CENTRAL BANK OF THE GAMBIA

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AT THE EUROSYSTEM / WESTERN CENTRAL AFRICAN CENTRAL BANKS SEMINAR, PARIS 01 FEBRUARY 2007

Central Bank Governance and Implementation of Monetary Policy

- Mr. Chairman
- Distinguished Colleagues

The organizational and institutional setting in which central banks conduct monetary policy has changed over the last two decades. Even though central banks around the world may place different degrees of emphasis on particular aspects of their governance frameworks, there appears to be a global convergence of views that price stability should be the primary objective of a central bank. The experience of stagflation in the 1970s clearly demonstrated that monetary policy was unable to durably push the economy to its potential rate of growth. A strong consensus has also emerged that central bank independence promotes successful implementation of monetary policy. Increasingly, central banks have sought to entrench these principles in legislation and in practice. I intend to share with you our experiences at the Central Bank of The Gambia (CBG) in relation to some of the topical issues in central bank governance.

Background

The Gambia is a small open economy with a per capita income of U.S $350.00 and population of 1.4 million (2003 census). Although the mainstay of economic activity has traditionally been the production and export of groundnuts, efforts to diversify the economy through tourism and re-exports have been broadly successful in broadening the export base.

In the decade after independence in 1965, the Gambia maintained broadly stable macroeconomic conditions and modest economic growth. In the subsequent years, economic performance deteriorated markedly because of adverse terms of trade, overvalued exchange rate, huge government recourse to Central Bank financing of the deficit and increased reliance on Government intervention in allocating credit at subsidized interest rates primarily to the agricultural sector.

In June 1985, The Gambian authorities embarked on a comprehensive and far reaching Economic Recovery Programme (ERP) which aimed, amongst other things, at liberalizing trade and price policies, introduction of a flexible exchange rate regime, streamlining credit and fiscal policies and privatizing public enterprises. The implementation of these reform measures resulted in an improvement in The Gambia's economic and financial performance and led to the implementation of a successor programme, the Programme for Sustainable Development (PSD). The PSD aimed to consolidate the gains of the ERP as well as promote private sector-led growth.

Independence of Central Bank of The Gambia

Our recent experience at the CBG appears to support the evidence of a general trend towards greater central bank independence. During 2002-03, The Gambia's economic performance deteriorated markedly. Governance related monetary and fiscal policy slippages were exacerbated by a drought which resulted in significant exchange rate depreciation and a sharp rise in inflation. These events triggered a review of the central bank law to protect the CBG from short term political influence in its conduct of monetary policy.

A new central bank law, the Central Bank of The Gambia Act, 2005, became effective in January 2006. The 2005 Law contains provisions that strengthen the operational independence of the CBG in the following ways:

Price Stability Objective

The 2005 Law provides that the achievement and maintenance of price stability was one of the primary objectives of the CBG. The previous law did not include a reference to price stability.

To strengthen the operational independence of the Bank in the conduct of monetary policy, a Monetary Policy Committee (MPC) was established. The MPC comprises the Governor, as Chairman, two Deputy Governors and five other members of which two are representatives of the Department of State for Finance and Economic Affairs (DoSFEA). The MPC is the highest monetary policy making body and is tasked with setting interest rates to achieve the price stability objective.

Political Autonomy

The Board of Directors is the highest oversight authority of the Bank. It consists of the Governor as the Chairman and four other Directors. The 2005 Act clearly defines the appointment and removal of Board Directors to ensure personal independence of directors. The members of the Board are appointed by the President in consultation with the public service commission, from among persons of outstanding qualifications and experience in financial matters. The 2005 Law also provides procedural safeguards against arbitrary dismissal of the Governor and Deputy Governors including investigation by an independent tribunal.

Economic Autonomy

Given our experience in 2002-03 as outlined above, I agree that one of the most important elements of central bank independence is to limit government recourse to central bank funds for financing the budget. The starting point for enforcing this is to provide for it in the law. Therefore, the 2005 Law stipulates much stricter duration and quantitative limits on government borrowing from the CBG. It provides that the total of CBG advances to government and direct purchases of treasury bills by the CBG at the end of a financial year shall not exceed ten percent of the tax revenue in the previous year. The new law also requires that advances to government shall be repaid within six months. The CBG cannot make any further advances to government if this duration limit is breached.

Given that the quantitative limit on lending to government was significantly higher under the previous law, the CBG and government have agreed a plan for gradual phasing out of central bank advances to government in order to comply with the requirements of the 2005 Law by end-December 2007. From that date onwards, government need for resources over the statutory debt limit would be met from issuance of debt in the financial markets. A precondition for reduced government reliance on central bank financing is to implement prudent fiscal policy in order to contain domestic borrowing requirements and promote stable macro economic conditions necessary for the orderly development of domestic financial markets.

Financial Autonomy

In addition to reducing central bank financing of the budget, for us at the CBG, another important issue has been the financial condition of the central bank. During the past few years, the CBG has made significant losses. The central bank law provides that these losses be replenished by government. Excessive reliance on government to prevent impairment of capital may have a negative impact on central bank independence. The CBG has attempted to address this issue in two ways. First, the 2005 Law increases the CBG's authorized capital from D1 million to D100 million allowing the CBG to increase its general reserve to D400 million. This would give the CBG a buffer to absorb some of its losses without recourse to government financing. Secondly, the CBG is restructuring its balance sheet to reduce poorly performing assets which arose as a result of transactions with the government. The new 2005 Law provides for the provision of loans to government at market related terms.

Other Internal Governance Issues

Of equal importance to the successful conduct of monetary policy and the credibility of the central bank are the internal organizational and operational processes of the central bank. Without adequate human and technical capacity, central banks may not be able to keep abreast with developments in financial markets and may actually hinder such developments with inappropriate regulation. Central bank incompetence is punished by economic agents by a loss of confidence and an increase in the inflationary bias.

Central bank stakeholders expect central banks to perform to a high level of professionalism. This is perhaps even more relevant in developing countries where the central bank may be perceived as one of the few credible public sector institutions. At the CBG, we have attempted to improve internal governance in the following ways:

- Establishment of an Audit Committee of non executive board directors;
- Statutory provision for the office of an Internal Auditor with a requirement for regular reporting by the Internal Auditor;
- Annual statutory audits and publication of audited financial statements;
- Publication of an unaudited balance sheet every two weeks;
- Publication of a five year strategic plan;
- Continuous professional development of staff to build requisite capacity;
- Reversing the loss-making situation.
- Improvements in data collection and publication;
- Immediate publication of the MPC decision and the rationale for the decision on the CBG website and local press.

The transparency of the monetary policy making process and financial accountability have helped improve the credibility of the CBG and thus the effectiveness of monetary policy. We have also been able to send clearer signals of the CBG's monetary policy stance enabling the private and public sectors to plan more effectively.

I THANK YOU FOR YOUR KIND ATTENTION