Central Bank Independence and Institution Building During the Neo-Liberal Era: The Case of Bank of Zambia

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June 7, 2021

Continent-wide, questions are arising whether central banks should have their monetary policy mandates so narrowly and rigidly confined to inflation targeting, when this comes at the expense of financial inclusion and private-sector credit extension. One aspect of this polemic concerns the independence of the central bank. Indeed, as the case study of the Bank of Zambia (BOZ) illustrates, the ability of a central bank to effectively execute its mandate, no matter how broad or narrow, hinges on its independence from the government and its politics. In this case study of BOZ, we show that the effective execution of the central bank's mandate does not merely depend on a sound legal framework for the central bank; it – above all – results from the government's prevailing ideology (neoliberalism or central planning) regarding the economy and the country's development.

This blog post largely derives from a recent study entitled *Bank of Zambia's Autonomy Amidst Political Turnovers in Zambia*, which investigated whether BOZ could effectively deliver on its mandate given the context of political interferences arising out of Zambia's competitive clientelist democracy. That study concluded that, over time, BOZ had enshrined its independence in the law and had been quite effective at delivering on its mandate to stabilize prices and develop the financial system as required in a market economy. BOZ's steadiness stood out especially when compared to other economic institutions, like the Ministry of Finance and the Zambia Revenue Authority, whose functioning was at times notably undermined by the ruling coalition. This situation ended abruptly when the President fired the respected BOZ Governor – an issue that forms the topic of another blog.

From 1990 onward, the Bank of Zambia transformed from an institution that served to support a state-led, command economy under a one-party political dispensation to a 'modern' central bank, in line with international standards and Zambia's liberalized economy, under the guidance of the International Monetary Fund (IMF). Under the state-led economy, BOZ Act No. 24 of 1985 provided for a credit guarantee scheme that obliged BOZ to establish a fund to serve as protection for financial institutions against losses incurred by them for advancing funds or granting loans to small-scale enterprises. The scheme took into account that banks balked at extending credit to entrepreneurs that could not post adequate collateral. In the new dispensation in the 1990s, BOZ's role assumed that a liberal financial sector would open new opportunities through commercial banks for entrepreneurs to access finance.

The post-1991 economic reforms aimed to, among others, secure the independence of BOZ by means of structure and legislation. The 1965 Bank Act gave monetary policy-making powers to the Minister of Finance, thereby constraining the Governor, who was regarded as an administrator. This changed with the 1996 Bank Act, which, in the words of former BOZ Governor Jacob Mwanza, "provided more autonomy on matters of monetary policy, financial stability and macroeconomic policy" (Mwanza, quoted in Bank of Zambia 2014: 93).

In the market economy, BOZ fulfils an important position as a ‘signaller’ to the international capital markets, especially in the persona and capabilities of the Governor. BOZ’s functioning is further reinforced by the need to adhere to international central banking standards set by IMF and Basel I and II as well as those by regional bodies like the Southern African Development Community (SADC) and the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI). From this perspective, BOZ has performed well over the last decades in adherring to international central banking standards, and many people see the central bank as one of the most professional and effective institutions in the country.

After a period of ‘wild-west capitalism’ in the 1990s, some protagonists pushed back against neo-liberal policies in the 2000s. While President Levy Mwanawasa’s economic team did not counter the dominant IMF orthodoxy, they agreed that the economic reforms in Zambia had been too hasty and had to be moderated. The Minister of Finance recounts it as follows:

> I was uncomfortable with independent operations of the central bank, as the fiscal and monetary activities were still closely interrelated but inadequately coordinated. Zambia was still grappling with a hurriedly announced market economy after so many years of centrally planned socialist command economy. Government operations were inclined towards sector policy instruments, with no long-term planning.

Sustained economic growth in the 2000s, however, did not translate into an inclusive economy. This handed the left-leaning and populist Patriotic Front (PF) opposition party both ammunition and a golden opportunity to challenge the status quo and promise Zambians ‘more money in your pocket’. The PF party targeted BOZ as well, regarding high interest rates, the continued dominance of foreign banking ownership, and the high renumeration of the BOZ Governor – all of which proved fertile topics for PF to build its support base. After winning the election in 2011, President Michael Sata appointed a 1970s UNIP old-hand as Minister of Finance, Alexander Chikwanda, and replaced the long-serving BOZ Governor Caleb Fundanga with an untried lawyer Michael Gondwe. True to its political promises when it came to banking, PF immediately imposed an administrative cap as a direct control on high interest rates. In addition, two statutory instruments were introduced to put controls on the exchange rate and the dollarisation of the economy. All these measures were reversed after causing severe unrest in the market, as well as a push back from the IMF. Sata's regime also started with an inquiry into the privatisation of the ZANACO bank, amidst an ideological shift towards the re-nationalisation of some of the privatised business entities. The main contention revolved around the amount for which the bank shares were sold. Then Minister of Justice, Sebastian Zulu, appointed a team of officials from the Ministry of Justice and experts from the private sector to investigate what transpired during the sale and how the resources were used. However, neither the team nor Sata's government ever published the report, and ZANACO remained intact.

Presidential by-election in January 2015 followed President Sata's death in 2014. In February 2015, President Edgar Lungu appointed Denny Kalyalya as BOZ Governor – an appointment that marked a return to a more liberal regime. President Lungu also replaced Finance Minister Chikwanda with Felix Mutati, a former minister of commerce and trade. Both appointments came as a surprise, given PF's track record on rewarding loyalty, because both candidates were political outsiders. A possible explanation is that Zambia, as one of the highest issuers of Eurobonds in sub-Saharan Africa at the time, needed a reputable finance minister and central bank governor to maintain access to international finance. A credible BOZ also helps to maintain a good credit rating. Kalyalya previously held senior positions at BOZ and the World Bank. These appointments quickly proved to be a mere façade, as the current economic policy environment in Zambia remains at odds with their IMF- and Basel I/II-influenced policies, an environment which has diminished BOZ function vis-à-vis banking regulation, monetary policies, interest rates and debt burden. So far, this change of course away from IMF has not led to a more inclusive economy, nor has it led to easier/cheaper access to capital for SMEs.

In reality, central banking entails balancing political interests with developmental goals, while maintaining international credibility. In a situation characterized by high levels of corruption and conspicuous debt accumulation, which has resulted in Zambia going into foreign debt default, international and regional disciplining forces like the IMF and SADC can potentially serve to help build capacity and shore up BOZ. For now, a salient driver of the effectiveness of BOZ in both maintaining independence and fulfilling its mandates is the legal framework established by the current BOZ Act (1996). The Act not only defined and elaborated the primary, secondary and tertiary mandates of the central bank, but also stabilized the tenures of office for the BOZ Governor and the bank's two deputy governors. It also prescribed the right qualifications and experience of the Governor, and strengthened appointments by requiring that the President's BOZ appointments be ratified by the National Assembly. However, weaknesses and risks in the law persist, in that the power to remove the Governor remains the sole preserve of the president. The firing of the BOZ Governor in August 2020 (and his replacement by a political ally of the President) reminds us of those weaknesses, while the consequences of the change in Governors still have to play out.

Overall, the Zambia case shows that the Constitution and central bank laws, the institutional technocratic culture in BOZ, and particularly, the persona and competence of the Governor were all crucial factors for central bank autonomy and effectiveness. Central bank effectiveness therefore rests in a country's willingness and ability in investing in establishing a robust legal framework to define the establishment and mandates of the central bank, including for the appointment of the Governor as well as in its ability to install and insulate the central bank as a highly technically competent and well-compensated autonomous policy-making and regulatory institution.

However, despite many of the right conditions for autonomy and effectiveness having been well-established in Zambia, the political settlement was able to significantly interfere with the functioning of BOZ and threaten its effectiveness. Recently, the inherent weakness in the legal provisions for dismissing the Governor have proven to be particularly problematic. Thus, other countries seeking to circumscribe the power of a President to remove a Governor would do well to ensure they have legal provisions and policies that protect the tenure of office of the Governor and the Deputy Governor from undue external influences, including from the President and thus insulate the central bank from political settlement. The process of presidential dismissal of the Governor should be more rigorous than that of appointment. Moreover, dismissal of a Governor should, at the very least, apply all the check, balances and peer review mechanisms that obtain at appointment.

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