Amending the Bank of Ghana Act, 2002 (Act 612)?

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Problem Statement

The Institute for Fiscal Studies has gathered that as part of the structural reforms to strengthen the country's public finances and fiscal discipline, the International Monetary Fund (IMF) has advised that the Bank of Ghana Act, 2002 (Act 612) be amended. The amendment is intended to significantly strengthen the Central Bank's functional autonomy, governance, and ability to respond to banking sector crisis. The Bill seeks to plug the loopholes identified in the Act. The amendment also seeks to separate the autonomy provisions from other objectives of the Bank to strengthen the functional autonomy of the Bank of Ghana in the performance of its functions. Furthermore, the amendment provides for the preparation of the financial statements of the Bank in compliance with generally accepted accounting practices. The IFS welcomes the proposal to amend the Bank of Ghana Act, 2002 (Act 612) and wishes to make the following contribution to the discussions around the amendment of the Act.

Context

Central banks perform a variety of functions. In addition to performing the traditional functions of issuing notes, being banker to the government, bankers' bank, lender of last resort, controller of credit and maintaining stable exchange rate, central banks in developing countries perform the foremost function of helping in the economic development of their countries. The banks are usually given wide powers to help establish and support financial institutions such as rural banks, industrial banks, finance corporations; bring about proper balance between demand for and supply of money to ensure price stability; develop the financial sector's capability; pursue suitable interest rate policy and control credit in order to influence patterns of investment and economic growth; manage government debt; and manage the balance of payments (including the control of foreign exchange and the exchange rate). The objective underlying these functions of a central bank is to promote the economic interests of the nation, consistent with government policy[1].

Internationally, there are various models for setting and implementing monetary policy. In New Zealand, England and Canada, the responsibility of the government for economic policy is given statutory recognition in the enabling legislation of the central bank. In addition, the government (Ministry of Finance) has the power to issue directives to the central bank, subject to restrictions on the types of directives, their duration and cabinet/parliamentary ratification. In other jurisdictions (Germany, France, Italy), the central bank sets targets and implements monetary policy.

The model reflected in the Bank of Ghana Act, 2002 (Act 612) gives the Central Bank a responsibility for setting targets and implementation and the Bank is to operate *independently of instructions from any authority*. There is no statutory requirement for coordination of monetary policy with the economic policy of government.

The following summarizes a variety of approaches to the harmonization of economic and monetary policy that can inform amendments to the Bank of Ghana Act

Bank of Canada Act, 1985. The preamble to the Bank of Canada Act, 1985 establishes the role of the Bank as follows: "to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of Canada". The specific powers of the Minister of Finance include the following:

- The Minister and the Governor shall consult regularly on monetary policy and on its relation to general economic policy.
- If, notwithstanding the consultations there should emerge a difference of opinion between the Minister and the Bank concerning the monetary policy to be followed, the Minister may, after consultation with the Governor and with the approval of the Governor in Council [Cabinet], give to the Governor a written directive concerning monetary policy, in specific terms and applicable for a specified period, and the Bank shall comply with that directive.
- A directive given under this section shall be published forthwith in the Canada Gazette and shall be laid before Parliament within fifteen days after the giving thereof, or, if Parliament is not then sitting, on any of the first fifteen days next thereafter that either House of Parliament is sitting.

New Zealand Reserve Bank Act, 1989. The preamble to the New Zealand Reserve Bank Act recognizes the "Crown's (Government's) right to determine economic policy" and the central bank to be responsible for "formulating and implementing monetary policy designed to promote stability of the general level of prices". Under this arrangement, the Government (the Minister) sets the inflation target but the Reverse Bank has operational independence in deciding how that inflation target will be achieved. The inflation target must however be made public, and indeed there is a requirement that all government instructions to the Reverse Bank shall be made public

The specific powers of the Minister include the following:

- At the time of the appointment of the Governor, the Minister fixes in agreement with the Governor the policy targets for carrying out the Bank's functions. The Minister and the Governor may from time to time review or alter the policy targets. The Minister shall ensure that policy targets are published and a copy laid before parliament.
- The Government may from time to time, by notice in writing to the Bank, direct the Bank to deal in foreign exchange within Guidelines prescribed by the Minister.
- The Minister may fix exchange rates for foreign exchange dealing by the Bank.
- The Minister shall in consultation with the Bank determine the level at which foreign exchange reserves shall be maintained.

Bank of England Act, 1998. The Bank of England Act states that the objective of the Bank shall be to contribute to protecting and enhancing the stability of the financial system. In pursing this objective, the Bank shall aim to work with other relevant bodies (including the Treasury and the Financial Services Authority). The Bank is directed by the Act to support the economic policy of the Government. The specific powers of the Treasury are as follows:

- The Treasury may by notice to the bank:
    - Specify what price stability is to be taken to consist of in the conduct of monetary policy;
    - What the economic policy of the government is.
- The Bank of England Act 1998 stipulates the Treasury's reserve powers as follows:

    - The Treasury, after consultation with the Governor of the Bank, may by order give the Bank directions with respect to monetary policy if they are satisfied that the directions are required in the public interest and by extreme economic circumstances.
    - An order under this section may include such consequential modifications of the provisions of this Part relating to the Monetary Policy Committee as the Treasury think fit.[In effect, the UK Chancellor of the Exchequer retains the power to set the numerical inflation target for the Monetary Policy Committee of the Bank of England]
    - A statutory instrument containing an order under this section shall be laid before Parliament after being made.

- Unless an order under this section is approved by resolution of each House of Parliament before the end of the period of 28 days beginning with the day on which it is made, it shall cease to have effect at the end of that period.

Bank of Ghana Act, 2002. The objects of the Bank of Ghana are stated as follows:

- The primary objective of the Bank is to maintain stability in the general level of prices.
- Without prejudice to subsection (1) the Bank shall support the general economic policy of the Government and promote economic growth and effective and efficient operation of banking and credit systems in the country, *independent of instructions from the Government or any other authority.*

The Bank of Ghana is not required to formulate and implement monetary policy within the dictates of the government's economic policy. Compared to New Zealand, England and Canada, the Government of Ghana has no reserve powers to intervene in monetary policy even in a national emergency.

Some Observations

The relationship between the Treasury and the Central Bank is at the heart of financial policies and should therefore be handled with some thought. Of course, there will be differences in policy priorities, actions, and perceptions of risks. Without adequate governance, planning mechanisms, proper coordination and, indeed, goodwill on both sides, wider economic damage could result from these differences. In general, a strong appreciation of the different objectives and operating frameworks of the Central Bank and the Treasury will be conducive to a fruitful dialogue between the two institutions, because information and views are shared more easily when all parties understand and respect the others' rights and responsibilities. A well-designed framework is vital for policy understanding and common policy interests, operational coordination and harmony, and service provision on issues ranging from the high-level coordination of fiscal, financing, and monetary policies, to the management of Treasury bill auctions and the government's banking arrangements[2].

The model reflected in the current Bank of Ghana Act gives the Central Bank responsibility for both monetary policy targets and implementation. The Central Bank is expected to operate independently of instructions from the Government or any other authority. This is quite strange because international best practice will require the government to set the target and give the Central Bank the operational independence in deciding how the target will be achieved. In many countries the world over, central banks have been given the mandate to preserve price stability and granted autonomy from government to make sure that short term political considerations do not interfere with achieving this objective. Clearly, monetary policy autonomy may be at risk if the Central Bank can be obliged to lend to the government or provide it with implicit or explicit subsidies in other ways. Where financial markets are well developed, this risk underscores the reason why lending to government may be prohibited or reduced to the minimum in some Central Bank laws. Where domestic money and bond markets are not well-developed, a large portion of the government's borrowing needs will be left unfulfilled, and it will be very difficult to convince governments, particularly in a low-income country like Ghana, to agree to a reform of the Central Bank law that includes a wholesale prohibition of lending to government[3]. To address this problem, deep thought is needed to draft central bank laws that limit government access to or facilitate a gradual weaning of the government off the bank's credit.

A major weakness of the Bank of Ghana Act is therefore that there is no formal mechanism for ensuring that the Bank of Ghana operates in consonance with the economic policy of the elected government. This weakness risks dis-coordinated fiscal and monetary policies and is a recipe for general policy disharmony. The government, being the elected body, has overall responsibility for the management of the economy and should be supported by the central bank to achieve its national policy objectives.

A Possible Way Forward

In order to address major shortcomings in the Bank of Ghana Act in a manner that will be seen by all parties as fair and productive, government might want to set up an independent review of the Bank of Ghana Act by a Committee with technical competence on the subject. The terms of reference of such a Committee may include the recommendation of appropriate amendments to the Bank of Ghana Act to achieve the following:

- Improved coordination of economic policy and monetary policy;
- Enhanced accountability of the Bank of Ghana;
- Reserve powers that can be invoked by the government when there is an economic necessity or emergency

Internationally, central banks' Acts seek to carefully balance the issue of autonomy with accountability. While the proposed Bill to amend the Bank of Ghana Act appropriately seeks to strengthen the operational independence of the Bank, it should similarly reinforce the Bank's accountability.

In line with the above principles and, in particular, to ensure an equally independent and accountable central bank, IFS makes the following specific recommendations for consideration of the authorities.

First, any proposal to make price stability the "*sole objective*" of the Bank of Ghana will appear misplaced as it implies that the Bank should pursue price stability exclusive of other important and related economic goals. The original construction in Section 3(1) of Act 612 whereby price stability is the "*primary objective*" of the Bank is appropriate and should be maintained. That is in line with international best practice (Bank of England, Bank of Canada, and Reserve Bank of New Zealand, European Central Bank System, US Fed) and Bank of Ghana should not be an exception.

Second, in line with the predominant international practice, the government should be vested with the authority to set the monetary policy goal or the inflation target while the Bank of Ghana is charged with the responsibility to use whatever instruments are available to it to achieve the set target. In other words, government sets the target but the Bank of Ghana has operational independence in deciding how the target will be achieved.

Third, section 3(2) of the Bank of Ghana Act, 2002, provides that the Bank "*shall support the general economic policy of the Government*" and this should be maintained. Price stability—which is assigned to the central bank— is only one component of government's broad policy objectives, which also include economic growth, maximum employment, exchange rate stability and external balance. That said, the last part of sub-section 3(2) that states that the support should be "*independent of instructions from the Government or any other authority*" should be expunged. This is because the Bank cannot operate with absolute independence but should rather work in harmony with the government, which has overall responsibility for the management of the economy. No central bank has absolute independence but just an operational or functional independence to achieve the set target. All central banks are accountable to some level of "government", either the Executive and/or the Legislature.

Fourth, the enhanced independence of the Bank of Ghana in the proposed amendments should be accompanied by increased accountability and transparency on the part of the Bank. Accountability to the legislature and the public at large should balance the central bank's autonomy. Transparency is also important for holding the central bank to account, and for making monetary policy efficient by shaping inflation expectations. To this end, and also in line with international best practice, we propose the addition of a clause that enjoins the Governor of the Bank of Ghana to appear regularly before the Finance Committee of Parliament to give account of the Bank's performance of its statutory mandate.

1. *See Mario P. and M. William (2012). Government Cash Management: Relationship between Treasury and the Central Bank. Washington DC: The IMF, November*
2. *Pujari, S (2012). The Role of Central Bank in a Developing Economy of a Country. YourArticleLibrary.com*
3. *Moser-Boehm. P (2006). The Relationship between the Central Bank and the Government.*