CENTRAL BANK OF NIGERIA

UNDERSTANDING MONETARY POLICY SERIES NO 13

CENTRAL BANK INDEPENDENCE

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Aims and Scope

Understanding Monetary Policy Series are designed to improve monetary policy communication as well as economic literacy. The series attempt to bring the technical aspects of monetary policy closer to the critical stakeholders who may not have had formal training in Monetary Management. The contents of the publication are therefore, intended for general information only. While necessary care was taken to ensure the inclusion of information in the publication to aid proper understanding of the monetary policy process and concepts, the Bank would not be liable for the interpretation or application of any piece of information contained herein.

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Central Bank of Nigeria

Mandate

▪Ensure Monetary and Price Stability

▪Issue Legal Tender Currency in Nigeria

▪Maintain External Reserves to safeguard the international value of the Legal Tender Currency

▪Promote a Sound Financial System in Nigeria

▪Act as Banker and Provide Economic and Financial Advice to the Federal Government

Vision

"To be a people-focused Central Bank promoting confidence in the economy and enabling an improved standard of living"

Mission Statement

"To **ENSURE** Monetary, Price and Financial System Stability as a Catalyst for Inclusive Growth and Sustainable Economic Development."

Core Values

Integrity

Partnership

Accountability

Courage

Tenacity

MONETARY POLICY DEPARTMENT

Mandate

To Facilitate the Conceptualization and Design of Monetary Policy of the Central Bank of Nigeria

Vision

To be Efficient and Effective in Promoting the Attainment and Sustenance of Monetary and Price Stability Objective of the Central Bank of Nigeria

Mission

To Provide a Dynamic Evidence-based Analytical Framework for the Formulation and Implementation of Monetary Policy for Optimal Economic Growth

FOREWORD

The Understanding Monetary Policy Series is designed to support the communication of monetary policy by the Central Bank of Nigeria (CBN). The series therefore, explain the basic concepts/operations, required to effectively understand the monetary policy framework of the Bank.

Monetary policy remains a very vague subject area to the vast majority of people in spite of the abundance of literature on the subject, most of which tend to adopt a formal and rigorous professional approach, typical of macroeconomic analysis.

In this series, public policy makers, policy analysts, businessmen, politicians, public sector administrators and other professionals, who are keen to learn the basic concepts of monetary policy and some technical aspects of central banking, would be treated to a menu of key monetary policy subject areas that will enrich their knowledge base of the key issues.

In order to achieve the primary objective of the series therefore, our target audience include people with little or no knowledge of macroeconomics and the science of central banking and yet are keen to follow the debate on monetary policy issues, and have a vision to extract beneficial information from the process. Others include those whose discussions of the central bank makes them crucial stakeholders. The series will therefore, be useful not only to policy makers, businessmen, academicians and investors, but to a wide range of people from all walks of life.

As a central bank, we hope that this series will help improve the level of literacy on monetary policy and demystify the general idea surrounding monetary policy formulation. We welcome insights from the public as we look forward to delivering contents that directly address the requirements of our readers and to ensure that the series are constantly updated, widely read and readily available to stakeholders.

Hassan Mahmud
Director, Monetary Policy Department
Central Bank of Nigeria

CONTENTS

UNDERSTANDING CENTRAL BANK INDEPENDENCE[1]

George Okorie [2]

Abstract

Central bank independence confers freedom on central banks or monetary authorities to facilitate the conduct of monetary policy in fulfillment of their set mandates, free of political interference. The overwhelming evidence shows some correlation between central bank independence and monetary and price stability, implying that independent central banks are more able to fulfill their monetary policy mandates, justifying the widespread call for independence among major central banks. The section on country experiences portrays the degree of central bank independence across various countries. On balance, central banks in most countries are accountable to an elected parliament and the public, while a significant number enjoy instrument independence.

SECTION ONE

Introduction

Central bank independence refers to the freedom of central banks or monetary authorities to conduct monetary policy in accordance with their set mandates without political interference. In recent times, the independence of central banks in the formulation and implementation of monetary policy continues to attract considerable interest in many quarters.

Following the success of Germany's Bundesbank in lowering inflation in post-World War II Germany, as a result of the Bank's independence, there has been a growing body of literature on the subject, linking central bank independence directly to price and monetary stability. Other reasons for the growing interest in

[1]This material is designed specifically as an educational material for enlightenment on the monetary policy of the Bank. Consequently, the Central Bank of Nigeria (CBN) does not take responsibility for the accuracy of the contents of this publication as it does not represent the official views or position of the Bank on the subject matter.

[2] This publication was originally authored by **G Okorie** in 2013 (Principal Economist Manager in the Monetary Policy Department, Central Bank of Nigeria) and revised/reviewed in 2021 by **Gaiya Blessing** (Assistant Director, Research Department, Central Bank of Nigeria)

the subject include, the Maastricht Treaty, which required an independent central bank as a pre-condition for membership of the European Monetary Union (EMU); and the Latin American view that central bank independence is a viable institutional arrangement to reduce high and persistent inflation. In addition, the emergence of independent central banks in many former socialist countries as part of a more general approach to the orderly functioning of a market economy, added to the need for central bank independence.

These overwhelming views in the academic literature have compelled many governments to consider strengthening the autonomy of their central banks. Furthermore, international monetary institutions, such as the World Bank and the International Monetary Fund (IMF), have added their voice to the growing interest in central bank independence and the role it plays in achieving stable inflation.

Against this background, this article discusses central bank independence in some detail to enhance the knowledge of readers on the subject. Following the introduction, section two examines some conceptual issues in central bank independence. Section three reviews arguments for and against central bank independence, while section four presents and discusses selected country experiences. Section five analyses the evolution and key features of central bank independence in Nigeria, while section six concludes the paper.

SECTION TWO

Conceptual Issues

2.1 Central Bank Independence

A central bank is the monetary authority of a country with a mandate to formulate and implement monetary policy. Central banks supervise the deposit-taking financial institutions of their respective countries. A central bank possesses a monopoly on printing the national currency, which usually serves as the nation's legal tender. The role of central banks globally involves attaining and ensuring price stability, issuance of legal tender currency, and maintenance of a safe, sound, and stable financial system.

To effectively carry out these functions, central banks in most developed nations are statutorily insulated from political interference. Central bank independence or autonomy refers to the freedom of monetary authorities from direct political or government interference in the conduct of monetary policy (Walsh, 2005). Eijffinger and De Haan (1996), citing Friedman (1962), liken the relationship between the government and an independent central bank to that between the judiciary and the legislative arm of government. The judiciary can only make judgments based on laws enacted by the legislature, and it can only be forced to rule differently through a change in the law. A central bank is deemed to be independent if it can make decisions at its discretion, based on its mandate, previously defined by the government.

2.2 Dimensions of Central Bank Independence

In the literature, there are various degrees of central bank independence as discussed below:

(i) **Goal independence:** In this type of independence, the central bank has the right to set its own policy goals i.e., inflation target, interest rates, money supply and stable exchange rate. While this type of independence is more common, many central banks prefer to set their policy goals in collaboration with the appropriate government departments or ministries. This increases the transparency of the policy-setting process, and thereby enhances the credibility of the monetary authority. It also ensures that the goals would not be subject to discretionary impulses. In addition, setting common goals by the central bank and the government encourages coordination between monetary and fiscal authorities.

(ii) **Instruments independence:** Instrument independence confers on the central bank the ability to freely choose appropriate instruments or adjust its existing policy tools in pursuit of the goals of monetary policy. The central bank has the independence to determine the best way of achieving its policy objectives, including the types of instruments to be used and the timing of their use. This is the most common form of central bank independence.

(iii) **Operational independence:** The central bank has the authority to run its operations (appointing staff, setting budgets, and so on.) without the overbearing oversight of the government. This type of independence helps to facilitate other forms of independence.

SECTION THREE

The Case for and against Central Bank Independence

3.1 The Case for Central Bank Independence

One of the most important arguments for central bank independence is the time inconsistency problem (Kydland and Prescott, 1977; Barro and Gordon, 1983; Kasseeah *et al,* 2011). Time inconsistency occurs when what is thought to be the best plan for a future period is no longer desirable in that period, thereby requiring the policymaker to modify the original pre-announced plan. In the framework of monetary policy, the time inconsistency problem can arise when politicians attempt to exploit the short-run trade-off between unemployment and inflation. Due to political considerations, governments may be tempted to reduce interest rates ahead of elections to cause a temporary boom in economic activities. This may boost spending and employment in the short term but will ultimately lead to higher inflation in the longer-term horizon unless the economy has the capacity to expand its productive base to accommodate the higher level of demand. Put differently, an elected government concerned about its immediate popularity might be tempted to go for short-term gains from lower interest rates at the risk of higher inflation further down the road because of the short-term nature of its tenure in office. Central bankers, however, normally operate with a longer-term perspective than politicians, and therefore, do not face the same temptation to relax policy to achieve short-term objectives. By delegating interest rate decisions to such an independent institution with a clearly defined mandate, society can hope to achieve a better inflation outcome over the longer term.

Another major benefit of central bank independence is its impact on economic growth. Independence insulates central banks, making them less susceptible to political interference. They are, therefore, able to behave more predictably in their day-to-day decision making process. This may enhance economic stability and stimulate growth. Also, since high inflation rates can hinder the price mechanism, central bank independence reduces inflation variability and promotes economic prosperity.

Studies have suggested that there is an inverse relationship between central bank independence and long-term inflation. In other words, a low and stable inflation rate is more likely to be found in countries with independent central banks than in those without independent central banks. In addition, there tends to be a negative correlation between central bank independence and the long-term budget deficit expressed as a percentage of the gross national product. This suggests that countries with independent central banks tend to have smaller budget deficits than those without independence.

3.2 The Case Against Central Bank Independence

Critics of central bank independence argue that although the average inflation rate and the degree of central bank independence are negatively correlated, this relationship does not reflect any causal link running from central bank independence to low inflation. They claim that in countries where economic agents strongly object to high inflation, there is a strong will to keep inflation down. Conversely, where the economic agents are more tolerant of inflation, they are less inclined to have monetary policy in the hands of an autonomous central bank. Furthermore, they argue that average inflation is influenced largely, by its persistence and the preferences of a country's inhabitants, with causality originating from inflation to the institutional structure of the central bank.

In the literature, a pervasive argument against the autonomy of central banks is that monetary policy forms a part of the overall economic policy, implying that there can be no meaningful and effective monetary policy, where there is a separation between fiscal, monetary, labour, trade and any other macro-policies. Where such a separation exists and policies run at cross-purpose, then the resultant conflict in objectives may have considerable repercussions for the economy. Proponents of this view argue that efficient fiscal and monetary policy formulation and implementation requires coordination.

The political argument is that turning over interest and exchange rate decisions to a body of unelected officials, is simply "undemocratic". In a democracy, they argue, all decisions should be subject to scrutiny by the elected members of the legislature, thus the concept of an autonomous central bank is, therefore, not acceptable (Mboweni, 2000).

SECTION FOUR

Country Experiences with Central Bank Independence

This Chapter reviews the main features of central bank independence in a select group of advanced and emerging and developing economies and offers some key lessons from their experiences.

4.1 The European Central Bank (ECB)

The independence of the European Central Bank (ECB) is laid down in the institutional framework for the single monetary policy (found in the Treaty Statute of the Bank). Neither the ECB, the national central banks (NCBs), nor any member of their decision-making bodies, is allowed to seek for or take instructions from EU institutions or bodies, any government of an EU Member State, or any other body. European Union (EU) institutions and bodies and the governments of the Member States must respect this principle and not seek to influence the members of the decision-making bodies of the ECB (Article 130 of the Treaty). This arrangement helps to strengthen the independence of the ECB and insulates it from external influences.

The ECB's financial arrangements are kept separate from those of the EU. The ECB has its budget. Its capital is subscribed and paid up by the euro area NCBs. Under the Statute, members of the Governing Council are allowed lengthy terms of service while members of the Executive Board cannot be reappointed. Governors of NCBs and members of the Executive Board have the security of tenure: NCB governors have a minimum term of office of five years; members of the Executive Board of the ECB have a non-renewable term of office of eight years; both can be removed from office only in the event of incapacity or serious misconduct, and the Court of Justice of the European Union is the designated institution to settle any disputes.

The Euro system is functionally independent and prohibited from granting loans to EU bodies or national public sector entities, thus shielding it further from any influence exercised by public authorities. The ECB possesses all instruments and competencies necessary for the conduct of efficient monetary policy and is autonomous in its decision-making process. The ECB has the right to adopt binding regulations to the extent necessary to carry out the tasks of the European System of Central Banks (ESCB), and in certain other cases, as laid down in specific Acts of the EU Council.

Although, price stability is mandated as the goal of the European Central Bank, the ECB can, choose how it interprets this goal in terms of a specific price index and definition of price stability. In the European Union, central bank independence is a legal prerequisite for Eurozone membership.

4.2 The Deutsche Bundesbank

The Deutsche Bundesbank is the central bank of the Federal Republic of Germany, and also part of the European System of Central Banks (ESCB). Due to its strength and size, the Bundesbank is the most influential member of the ESCB.
The Deutsche Bundesbank was the first central bank to be given full independence, making it a central banking model referred to as 'the Bundesbank model', as opposed, to the New Zealand model, which has a goal (i.e. inflation target) set by the government. The Bundesbank has a leading reputation for its effective control of inflation throughout the second half of the 20th century. This made the then German Mark, one of the most stable currencies in the world. On this basis, the ECB was modeled after the Bundesbank to replicate the success of the Bank across member states of the European Monetary Union.

The Bundesbank has a prime, though less specific, the objective of price stability formally referred to as the defense of the value of the currency. In addition, the Bank has the obligation to offer general support to the government's economic policy, providing such support does not undermine the primary objective of price stability. The Bundesbank has no obligation to accept the government's pre-announced inflation targets. The Bundesbank is referred to as the world's most independent central bank, a feature which earned it a huge success in anchoring inflation and safeguarding the German mark (prior to the introduction of the euro). This success story has helped create a wave of central bank independence among many countries in the European Community.

Since 1974, the Bundesbank has been announcing the targeted rate (or zone) for money growth, which has implications for the country's inflation target. The German government has been responsible for decisions about the exchange rate. In Germany the government can suspend the decisions of the Bundesbank for a maximum of two weeks, requiring only a change in the relevant legislature by a simple majority in parliament to overrule the decision of the Bank (Eijffinger and De Haan, 1996).

4.3 The Bank of England (BOE)

The Bank of England is the central bank of the United Kingdom of Great Britain and Northern Ireland and represents the model on which most modern central banks were established. The Bank's monetary policy objective is to deliver price stability (low and stable inflation) and support the Government's economic objectives, including those of growth and full employment. In recent times, price stability is defined by the Government's inflation target of 2.0 per cent. The remit recognizes the role of price stability in achieving economic stability more generally, and in providing the right conditions for sustainable growth in output and employment. The Government's inflation target is announced each year by the Chancellor of the Exchequer in the annual budget statement.

The 1998 Bank of England Act granted the Bank its independence in setting interest rates. The Bank is, however, accountable to parliament and the wider public. The legislation provides that in extreme circumstances, depending on the national interest, the government has the power to give instructions to the Bank on interest rates for a limited period. The inflation target of 2.0 per cent is expressed in terms of an annual rate of inflation based on the Consumer Price Index (CPI). The objective is not to achieve the lowest possible inflation rate, as Inflation below the target of 2.0 per cent is judged to be just as bad as inflation above the target. The inflation target is, therefore, symmetrical.

If the target is missed by more than 1.0 percentage point on either side – i.e. if the annual rate of CPI inflation is more than 3.0 per cent or less than 1.0 per cent – the Governor of the Bank must write an open letter to the Chancellor of the Exchequer, explaining the reasons why inflation has increased or fallen to such an extent and what the Bank proposes to do to ensure inflation reverts to the target. The members of the Monetary Policy Committee (MPC) meet periodically to set interest rates, so that inflation can be brought back to target within a reasonable period, without creating undue instability in the economy.

The Bank seeks to meet the inflation target by setting an interest rate, which is decided by its Monetary Policy Committee (MPC). The Committee, chaired by the Governor of the Bank of England, consists of nine members, five of whom are from the Bank of England and four external members appointed by the Chancellor of the Exchequer. The MPC meets monthly for a two-day meeting. Decisions are made by a vote of the Committee on a one-person-one-vote basis. While lacking goal independence, the Bank operates with instrument independence. Although the country's inflation target is set by the government, however, the Bank can choose its instruments to achieve the target without influence from the government.

4.4 The United States Federal Reserve Bank (The Fed)

The Federal Reserve Bank is an independent agency of the US government but is also ultimately accountable to the public and Congress. The US Congress established maximum employment and stable prices as the key macroeconomic objectives of monetary policy for the Federal Reserve Bank. Congress also structured the Federal Reserve to ensure that its monetary policy decisions focus on achieving these long-run goals and do not become subject to political pressures that could lead to undesirable outcomes. Consequently, members of the Board of Governors are appointed for staggered 14-year terms, and the Chairman of the Board is appointed for a four-year term. Elected officials and members of the Administration are not allowed to serve on the Board. This organisational structure ensures that the Fed is insulated against external political influences.

The Federal Reserve Bank does not receive funding through the congressional budgetary process. The Fed's income comes primarily from the interest on government securities acquired through open market operations. Other sources of income include the interest on foreign currency investments held by the Federal Reserve System; fees received for services provided to depository institutions, such as cheque clearing, funds transfers, and automated clearinghouse operations; and interest on loans to depository institutions. After paying its expenses, the Federal Reserve turns the balance of its earnings over to the U.S. Treasury.

While Congress establishes key objectives that the Fed must follow, the Fed generally works independently of the federal government to administer its core responsibilities.

These duties include:

I. Conducting monetary policy
II. Supervising and regulating banking and financial institutions
III. Providing payment services to financial institutions

The goals of the Federal Reserve Bank are set in its legal charter, but these goals are described in vague terms (e.g., maximum employment), leaving it open to the Fed to translate into operational terms. Thus, the Fed has a high degree of goal independence and complete instrument independence.

4.5 The Reserve Bank of New Zealand

The Reserve Bank of New Zealand is the central bank of New Zealand. The Bank's monetary policy ensures price stability, promotes the maintenance of a sound and efficient financial system, and manages the country's currency. The Reserve Bank also aims to ensure employment is near its maximum sustainable level.

The Reserve Bank has only one formal objective - price stability. The Bank is not independent with respect to its goals. It must agree with its inflation target with the government, but is, however, free to choose the instruments to achieve the target. The Governor of the Bank can be dismissed if he fails to deliver on the inflation target, although there are escape clauses such as a rise in indirect taxes or a change in exchange rate regimes.

Under the Reserve Bank of New Zealand Act 1989, the Bank was vested with instrument independence to operate monetary policy with the primary objective to maintain overall price stability. The operational details of the Bank's inflation target are set out in a separate agreement between the Governor and the Minister of Finance, known as the Policy Targets Agreement (PTA). The PTA is a written contract between the Minister of Finance and the Governor, detailing the monetary policy outcomes that the Bank is required to achieve. The key document in relation to the Reserve Bank's monetary policy decision-making is its quarterly Monetary Policy Statement. The Monetary Policy Statement describes in detail, factors that influence the Reserve Bank's monetary policy decisions, which in turn are based on the Policy Targets Agreement.

The Bank's Funding Agreement is a five-yearly agreement between the Governor and the Minister of Finance that specifies how much of the Bank's income can be retained by the Bank to meet its operating costs; and the Statement of Intent (SOI), which is an annual statement provided to the Minister of Finance, highlighting the Bank's operating environment, functions, objectives and strategies for the next three years, as well as projected income and expenditure for the first financial year.

The Reserve Bank Act makes the Bank's Chief Executive – the Governor, accountable for the Bank's actions in monetary policy and most other matters. The Governor is appointed for a five-year term while the Act sets specific criteria for the appointment, reappointment, and dismissal of a Governor.

The Reserve Bank has a Board of Directors, chaired by a non-executive member with the Governor sitting as a Board member. The Board's primary function is to monitor the performance of the Governor and the Bank, on behalf of the Minister of Finance. It has the responsibility to confirm that the Monetary Policy Statements (MPSs) are consistent with the PTA. The Board also provides advice to the Governor. The Board does not direct Bank policy, monetary or otherwise.

4.6 The Bank of Japan (BOJ)

The BOJ was granted legal independence in its 1998 Act, following decades the Bank's persistence in making a case for more autonomy. Its previous charter, based on the Reichsbank of Nazi Germany, was enacted as part of Japan's World War II-era mobilization.

Thus, the Bank secured twin independence, namely monetary policy independence and business operations independence under the Act. The Bank's monetary policy independence involves its autonomy regarding currency and monetary control. With respect to business operations, the Act also stipulates that due consideration shall be accorded the autonomy of the business operations of the Bank. Thus, the BOJ has a full range of independence that is conducive to conducting monetary policy without pressure from the government.

There is, however, a caveat, aimed to ensure that the stance of the government's economic policy is sufficiently compatible with the Bank's monetary policy. To this end, the Act provides that the Bank should collaborate with the government and encourage the exchange of views between them. To further encourage coordination, the Act provides an institutional framework that allows government representatives to attend the Policy Board's periodic meetings (Monetary Policy Meetings). At these meetings, government representatives may submit proposals, express opinions, and/or request the postponement of the Board's vote on proposals.

The current law sets the BOJ's objective as achieving "price stability." The BOJ does not have a dual mandate like the U.S. Federal Reserve, which is tasked with keeping inflation in check and pursuing full employment.

The Bank's Law also does not have an explicit numerical target for inflation. The Bank can set an inflation target for itself but has no legal obligation to achieve it.
The government is prohibited from firing the central bank governor or members of its board but has the right to appoint them with approval from both houses of parliament. Thus, the BOJ has a very high degree of central bank independence, when compared with the monetary authorities of most advanced.

4.7 The Reserve Bank of South Africa

The constitution of the Republic of South Africa provides for an independent central bank. Section 224(2) of the constitution states that "The South African Reserve Bank, in pursuit of its primary object must perform its functions independently and without fear, favour or prejudice, but there must be regular consultation between the Bank and the Cabinet member responsible for national financial matters". In February 2000, the Bank adopted a formal inflation targeting framework for monetary policy. The setting of monetary policy instrument values (like the level of the 'repo rate') is entirely at the Bank's discretion as the Reserve Bank Act, Act No 90 of 1989, allows the Bank a great deal of autonomy in its operations. Section 10(2) clearly states that "the rates at which the Bank will discount or rediscount the various classes of bills, promissory notes and other securities, shall be determined and announced by the Bank from time to time". This gives the Bank the right to determine Bank Rate, or rather the repo rate in an autonomous manner (Mboweni, 2000). Therefore, the chosen inflation-targeting variable provides for instrument independence of the Reserve Bank, but not goal independence. The Bank conducts monetary policy in a transparent manner, following the adoption of an inflation-targeting framework. The Government and the public are informed about the monetary policy stance of the Bank, through a monetary policy communique and a regular appearance at the Parliamentary Portfolio Committee on Finance. Based on this information, the public can evaluate the actions of the Reserve Bank in attaining its objectives.

4.8 Major Lessons from Country Experiences

The major lessons from the foregoing analysis of country experiences include:

I. The degree of central bank independence varies across countries.
II. Most central banks are accountable to an elected parliament and the public in most countries.
III. Most central banks enjoy instrument independence.
IV. Central bank's independence does not necessarily undermine the coordination between monetary and fiscal policy.
V. Central bank's independence aims to create the enabling environment for central banks to pursue and achieve their primary mandate, which is usually price stability.

SECTION FIVE

The Evolution and Key Features of Central Bank Independence in Nigeria

5.1 Evolution of CBN's Independence

The CBN independence began with the promulgation of the CBN Decree (now Act) No. 24 of 1991. The enactment of the Banks and Other Financial Institutions Act (BOFIA) 1991 was considered a landmark accomplishment in the Bank's history as it conferred on the CBN some degree of instrument autonomy for the effective discharge of its core mandate. However, the law and its subsequent amendments could not keep pace with the challenges that emerged because of the rapid reforms in the financial sector of the 2000s. These necessitated a comprehensive review of the existing legal framework to strengthen monetary policy formulation and implementation, while ensuring its effective transmission as well as the enhancement of the supervisory capacity of the Bank.

Following the CBN amended Decree No 3 and BOFIA (amended Decree No 4) of 1997, the CBN was directly under the responsibility of the Ministry of Finance, with respect to supervision and control of banks and other financial institutions. The amendment placed enormous power on the Ministry of Finance, while leaving the CBN with a subjugated role in monitoring financial institutions with little room for the Bank to exercise discretionary power. However, the CBN regained operational autonomy in 1998, because of the CBN amendment Decree No 37 of 1998 that repealed the 1997 Decree.

In 2007, the Bank proposed several measures to strengthen both the CBN and BOFI Acts. Eventually, only the Bill embodying the CBN Act was passed into law by the National Assembly (NASS) and assented to by the President.

5.2 Key Features of CBN's Independence in the CBN Act of 2007

i. **Autonomy of the Bank (Section 1(3):** In the CBN Act of 2007, the operational autonomy of the Bank is clearly expressed in line with international best practice. This has not only facilitated the achievement of its mandate but also instils stakeholder confidence. Section 1(3) states that "To facilitate the achievement of its mandate under this Act and the Banks and Other Financial Institutions Act, and in line with the objective of promoting stability and continuity in economic management, the Bank shall be an independent body in the discharge of its functions". For instance, the Act in Section 30 empowers the Bank to carry out open market operations, issue other forms of securities including treasury bills, as may be deemed necessary for liquidity management.

ii. **Objects of the Bank (Section 2):** The objective of price stability is explicitly stated as the core mandate of the Bank. This is informed by the fact that the core function of every central bank is the maintenance of price stability, which is a precondition for economic growth and development.

iii. **Appointment and Qualifications of the Members of the Board (Sections 8, 10 & 11):** To facilitate the achievement of its mandate, the Act states that the appointment of the Governor, the Deputy Governors, and non-executive directors shall be by the President subject to confirmation by the Senate while the removal of the Governor is also subject to a two-thirds majority of the Senate. The Governor, as the chairman of the Board, is required to keep the President informed of the affairs of the Bank, including a report on its budget; and appear before the National Assembly periodically to present a report on the activities of the Bank.

iv. **Establishment of the Monetary Policy Committee (MPC) (Section 12):** The MPC was established to facilitate the Bank's instrument independence in the attainment of its price stability objective. To improve the process for monetary and credit policy formulation and implementation, the MPC, with the Governor as its Chairman, is formally constituted with membership drawn from within and outside the Bank. Membership of MPC includes the Governor and four Deputy Governors, two external members appointed by the Governor and three external members appointed by President as well as two members representing the Board. The Committee, in its periodic meetings, makes informed decisions, chooses appropriate instruments to enhance the quality of monetary policy, and introduce transparency to the process. The MPC meets bi-monthly to review the conditions and challenges that confront the domestic economy and makes appropriate decisions in line with its price stability objective. At the end of every meeting, the Governor reads the communique of the MPC on live television, following which it is published on the Bank's website along with the personal statements of members of the MPC.

v. **External Reserves Management (Section 24):** The Act gives the Bank greater flexibility in the selection of instruments for monetary policy and assets in which to invest the external reserves. While the existing restrictions are based on considerations of safety and security of the reserves, the dynamics of modern-day reserve management make it necessary for the

CBN to retain some flexibility in determining the choice of investments. The Bank has also been empowered to invest part of the external reserves as loans or debentures, in any suitable development finance institution subject to appropriate limitations.

SECTION SIX

Conclusion

The broad consensus is that monetary policy committees may be established by the government, but the conduct of monetary policy must be free from political interference. To achieve both price stability and sustainable employment, monetary authorities must steer the economy towards economic growth. Given the lags in the transmission of monetary policy, achieving this objective requires policymakers to take a longer-term perspective of desired macroeconomic developments. An independent central bank with a mandate to achieve the best possible economic outcome in the longer term is better placed to take monetary policy decisions with such a perspective. Excessive political influence on monetary policy decisions can also weaken the ability of the central bank to control inflation. There is, therefore, a growing number of countries adopting central bank independence, thereby insulating their monetary authorities from political and other external interference.

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