserve requirements for the financial sector. Section 41 provides for the application of interest rate and credit ceilings as monetary policy measures (Swaziland, 1974).

5.12.3 CWN Variable 3 Clear Policy Objectives

The Central Bank of Swaziland (BOS) is mandated in its statute, Central Bank of Swaziland (BOS) Order, (Swaziland, 1974) with, within the overall national economic framework set by government, the promotion of monetary stability and a sound financial structure, The BOS is further mandated with the fostering of financial conditions conducive to orderly and balanced economic development. These objectives are vague and may even be contradictory.

5.12.4 CWN Variable 4 Limitations on Lending to Government

The original BOS Act in Section 45 (Swaziland, 1974) prohibited the granting of credit to government. Amendments to the Act made in 1982 (Swaziland, 1982) now allows for the board to set the terms and conditions of temporary advances made to government or other statutory bodies in cases of budget deficits. These advances to government must be repaid within 6 months and may not exceed 20% of the average ordinary revenue of government. If the limit is about to be reached the Bank must inform the Minister and make recommendations how the situation can be

rectified. The Bank may according to Section 54, also invest or hold shares in any statutory body or licensed financial institutions (Swaziland, 1974).

Table 5.11 Swaziland CWN Index

	Description of variable	Swaziland
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.17
	a) Who formulates monetary policy	0.3
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.4
4	Limitations on lending to government	0.55
	a) Advances	0.33
	b) Securitised lending	0.33
	c) Terms of lending	1
	d) Potential borrowers from the bank	0.67
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	1
	g) Interest on loans must be	0.75
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.41

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.13 Tanzania

5.13.1 CWN Variable 1 Appointment of CEO/Governor and board

According to the Bank of Tanzania (BOT) Act (Tanzania, 2006) the President appoints the Governor and three deputies for 5 year terms. The board comprises of the Governor, Deputy Governors and two ex officio members who are the Permanent Secretaries to the Treasury. It is important to note that the two permanent Secretaries do not have voting powers. An additional four non-executive Directors are appointed by the Finance Minister for three year terms. The Act states that no Member of Parliament, Civil Servant or party political office bearer may serve on the board. The Act clearly prohibits the removal from office of members of the board on arbitrary or political grounds. The Monetary Policy Committee (MPC) comprise of the Governor and Deputies as well as one non-executive director. The BOT complies with the CBI criteria of having an independent Governor and Board

5.13.2 CWN Variable 2 Policy Formulation

The BOT Act states in Section 5(3) (Tanzania, 2006) that the Bank shall be autonomous and accountable in its objectives and performance. Section 5(1) specifically gives the BOT the autonomy to formulate and implement exchange rate policy and to supervise the financial sector.. The BOT act empowers in section 39 the Bank to use whatever tools it needs to operate open market operations. Section 42 empowers the Bank to set rediscount interest rates, and Section 43(2) empowers the Bank to issue its own securities for open market operation purposes. The bank has the freedom to independently set reserve requirements and liquid asset ratios (Tanzania, 2006).

5.13.3 CWN Variable 3 Clear Policy Objectives

The Bank of Tanzania (BOT) is mandated in its statute, (Tanzania, 2006) with the primary objective of formulating and implementing monetary policy directed at the economic objective of maintaining domestic price stability conducive to the balanced and sustainable growth of the national economy.

5.13.4 CWN Variable 4 Limitations on Lending to Government

The BOT Act states in Section 34(2) that the Bank may grant advances to government solely for the purpose of providing temporary accommodation, at an interest rate determined by the Bank. These advances must be repaid within 180 days. Section 35 states that these advances may not be more than 1/8th of the average government budget revenue. Section 37 specifically prohibits the granting of credit to government or any statutory body (Tanzania, 2006).

Table 5.12 Tanzania CWN Index

	Description of variable	Tanzania
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.29
	a) Who formulates monetary policy	0.67
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	1
4	Limitations on lending to government	0.51
	a) Advances	0.67
	b) Securitised lending	0.67
	c) Terms of lending	1
	d) Potential borrowers from the bank	0
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	0.67
	g) Interest on loans must be	0.75
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.50

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.14 Zambia

5.14.1 CWN Variable 1 Appointment of CEO/Governor and board

The Bank of Zambia (BOZ) Act (Zambia, 1996) states that the President appoints the Governor and not more than 6 other directors for renewable five year terms. The Treasury Secretary is an ex officio member of the board, but does not have voting rights. The Act stipulates that any director, other than the Governor, may be removed by the Minister at any time by notice in writing. There are no provisions for an open, transparent and democratic procedure or grounds for removal of a member of the board. The BOZ does not meet the CBI criteria of having an independent Governor and board.

5.14.2 CWN Variable 2 Policy Formulation

The BOZ Act states in Section 5 (Zambia, 1996) that the Minister has the power to may convey to the governor of the Bank such government policies as may affect the conduct of the Bank. The Bank is then required to implement those stated policies. In effect the Bank is subordinate to the government. The BOZ Act empowers in Section 41 the bank to determine discount, rediscount rates as well as the rate on any advances. The Bank does not have to consult the Minister before determining these interest rates (Zambia, 1996).

5.14.3 CWN Variable 3 Clear Policy Objectives

The Bank of Zambia (BOZ) is mandated in its statute, (Zambia, 1996) with the formulation and implementation of monetary and supervisory policies that will ensure the maintenance of price and financial stability in order to promote balanced macroeconomic development.

5.14.4 CWN Variable 4 Limitations on Lending to Government

The BOZ Act states in Section 47 (Zambia, 1996) that the Bank shall, on terms and conditions determined by the Minister, grant loans or loan guarantees to government. Section 49 states that the Bank shall only advance money to government under terms and conditions agreed upon between the Bank and the Minister. The amount that the Central Bank may grant to government as credit is limited to 15% of the ordinary revenue of government of the previous financial year. If the limit is about to be reached the Bank must inform the Minister and make recommendations how the situation can be rectified.

Table 5.13 Zambia CWN Index

	Description of variable	Zambia
1	Chief executive officer	0.52
	a) Term in office	0.5
	b) Who appoints CEO	0.25
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.29
	a) Who formulates monetary policy	0.67
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.6
4	Limitations on lending to government	0.42
	a) Advances	0.67
	b) Securitised lending	0.67
	c) Terms of lending	0.33
	d) Potential borrowers from the bank	
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	0
	g) Interest on loans must be	0.5
	h) CB prohibited buying/selling govt securities	
	Aggregate CBI	0.45

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.15 Zimbabwe

5.15.1 CWN Variable 1 Appointment of CEO/Governor and board

According to the Bank of Zimbabwe (BOZIM) Act (Zimbabwe, 2001) the President appoints the Governor and two Deputy Governors after consultation with the Minister. No Member of Parliament may serve as a member of the board. The President is empowered to, after consulting with the Minister, request a member of the board to depart from office if the member has failed to comply with any terms or conditions of appointment. . There are no provisions for an open, transparent and democratic procedure or grounds for removal of a member of the board.

5.15.2 CWN Variable 2 Policy Formulation

The BOZIM Act states in Sections 6(1)(d), (8)(2) and 45 (Zimbabwe, 2001) that the monetary policy function of the BOZIM is subordinate the umbrella of government

policy-making . There is no doubt that locus of decision-making regarding monetary policy lies with government, and not the Bank. The BOZIM Act in Section 7 (1,d,iii) empowers the Bank to issue its own securities and buy and sell securities. Subsection 1(0) however instructs the Bank to underwrite any proposed loan by the state or any statutory body. Section 13 states that the Bank determines the discount rate as well as the conditions thereof. It is important to note that Section 26 empowers the Minister to issue general directives to the Board of the Bank.

5.15.3 CWN Variable 3 Clear Policy Objectives

The Reserve Bank of Zimbabwe (BOZIM) is mandated in its statute, (Zimbabwe, 2001), with a number of multiple objectives. One of these is to achieve and maintain stability of the Zimbabwe Dollar. Another function is to advance the general economic policies of the government. This means in practical terms that the BOZIM is a functionary of government and is mandated to follow and implement government policies, which contradicts the basic principles of CBI

5.15.4 CWN Variable 4 Limitations on Lending to Government

The BOZIM Act states in Section 7(2a) that credit provided by the Bank to the state may not exceed 20% of the previous year's ordinary state revenue. Section 8 states that "Nothing in this section shall prevent the state from carrying on transActions in such manner as the state may require and...the Bank shall make the necessary arrangements to this end" This implies that the Bank is clearly subservient to the state, which was also apparent in some of the other criteria discussed above.

Table 5.14 Zimbabwe CWN Index

	Description of variable	Zimbabwe
1	Chief executive officer	0.46
	a) Term in office	0.5
	b) Who appoints CEO	0
	c) Dismissal	0.83
	d) Other positions in government	0.5
2	Policy Formulation	0.29
	a) Who formulates monetary policy	0.67
	b) Final word in resolution of conflict	0.2
	c) Role in government budget process	0
3	Objectives	0.6
4	Limitations on lending to government	0.27
	a) Advances	0.33
	b) Securitised lending	0.33
	c) Terms of lending	0.33
	d) Potential borrowers from the bank	
	e) Limits on central bank lending defined	0.33
	f) Maturity of loans	0.33
	g) Interest on loans must be	0.25
	h) CB prohibited buying/selling govt securities	0
	Aggregate CBI	0.37

Source: Cukierman, Webb & Neyapti 1992, Central Bank Act

5.16 Accountability

Accountability is not part of the current CWN index, it is however an important aspect in legal independence (Jefferis, 2007). No Central Bank that operates in a democratic country can operate in complete isolation from the executive and legislative branches.. The Central Bank is accountable to parliament and/or specific parliamentary committees. Central Bank governors in democracies appear before these committees from time to time in order to give evidence. This contributes to the transparency and accountability of the Central Bank, without undermining its independence. Central Banks further publish minutes of meetings, policy documents, research reports etc.(Wessels, 2008).

5.16.1 Angola

The BNA is required to submit financial statements as well as a report on its operations to the government after the end of the financial year (Angola, 1991).

5.16.2 Botswana

Section 68 of the BOB Act (Botswana, 1996) states the Bank must within three months of the financial year end, provide the Minister of Finance with a copy of its Financial statements as well as a report on its operations, which will be tabled in Parliament. The BOB must on a monthly basis provide the Minister with a statement of its assets and liabilities, which is published in the Government Gazette. The above mentioned documents as well as the parliamentary testimony provide an acceptable level of accountability.

5.16.3 Democratic Republic of Congo

No information could be found regarding the DRC Central Bank statutes in either French or English

5.16.4 Lesotho

Section 46 of the BOL Act (Lesotho, 2000) states that the Bank must submit periodic reports on the state of the economy to the Minister. The BOL must include the Banks recommendations on how to achieve various economic objectives. The Bank must also according to section 53 submit certified annual accounts as well as a report on its operations to the minister within 3 months of the end of the financial year. These documents are then tabled in Parliament for discussion. The Bank must on a monthly basis publish a statement of its assets and liabilities.

5.16.5 Malawi

The BOM Act states in Section 52 (Malawi, 1989) that the Bank must submit annual accounts as well as a report on its operations to the Minister within 3 months of the end of the financial year. These documents are then tabled in Parliament and published in the Gazette. These provisions exclude reporting to an expert and democratic body such as a parliamentary committee.

5.16.6 Mauritius

The BMA Act states in Section 32 (3) (Mauritius, 2004) that the Bank must within 4 months of the close of the financial year, submit a copy of its financial accounts as well as an annual report on its operations to the Minister, who must table it in parliament. Section 33 requires that statements on price stability and the financial system must be published at least twice a year, and a statement on monetary policy at least once a year. The Bank is further required to promote open discussions and comments on its monetary and financial stability policies.

5.16.7 Mozambique

The BMOZ Act states in Article 62 (Mozambique, 1992) that the annual budget as well as annual accounts must be provided to the Minister of Finance. It is important to note that there is no obligation stated that these documents must be tabled before parliament. Article 63 specifically states that the books and other elements of accounting may not leave the headquarters of the Bank, “even if requested by any authority”. This is a clear violation of accountability and transparency. There are no provisions in the Act for the Bank to be held accountable before a democratic institution such as parliament.

5.16.8 Namibia

The BON Act states in Section 52 (Namibia, 1997) that the Bank must submit annual accounts as well as a report on its operations to the Minister together with a report on the state of the economy. These documents are then tabled in the National Assembly. The Bank must on a monthly basis publish a statement of its assets and liabilities. These provisions exclude reporting to an expert and democratic body such as a parliamentary committee. The documents are mostly retrospective in nature and does not comply the Bank to defend or explain any of its current policies.

5.16.9 Seychelles

The Bank is required in Section 47 (Seychelles, 2004) to within 3 months of the end of the Financial year, submit to the President a report on its operations, as well as a copy of the bank’s financial accounts. Section 48 requires the Bank to publish a

summary of its monetary policy decisions as soon as possible, and must report annually to the National Assembly on its activities, and the Governor may appear before the National Assembly for the purpose of explaining the Banks policies and activities and to answer questions.

5.16.10 South Africa

The SARB Act states in Section 32 (South Africa, 1989) that the Bank must submit an annual report to the Minister of Finance and Parliament. The SARB publishes on a monthly basis a statement of its assets and liabilities, as well as a annual report of its finances. The Governor of the SARB appears before the Portfolio Committee on Finance to testify regarding the SARB's policy stance and its views on monetary and economic developments.

5.16.11 Swaziland

According to Section 52 of the BOS Act (Swaziland, 1974) the Bank must submit annual accounts as well as a report on its operations to the Minister within 2 months of the end of the financial year. These documents are then tabled in Parliament and published in the Gazette. The Bank must on a monthly basis publish a statement of its assets and liabilities. These provisions exclude reporting to an expert and democratic body such as a parliamentary committee.

5.16.12 Tanzania

According to Section 21 of the BOT Act (Tanzania, 2006) the Bank must submit to the Minister for tabling in the National Assembly an annual report on the Banks Activities, operations and balance sheet. The Bank must also submit progress report on the conduct and implementation of monetary policy, as well as its opinion on future economic trends. The report must include the intended policy outcomes and targets of the Bank over the next 12 months, as well as the reasons for adopting the policies. The BOT has the most comprehensive democratic accountability structure of all the SADC Central Banks.

5.16.13 Zambia

According to Section 9 of the BOZ Act (Zambia, 1996) the Bank must publish a six monthly policy statement in the Government gazette. This should include an explanation of the reasons for the monetary policy that was adopted by the Bank during the next 6 months. The Bank must also report on the monetary policy principles it will follow over the next 2 years.

5.16.14 Zimbabwe

According to Section 45 and 46 of the BOZIM Act (Zimbabwe, 2001) the Bank must provide the Minister with copies of its annual accounts. The Bank must also provide the Minister with a description of the monetary policy that the Bank intends to follow over the next 6 months, as well as an explanation of the monetary policy that was followed in the previous 6 months..

5.17 Financial independence

As with accountability above, is financial or budgetary independence not part of the current CWN index. It is however an important criterion when assessing CBI. The Central Bank should have full authority over its internal budgetary matters.. If the Bank does not have the above guarantees of financial independence, the government may have a strong incentive to manipulate the Bank into politically expedient policies or Actions (Wessels 2008).

5.17.1 Angola

The BNA act empowers the Bank to draw up its own budget and manage its own financial affairs (Angola, 1991).

5.17.2 Botswana

Section 8 of the BOB Act (Botswana, 1996) empowers the Board with the sole powers to oversee the administration of the Bank, while Section 66 empowers the BOB to draw up its own Budget.

5.17.3 Democratic Republic of Congo

No information could be found regarding the DRC Central Bank statutes in either French or English

5.17.4 Lesotho

The BOL Act (Lesotho, 2000) makes no reference to any stipulations regarding the Bank's financial independence. There are no sections declaring that the Bank is responsible for drawing up its own budget and financial management.

5.17.5 Malawi

The BOM Act states in Section 53 (Malawi, 1989) that the Bank manages its own financial affairs. Any profits that remain are transferred to the government. This is however standard practice and does not imply a threat to the independence of the Bank.

5.17.6 Mauritius

The Act states in Section 31 (Mauritius, 2004) that the accounting of the Bank shall at all times conform with accounting principles and international best practices. There are no other provisions that specifically threaten the financial independence of the Bank.

5.17.7 Mozambique

The BMOZ Act states in Article 61 (Mozambique, 1992) that the Bank shall be independent and have its own budget.

5.17.8 Namibia

The BON Act states in Section 15 (Namibia, 1997) that the Bank will, in consultation with the minister, transfer its profits to the government revenue fund. There are no provisions in the Act that threaten financial independence of the Bank, but neither are there any explicit guarantees that the Bank is financially independent.

5.17.9 Seychelles

Part VII of the BSE Act (Seychelles, 2004) empowers the Board to set the budget of the Bank, and the Board is solely responsible for management, accounting, and auditing of the budget.

5.17.10 South Africa

The SARB Act (South Africa, 1989) does not explicitly state that the Bank is financially independent. The Bank does however have full operational control over its budget. It is important to keep in mind that the SARB is a private company, which guarantees financial independence even if the statute does not explicitly provide for it.

5.17.11 Swaziland

The BOS Act (Swaziland, 1974) does not make any provision for financial independence of the Bank. It is lacking in a section that clearly states that the Bank has control over its internal finances and budget.

5.17.12 Tanzania

The BOT Act states in Section 9 (Tanzania, 2006) that the board approves the budget of the Bank. There are no provisions that indicate the possibility of outside interference in the finances of the Bank.

5.17.13 Zambia

The BOZ Act (Zambia, 1996) makes no reference to any stipulations regarding the Bank's financial independence. There are no sections declaring that the Bank is responsible for drawing up its own budget and financial management.

5.17.14 Zimbabwe

The BOZIM Act states in Section 26(k) (Zimbabwe, 2001) that the Minister must approve the budget of the Bank. This is a clear violation of the financial independence of the Bank.

5.18 Interpretation

5.18.1 National CBI Indexes

The levels of compliance with Central Bank independence criteria of the various SADC Central Banks were tabulated using the CWN index for each individual Central Bank.

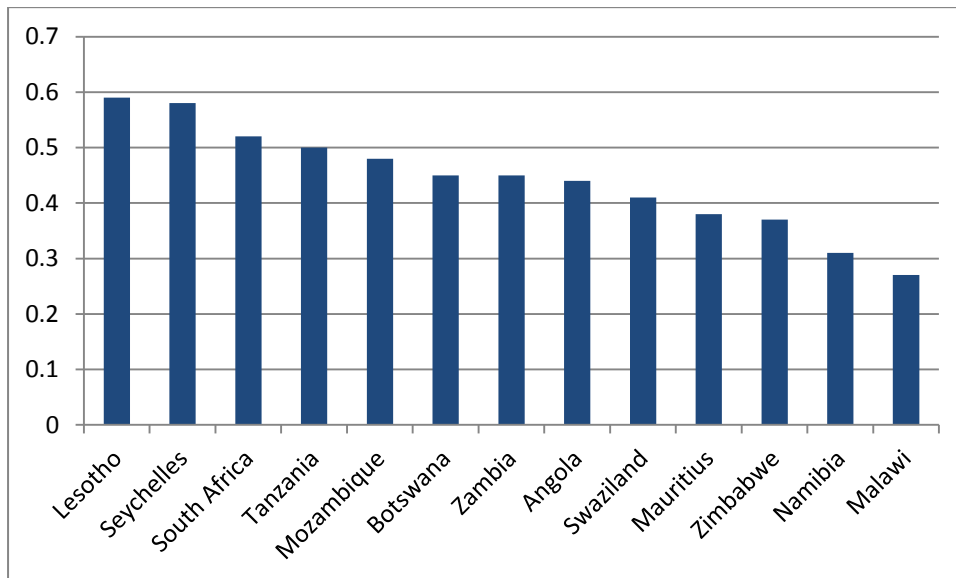
Table 5.15 CWN Index by country

Country	Index Score	Ranking
Lesotho	0.59	1
Seychelles	0.58	2
South Africa	0.52	3
Tanzania	0.50	4
Mozambique	0.48	5
Botswana	0.45	6
Zambia	0.45	7
Angola	0.44	8
Swaziland	0.41	9
Mauritius	0.38	10
Zimbabwe	0.37	11
Namibia	0.31	12
Malawi	0.27	13
Average	0.44	

Source: Various SADC Central Bank Acts, own calculations

The average score is 0.44, with Lesotho scoring the highest with 0.59 and Malawi the lowest with 0.27. Most SADC countries do not have a sufficiently independent Central Bank at present, and substantial legislative reforms will have to be undertaken to bring all the Central Banks in line with international best practice.

Figure 5.1 Levels of CBI in SADC countries



Source: Various SADC Central Bank Acts, own calculations

As can be seen in Figure 5.1 wide discrepancies exist within the SADC regional CBI levels, which makes the prospect of a unified monetary policy and single Central Bank very unlikely, at least in the short to medium term. The integration of for example Malawi and Lesotho into a single unified monetary policy framework and Central Bank is not feasible at present. In a number of countries in the SADC monetary policy is subservient to government economic policies, which leads to clear conflicts of interest.

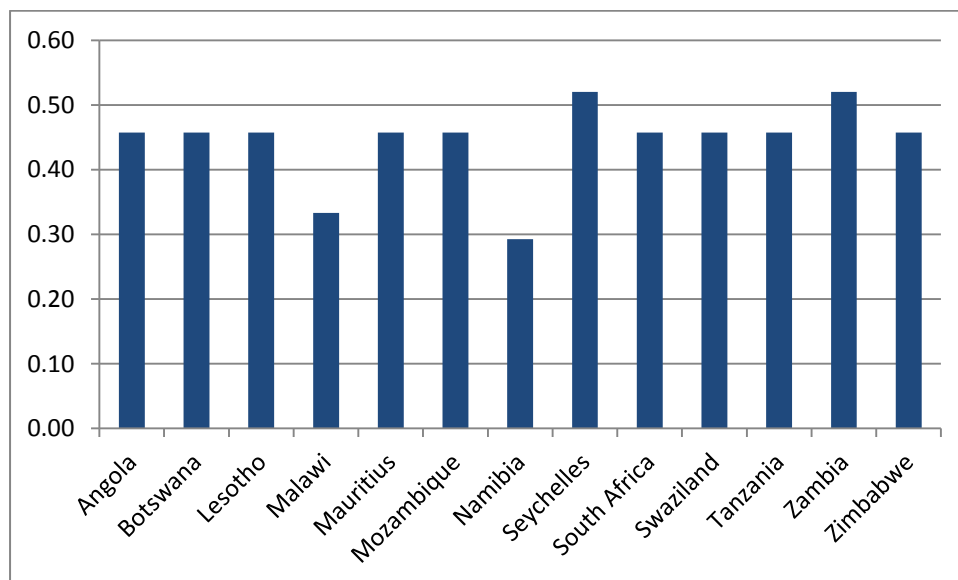
Table 5.16 SADC Central Banks CWN Index

Description of variable	Angola	Botswana	Lesotho	Malawi	Mauritius	Mozambique	Namibia	Seychelles	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe	Average
1 Chief executive officer	0.46	0.46	0.46	0.33	0.46	0.46	0.29	0.52	0.46	0.46	0.46	0.52	0.46	0.45
a) Term in office	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.75	0.5	0.5	0.5	0.5	0.5	0.5
b) Who appoints CEO	0	0	0	0	0	0	0	0	0	0	0	0.25	0	
c) Dismissal	0.83	0.83	0.83		0.83	0.83	0.17	0.83	0.83	0.83	0.83	0.83	0.83	
d) Other positions in government	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
2 Policy Formulation	0.29	0.29	0.67	0.18	0.29	0.29	0.29	0.67	0.40	0.17	0.29	0.29	0.29	0.34
a) Who formulates monetary policy	0.67	0.67	1	0.33	0.67	0.67	0.67	1	1	0.3	0.67	0.67	0.67	
b) Final word in resolution of conflict	0.2	0.2	1	0.2	0.2	0.2	0.2	1	0.2	0.2	0.2	0.2	0.2	
c) Role in government budget process	0	0	0	0	0	0	0	0	0	0	0	0	0	
3 Objectives	0.4	0.6	0.8	0.4	0.6	0.8	0.4	0.6	1	0.4	1	0.6	0.6	0.63
4 Limitations on lending to government	0.48	0.44	0.63	0.36	0.27	0.46	0.36	0.59	0.57	0.55	0.51	0.42	0.27	0.46
a) Advances	0.67	0.67	0.67	0.33	0.33	0.67	0.33	0.67	0.67	0.33	0.67	0.67	0.33	
b) Securitised lending	0.67	0.67	0.67	0.33	0.33	0.67	0.33	0.67	0.67	0.33	0.67	0.67	0.33	
c) Terms of lending	0.67	0.33	1	0.33	0.33	1	0.33	0.33	0.33	1	1	0.33	0.33	
d) Potential borrowers from the bank	0	0.67	0.33	0.33	0	0	0.33	1	1	0.67	0			
e) Limits on central bank lending defined	0.67	0.33	0.33	0.33	0.33	0.67	0.33	0.33	0.67	0.33	0.33	0.33	0.33	
f) Maturity of loans	0.67	0.33	0.67	1	0.33	0.67	1	1	1	1	0.67	0	0.33	
g) Interest on loans must be	0.5	0.5	0.75	0.25	0.5	0	0.25	0.75	0.25	0.75	0.75	0.5	0.25	
h) CB prohibited buying/selling govt securities	0	0		0	0	0	0	0	0	0	0		0	
Aggregate CBI	0.44	0.45	0.59	0.27	0.38	0.48	0.31	0.58	0.52	0.41	0.50	0.45	0.37	

Source: Various SADC Central Bank Acts, own calculations

5.18.2 CWN Variable 1 Appointment of CEO/Governor and Board

Figure 5.2 CWN Variable Appointment of CEO/Governor

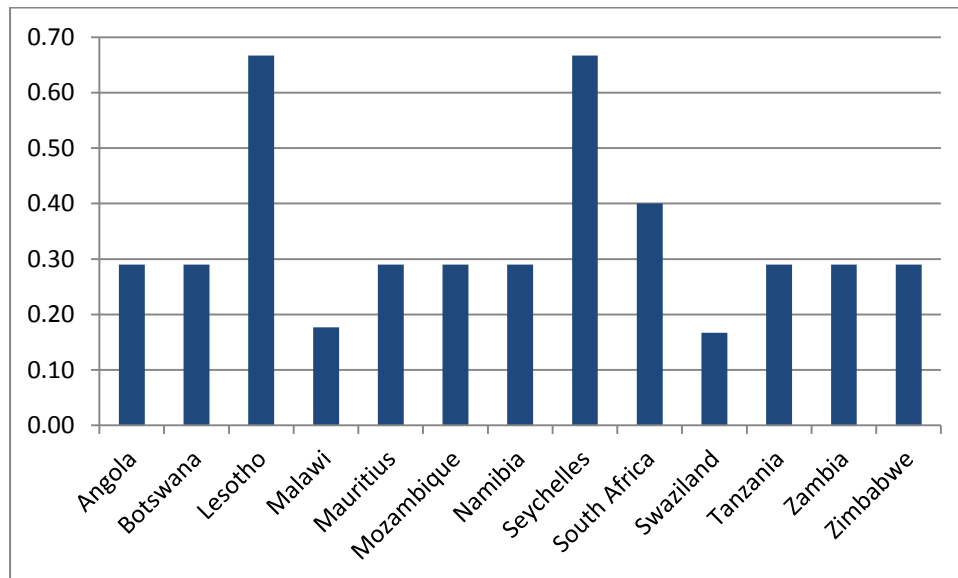


Source: Various SADC Central Bank Acts, own calculations

Figure 5.2 indicates the average level of CBI for CWN variable 1: Appointment of CEO/Governor and Board of the various SADC Central Banks. The average is 0.45, with the Seychelles with the highest rating of 0.52 and Namibia the lowest of 0.29. Only the Seychelles and Zambia achieved a rating of higher than 0.5, which is of concern. The fact that in most SADC countries the process of appointing the Central Bank Governor and Board does not comply with the criteria of Central Bank independence is problematic. Far greater independence from government in a far more transparent and open process is required.

5.18.3 CWN Variable 2 Policy Formulation

Figure 5.3 CWN Variable Policy Formulation

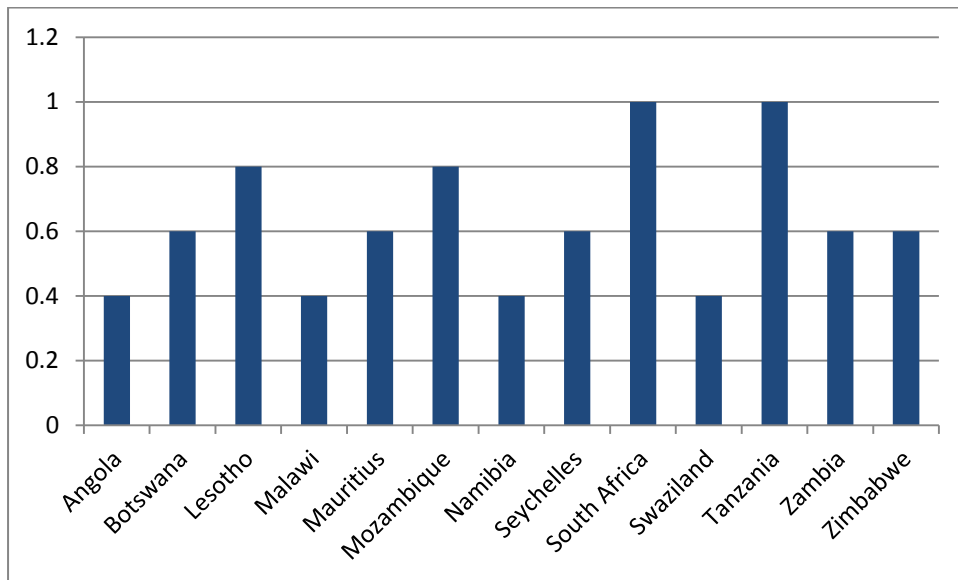


Source: Various SADC Central Bank Acts, own calculations

Figure 5.3 indicates the average level of CBI for variable 2: Policy Formulation of the various SADC Central Banks. The average is 0.43, which is the lowest of all four of the variables in the CWN index for the SADC countries. The Seychelles and Lesotho are have the highest rating of 0.67, with Swaziland the lowest at 0.17. Only the Seychelles and Lesotho achieved a rating of above 0.5, which is cause for concern. In the majority of SADC countries policy formulation is not conducted in a independent manner, and in countries such as Malawi and Swaziland the Central Bank is an extension of the Executive. The wide disparities that exist within the SADC Central Banks indicate that a lot of reforms regarding policy formulation will have to be undertaken before the possibility of a unified SADC Central Bank is possible.

5.18.4 CWN Variable 3 Clear Policy Objectives

Figure 5.4 CWN Variable Clear Policy Objective



Source: Various SADC Central Bank Acts, own calculations

Figure 5.4 indicates the average level of CBI for criteria 3: Clear Policy Objectives. The average is 0.63, which is the highest of all the variables in the CWN index for the SADC countries. South Africa and Tanzania have perfect ratings of 1, however 4 countries namely Angola, Malawi, Namibia and Swaziland have ratings below 0.5. This is the variable where the SADC Central Banks received the highest rating. Most Central Banks have Clear Policy Objectives, but as can be seen from the other variables, the independence to implement those policies are lacking in a large number of countries within the SADC.

5.18.5 CWN Variable 4 Limitations on Lending to Government

Figure 5.5 CWN Variable Limitation on Lending to Government

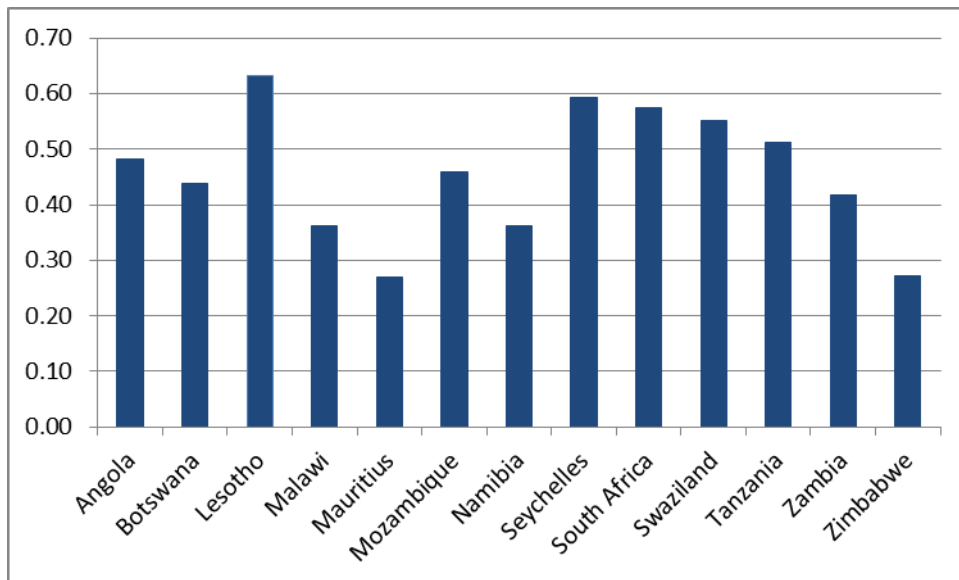


Figure 5.5 indicates the average level of CBI for criteria 4 Limitations on Lending to Government. The average is 0.46, with Lesotho rating the highest with 0.63 and Zimbabwe the lowest with 0.27. Only 5 countries namely Lesotho, Seychelles, South Africa, Swaziland and Tanzania scored above 0.5. In the majority of SADC countries the Central Banks can or are used to finance government deficits in a manner that impedes on Central Bank Independence.

5.18.5 Accountability

Table 5.21 Accountability

	Accountability
Angola	1
Botswana	1
Lesotho	1
Malawi	0
Mauritius	1
Mozambique	0
Namibia	0
Seychelles	1
South Africa	1
Swaziland	0
Tanzania	1
Zambia	1
Zimbabwe	1
Average	0.7

Table 21 indicates the level of accountability of the various SADC Central Banks. A Binary variable was used, with 1 indicating a satisfactory level of accountability and 0 an unsatisfactory level of compliance. An interpretive methodology was used where the various Central Bank Acts were studied in order for a conclusion to be reached. Compliance indicates that there are transparent and democratic processes whereby the Central Bank keeps the executive, the legislature and the country at large informed of its policies and actions. The average is 0.7, with only 3 countries namely Swaziland, Namibia and Mozambique not meeting the requirement.

5.18.6 Financial Independence

Table 5.22 Financial Independence

	Financial Independence
Angola	1
Botswana	1
Lesotho	1
Malawi	0
Mauritius	1
Mozambique	0
Namibia	0
Seychelles	1
South Africa	1
Swaziland	0
Tanzania	1
Zambia	0
Zimbabwe	0
Average	0.5

Table 5.22 indicates the level of financial independence of the various SADC Central Banks. Financial independence refers to the ability of the Central Bank to draw up its own budget and manage its own financial affairs. . A Binary variable was used, with 1 indicating a satisfactory level of financial independence and 0 an unsatisfactory level of compliance. An interpretive methodology was used where the various Central Bank Acts were studied in order for a conclusion to be reached. The average is 0.5, with only Angola, Botswana, Lesotho, Mauritius, Seychelles, South Africa and Tanzania having sufficient statutory safeguards of financial independence of the Central Bank. This is of concern, as the ability to independently conduct its financial affairs is a crucial indicator of CBI.

5.19 Conclusion

There are wide differences in the levels of CBI of the various SADC Central Banks. The CWN index score ranges from 0.27 in the case of Malawi to 0.59 in the case of Lesotho. The average of 0.44 indicates is also quite low, and only 4 countries have scores above 0.5. This implies that the ability of the various SADC Central banks to move towards monetary policy integration is limited. The various Banks have

substantial differences in their policy and operational environments, and major legislative and constitutional reforms will have to be undertaken before a unified SADC Monetary policy or Central bank can be considered. In many countries the Central Bank is to a large degree subservient to the government, and does not operate as a fully independent Central Bank. The majority of SADC Central Banks do not meet the CBI criteria to be called “independent”. This is of concern as any future SADC Central Bank will have to have a high level of independence, and more important be seen to be independent by SADC governments, investors, international organizations, donor countries, trading partners and the public at large.

Chapter 6 Conclusion

This study made use of the CWN index of Central Bank Independence in order to determine the levels of CBI within the various SADC countries. The CWN index was augmented by using 2 criteria namely Accountability and Financial (budgetary) independence in order to understand the impact of Central bank Independence on policy making in the SADC.

The level of CBI would have a direct impact on the ability of the various Central Banks to independently formulate and implement Monetary policy. Aggregate CBI within the SADC is low; the average CWN rating is 0.44, with only 4 countries having a rating above 0.5. This indicates that in most SADC Central Banks the ability of the Bank to independently determine and implement monetary policy is restricted by a lack of CBI. In a number of countries such as Namibia and Malawi the very low which suggests that the Central Bank is for all means and purposes subservient to government.

The average rating for the appointment of the CEO/Governor is 0.45, with the Seychelles with the highest rating of 0.52 and Namibia the lowest of 0.29. Only the Seychelles and Zambia achieved a rating of higher than 0.5, which is of concern. The fact that in most SADC countries the process of appointing the Central Bank Governor and Board does not comply with the criteria of Central Bank independence is problematic. Far greater independence from government in a far more transparent and open process is required. In almost all countries it is the sole prerogative of the executive to appoint the Governor. . In most cases this is the President, who may in certain cases consult with the Prime Minister or Finance Minister.

The Governor can in most countries only be dismissed by the State President. A number of countries specifically exclude policy reasons from the legal grounds for dismissal of the Governor. There are however a lack of clear and specific guidelines for the procedures and grounds for dismissal of the governor in most countries within the SADC.

The average for policy formulation is 0.34, which is the lowest of all four of the variables in the CWN index for the SADC countries. The Seychelles and Lesotho have the highest rating of 0.67, with Swaziland the lowest at 0.17. Only the Seychelles and Lesotho achieved a rating of above 0.5, which is cause for concern. In the majority of SADC countries policy formulation is not conducted in an independent manner, and in countries such as Malawi and Swaziland the Central Bank is for all purposes an extension of the executive. In all countries consultation takes place between the executive and the Central Bank, which is conducive for policy coordination. This becomes problematic however when the executive stops acting in a consultative role and starts to issue instructions to the Bank.

The wide disparities that exist within the SADC Central Banks indicate that a lot of reforms regarding policy formulation will have to be undertaken before the possibility of a unified SADC Central Bank is possible. Most Central Banks have a Monetary Policy Committee (MPC), and the role of the MPC in independently formulating monetary policy must be strengthened.

The average rating for having Clear Policy Objectives is 0.63, which is the highest of all the variables in the CWN index for the SADC countries. South Africa and Tanzania have perfect ratings of 1, however 4 countries namely Angola, Malawi, Namibia and Swaziland have ratings below 0.5. This is the variable where the SADC Central Banks received the highest rating. Most Central Banks have Clear Policy Objectives, but as can be seen from the other variables, the independence to implement those policies are lacking in a large number of countries within the SADC.

Most countries stipulate price stability as one of their major policy objectives, although there are in a number of countries other, possible conflicting objectives. Of note is the fact that South Africa has introduced an inflation targeting regime, which further strengthens the commitment to price stability as being the primary policy objective. It is suggested that all Central Banks, including a proposed SADC Central Bank introduce a inflation targeting regime.

The average rating for Limitations on Lending to Government is 0.46. Although most governments place some kind of limit on credit to government, the amount of the limit is in a lot of countries set very high, at up to 20% of government revenue. The limit is usually a fixed percentage of government revenue from the previous year. This severely diminished the impact of the limit on government credit.

The fact that in a number of countries the terms of credit to government is negotiated between government and the Central Bank implies a low level of CBI. The SADC governments may use their influence over the Central bank to negotiate very favourable conditions such as below market interest rates. Seen in the context of the low overall levels of CBI in the SADC this may lead to the abuse of the Central Bank by government.

Most SADC Central Banks have acceptable levels of accountability. Central Banks are accountable to parliament and/or specific parliamentary committees in a number of countries. This contributes to the transparency and accountability of the Central Bank, without undermining its independence. All Central Banks must publish minutes of meetings, policy documents, and research reports. Central Banks must provide reports of their activities as well as their own financial position to the executive and legislature. These provisions are enshrined in the various Central Bank Acts and provide a sufficient level of accountability.

Financial independence is an important criterion when assessing CBI. The Central Bank should have full authority over its internal budgetary matters. If the Bank does not have the above guarantees of financial independence, the government may have a strong incentive to manipulate the Bank into politically expedient policies or actions. The majority of Central Banks within the SADC have a provision that ensures financial independence in the relevant CB Act. The Banks have the ability to draw up their own budgets and manage their own affairs.

Governments need to undertake reforms that will increase the independence of their Central Banks. This should be done through legislative reforms, and more specifically Central Bank Independence should be constitutionalized. A provision in

the constitution that guarantees Central Bank Independence together with a reformed Constitutional Court Act that includes best international practices regarding CBI will ensure that the Central Bank is truly independent. The effectiveness of the proposed constitutional provision regarding CBI will however depend on how much respect the various governments have for their Constitution.

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