

# CENTRAL BANK INDEPENDENCE IN NORTH AFRICA

BESSMA MOMANI AND SAMANTHA ST. AMAND

## KEY POINTS

- Over the past 30 years, North African states have made positive strides toward central bank independence (CBI) that are correlated with overall structural transformations toward economic liberalization.
- The Arab uprisings appeared to provide a positive political nudge for advancing statutory amendments toward CBI.
- Compared to other emerging market economies and developing regions, there is further room for improvement on achieving the goals of CBI in North Africa.
- CBI in North Africa can be strengthened by promoting a learning culture and technocratic values within the central banks.



### BESSMA MOMANI

Bessma Momani is associate professor in the Department of Political Science at the University of Waterloo and the BSIA. She is also a senior fellow with the Centre for International Governance Innovation (CIGI).



### SAMANTHA ST. AMAND

Samantha St. Amand is a research associate in the Global Economy program at CIGI. Her current research focusses on the political economy of central banking and the international implications of monetary policy.

## INTRODUCTION

Securing CBI has become best practice in global governance. Both the political and economic literatures suggest that CBI facilitates price stability, promotes transparency to citizens and provides accountability toward the public good. CBI is also credited with protecting the economic and financial system from the trappings of regulatory capture. In addition, a number of scholars have argued that CBI is correlated with positive policy outcomes, including balanced long-term economic growth, stable financial markets and a reduced likelihood of publicly funded financial institution bailouts. Moreover, some have suggested that CBI is important for fostering a healthy liberal democracy. As global markets have become increasingly integrated and interdependent, securing CBI is also considered a domestic, regional and global public good.

The North African region was a laggard among emerging market economies in improving CBI during the 1990s and early 2000s. The impact of the Arab

uprisings seems to have provided the necessary push for securing independence going forward. Progress toward CBI for the North African countries of Morocco, Tunisia and Egypt, has been observed as all three countries responded to the uprisings with constitutional reforms. While none of these countries can claim to have achieved CBI to the same degree as some of the central banks of the major advanced countries, they have all instituted some measures toward greater CBI. As many of these countries are on the path toward political liberalization and are implementing economic liberal reforms, the goal of CBI will further ensure economic gains are not lost to potential political interferences.

Offering the first policy study on CBI in North Africa since the uprisings, this brief argues in favour of furthering reforms by promoting transparency, meritocracy and an open-learning culture to solidify the modest gains made in CBI in the region.

**MEASURING CBI**

CBI is often defined by fulfilling four categories — personnel, policy objectives, policy instruments and financial independence — that reflect an institutional and legal framework allowing central banks to operate in a technocratic and accountable manner (Eijffinger and de Haan 1996).

**PERSONNEL**

CBI is ideally characterized by personnel independence, where a government’s role in either appointing or dismissing the central bank’s governor and board is limited; the term of the governor and board is preset and legally defined; and the representation of the government on the board of governors has an arm’s length relationship.

Copyright © 2014 by the Centre for International Governance Innovation

The opinions expressed in this publication are those of the authors and do not necessarily reflect the views of the Centre for International Governance Innovation or its Operating Board of Directors or International Board of Governors.



This work is licensed under a Creative Commons Attribution-Non-commercial — No Derivatives Licence. To view this licence, visit ([www.creativecommons.org/licenses/by-nc-nd/3.0/](http://www.creativecommons.org/licenses/by-nc-nd/3.0/)). For re-use or distribution, please include this copyright notice.

However, best practice in personnel independence does not completely remove the government's role in determining the composition of the governor and board. Instead, the government can have a role in the appointment process, but the length of their terms are predetermined and should not be altered by political whims or changes of government. In addition, government representatives should not be members of the central bank's board of governors so that they cannot influence the bank's decision-making process.

## **POLICY OBJECTIVES**

CBI is ideally characterized by a central bank having safeguards on amendments to its policy objective. Generally, best practice for CBI includes a primary monetary policy objective of maintaining price stability and this objective is either constitutionally entrenched or cannot be frequently reassessed by an incumbent government.

## **POLICY INSTRUMENTS**

A related element of CBI is to ensure that the central bank has autonomy for achieving its monetary policy objective through policy instrument independence. Instrument independence refers to the bank's ability to use the tools and methodology that it deems appropriate to pursue its targets and objectives.

## **FINANCIAL INDEPENDENCE**

Financial independence limits the interdependence of the government and central bank in budgetary matters. This precludes the central bank from lending to the government or having a role in determining fiscal policy. It also includes considerations for whether the central bank's budget is subject to executive or legislative

decisions. This form of financial independence is important for restricting central bank financing of the government's budget deficit.

Best practice requires that these CBI features be constitutionally established or codified by central bank statutes; therefore, our analysis will mainly rely on the de jure independence of central banks in North Africa. A number of legal scores or indices are available to measure CBI. Legal measurements are useful in that they provide a good basis for comparison across countries. There are, however, some caveats with these measurements. The coding, weights and criteria used in the score or index are subjective, and consequently there can be a weak correlation between different legal indices. Furthermore, the degree of de jure independence does not necessarily reflect its de facto levels. This is particularly a concern for emerging markets and developing economies that do not have the same level of abidance to its laws or are more exposed to corruption. The legal measurements, nevertheless, do provide a good basis to compare progress within regions or countries and will be a starting point for comparison in this brief.

## **CBI IN NORTH AFRICA**

After years of strong statist involvement in economic affairs and relatively closed economies to trade, many North African countries underwent extensive economic and institutional reforms in order to pursue greater integration with the world economy. This generally commenced during the 1990s, as North Africa underwent modest economic liberalization. Much of the pressure in the 1990s came from international financial institutions (IFIs) to liberalize the statist economies. The International Monetary Fund (IMF) had successfully pushed for CBI in its loan conditionality with debtor

members such as Morocco, Tunisia, Egypt, Jordan and a number of others that were signed in the 1990s.

By the 2000s, countries throughout North Africa were becoming more hospitable to foreign investment, privatized state-owned assets, reduced fiscal budgets, tackled inflation, expanded export-oriented trade and increased protection on intellectual property rights, and proceeded to actively trade with the global economy. Much of the gains in this time period were attributed to free trade agreements (FTAs) signed with key trading giants. For example, many of the North African countries signed the Agadir Agreement in 2004 with the European Union in the hope of fostering intraregional trade and policy harmonization. Encompassing Tunisia, Egypt, Morocco and others, the agreement would create a free trade zone in the Middle East and then link the region to the European Union to facilitate “south-south integration” (Momani 2007a). In North Africa, the United States signed an FTA with Morocco and pursued FTA talks with Egypt, again in an effort to liberalize these economies and prop up its geostrategic allies in the region (Momani 2007b). Nevertheless, despite the general economic liberalization of the 2000s, many North African countries did not advance CBI as aggressively as they did other structural economic reforms.

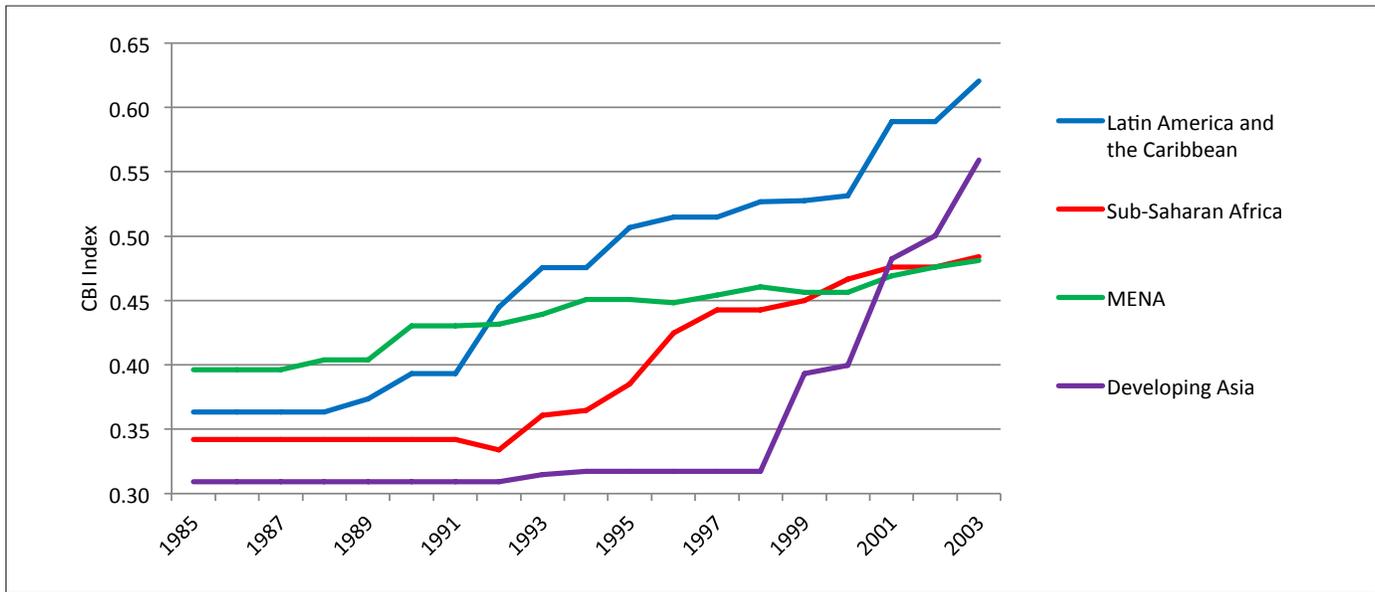
One gets a better sense of the North African region being a laggard in pursuing CBI when it is compared to progress in other emerging market economies. The drive toward CBI took hold in emerging markets and developing economies in the 1990s and early 2000s. The wave of reforms securing CBI was stronger in other emerging markets than they were for the Middle East and North Africa (MENA) region (see Figure 1). Responding to banking and capital flows concerns, the Asian crisis clearly sparked a surge of reforms toward

CBI in the late 1990s and early 2000s. In Sub-Saharan Africa, economic liberalization reforms, which were arranged as part of debt rescheduling agreements with IFIs, also led to improvements toward CBI. Hyperinflation, coupled with severe recessions, led many countries in Latin America to secure higher levels of CBI in the 1990s (Gutiérrez 2003).

The economic and external push factors that have generally motivated reforms in other emerging market economies and developing regions were less pronounced in the MENA region. Despite some external push for economic liberalization in the 1990s by IFIs and by conditions placed on North African countries by larger trading partners, these liberal reforms did not spill into central bank reforms. Having missed the opportunity to achieve CBI as part of the liberal economic reforms of the 1990s, further developments in the North Africa region would thwart efforts toward CBI in the 2000s.

By the early 2000s, oil price surges prompted rapid economic growth in North Africa as intraregional investment from the oil producing states poured in. This surge of capital and investment delayed liberal economic reforms including improving CBI, as many North African governments lauded their own economic success as good policy choices.

Many of these North African countries were experiencing positive economic growth, but plummeting oil prices and the global financial crisis of 2008 had a negative socio-economic effect on many people in the region, which led to the start of the Arab uprisings in 2010. The uprisings shook many North African governments to further political and economic reforms, loosening their autocratic decision-making authority to more technocratic ones. Rather than retreating from CBI, a number of North African

**FIGURE 1: CBI INDEX REGIONAL TRENDS**

Data sources: Arnone, Laurens and Segalotto (2006); Chrighui, Boujelbene and Mhamdi (2011); Crowe and Mead (2007); Cukierman (1992); Farrag and Kamaly (2007); Gisolo (2009); Neyapti (2012); Polillo and Guillén (2005); Sadek, Jarehi and Latifah (1996).

The CBI legal index is scaled between 0 and 1, with 1 referring to a fully independent central bank.

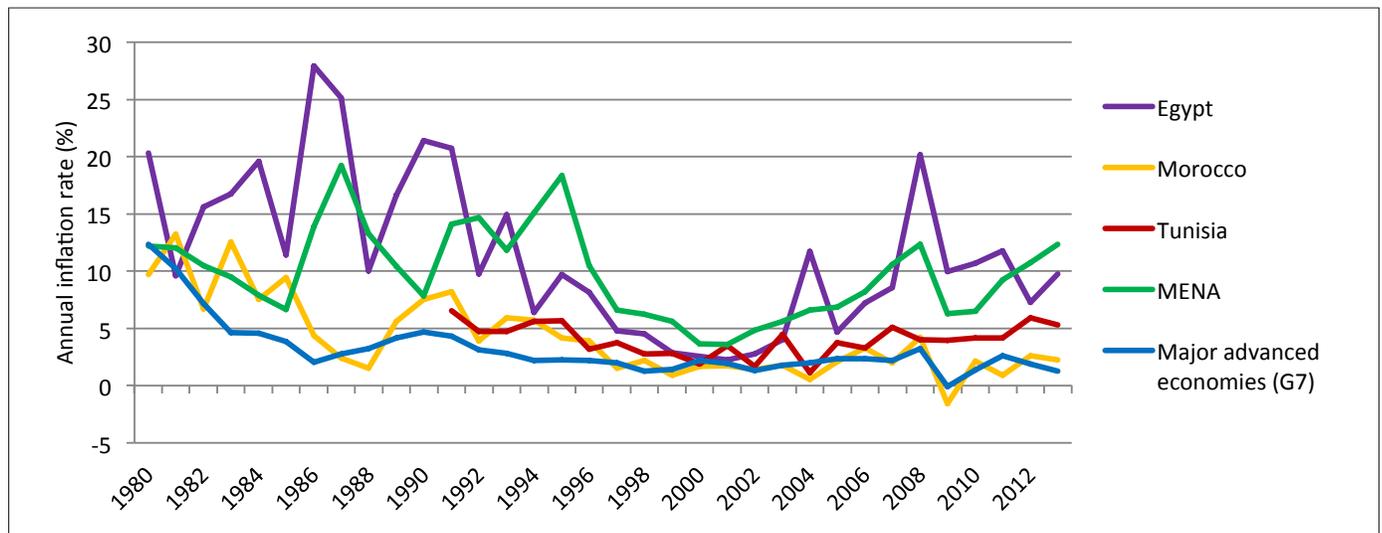
governments took this opportunity to strengthen liberal economic reforms to meet the ever-increasing demands of citizens for accountability and transparency. Of course, the states did not all follow the same track, and such variation needs to be noted.

In the North African region, progress toward CBI has been strongest in Morocco and Tunisia, while it has been much slower in Egypt over the last two decades (Table 1). Interestingly, they are all approaching the levels of the CBI legal indices observed by some of the most independent central banks in the world, including the German Bundesbank (0.83), the Swedish Riksbank (0.85) and the Swiss National Bank (0.63) (Crowe and Meade 2007). While Egypt, Morocco and Tunisia have all implemented significant amendments to the relevant central bank statutes over the last decade, the actual progress toward independence has varied. In each of these countries, the most recent statutory amendments have introduced price stability

as the central bank's main objective. Here, the de jure progress is not necessarily reflective of the de facto implementation of reforms.

Despite the statutory amendments, the credibility of price stability, as reflected in North Africa's inflation performances, is varied. Moroccan inflation has averaged two percent, the preferred inflation target for central banks in most advanced economies, while in Tunisia, inflation has become very stable, around 4.5 percent since the price stability objective was implemented. The inflation outcomes in Tunisia and Morocco are impressive, considering the turmoil that the global economy has faced since 2008 and the volatility of commodity prices. In Egypt, on the other hand, inflation has averaged 10 percent and has been much more volatile than the other two countries (Figure 2). Interestingly, both Tunisia and Morocco have also made the most advances in terms of political liberalization since the Arab uprisings,

FIGURE 2: INFLATION PERFORMANCE



Data source: IMF (2013).

The Group of Seven (G7) countries are Canada, France, Germany, Italy, Japan, the United States and the United Kingdom.

and their progress toward CBI is indicative of their successful reforms.

### TUNISIA

Besides improving inflation stability, the statutory reforms in Morocco and Tunisia further enhanced the transparency and independence of their central banks. In Tunisia, the amendments improved the Central Bank of Tunisia’s (CBT’s) transparency and independence by removing government oversight and influence on all of the bank’s operations, replacing it with independent auditor oversight. The amendments also prohibit the CBT from purchasing government securities from the primary market and enhances the central bank board’s ability to freely decide the appropriate instruments to achieve price stability. In total, these amendments have increased the CBI legal independence index by 0.15 points (Table 1). The CBT’s biggest weakness in securing independence remains its low level of personnel independence; however,

some improvements to personnel independence were entrenched in the 2014 constitution. Prior to the Arab uprisings, the president alone appointed the governor of the central bank. Since the uprisings, the Tunisian government has undergone significant changes — from a democratically elected Islamist government to the current caretaker government of technocrats. The new constitution has slightly improved personnel independence, as the president’s appointment and dismissal of the governor of the CBT must be approved by a majority vote in Parliament. This component of independence, however, remains low because the president alone continues to appoint half of the board members, while another 20 percent are government officials.

### MOROCCO

In Morocco, the new central bank statutes implemented in 2006 and the introduction of new constitutions after the Arab uprisings in 2011 specified improvements

**TABLE 1: CBI INDEX IN SELECT NORTH AFRICAN COUNTRIES**

	1989	1993	2003	2013
<b>Egypt</b>	0.49	0.55	0.47	0.54
<b>Morocco</b>	0.14	0.14 <sup>e</sup>	0.31	0.70
<b>Tunisia</b>	0.51 <sup>e</sup>	0.51 <sup>e</sup>	0.51	0.66

Data sources: Cukierman (1992); Polillo and Guillén (2005); Crowe and Mead (2003).

*Authors' calculations based on central bank statutes and national constitutions. The methodology used by all sources is the Cukierman (1992) weighted index. The "e" represents an estimate, based on the fact that no relevant amendments occurred that would affect the index for the indicated period.*

to all four categories of CBI for Bank Al-Maghrib, the Moroccan central bank. Its personnel independence improved: there are now restrictions on the dismissal of board members, there is no representation of the government with voting capabilities and the constitution has granted power to appoint the governor to a council with legislative, executive and judicial representation, rather than just the king himself. Personnel independence remains weak, however, as the governor neither has a set term, nor are there provisions restricting dismissal. Instrument independence is now at what is considered best practice, because the central bank board (independent of government voting representation), has full control over the instruments it wants to use to achieve its objective. Financial independence has been strengthened because of stronger restrictions on central bank advances to the government where the central bank has authority over the arrangement. The new laws governing Bank Al-Maghrib had the effect of raising its CBI legal index by 0.39 points and establishing it as the most independent central bank, by law, in North Africa (Table 1). Responding to public pressure for a more accountable governance structure, the Moroccan king transferred significant power to Parliament, and this

also seems to have had a positive effect on transferring independence to its central bank.

## EGYPT

The new laws governing the Central Bank of Egypt (CBE) implemented in 2003 did not mark a significant improvement in this central bank's legal index as they have in Tunisia and Morocco. The most significant improvement in the statute was the establishment of price stability as the CBE's primary objective, but as noted, the volatility of prices since this time does not play in favour of its credibility. High and volatile inflation could be related to the loss of personnel independence of the CBE from these statutes: the executive retained responsibility for appointing the majority of the board of directors and is no longer restricted from dismissing these members at will (Farrag and Kamaly 2007). Some changes to these legal statutes have been observed since the Arab uprisings, owing to the fact that several amendments to the constitution were undertaken. The uprisings in Egypt produced significant political turmoil since the military takeover of the Hosni Mubarak government in January 2011. Following the revolution, two constitutions were enacted. The first was enacted in 2012 under the short-lived democratic government of Mohamed Morsi. This constitution actually decreased the policy objective independence of the central bank by stressing the central bank's requirement to pursue monetary policy in accordance with the state's economic policy. The second constitution was enacted in 2014, under the auspices of a military coup led by Abdel Fattah el-Sisi, who remains in power today. This constitution drops the strong language of the previous constitution requiring monetary policy to abide by the state's economic policy. It also improves

personnel independence by requiring parliamentary approval for the president's governor appointment, placing stronger restrictions on the governor's term and placing some restriction, however vague, on dismissing the governor.

**LEGAL INDICES**

The limitations of the legal index of CBI, as well as establishing CBI by itself, are highlighted by the fact that the legal indices in these North African countries have surpassed that of some of the most reputable central banks in the world, including the Bank of Canada (0.47), the Bank of England (0.31), the Reserve Bank of New Zealand (0.38) and the US Federal Reserve (0.48) (Crowe and Meade 2007). In order for central banks to effectively support the stability of the macroeconomy, their independence must be complemented by a strong reputation to secure credibility. The importance of a culture of internal learning, greater transparency (in conducting monetary policy) and openness (in reporting data and methodology), as well as meritocratic recruitment and stronger accountability to the core principles of CBI cannot be underestimated. To illustrate the importance of these facets of effective CBI, consider the fact that the United Kingdom, Sweden, the United States, New Zealand and Canada are highlighted for their top scores for transparency; in contrast, Egypt's scores on transparency remain very low (ibid.).

**ISLAMIC BANKING**

While all North African states are Muslim-majority countries, Islamic banking has a relatively low penetration in the region's banking system. For example, Egypt's Islamic banks penetrate less than 10 percent of the nation's banking sector. While there are no direct constraints that might be imposed on countries

by the principles of Islamic banking, central banks will have to follow the principles of Islamic finance, which may limit the ability to operate in ways that would be found in a conventional system. One challenge for the development of Islamic finance is the need for Sharia-compliant liquid assets for Islamic banks to hold. Consequently, central banks would need to issue different kinds of securities for these institutions. There are substantive differences between conventional and Sharia-compliant securities, which may occasionally justify a greater degree of governmental oversight than would be appropriate in Western economies. Again, for now, Islamic finance is only a concern for CBI in Egypt — and only to a small degree.

**RECOMMENDATIONS**

De jure CBI has significantly improved in North Africa over the last two decades, approaching or even surpassing the indices of some of the most admired central banks in the world. Securing de facto independence and establishing transparency will be the next steps in determining the credibility of these central banks. The following recommendations, in order of priority, would accommodate this process:

- Central banks should foster an internal learning culture. This culture can be instituted by consulting with central banks in developed countries and emphasizing the importance and openness of the research department. An open and engaging central bank culture is important for establishing credibility and achieving best practice in central banking.
- To meet best practice in CBI, personnel independence must be improved by placing checks and balances or restrictions on the appointment and dismissal processes of the central bank's board

and governor. In addition, government voting representation on the central bank's decision-making board should be restricted.

- Central banks should improve transparency in order to establish their credibility as independent bodies, which is important for maintaining macroeconomic stability. If central banks do not have de facto independence, the inconsistency of monetary policy could generate public and financial market dissatisfaction and create a push factor for improving CBI.

## CONCLUSION

Significant de jure progress toward CBI has been achieved in North Africa over the last two decades. Economic liberalization in the early 2000s was associated with revisions to, or the implementation of, new central bank statutes. The Arab uprisings saw improvements in democratic accountability, and with it the adoption of new constitutions, which also improved CBI. Despite these improvements in de jure independence, North African central banks will require a stable political foundation, and time to prove their credibility and accountability and to establish de facto independence.

The pace toward political liberalization, and hence de facto CBI, varies among the country studies. While Tunisia has made the greatest gains toward democratization, Morocco has also successfully implemented a number of reforms promoting political liberalization. At the time of this brief, Egypt is still in the throes of a military regime and its path toward political liberalization remains unclear, although an additional push toward securing CBI could emerge from the will to promote democracy and progress

toward political stability gained from the Arab uprisings. Macroeconomic stability is important for securing political stability, thus establishing de jure CBI and the credibility of the central bank is an important first step in this regard. Nevertheless, continuing to promote political liberalization and stability in North Africa will play a vital role in bringing de facto CBI to fruition, along with the implementation of the recommendations contained in this brief.

## WORKS CITED

- Arnone, Marco, Bernard J. Laurens and Jean-François Segalotto. 2006. "Measures of Central Bank Autonomy: Empirical Evidence for OECD, Developing, and Emerging Market Economies." *IMF Working Paper* 06/228.
- Chrigui, Zouhair, Younes Boujelbene and Ghrissi Mhamdi. 2011. "Central Bank Independence and Inflation: Evidence from Emerging Countries." *Journal of Policy Modeling* 33: 453–69.
- Crowe, Christopher and Ellen E. Mead. 2007. "Evolution of Central Bank Governance Around the World." *Journal of Economic Perspectives* 21 (4): 69–90.
- Cukierman, Alex. 1992. *Central Bank Strategy, Credibility, and Independence: Theory and Evidence*. Cambridge, MA: MIT Press.
- Eijffinger, Sylvester C. W. and Jakob de Haan. 1996. "The Political Economy of Central Bank Independence." *Special Papers in International Economics*, no. 19.
- Farrag, Noha and Ahmed Kamaly. 2007. "Measuring Central Bank Independence in Egypt." German University in Cairo Working Paper No. 4.

- Gisolo, Enrico. 2009. "The Degree of Legal Central Bank Independence in MENA Countries." In *Monetary Policy and Central Banking in the Middle East and North Africa*, edited by David Cobham and Ghassan Dibeh. New York: Routledge.
- Gutiérrez, Eva. 2003. "Inflation Performance and Constitutional Central Bank Independence: Evidence From Latin America and the Caribbean." IMF Working Paper 03/53.
- IMF. 2013. World Economic Outlook Database. October. Washington, DC: IMF.
- Momani, Bessma. 2007a. "The EU, the Middle East, and Regional Integration." *World Economics* 8 (1).
- . 2007b. "A Middle East Free Trade Area: Economic Interdependence and Peace Considered." *The World Economy* 30 (11). doi:10.1111/j.1467-9701.2007.01036.x.
- Neyapti, Bilin. 2012. "Monetary Institutions and Inflation Performance: Cross-country Evidence." *Journal of Economic Policy Reform* 15 (4): 339–54.
- Polillo, Simone and Mauro F. Guillén. 2005. "Globalization Pressures and the State: The Worldwide Spread of Central Bank Independence." *American Journal of Sociology* 110 (6): 1764–1802.
- Sadek, A., M. Jarehi and N. Latifah. 1996. *Monetary Policy in the Arab Countries*. [In Arabic.] Abu Dhabi: Arab Monetary Fund Publications.

## ABOUT CIGI

The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI's current research programs focus on three themes: the global economy; global security & politics; and international law.

CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion (BlackBerry), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario.

Le CIGI a été fondé en 2001 par Jim Balsillie, qui était alors co-chef de la direction de Research In Motion (BlackBerry). Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l'appui reçu du gouvernement du Canada et de celui du gouvernement de l'Ontario.

For more information, please visit [www.cigionline.org](http://www.cigionline.org).

## CIGI MASTHEAD

Managing Editor, Publications	Carol Bonnett
Publications Editor	Jennifer Goyder
Publications Editor	Sonya Zikic
Assistant Publications Editor	Vivian Moser
Media Designer	Steve Cross

## EXECUTIVE

President	Rohinton Medhora
Vice President of Programs	David Dewitt
Vice President of Public Affairs	Fred Kuntz
Vice President of Finance	Mark Menard

## COMMUNICATIONS

Communications Specialist	Declan Kelly	<a href="mailto:dkelly@cigionline.org">dkelly@cigionline.org</a> (1 519 885 2444 x 7356)
Public Affairs Coordinator	Erin Baxter	<a href="mailto:ebaxter@cigionline.org">ebaxter@cigionline.org</a> (1 519 885 2444 x 7265)



57 Erb Street West  
Waterloo, Ontario N2L 6C2, Canada  
tel +1 519 885 2444 fax +1 519 885 5450  
[www.cigionline.org](http://www.cigionline.org)

