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Walking a Tightrope

Progress in Balancing Multiple Central Bank Objectives
in Kenya, Nigeria and Uganda

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Abbreviations

AFI	Alliance for Financial Inclusion
AMCON	Asset Management Company of Nigeria
BoU	Bank of Uganda
CBK	Central Bank of Kenya
CBN	Central Bank of Nigeria
EAC	East African Community
FDI	Foreign direct investment
FSDK	Financial Sector Deepening Trust Kenya
GDP	Gross domestic product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GNI	Gross national income
IFI	International financial institution
IMF	International Monetary Fund
IT	Inflation targeting
KANU	Kenya African National Union
MDI	Microfinance deposit-taking institution
MPC	Monetary Policy Committee
NIRSAL	Nigerian Incentive-Based Risk Sharing System for Agricultural Lending
NPL	Non-performing loan
NRM	National Resistance Movement
SACCO	Savings and credit cooperative
SSA	Sub-Saharan Africa
SMEEIS	Small and Medium Enterprises Equity Investment Scheme
SMEs	Small and medium-sized enterprises

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Executive Summary

When it comes to central banking in Africa, much of the discussion in academic and policy circles has focused on the challenges African central banks face in safeguarding price and financial stability while facilitating financial deepening. However, in many African countries, price stability, financial stability and financial depth have been enhanced over the past decade, and changes in central bank policy have often been conducive to such better outcomes.

This report sheds light on some selected cases of recent progress by central banks in Africa in striking a balance between their multiple, and at times conflicting, objectives. Taking the cases of Kenya, Nigeria and Uganda as examples, the report explores the extent to which and the ways in which central banks have made progress over the past decade in striking a balance between the objectives of price stability, financial stability and financial deepening. The report also identifies drivers of progress and challenges to sustaining it, building particularly on data obtained from interviews with policy-makers, donors and researchers in Kenya, Nigeria and Uganda.

By describing progress recently made by selected African central banks in balancing multiple objectives, the report seeks 1) to contribute to the ongoing debate on the risks and opportunities arising when central banks juggle multiple objectives; and 2) to provide some starting points

for thinking about a guide to central banking practice in Africa. Given the current wide gap between central bank theory and practice in Africa, a new framework for guiding central banking in African countries, where central banks are coming under mounting pressure to support economic growth, will be invaluable.

The case studies point to six key drivers of progress: susceptibility to the interests of providers of crucial investment resources, economic and/or banking crises, political pressure to achieve more inclusive growth, global knowledge exchange, central bank independence and leadership of central bank governors. As major challenges to sustaining progress, the case studies identify the regulation of financial innovation, limited flexibility of central bank policy in reacting to economic challenges, political pressure to achieve financial deepening and weak partnerships between central banks and other domestic stakeholders seeking to promote financial deepening.

Learning lessons from the case studies, the report emphasises the importance of addressing the obstacles to striking a balance between stability and financial deepening objectives and makes some suggestions on how such relevant stakeholders as central banks and donors might help to reduce the tensions between multiple central bank objectives.

1. Introduction

“A central bank in a democratic society is a magnet for many of the tensions that such a society confronts.”

Alan Greenspan (1996)¹

When it comes to central banking in Africa,² much of the discussion in academic and policy circles has focused on the challenges African central banks face in safeguarding price and financial stability while facilitating financial deepening. Many African central banks are assigned the mandate of safeguarding price and financial stability and promoting financial deepening and inclusion, the objective of financial deepening usually being assigned to them de facto rather than de jure. Pursuing all three objectives together is challenging, because they are linked not only by synergies but also by trade-offs. There are many examples in Africa of central banks having encountered technical, economic and political obstacles to pursuing the objectives of price stability, financial stability and financial deepening simultaneously. Most notably during the 1970s and 1980s, many African central banks had difficulties striking a balance between the objectives assigned to them and placed the emphasis on that of promoting financial deepening at the expense of safeguarding price and financial stability. In many African countries, however, price stability, financial stability and financial depth have been enhanced over the past decade, and in many cases, central bank policy reforms to improve the balance between these objectives have produced better outcomes.

This report sheds light on some selected cases of recent progress made by central banks in Africa in *striking a balance between their multiple, and at times conflicting, objectives*. Taking the cases of Kenya, Nigeria and Uganda as examples, the report explores the extent to which and the ways in which central banks have made *progress over the past decade in striking a balance between the objectives*

of price stability, financial stability and financial deepening. Progress is deemed to have occurred where central banks have *moved towards pursuing these goals together by increasing the emphasis on those goals which had previously received less attention*. To illustrate central banks' progress in striking a balance between multiple objectives, the report outlines the *stated and demonstrated objectives of central banks' monetary and financial policies*, as evident from their policy trajectories. The report also identifies drivers of progress and challenges to sustaining it. It builds on political economy literature, literature on the political and economic history of the country cases, policy documents, economic data and data obtained from interviews with policy-makers, donors and researchers in Kenya, Nigeria and Uganda.

The aim of the report is twofold: by identifying progress recently made by selected African central banks in balancing different, and at times conflicting, objectives, the report seeks 1) to contribute to the ongoing debate on the risks and opportunities arising when central banks juggle multiple objectives; and 2) to provide some starting points for thinking about a guide to central banking practice in Africa. Given the current wide gap between central bank theory and practice in Africa, a new framework for guiding central banking in Africa, where central banks are coming under mounting pressure to support economic growth, will be invaluable.

While central banking in all three of the countries selected has made progress towards striking a balance between the objectives of price stability, financial stability and financial deepening, this progress has been uneven across countries owing to their different starting points and political-economic environments. Of the three countries, Kenya comes closest to an African success story, given its sustained commitment to balancing the stability and financial deepening objectives over the past decade. In Nigeria and Uganda progress has been more recent.

1 Alan Greenspan was Chairman of the US Federal Reserve Board of Governors from 1987-2006. Once hailed as an outstanding central banker, he is now often blamed for the US asset bubble and the global financial crisis.

2 This report focuses on sub-Saharan Africa. For ease of reference, “Africa” will be used synonymously with “sub-Saharan Africa” (SSA).

The case studies point to six key drivers of progress towards striking a balance between central bank policy objectives: first, susceptibility to the interests of providers of crucial investment resources; second, economic and/or banking crises; third, political pressure to achieve more inclusive growth; fourth, global knowledge exchange; fifth, central bank independence; and sixth, effective leadership by central bank governors. While the first of these seems to be a long-term determinant of a central bank's ability to strike a balance between the three objectives, the others operate more in the short to medium term by influencing a central bank's ability to adjust the importance they attach to different objectives.

The major challenges to sustaining progress identified by the case studies are the regulation of financial innovation, the limited flexibility of central bank policy in reacting to economic challenges, political pressure for financial deepening and weak partnerships between central banks and other domestic stakeholders aimed at promoting financial deepening.

The remainder of the report is divided into four sections: section 2 outlines the analytical framework, section 3 the research design. Section 4 describes, from a historical perspective, the progress Kenya's, Nigeria's and Uganda's central banks have made in striking a balance between their policy objectives and the drivers of progress and challenges to sustaining it. Section 5 concludes the report, summarising the findings on the drivers of progress, the challenges to sustaining it and the lessons learnt.

2. Setting the stage: central banking in Africa

Central banks play a crucial role in determining countries' development paths. They have been assigned a wide range of functions to achieve their set objectives, which include, in particular, price stability, financial stability and financial deepening (for an overview see Box 1). Price stability commonly refers to the goal of low and stable inflation, with thresholds varying across countries. Financial stability can be defined as a "condition in which the financial system (...) is capable of withstanding shocks, thereby reducing the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities" (ECB, 2012). Financial depth is a state where savers can invest in a broad range of quality investment and risk-sharing instruments, and borrowers can likewise tap a broad range of financing and risk management instruments (Goyal et al., 2011). Financial deepening in developing countries thus usually implies measures to promote financial sector development, encourage financial intermediation and raise rates of financial inclusion. Financial inclusion can be defined as an increase in the number of working-age adults who have effective access to credit, savings, payments and insurance from formal service providers (CGAP, 2011). By enhancing price and financial stability and financial deepening, central banks can influence investment and economic growth.

Moreover, their monetary policy and financial policy (e.g. bank regulation) shape the structure of financial sectors and thus the quality of financial intermediation.

There are synergies between the three objectives of price stability, financial stability and financial depth. For instance, low and stable inflation is a precondition for financial stability, because high and volatile inflation can erode the real value of debt and hence the interest earnings of banks and provide an incentive for non-financial forms of savings (Rousseau and Wachtel, 2002, Boyd et al., 2001). Similarly, financial stability is important for safeguarding price stability, for instance, because the effectiveness of the link between monetary policy instruments and aggregate demand – the monetary transmission mechanism – also depends on the stability of the financial system. Furthermore, by ensuring price and financial stability through their monetary and financial policies, central banks create the necessary – though insufficient – preconditions for financial deepening. Financial depth in turn is important, for instance, for ensuring price stability, since it improves the functioning of the monetary transmission mechanism (Mishra and Montiel, 2012, Mishra et al., 2010). Deep financial markets can also help to ensure financial stability by providing alternative sources of funding at times of global financial fragility, for example (Goyal et al., 2011).

Box 1

The functions and objectives of modern central banks

Central banks' key functions tend to include monetary policy, exchange rate policy, financial regulation, supervision of financial institutions and the payment system, the lender-of-last-resort function, currency provision, provision of banking services for the government, research and consumer protection (BIS, 2009). As a source of expertise for a wide range of applications, central banks in developing countries tend to be allocated a wider range of functions than their counterparts in industrialised economies, where the range has tended to narrow over time (BIS, 2009). In many developing countries central banks are, for instance, responsible for guiding financial development, a function that is needed less once key financial structures are in place.

Historically, central banks have been understood more in terms of their functions than of their objectives, and even now many of their key functions are not tied to statements of the relevant objectives (BIS, 2009). Most central banks have been legally assigned a price stability objective, sometimes with a quantitative inflation target. Many have (usually shared) responsibility for financial stability, often not stated explicitly in central bank law, but derived from central bank functions aimed at ensuring financial stability (e.g. the lender-of-last-resort function). The third major set of central bank objectives concerns employment, growth and welfare (BIS, 2009). Quantitative definitions of the financial stability, employment, growth and welfare objectives are not common. Since the global financial crisis, it has been more widely accepted that most central bank functions can serve more than one goal. In certain circumstances loose monetary policy can, for instance, restore financial stability and maintain financial depth in a crisis.

Nonetheless, price stability, financial stability and financial deepening do not always move in step: there are trade-offs, in the short term at least. Take the example of financial deepening: the tighter monetary policy and the more stringent prudential regulation become, the more costly credit grows, so that access to finance becomes challenging, particularly for borrowers already paying a high risk-premium, such as small and medium-sized enterprises (SMEs) and farmers. Thus placing a strong emphasis on tight monetary policy and stringent financial regulation may have negative effects on financial depth by affecting financial access, for instance (IMF, 2012a, CGAP, 2011, FSB, 2012). A central bank that seeks to promote financial deepening is therefore more likely to avoid tight monetary policies and very stringent regulation than a central bank which focuses solely on the objectives of price and financial stability. However, the more a central bank pursues policies with a view to promoting financial deepening, the greater the risk of its compromising the objectives of price and financial stability. Allowing major and rapid expansion of bank credit to the private sector as part of the financial deepening process may, for instance, create excessive demand and so raise inflation. It may also result in financial fragility where authorities fail to implement more stringent prudential policies to counter looser lending standards or excessive leverage. Thus placing the emphasis on financial deepening at the expense of the price and financial stability objectives may damage the prospects of sustainable financial deepening in the medium to long term. There may similarly be trade-offs between price and financial stability. Interest rate rises resulting from monetary tightening in response to inflation, for instance, pose risks for financial stability, since credit then becomes more costly and non-performing loans (NPLs) may increase in number. In fact, central banks that are officially mandated to regulate banks seem to be more sensitive to the profitability and stability of the banking sector and therefore less likely to alter interest rates solely on the basis of price stability considerations than central banks whose only mandate is to ensure price stability (Copelovitch and Singer, 2008).

These trade-offs have prompted an intense debate on what importance a central bank should attach to the at times conflicting objectives of price stability, financial stability and financial deepening (BIS, 2009, Eichengreen et al., 2011, AACB, 2011). This is a political as well as

economic debate, because monetary and financial policies shape the price of crucial investment funds and hence different social groups' access to them (Winters, 1994). As economic structures and political systems differ, the objectives that governments assign to their central banks vary from country to country, developing countries tending to have a wider range of functions (BIS, 2009). Central banks, which tend not to have the discretion to choose objectives, only the instruments with which to try to achieve those set by the government (i.e. "instrument" or "operational" independence), are then left to face the challenge of choosing the optimal trade-offs between multiple objectives.

2.1 Central bank objectives and development challenges in Africa

After decades of instability most African central banks have adopted price and financial stability objectives. High inflation in the advanced economies in the 1970s and in developing countries in the 1980s and 1990s was instrumental in shaping a global consensus that safeguarding price stability should be one of any central bank's main objectives. African central banks have therefore been given the mandate of ensuring price stability and a variety of instruments for this purpose. While the tendency in some other developing and in many industrialised countries has been to entrust banking regulation and supervision to separate agencies, the financial stability mandate of many African central banks has been formally strengthened over the past decade and become widely accepted (Quintyn and Taylor, 2010, Brownbridge et al., 1998, Kasekende, 2010, Gray, 2006). Quintyn and Taylor (2010) identify four major reasons for African central banks rather than separate agencies being given the financial stability mandate:

- Capacity constraints in African countries argue against the establishment of a separate agency for financial regulation and supervision on the ground that resources would then be spread too thinly across a number of different regulatory bodies.
- There are informational advantages in keeping banking supervision and monetary policy under the same roof, since the information collected for the two functions overlaps.

- In many developing economies only the central bank has the financial resources and budgetary independence to ensure that regulation is adequately funded.
- Developing countries are more prone to financial fragility than industrialised countries. Giving the central bank, as the lender-of-last-resort and the institution with most financial sector expertise, the mandate and instruments to safeguard financial stability will therefore facilitate coordination and the timely exchange of information at times of crisis.

A view also held in many African countries is that, if it is to be ensured that finance serves the needs of the real economy, central banking may have to go beyond safeguarding price and financial stability and promote financial development. This view is not entirely new: in the first few decades of their operation, most central banks in developing countries were strongly engaged in the promotion of financial sector development and development finance activities (BIS, 2009). As, however, this came at the expense of price and financial stability objectives in many countries, central banking began in the 1980s, with the support of donors and international financial institutions (IFIs), to become more focused on the objectives of price and financial stability (Epstein, 2006a, Fry, 1997, Fry et al., 1996). Over the past decade, many African countries have made progress in safeguarding price and financial stability, thus laying the foundations for financial deepening (Beck et al., 2011). Yet levels of financial intermediation have remained low and, as a consequence, the contribution of financial systems to economic development and poverty reduction has been limited. Such market failures as information asymmetries, combined with the small scale of many African economies, high levels of informality and governance problems, increase the transaction costs and risks of financial services provision in Africa and hinder financial deepening and inclusion, even in environments of relative price and financial stability (Beck et al., 2011). In the light of such developments, there is growing agreement among developing countries' policy-makers and financial sector development experts that developing countries' public institutions might promote financial deepening and inclusion (Ehrbeck et al., 2012, De la Torre et al., 2007, CGAP, 2011, CGAP, 2010, Honohan and Beck, 2007). One particular view emerging is that central banks in developing countries might support efforts to enhance financial deepening, preferably through financial regula-

tion that provides an enabling environment (Beck et al., 2011, AACB, 2011, Hawkins, 2011, Ndungu, 2012, Gray, 2006, Republic of South Africa, 2011). There are three major reasons why African central banks should support financial deepening efforts:

- As monetary and regulatory authorities and often banking supervisors, central banks have the power to facilitate financial deepening, and they have the mandate and instruments to promote the price and financial stability that is essential in this respect. Moreover, they can ensure that financial deepening is not impeded by overly tight monetary policy or overly stringent, disproportionate regulation and that financial policy is pursued with a view to enabling financial deepening and inclusion.
- There are informational advantages and synergies in assigning central banks the responsibility of promoting price stability, financial stability and financial deepening, since the expertise needed and the information to be collected in pursuit of these objectives overlap (BIS, 2009). In Africa, shortages of human and financial resources place a high premium on the exploitation of such synergies.
- In many developing countries, only the central bank has the financial resources and budgetary independence needed to adequately fund enabling financial policies.

Both the responsibilities of central banks and the financial sector development programmes run by aid agencies suggest that, in practice, these arguments outweigh the standard reasons given for limiting the mandate of central banks to safeguarding price and financial stability, which include the argument that multiple mandates increase conflicts of interests. While the statutes of African central banks tend to be explicit only on the subject of the price and financial stability objectives, many central banks seek de facto to encourage financial deepening, for instance by promoting financial sector development or maintaining an accommodating monetary policy stance. A study by CGAP (2012), for example, finds that 61 percent of the financial regulators in 33 sub-Saharan African countries are responsible for the promotion of savings, 64 percent for the promotion of SME finance and 70 percent for the promotion of rural finance.³ Moreover, many of the donor-led financial sector development programmes and initiatives have central banks as their key partners. The Alliance for

3 For developing countries as a whole these figures are 48 percent, 52 percent and 51 percent, respectively.

Financial Inclusion (AFI), a donor-funded network for financial policy-makers, including developing countries' central bankers, which seeks to promote financial inclusion, is a case in point. In many cases, proponents of multiple central bank mandates assume that, where central banks have multiple objectives, their mandate allows them to optimally choose trade-offs between these objectives, without prejudice to price and financial stability (Kasekende and Brownbridge, 2011, Beck et al., 2011, Epstein, 2006a, Hawkins, 2011).

While the promotion of financial deepening by central banks has its advantages in the African context, it also poses challenges. For instance, trade-offs between policies may increase conflicts of interest for central banks. Introducing agent banking, for example, is likely to enhance financial inclusion and, therefore, financial deepening, but it is a threat to financial stability if the relevant regulation is too lax. Moreover, there is the risk that assigning the

central bank a financial deepening objective will make it more susceptible to political interference: if, for instance, it tightens monetary policy to fight inflation, politicians favouring expansionary policies will find it easier to exert pressure on the central bank to reverse its policy on the ground that it compromises the financial deepening objective.

The debate on the pros and cons of giving central banks in African countries a wider mandate has similarities with that in advanced and emerging economies. While the debate in Africa (as in many developing countries) concerns the addition of a financial deepening objective (often equivalent to a financial sector development objective) to existing price and financial stability objectives, advanced and emerging countries have launched a debate about central banks being formally assigned a financial stability objective as well as the conventional price stability objective in the aftermath of the financial crisis (see Box 2).

Box 2

Rethinking central banking in industrialised and emerging countries

In advanced and emerging countries the global financial crisis has given rise to a debate on the reform of central banking. By the early 2000s, a growing number of central banks in these countries had agreed on flexible inflation targeting (IT) as the policy framework that should underpin modern central banking (for an overview of IT see, for instance, Geoffrey et al. (2006)). In the light of lessons learnt from the global financial crisis, there is now growing recognition that central banking needs to be rethought (Eichengreen et al., 2011, Blanchard et al., 2010). The Committee on International Economic and Policy Reform (Eichengreen et al., 2011) identifies three main shortcomings in the conventional approach to central banking centred on IT:

- First, it fails to take adequate account of the fact that a monetary policy framework that focuses on price stability will also affect financial stability through its impact on asset valuations, commodity prices, credit, leverage, capital flows and exchange rates.
- Second, it assumes limited cross-border spill-overs of monetary policies, whereas, in practice, the lack of convergence towards similar monetary and exchange rate regimes has resulted in incompatibilities among the monetary policies of some key countries, such as China and the USA, and in substantial global imbalances.
- Third, the global financial crisis has given rise to new sources of political pressure that central banks will find difficult to ignore, in particular high levels of debt in advanced countries and the slowing of the growth of export markets for developing countries.

While details of a new framework for central banking are still being debated, the view is gaining ground that central banks should place less emphasis on low inflation and adopt financial stability as an explicit goal (Cihák, 2010, Eichengreen et al., 2011, Goodhart, 2010). Macro-prudential tools could be used alongside monetary policy in pursuit of that objective. In the light of strong pressures on central banks to support government efforts to reduce high public and private debts and to support the competitiveness of export sectors, Eichengreen et al. (2011) recommend that central banks should acknowledge and address the tensions between IT and competing objectives.

Two issues figure prominently in both debates:

- The risks associated with central banks’ juggling multiple mandates and the fear that, if they do not explicitly acknowledge and address the tensions between price stability and competing objectives, they will be seen as part of the problem and risk losing their independence (Eichengreen et al., 2011, James, 2010, BIS, 2009, AACB, 2011);
- The wide gap that exists between the theory and practice of central banking. While the overarching objective that theoretically guides central banking in many advanced countries is price stability, central banking has in practice been sensitive to such possibly competing objectives as financial stability (Eichengreen et al., 2011, Briault, 1999, George, 1994). Similarly, African central banks’ formal mandates usually extend only to price and financial stability, but in practice they also pursue monetary and financial policies to enhance financial deepening (Beck et al., 2011, CGAP, 2012, BIS, 2009).

The similarities and importance of these debates suggest that the time is now ripe for rethinking central banking and working towards a framework that will guide central banking in a post-crisis environment, both in advanced economies and in Africa. As this framework for central banking in Africa is being established, it will be important to learn from the experience of African central banks in balancing the objectives of price stability, financial stability and financial deepening. This report contributes to this objective, using three case studies to explore the ways in which and the extent to which African central banks have made progress over the past decade towards striking a balance between their multiple objectives and to consider what drives such progress and what poses challenges to sustaining it.

2.2 Performance in enhancing financial deepening and price and financial stability

How have African countries fared as regards price stability, financial stability and financial depth? For a long time, African countries struggled to achieve price stability, financial stability and financial depth, as commonly used indicators show, but this has changed over the past decade. As evident from Figure 1, price stability has improved. Median inflation, for example, was 6 percent from 2000 to 2011, down from 10 percent during the 1990s.⁴

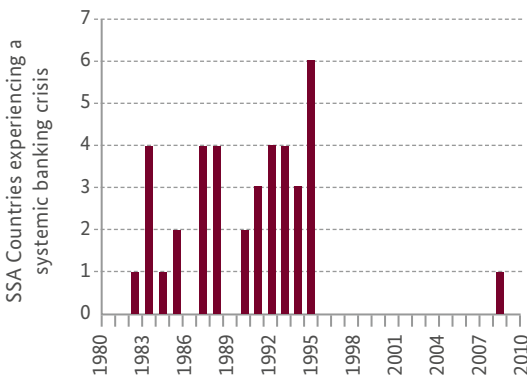


Figure 2 shows that financial soundness has also improved: during the 1990s, 22 countries in SSA experienced a systemic banking crisis, whereas only one such crisis – that in Nigeria in 2009 – occurred from 2000 to 2010. Data on the ratio of NPLs to total loans are available only from 2000. Here the recent trend also appears to be positive, with NPLs falling by almost half from an average of 15 percent from 2000 to 2005 to 8 percent from 2006 to 2011 (World Bank, 2012). African financial regulators have also received much recognition for the resilience of financial sectors to the global financial crisis (Fuchs et al., 2012). Figure 3 illustrates the remarkable progress in financial deepening: since the mid-1990s, lending to the private

4 Figures show the median rather than the average because several outlier cases experienced hyperinflation.

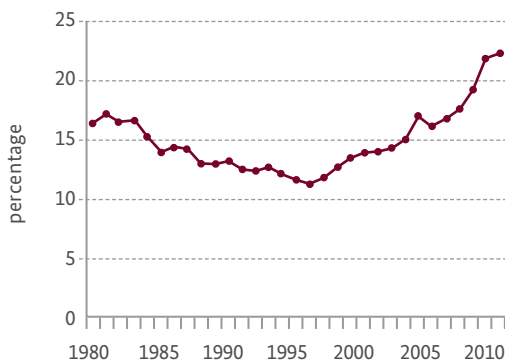
sector has increased almost continuously in SSA (World Bank, 2012). This increase has not been driven by individual countries, but has occurred throughout the region (Beck et al., 2011).

Figure 2
Incidence of systemic banking crises in SSA, 1980-2010



Source: Laeven and Valencia (2012).

Figure 3
Private credit by deposit money banks/GDP



Source: Beck et al. (2012). Note: SSA sample size: 34 countries (see list of countries in Appendix I).

There is some agreement that improved monetary and financial policies have contributed to Africa’s achievements in the areas of price stability, financial stability and financial deepening (Brownbridge et al., 1998, Boone, 2005, Beck et al., 2011, Sachs and Warner, 1997, Arbach and Page, 2010, Kasekende, 2007, van Donge et al., 2012). Clearly, factors other than central banking, often outside government control, also affect these three factors.⁵ However, this report’s focus on the importance they attach to these objectives is reasonable because African central banks are (at least partly) responsible for each of the three objectives and, as monetary authorities, financial regulators or supervisors, have a variety of instruments at their disposal to pursue them.

From the 1970s to the 1990s, central banks in many African countries had difficulties in striking a balance between the objectives of price stability, financial stability and financial deepening assigned to them: until the mid-1980s there had been broad agreement that public intervention in financial markets, by central banks among others, was an important means of correcting market failures and enhancing financial depth in developing countries (Beck et al., 2009, De la Torre et al., 2007). Yet, as in a majority of developing countries, many African central banks emphasised the objective of financial deepening and neglected those of safeguarding price and financial stability. Loose monetary policy aimed at reducing the cost of public and private borrowing, lax bank supervision and financial policies that directed resources to politically determined development priority sectors and firms caused high inflation and banking sector distress. Yet because it is conditional on low and stable inflation and financial stability, financial deepening also slowed and, in some countries, even went into reverse at that time. Over the past decade, several African central banks have attached greater importance to the price and financial stability objectives while continuing to focus on financial deepening. They have made progress towards striking a better balance between their objectives of price stability, financial stability and financial deepening. What factors have driven this progress in African countries over the past decade and what are the obstacles to sustaining it are the questions that this report seeks to answer.

5 For instance, shocks beyond the control of the central banks which may affect price stability include changes in the global economy, changes in fiscal policy and changes in commodity prices.

2.3 Explaining central bank policy

To explore the drivers of the progress made by central banks in managing multiple objectives, this report builds on political economy theory, since previous research on the determinants of central banking in developing countries (Maxfield, 1990, Winters, 1994, Haggard and Lee, 1993, Copelovitch and Singer, 2008, Boone, 2005, Bernhard et al., 2002, Singer, 2004) has found that central bank policy is driven by a combination of economic and political factors.

The literature on the political economy of central banking in developing countries suggests that a country's need to mobilise investment resources and the policy preferences of those able to act as essential providers of such resources are key drivers of central bank policy (Winters, 1994, Bräutigam et al., 2008, Maxfield, 1990, Lukauskas and Minushkin, 2000, Posen, 1996, Maxfield, 1997). From a policy-maker's perspective, financial resources need to be mobilised for investment for two major reasons. First, the state apparatus depends on the inflow of financial resources to fulfil its functions. Second, politicians need private investors to invest within their own jurisdictions in order to maintain the minimum level of economic prosperity that assures the government of popular acceptance and increases its chances of staying in power (Bates and Lien, 1985, Winters, 1996). Where a country becomes dependent on the providers of crucial investment funds (in the form, for instance, of tax payments or external finance for firms), they are likely to gain some leverage over economic policy, including central bank policy (Winters, 1994, Bräutigam et al., 2008, Maxfield, 1990, Posen, 1996). In other words, policy-makers in need of investment resources are likely to become susceptible to the policy preferences of those able to assume the role of crucial providers of investment resources, which may result in policy being changed.

This report builds on these propositions and considers, in particular, how a country's need to mobilise investment resources and the policy preferences of those who are the main providers of such resources shape central bank policy objectives. In so doing, it adapts the propositions to the African context. Many African countries differ from industrialised countries in terms of their key sources of investment finance, owing to the limited development of their domestic private sectors and the low level of private foreign capital inflows. This report therefore explores how

the key sources of investment finance in many African countries – domestic private investment, aid and natural resource revenues – shape central banking. The effects of aid and natural resource dependence on central banking have so far received little attention in the literature on the political economy of finance, since it focuses mainly on advanced countries, where natural resources and aid tend to be less vital sources of investment finance.

Countries which are dependent on private investors⁶ for investment finance and whose governments lack such alternative financing sources as aid and natural resource revenues are likely to be more susceptible to private investors' preferences for particular economic policies, if only as a means of increasing their contribution to tax revenues and productive investment (Bräutigam et al., 2008, Maxfield, 1990).

In aid-dependent countries, where donors become crucial providers of investment funds, central banks are likely to emphasise the objectives of price and financial stability, because many donors and international financial institutions (IFIs) have long recommended that developing countries' central banks confine themselves to these two objectives (Epstein, 2006a, Epstein, 2006b, Gelb and Honohan, 1989, Caprio and Honohan, 2001).

As governments of oil-rich countries tend to have considerable discretion over the use of natural resource revenues, they are likely to have more policy space to pursue their own agendas. For a number of reasons their central banks are likely to emphasise the financial deepening objective. Oil-dependent countries in particular are vulnerable to volatile oil revenues owing to their lack of economic diversification, which is a threat to economic prosperity and so to regime stability (Karl, 1997). This is likely to act as an incentive for the government to ensure that the central bank, like other public institutions, supports productive expansion and thus economic diversification by facilitating financial deepening. Moreover, in countries where oil revenues are abundant and the private sector weakly developed, political supporters expect governments to reward them by sharing the rents from oil or, as Nigerians say, "the national cake" (Karl, 1997). There is empirical evidence that oil-dependent countries use their oil revenues for redistribution to stabilise their political regimes (Morrison, 2009). The governments of oil-dependent

6 The term "investors" is used broadly in this report and includes entrepreneurs and firms.

countries thus have an incentive to assign their central banks a financial deepening objective, one reason being that they want to redistribute funds to groups or sectors that would otherwise have difficulty accessing them.

Besides evaluating the role of a country's investment sources as drivers of central bank policy, this report pays particular attention to three additional factors highlighted as drivers of change in the literature on the political economy of reform: first, the global exchange of knowledge, spreading ideas on what is deemed the appropriate content of economic development policies (ODI, 2011, Hall, 1986). New knowledge is more likely to be embraced if it is backed by powerful actors (Goldstein, 1989). Second, economic crises, because they can alter the costs and benefits of pre-crisis policies and constitute a threat to political stability (Rodrik, 1996, Haggard and Maxfield, 1993). Where

the greater political challenge seems to be to restore stability, central banks are likely to place greater emphasis on price and financial stability, and where the greater political challenge seems to be growth, they are likely to place greater emphasis on policies that support financial deepening (Haggard and Maxfield, 1993). Third, leadership can induce policy change (ODI, 2011, Leftwich and Wheeler, 2011). While the emergence of catalytic leadership is not well understood in political economy theory, studies on the political economy of reform find that leadership matters as a driver of policy change, with leaders often invoking ideas as reasons for championing reform (Grindle, 1999, Leftwich and Wheeler, 2011). Yet in general, rather than imposing theory on the reality on the ground, this report inductively deduces drivers of progress from the country cases, on the basis of evidence from the literature, economic data and key informant interviews.

3. Methodology

The report considers *the extent to which and the ways in which central banks have made progress in striking a balance between the triple objectives of promoting price stability, financial stability and financial deepening over the past decade*. It also identifies drivers of progress and challenges to sustaining progress towards striking a balance between these central bank objectives. The focus will be on how central banks strike a balance between stability (i.e. price and financial stability) and financial deepening, given the difficulties developing countries' central banks have had in the past in managing this particular trade-off.

To illustrate the extent to which and the ways in which African countries have made progress over the past decade, the report outlines the trajectory of central bank policy over time, comparing the 2000s with previous decades. It uses a historical framework to highlight turning points in policy in selected countries and the effects of historical legacies. To assess progress towards striking a balance between multiple central bank objectives, the report describes stated and demonstrated objectives of central banks' monetary and financial policies as evident from their trajectories. The analysis of financial policy in this context focuses on financial regulation, supervision and development finance activities, mostly in relation to the banking sector, since Africa's financial systems are still largely bank-based. *Progress is deemed to have occurred where central banks have moved towards the simultaneous pursuit of the goals of price stability, financial stability and financial depth within the past decade by placing greater emphasis on goals which had previously received less attention*. The assessment of progress towards striking a balance between multiple central bank policy objectives is based on the stated and demonstrated objectives of central banks. The report also points out country-specific indicators of the achievement of policy objectives – inflation rates as a proxy for price stability, the ratio of NPLs to total loans (NPL ratios) as a proxy for financial stability⁷ and lending to the private sector and account penetration as indicators of financial deepening and inclusion. Performance in these areas should not be seen as an indication of a particular central bank's objectives, since price stability, financial stability and financial depth are influenced by a number of variables besides central bank policy.⁸ Yet while outcome variables cannot be linked directly to particular central bank policy stances, they do give some indication of the policy objective on which a central bank should place greater emphasis if it is to achieve all its various objectives.

The report relies on multiple sources for assessing progress, its drivers and challenges: first, an extensive desk review of secondary literature on the political and economic history of the case-study countries and on the political economy of finance and reform; second, economic data from the World Bank and International Monetary Fund (IMF); third, interviews with policy-makers, donors and researchers in the case-study countries. The interviews were a key source of information for assessing the drivers of and challenges to the progress that central banks have made towards striking a balance between multiple policy objectives.

The countries selected for the case studies were African countries whose central banks had, according to some outcome indicators, made progress in the past decade towards balancing the three objectives of price stability, financial stability and financial deepening and whose prospects of sustaining that progress in the medium term are good. The countries of the West African Economic and Monetary Union were excluded because they have a regional central bank and do not pursue independent central bank policies. Kenya, Nigeria and Uganda were selected for case studies by the "diverse case method" (Seawright and Gerring, 2008): using this method, the study identified a set of African countries that cover a wide range of values relating to the main variable proposed by the literature on the political economy of central banking, namely the key source of investment funds. Nigeria was chosen because oil is its most important source of government revenue and foreign exchange and because little research has so far been carried out into its central bank policy despite the economic weight it carries in Africa. Kenya and Uganda were chosen because their main sources of investment finance differ from Nigeria's. Kenya's private sector is well developed by African standards and it relies on domestic private investors as a source of investment funds (African Development Bank, 2010). Uganda has a weakly developed private sector and is dependent on foreign aid for the financing of investment. While private investors are an increasingly important source of investment funds, their provision of such funds, in the form of tax payments and external finance for firms, for instance, is still limited. The extent to which the three countries are representative cases that allow generalisations to be made is clearly limited. However, they allow some light to be shed on the mechanisms by which progress has been made in different types of African countries and on common features in this process.

⁷ A variety of measures help in the assessment of financial stability. The NPL ratio is widely used (in financial stability assessments, for example) and serves the purpose of this paper by providing an (albeit partial) picture of the riskiness of the banking sector (Gadancecz and Jayaram, 2009, Aspachs et al., 2006).

⁸ Inflation rates in Africa, for instance, tend to be driven by several factors, some of which (such supply shocks as surges in global food and oil prices, for example) are, in the short term at least, beyond the control of central banks.

4. Walking a tightrope – central banking in Kenya, Nigeria and Uganda

The following chapters evaluate the objectives of central bank policy in Kenya, Nigeria and Uganda. Each chapter begins by outlining the respective country's success in achieving price stability, financial stability and financial depth. An overview is then given of the historical trajectory of the central bank's policies to illustrate recent progress towards striking a balance between the objectives of price stability, financial stability and financial deepening. This is followed by a discussion of the drivers of this progress and obstacles to it being sustained, as suggested by the literature and expert interviews.

4.1 The Kenyan experience

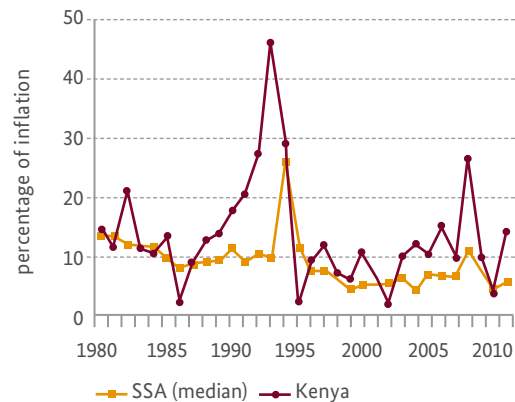
“Alongside financial stability comes another topical issue in development debates across the globe, financial inclusion. For the financial system to be relevant to society, it needs to ensure that as much of the eligible target population has opportunity to access a variety of financial services (...).”

Njuguna Ndung'u (2011)⁹

Kenya has seen major improvements in price stability, financial stability and financial depth over the past decade. As Figure 4 shows, inflation in Kenya, averaging 11 percent from 2000 to 2011, is above the African median of 6 percent, but lower than it was in the 1990s, when it averaged 17 percent.¹⁰ The ratio of bank NPLs to total loans, which averaged 18 percent from 2000 to 2011, was well above the African average of 12 percent, as can be seen in Figure 5. Yet Kenya's NPLs have shown a downward trend since 2003, indicating a relative improvement in financial stability. Financial depth has been remarkable, as evident from Figure 6. Lending to the private sector, which averaged 26 percent from 2000 to 2011, is well above the

Figure 4

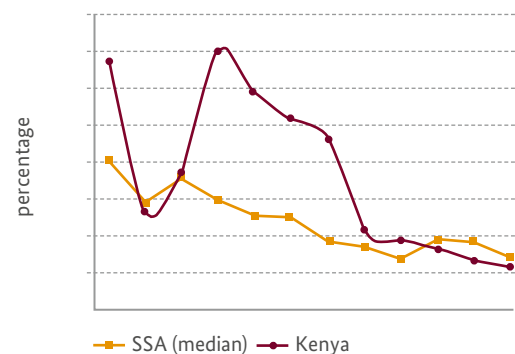
Kenya and SSA: inflation, consumer prices



Source: World Bank (2012). Note: SSA sample size: 37 countries (see list of countries in Appendix I).

Figure 5

Kenya and SSA: bank NPLs/total gross loans (percent)



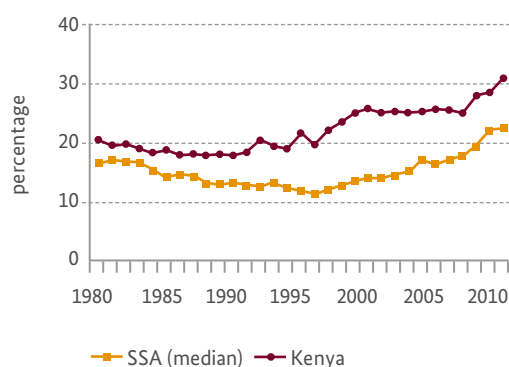
Source: World Bank (2012). Note: SSA sample size: 15 countries (see list of countries in Appendix I). Data available only from 2000. Data for Kenya in 2006 from CBK (2006).

African average of 17 percent and has improved since the 1990s, when it averaged 21 percent. Financial inclusion as measured by account penetration is, at 42 percent of the population, far higher than the African average of 24 percent, as Figure A1 in Appendix II reveals.

⁹ Governor of the Central Bank of Kenya since 2007.

¹⁰ One notable spike occurred in 2008 and was the result of the triple crisis of post-election violence, drought and a drop in export revenues due to the global financial crisis and the subsequent easing of monetary policy.

Figure 6

Kenya and SSA: private credit by deposit money banks/GDP

Source: Beck et al. (2012). Note: SSA sample size: 34 countries (see list of countries in Appendix I).

These economic outcome indicators cannot be seen as indicators of central bank objectives and hence of progress. However, they provide some indication of when a central bank should consider adapting its policy stance, i.e. the importance it attaches to price stability, financial stability and financial deepening, respectively. The next section gives a historical overview of the extent to which the Central Bank of Kenya (CBK) has sought to achieve these objectives and some examples of changes to the policy stance in response to economic conditions.

4.1.1 Central banking trajectory and progress towards balancing multiple objectives

When Kenya became independent in 1963, its government faced the challenge of having to mobilise revenues to finance the development of the state apparatus and the indigenous business sector. The banking sector, consisting entirely of foreign-owned banks at that time, did not provide sufficient investment funds for this purpose, but focused on lending to prime business borrowers and on short-term, trade-related financing (Brownbridge, 1998b: 82). When founded in 1966, the CBK was an orthodox central bank mandated to ensure price and financial sta-

bility. However, under the regime of the Kenya African National Union (KANU),¹¹ the CBK had to meet government demands to promote financial deepening in response to pressures arising from a government short of revenue and the need to increase productive investment at a time of weakly developed domestic banks (Brownbridge, 1998b).

Although the CBK sought to encourage financial deepening under the KANU regime, the degree and nature of its market interventions were more modest than in many other African countries, reflecting the political leverage of Kenya's more developed private sector (Bates, 2005, Boone, 2005). The CBK sought to promote access to investment funds for the productive sectors by regulating interest rates and credit ceilings. However, despite extensive intervention to influence the allocation of investment funds, CBK regulation did not interfere in banks' lending decisions. One exception was the requirement (usually not enforced) that all commercial banks lend 17 percent of deposits to the agricultural sector (Brownbridge, 1998b: 82). The CBK neglected its financial stability mandate, placing greater emphasis on allocative regulation than on prudential regulation and supervision. For instance, it rarely enforced capital requirements, partly to support indigenous banking sector development (Brownbridge, 1998b: 95-97). The Banking Act of 1968 gave the CBK no more than limited powers to safeguard financial stability without support from the Ministry of Finance, indicating the lack of central bank authority vis-à-vis the government. Moreover, from the 1970s onwards, monetary policy became increasingly loose and was driven more by the financial needs of the government and the weak indigenous banking sector than by price stability considerations (Brownbridge, 1998b: 93-97, Helleiner, 2003: 14).

As the CBK had adopted less extreme developmental policies than many other African central banks, their effects were less harmful to the economy. Owing to the moderate monetary policy it pursued until the mid-1980s, for instance, Kenya's inflation was relatively modest, as Figure 4 shows. Inflation averaged 11 percent in the 1970s and 12 percent in the 1980s, as compared to median inflation of 11 percent in Africa as a whole.

11 KANU ruled Kenya for nearly 40 years after it gained independence in 1963, relinquishing power when it lost the elections in late 2002.

Real interest rates were therefore sufficiently high to promote saving and lending despite interest rate controls (Brownbridge, 1998b: 83). In this environment, the financial system even expanded between independence and the mid-1990s. However, new, locally owned private banks experienced two periods of major financial fragility, first from 1984 to 1986, then in the early 1990s. Mismanagement and fraud, and particularly insider lending to politically connected individuals, were the primary causes of the banking distress (Brownbridge, 1998b, Daumont et al., 2004). Macroeconomic instability, the loss of monetary control in 1992/93 and deficiencies in bank supervision were contributory factors. However, as Figure 6 reveals, banking distress and the increase in government borrowing to finance rising budget deficits did not crowd out private lending completely thanks to the size of the domestic financial system and the access enjoyed by larger firms to foreign capital (Brownbridge, 1998b).

Although a fiscal crisis, balance-of-payments problems and banking-sector distress made it increasingly difficult for the CBK to maintain the emphasis on financial deepening, reforms under the KANU regime during the 1980s and 1990s stagnated. To improve the balance between the central bank's stability and financial deepening objectives, the government sought to reform central bank policies in three major areas: first, the pursuit of monetary policy to place greater emphasis on price stability; second, the strengthening of banking supervision to enhance financial stability; and third, the lifting of allocative controls. On the whole, the success of the reforms was limited. Expansionary fiscal policy restricted the effectiveness of monetary policy, and while the CBK improved its management of reserve money, its stabilisation efforts in the early 1990s were disrupted by two major shocks. First, wishing to improve governance and accountability for the use of aid money, donors withheld aid disbursements in 1991, and the government financed the escalating deficit by printing money. The second shock was the expenditure pressure arising from the first multiparty election in 1992, again financed mainly by borrowing from the central bank. Reforms of bank supervision did not become effective until 1993 owing to the politically determined allocation of banking licences and interference in the enforcement of prudential regulation. Only then, after another banking crisis, did supervision become more effective (Brownbridge, 1998b).

Reforming central banking to improve the balance between the (price and financial) stability and financial deepening objectives was also made difficult by a strong constituency in favour of maintaining the CBK's policy stance (World Bank, 1992). The revenue-needy government had a preference for the status quo because it relied on the domestic banking system, including the CBK, for public and election campaign finance, and many of the banks were owned by political supporters (Isaksson, 2001, Brownbridge, 1998b, Nyanjom and Ong'olo, 2012, CBK, 2012a). The distressed local banking sector was opposed to change, since it relied on the CBK to provide it with liquidity support and sought to retain its business models (Brownbridge, 1998b). In addition, the productive sector was not in favour of reducing the CBK's focus on facilitating financial deepening because its access to finance was still poor.

Progress towards balancing multiple objectives over the past decade

Over the past decade, Kenya's political and economic regime has changed dramatically. When Mwai Kibaki won the presidential election against Daniel Arap Moi in December 2002, ending some 40 years of KANU rule, the new government inherited a weak economy and financial system. It set out an economic reform programme for 2003-2007, the Economic Recovery Strategy for Wealth and Employment Creation. Among its principal aims were the restoration of macroeconomic stability, notably through a reduction in domestic government borrowing, and the creation of an enabling environment for the private sector. The strategy provided for "a monetary policy consistent with low inflation without compromising the recovery effort." This entailed ensuring "adequate growth in credit to the private sector" (Government of Kenya, 2003). In the ensuing years, the economy experienced a sustained recovery, with growth averaging about 4 percent in the 2000s.

Stated and demonstrated objectives of central bank policy

CBK policy over the past decade has sought to promote price stability, financial stability and financial deepening at the same time (Arora and Ferrand, 2007, IMF, 2012e). In interviews public officials were unanimously of the view that price stability followed by financial stability and then

financial deepening and inclusion are the CBK's policy priorities. Vision 2030, Kenya's national development plan, which defines the goal as making Kenya a middle-income country by 2030, highlights the need for growth and investment through both stability and financial depth and sets out the CBK's policy thrust (Ndung'u, 2010, GOK, 2007).

Interviews with experts revealed that, in line with the Central Bank Act, there is a consensus among public officials that price stability is the CBK's primary objective because it is considered a precondition for growth. Senior public officials interviewed believe that, once it has inflation under control, the central bank can also pursue additional objectives, such as support for the government's economic development policy, financial deepening and inclusion; yet, if inflationary pressures arise, other objectives have to be dropped. Recent developments show that this is the approach the CBK is adopting: when inflation started to rise sharply in early 2011 owing to high global oil and food prices, the CBK prioritised price stability and sought to restore it by tightening monetary policy aggressively in the third quarter of 2011. However, the response to inflationary pressures was slightly delayed (IMF, 2012d), which is an indication of the challenges that prioritising stability at the expense of deepening posed for the CBK in practice. The medium-term inflation target of 5 percent and short-term target of 9 percent set by the Ministry of Finance indicate the desire for flexibility in reacting to challenges to both price stability and growth (CBK, 2012b). The CBK has adopted a monetary policy framework that is aimed at monetary aggregates consistent with inflation targets and sets a central bank rate (the rate at which the CBK lends money to commercial banks overnight) to signal the monetary policy stance and guide short-term interest rates. Owing to concerns about the structure of the real economy, which is characterised by frequent supply shocks and prices partly controlled by cartels, many public officials would currently not support a move towards an IT regime with an interest rate operating target, but would prefer a gradual transition (Misati et al., 2012, Sichei and Kamau, 2012). They see a need to begin by improving the functioning of the monetary transmission mechanism, through financial development, for example, before switching to a full IT regime.

In recent years, the CBK has stated and demonstrated its commitment to safeguarding financial stability. Its financial stability mandate finds formal expression most notably in the CBK Act, which outlines its banking regulation and supervision responsibilities. A recent example of the importance it attaches to safeguarding financial stability is its enhanced focus on mitigating credit risks arising from an environment of high interest rates following the monetary policy tightening in 2011 (IMF, 2012d). As Kenyan banks are expanding regionally, the CBK is also seeking to strengthen cross-border banking supervision to manage the risks posed by Kenyan banks' presence abroad (Githae, 2012). It is involved, for instance, in a number of joint initiatives with other EAC countries to enhance joint supervision and has proposed reporting requirements for consolidated supervision (i.e. supervision of banking groups on a consolidated basis) (IMF, 2012d). While these examples demonstrate commitment to safeguarding financial stability in deeper, more integrated financial markets, there are still gaps in banking regulation and supervision. For instance, the CBK applies the Basel Core Principles of Effective Banking Supervision selectively, following a roadmap towards the implementation of the remainder of Basel I standards before moving on to Basel II and III (AFI, 2011a). Nonetheless, a great deal has been achieved in recent years, and outcome indicators seem to have responded to improvements in policy. While there were 13 bank failures from 1994 to 2002, there have been only four since 2002, the last two occurring in 2005 (CBK, 2012a). As Figure 5 shows, the ratio of NPLs to total loans has also fallen, although this may partly be due to a fast expanding denominator.

The CBK's financial policy has sought to enhance both financial stability and financial deepening (see also IMF, 2012e). In 2006, for instance, the CBK began to regulate and license microfinance deposit-taking institutions (MDIs) with a view to improving the stability of this sector, creating confidence in it and so increasing the outreach of the formal financial sector. Again with the aim of enhancing both financial stability and depth, the CBK issued a credit reference bureau regulation in 2008. While there is no specific development finance department (see also the CBK's organisational chart in Appendix III), several departments, such as those responsible for banking supervision and research, are engaged in establishing financial

deepening and inclusion policies. To facilitate financial deepening and inclusion, the CBK has also sought to maintain an open regulatory mindset. Reversing the usual timeline of legislation–regulation–innovation and adopting a more test-and-see approach has contributed to Kenya’s success with the mobile payment service M-Pesa. This proportionate regulation of financial innovations has become a model globally. The CBK has also introduced Sharia-compliant banking and issued agent banking regulation to involve such third parties as petrol stations and other retail outlets in the provision of certain banking services. It is also collaborating with the Financial Sector Deepening Trust Kenya (FSDK) in research into ways of enhancing evidence-based policy-making for financial deepening. As part of this collaboration, the CBK and FSDK also promote consumer protection and financial education. In 2007 and 2008, for instance, they conducted joint surveys on bank charges and lending rates to educate the public, to enable them to make informed banking decisions – which will eventually enhance financial stability – and to promote competition among banks with a view to reducing interest rate spreads (CBK, 2008). In general, the CBK has avoided direct intervention in the banking sector, preferring to use moral suasion or to try to improve incentives for private-sector-led financial inclusion. This approach explains why financial service providers emphasised in interviews that they see the CBK as an empowering regulator that builds regulation around private-sector initiatives.

4.1.2 Drivers of progress towards balancing multiple central bank objectives

Of the three countries, Kenya comes closest to succeeding in balancing the three objectives of price stability, financial stability and financial deepening, because the CBK has sustained its efforts to this end for almost a decade. Interview data, policy documents and literature on the political economy of Kenya suggest that the combination of three factors has driven progress: Kenya’s dependence on a diverse group of private investors for its investment needs; global knowledge exchange; and leadership.

Kenya’s dependence on a diverse group of private investors for its investment needs

In line with earlier findings on the politics of central banking in developing countries, the CBK’s experience suggests that central bank policy objectives reflect the interests of those able to act as crucial providers of investment finance.

After years of emphasising the objective of financial deepening at the expense of price and financial stability, private investors have had a crucial role to play in redressing the balance between central bank objectives by demanding macroeconomic stability. With its legacy of settler colonialism and a strong agricultural export sector, Kenya has historically had a vibrant domestic private sector and a number of international investors. Yet more than a decade of macroeconomic instability, financial instability and low financial intermediation had depressed private-sector development and investment levels by the early 2000s. Consequently, when Mwai Kibaki beat Daniel Arap Moi in the presidential election in December 2002, his new government inherited a weak economy and a weak financial sector. As Kibaki’s government had won the election by promising economic recovery through private-sector development and as Kenya had historically relied on private investors rather than aid¹² or natural resources for its investment finance, the government had to create the necessary conditions to attract and raise private investment in order to strengthen its political and economic power base (Government of Kenya, 2003). This increased the government’s susceptibility to the concerns of private investors about central bank policy objectives when it came into power. In fact, the government is still susceptible to private-sector concerns, since it is aware that growth and prosperity depend on a growing and increasingly diversified private sector as a source of private investment and tax revenue (African Development Bank, 2010, OECD et al., 2010). In particular, the government is pursuing a “financial independence” strategy that relies on the mobilisation of domestic resources rather than aid in order to limit external interference in domestic policies (Mwega, 2009). Thus aid and natural resources, major sources of public finance in many other African countries, do not play a significant role in Kenya’s development financing mix.

12 The leverage of donors in Kenya has been limited, because aid has historically been only one of a number of sources of investment finance. During the 1990s, for instance, aid accounted for only 5 percent of GNI, domestic sources of investment funds for far more: taxes accounted for 17 percent of gross domestic product (GDP), exports for 28 percent and gross domestic savings for 14 percent (World Bank, 2012). Moreover, donors’ willingness to support the Moi government declined sharply in the late 1990s (Mwega, 2009).

The reforms of central bank policy in the past decade, which have strengthened the CBK's price and financial stability mandates and yet maintained the financial deepening objective, reflect the government's concern to respond to the various preferences of a diverse group of investors (including firms) who are crucial if the country is to meet its investment needs. Large and medium-sized investors or firms have access to finance and, while not opposed to cheap credit, they tend to favour a central bank which protects their wealth by focusing on preserving price and financial stability (see for instance KEPSA, 2011). The government takes these interests seriously because of the contribution that large and medium-sized investors make to GDP, tax revenues and private sector financing. Micro-entrepreneurs and small firms usually lack access to external finance and are likely to favour monetary and financial policies which focus not only on preserving price and financial stability but also on increasing financial deepening and inclusion (KEPSA, 2012b, KEPSA, 2012c). Government politicians take an interest in them because they remain the backbone of the economy (Government of Kenya, 2003, KEPSA, 2012a) and account for the majority of voters. Banks favour a central bank that focuses on the objectives of price and financial stability, because both are essential for profitability (see for instance KBA, 2011). However, as senior banking officials stated in interviews, banks also like to see the CBK providing an enabling environment for financial deepening. Such an environment helps them to reach out to new clients in Kenya's increasingly competitive financial markets, where government borrowing has fallen since the 1990s and such financial institutions as the Equity Bank have demonstrated the profit opportunities at the lower end of the market. The interests of banks are likely to have received particular attention because they are key sources of credit for the government and the private sector.

Global knowledge exchange

The CBK's progress towards striking a balance between multiple objectives can also be attributed to the exchange of ideas about the roles central banks can play to ensure that financial systems serve the needs of society. In recent years, a view that has gained ground is that the role of central banks in developing countries includes sustained

action to facilitate financial deepening and inclusion (De la Torre et al., 2007, Beck et al., 2011). In interviews public officials agreed that such international platforms as the regional meetings of the Monetary Affairs Committee of the East African Community (EAC) are important for the exchange of such ideas. The participation of regulators in networks like the Global Partnership for Financial Inclusion has raised awareness of the links between financial stability and inclusion and of the role central banks might play in the pursuit of both objectives (Ndung'u, 2011).

Leadership

The Kenyan experience also highlights the role of leadership in driving progress: the current CBK Governor, Njuguna S. Ndung'u, has earned a reputation as a champion of financial inclusion. In both Kenya and international fora he engages in discussions on the relationship between financial stability and inclusion and the contribution that central banks can make to the achievement of price stability, financial stability and financial deepening (Ndung'u, 2011). This suggests that the CBK Governor's personal leadership has been catalytic and contributed to the CBK's progress towards balancing its multiple objectives. However, economic conditions are important: a benign economic environment, characterised by price and financial stability and a dynamic business sector, has allowed the thinking to extend beyond ensuring price and financial stability and to focus on financial inclusion. Earlier CBK governors in less benign economic environments had less policy space, and it is unlikely that a private-sector-led approach to financial deepening would have been as successful.

4.1.3 Challenges to sustaining progress towards balancing multiple central bank objectives

While the CBK has made remarkable progress in striking a balance between its multiple objectives, it also faces challenges in sustaining that progress. Policy documents and interview data highlight the regulation of financial innovations and the limited flexibility of central bank policy in reactions to economic challenges as major obstacles in this respect:

Regulation of financial innovations

Striking a balance between generating a regulatory environment that is open to financial innovation and ensuring the safety and soundness of financial services is one of the key challenges faced by the CBK in sustaining its current policy stance. This has become particularly evident from the success of M-Pesa: while many factors have played a role, it is agreed that M-Pesa has been so successful because of the limited regulation to which it was exposed before it was tested, on the principle of proportionate supervision. Experts agree that, at a later stage of product development and at a higher level of outreach, regulation needs to be more stringent. Yet the regulation of M-Pesa and other financial innovations, such as agent banking, may pose challenges for regulators.

- They need to determine at what stage they should intervene and begin subjecting financial innovations to more stringent regulation, which may mean having to confront strong interests where a small number of players already dominate a lightly regulated market.
- Financial innovations in which non-bank financial service providers are involved call for closer coordination between the regulators of such institutions (e.g. telecommunications regulators in the case of mobile banking) and banking regulators.
- Financial innovations may require regulators to acquire new regulatory capacities. To regulate agent banking, for instance, regulators need to learn from global experience with this innovation and adapt the knowledge thus acquired to the domestic context.

Where regulators fail to address these challenges, they risk emphasising financial deepening at the expense of stability and so upsetting the fragile balance between these objectives.

Limited flexibility in reactions to changes in the economic environment

Another major obstacle to sustained progress is the limited flexibility of central bank policy in reactions to changes in the economic environment. Price and financial stability is a precondition for financial deepening. Consequently, while there are strong arguments for African central banks to be assigned the triple objective of price stability, finan-

cial stability and financial deepening, they need to maintain flexibility, optimally choose trade-offs between these objectives and adjust the importance attached to each in response to economic challenges. A rise in inflation, for instance, may require a temporary reduction in the emphasis placed on financial deepening and an increase in that placed on price stability with a view to redressing the balance later when price stability has returned.

The Kenyan experience shows that maintaining flexibility of the policy stance can be difficult in practice. In late 2010, inflation and exchange rate pressures rose in Kenya, partly because of the drought in the Horn of Africa and higher global food and oil prices. However, monetary policy was slow to respond to these challenges and maintained an accommodative stance, even when core inflation too was affected around June 2011. In September 2011, private-sector credit growth accelerated to 36 percent year-on-year, about twice the rate in the previous year, partly because of dynamic private-sector activity, but also because of loose monetary policy (IMF, 2012c). Only when inflation reached an initial peak of 19 percent in October 2011 did the CBK tighten the monetary policy and raise its policy rate substantially. Delays in the monetary-policy response put considerable pressure on the exchange rate and heightened credit and liquidity risks arising from the steep rise in interest rates in response to drastic monetary tightening (IMF, 2012c).

Why was the CBK's response to macroeconomic instability delayed? According to the CBK itself, the delay was due to uncertainty about the source of inflationary pressure and the expectation of a reversal of international and domestic food price increases (IMF, 2012c). However, interview data also suggest that the delayed response was due to concerns about maintaining the economy's growth momentum: the CBK emerged from a benign economic environment with relatively low inflation, relative financial stability and successes in financial inclusion and probably wanted to sustain credit and investment growth. Concerns about the government's economic development policy objectives may explain why, in practice, it can be difficult to react to short-term challenges and adapt the central bank policy stance, despite awareness of the interdependence of price stability, financial stability and financial depth.

4.1.4 Conclusions

Over the past decade, the CBK has made sustained progress towards balancing its multiple, and at times conflicting, objectives. This progress has been driven by the need to accommodate the policy preferences of a diversified business sector to meet Kenya's investment needs, global knowledge exchange and leadership. While progress has been remarkable, the regulation of financial innovations and limited flexibility in adjusting central bank policy to changes in the economic environment are key challenges to sustaining it. However, despite these challenges, there is cause for optimism: Kenya's business community is becoming increasingly powerful, and state-business relations have become more productive over the past decade (AfDB et al., 2011a). As the private sector has developed significantly in the past ten years, Kenya now has a strong constituency for both stability and financial deepening.

4.2 The Nigerian experience

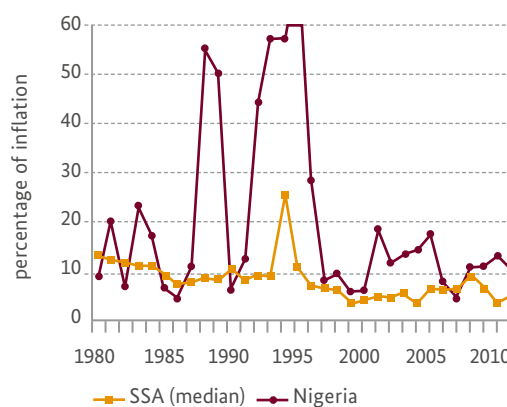
“Our objective is to bequeath to this country a stable financial system that will oil the wheels of economic development on a sustainable basis.”

Sanusi Lamido Sanusi (2010)¹³

Nigeria's performance with respect to price stability, financial stability and financial depth has been mixed over the past decade, but there have recently been signs of improvement. As Figure 7 shows, inflation in Nigeria is twice the African median of 6 percent, having averaged 12 percent from 2000 to 2011. Yet it has improved compared to the 1990s, when it averaged 31 percent. The ratio of bank NPLs to total loans, which averaged 17 percent from 2000 to 2011, has been above the African average of 12 percent and rose very sharply during Nigeria's financial crisis in 2009, as Figure 8 reveals. Yet crisis resolution measures and reforms of banking supervision have been launched with the aim of reducing NPLs, indicating a gradual restoration of financial stability (IMF, 2012f). As Figure 9 shows,

Figure 7

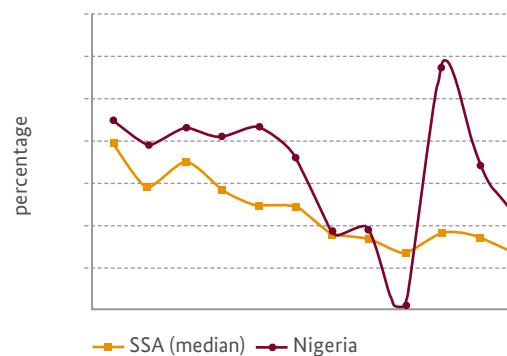
Nigeria and SSA: inflation, consumer prices



Source: World Bank (2012). Note: SSA sample size: 37 countries (see list of countries in Appendix I).

Figure 8

Nigeria and SSA: ratio of bank NPLs to total gross loans (percent)



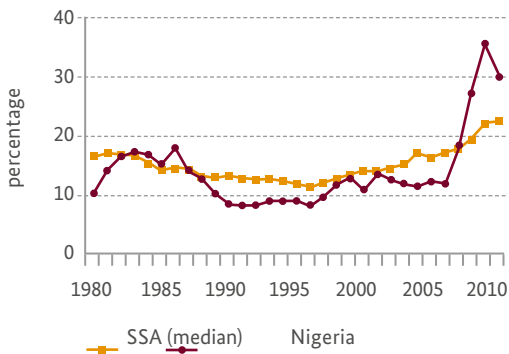
Source: World Bank (2012). Note: SSA sample size: 15 countries (see list of countries in Appendix I). Data available only from 2000. Data for Nigeria in 2011 estimated from CBN (2011d) and IMF (2012f).

the growth in NPLs followed massive credit growth, beginning in the mid-2000s. While Nigeria's private credit in the 1990s was, at an average of 10 percent, below the African average of 12 percent, it has grown substantially over the past decade. It averaged 18 percent from 2000 to 2010, slightly exceeding the African average of 17 percent.

13 Governor of the Central Bank of Nigeria since 2007.

Figure 9

Nigeria and SSA: private credit by deposit money banks/GDP



Source: Beck et al. (2012). Note: SSA sample size: 34 countries (see list of countries in Appendix I).

Financial inclusion as measured by account penetration is, at 30 percent of the population, higher than the African average of 24 percent (see Figure A1 in Appendix II).

This report stressed at the outset that economic outcome indicators should not be interpreted as indicators of central bank objectives and hence of progress made. Yet a comparison across time does indicate when an adjustment of the central bank's policy stance – the importance it attaches to price stability, financial stability and financial deepening – may be beneficial. The next section gives an historical overview of the extent to which the Central Bank of Nigeria (CBN) has sought to achieve these objectives and has adjusted its policy stance.

4.2.1 Central banking trajectory and progress towards balancing multiple objectives

When Nigeria became independent in 1960, banks, both foreign-owned and domestic, played a limited role in financing development: expatriate banks focused on providing banking services for British commercial enterprises and short-term trading activities rather than mobilising long-term capital for development and the growth of the domestic private sector (Brownbridge, 1998c). The domestic banking sector was not able to finance Nigeria's development needs because it was weakly developed and

in financial distress at the time of independence. Strengthening Nigerian banks and mobilising capital had been the key motives for the CBN's establishment in 1958, and after independence it increasingly focused on providing finance for the government and weak domestic banks (Uche, 1997).

From the 1970s in particular, economic aspirations motivated developmental central bank policies that sought to promote financial deepening through extensive intervention in the banking sector. Allocative regulations, such as interest rate controls and the direction of credit to priority development sectors and parastatal enterprises, rather than prudential controls, became the CBN's primary regulatory concerns (Brownbridge, 1998c). The CBN's role in promoting financial stability, for instance, was limited by the Ministry of Finance's power to direct central bank policy and grant banking licences, revealing the lack of central bank authority (Brownbridge, 1998c: 118-119). The granting of banking licences thus came to be guided by political considerations, including the objective of promoting a domestic banking sector. Moreover, given the government's interest in rescuing banks owned by political supporters and state governments, banks with liquidity shortages had unconditional recourse to the CBN. The policy space for the CBN to promote price stability also shrank substantially when oil prices fell and the government's financial needs began to determine CBN policy: the level of public spending had risen steeply in response to the oil boom, but it was a trend that was difficult to reverse when oil revenues fell sharply in the first half of the 1980s. As public finances were heavily dependent on oil revenues and the tax system had remained underdeveloped, the federal government became unable to control its budget deficit. From 1990 to 1994, 86 percent of the federal budget was financed by the domestic banking system, mainly by the CBN, which increased advances to the government by 359 percent from 1991 to 1993 (Brownbridge, 1998c: 122, CBN, 1994: 17).

The emphasis that central bank policy placed on financial deepening at the expense of price and financial stability paved the way for an economic crisis. By the mid-1990s, Nigeria's financial system was in a state of collapse. In 1995, the CBN classified nearly half of the 81 local banks as distressed (Brownbridge, 1998c). Many banks suffered from distress because of the requirements to which

lending to risk sectors was subject, mismanagement and fraud. Particularly lending to politically well connected, but uncreditworthy individuals, had led to an increase in NPLs (Daumont et al., 2004). The number of NPLs also rose because higher interest rates in response to rising inflation made it difficult for the real sector to service its debts (Brownbridge, 1998c). Nor were banks able to mobilise deposits, since negative real interest rates had depressed savings rates and bank failures had destroyed confidence in the banking sector. As a result, banks had become dependent on CBN support for survival. Moreover, the growing disarray in the economy and the banking distress limited the productive sector's access to finance. As Figure 9 shows, credit to the private sector, which had risen since the mid-1970s, began to fall in the mid-1980s.

As a strong domestic constituency was opposed to changing the CBN's policy objectives, financial reform was lengthy, inconsistent and limited in scope and effect. In the face of declining petroleum prices, rising external debt, high inflation, banking crises and decreasing financial intermediation, Nigerian leaders were forced to launch a financial reform programme in 1986. The CBN, for instance, removed and reintroduced some allocative regulations, such as interest rate controls, several times during the 1980s and 1990s (Lewis and Stein, 1997). It also sought to restore financial stability by making regulation more stringent (Brownbridge, 1998c: 120). However, limited supervision capacities and collusion among regulators and banks using their political leverage prevented the CBN from playing its stabilising role more effectively (Brownbridge, 1998c: 121). Moreover, macroeconomic instability and the crisis in the real sector made it difficult to buy political support for reforms in the 1980s and 1990s (Lewis and Stein, 1997). Banks challenged the CBN's policies only to a limited extent, because the government had stakes in many domestic and foreign banks, many were owned by politically connected individuals, and banks had become reliant on central bank finance (Uche, 2007, Brownbridge, 1998c). The government's revenue needs, the banking distress and the contraction of private credit also strengthened the constituency in the public and the private sector for the CBN's financial deepening policies. Politicians thus had strong incentives to maintain ineffective institutions.

Progress towards balancing multiple objectives over the past decade

When military rule ended in 1999 with the transition to democracy under President Olusegun Obasanjo, his government sought to promote economic recovery through gradual reforms. High oil prices generated a benign environment for reform: Nigeria experienced several years of moderate growth, averaging 4 percent in the 2000s, thanks to high oil prices. During the 2000s, high oil revenues, which the government could use entirely at its own discretion, increased its policy space, since they reduced the government's vulnerability to the demands of domestic and external investors and of donors.

Stated and demonstrated objectives of central bank policy

There is a political consensus in Nigeria that central bank policy should not confine itself to the objectives of price and financial stability, but also encourage financial deepening because oil-dependence and a lack of economic diversification are key obstacles to development (Sanusi, 2011, Soludo, 2004, National Planning Commission, 2004). Nigeria's national development plan, Vision 2020, outlines a path to economic diversification with the aim of transforming the country into one of the world's top 20 economies by the year 2020 (National Planning Commission, 2009). Yet financial depth has not yet reached the levels necessary for structural transformation: savings are low, access to finance is limited, and bank lending is concentrated on such prime borrowers as the government and the oil and telecommunications industries. The CBN is therefore seeking to promote financial deepening, by promoting financial sector development and inclusion, for example (Sanusi, 2011, Soludo, 2004). This is also evident from the CBN Act of 2007, which declares price and financial stability to be major objectives of central bank policy, but also refers to the CBN's developmental function (CBN, 2007). Interviews have shown that many public officials see price and financial stability not as objectives in themselves but as means to develop the real economy.

The CBN's monetary policy has price stability as its primary objective, but communiqués issued by the Monetary Policy Committee (MPC) also point to the importance of exchange rate stability and of maintaining low interest rates as a tool for lending to the real economy (CBN, 2010b, CBN, 2011b). The focus on the objectives of exchange rate

stability, financial stability and financial deepening partly explains the accommodative stance of monetary policy in recent years (IMF, 2011a). Particularly during Nigeria's financial crisis in 2009/2010, the CBN was concerned to maintain low interest rates in order to promote financial stability and avoid a credit crunch (IMF, 2012f). Moreover, its monetary targeting framework with a single-digit inflation target indicates a preference for flexibility in monetary policy to enable it to react to both growth and inflation challenges. While a narrower inflation objective might help to anchor inflation expectations, the CBN's argument for maintaining such a wide band is that Nigeria's oil-dependence and associated exchange rate volatility form a challenging environment for monetary policy: in its view, inflation is strongly influenced by such structural inefficiencies as uncompetitive markets and weakly influenced by monetary policy (IMF, 2012f, IMF, 2011a). Overly tight monetary policy would worsen structural inefficiencies and so increase inflation risks, whereas strengthening the real economy would help to improve the monetary transmission mechanism (CBN, 2012d). Nonetheless, the CBN seems more recently to have attached greater importance to the price stability objective, thus improving the balance between its multiple objectives. Since September 2010, after the resolution of the banking crisis, the CBN has tightened a monetary policy "freed from financial stability considerations" (CBN, 2011a) and supported by strong economic growth (CBN, 2012c). It is also more generally agreed within the CBN that price stability is a precondition for growth and financial stability and that the government's expansionary fiscal policy needs the counterbalance of monetary tightening (Sanusi, 2011, IMF, 2012f). Moreover, the MPC's activities have become more transparent in recent years in that it publishes information on its members' voting behaviour, for instance, thus increasing the CBN's accountability in the monetary policy field.

The CBN's financial policies show that it is still concerned about financial deepening, targeting such underserved segments as small and medium-sized enterprises (SMEs). Until 2008, for instance, the CBN administered the Small and Medium Enterprises Equity Investment Scheme (SMEEIS), which obliged banks to set aside 10 percent of their profits for equity investment in SMEs or single-digit interest-rate loans to SMEs. The various schemes run by the CBN's Development Finance Department to stimulate

the flow of resources at below-market interest rates to productive sectors and to reduce the risks of lending to priority sectors, such as agriculture and SMEs, also demonstrate the concern for financial deepening. These activities include the Commercial Agriculture Credit Scheme of 2009, which subsidised credit to agriculture, and the SME Credit Guarantee Scheme of 2010. The CBN is also involved in capacity-building, running an Entrepreneurship Development Centre and planning financial education activities, for instance. In addition, it established a Consumer and Financial Protection Department in 2012 (see also the CBN's organisation chart in Appendix III), also with a view to increasing the sustainability of financial deepening and inclusion.

In the area of financial policy, however, there is also more emphasis placed on safeguarding financial stability in response to the banking crisis in 2009, and this has improved the balance between the CBN's objectives. Its official financial stability mandate is most evident from the CBN Act and from its banking regulation and supervision responsibilities. Yet the banking crisis in 2009 revealed that banking supervision and regulation had not kept pace with financial deepening in the previous credit boom years. It was only when its inspections in 2009 revealed that eight banks, accounting for about a third of the banking system's assets, were either insolvent or undercapitalised, that the CBN took quick and firm action, placing greater emphasis on the financial stability objective. The CBN rescued the eight banks, replaced their senior management, guaranteed all inter-bank transactions, foreign credit lines, and pension deposits and kept the banking system under close surveillance, posting resident examiners in all banks. Together with the Nigerian government, the CBN set up the Asset Management Company of Nigeria (AMCON) in 2010. AMCON has issued bonds to Nigerian banks in exchange for NPLs as a means of absorbing bad loans and leaving the banks with cleaner balance sheets, which will facilitate their access to capital markets and financial intermediation. These activities enabled the CBN to avoid a systemic crisis. It has also undertaken longer-term reforms to promote financial stability, increasing compliance with Basel I (IMF, 2011a, World Bank, 2009a). Financial reforms include the transition to risk-based supervision, ongoing since 2008, the repeal of universal banking guidelines in 2010, the regulation of microfinance banks in 2005 (revised in 2011) and the strengthening of cross-border supervision,

through the adoption in 2011 of a clear framework for banks engaged in cross-border activities, for example, and the implementation of Memoranda of Understanding with regulators in various jurisdictions (CBN, 2012a). The CBN has also designed a macro-prudential policy framework, is working to improve coordination with other supervisory agencies, such as the Securities and Exchange Commission, which regulates the capital market, and harmonised Nigerian financial reporting standards in 2011/2012 (IMF, 2012f). The CBN's efforts to enhance financial stability seek to encourage the development of a banking sector supporting the country's economic development (Sanusi, 2010, Sanusi, 2012).

4.2.2 Drivers of progress towards balancing multiple central bank objectives

While the CBN has traditionally sought to play a developmental role, there has been remarkable progress towards a better balance between the CBN's price stability, financial stability and financial deepening objectives in recent years, particularly after the banking crisis in 2009. Interview data, policy documents and literature on the political economy of Nigeria suggest that a combination of three factors has driven this progress: Nigeria's financial crisis of 2009/2010, central bank independence and leadership.

The banking crisis of 2009/2010

By making the need for financial stability more evident, the banking crisis in 2009/2010 was a driver of progress towards a better balance between the CBN's multiple objectives. In response to solvency and liquidity problems in eight banks, which accounted for about a third of the Nigerian banking sector's assets, the CBN took firm action

to prevent a systemic banking crisis and rescued the eight banks. While its success in restoring confidence in this way led to a gradual increase in deposit mobilisation and lending, the cost of cleaning up the balance sheets and recapitalising the banks concerned is estimated by the authorities at about 2.4 trillion Naira, equivalent to almost 8 percent of GDP (IMF, 2011a). The systemic nature and high costs may explain why financial stability has been a policy priority since 2009.¹⁴

Moreover, following an analysis of the origins of the crisis, the CBN has embraced the objective of promoting sustainable and "socially useful" financial deepening (Sanusi, 2010). Inspections of the distressed banks showed that they held a sizable proportion of margin loans and NPLs associated with the oil sector. Banks had accumulated excessive risks, if only to meet the stringent capitalisation requirements for the banking-sector consolidation (see Box 3). Thus the substantial growth of the banks following the consolidation, which was supported by expansionary monetary policy, had not been matched by a corresponding regulatory upgrade, and the banking sector's activities were less focused on financing productive sectors than on short-term profits (IMF, 2011a, Sanusi, 2010). In the light of these findings, the CBN has sought to strengthen supervision and pursue financial policies with a view to encouraging sustainable financial development. The analysis of the origins of the crisis also identified politically exposed persons in default and the lack of corporate governance as factors leading to the crisis (Sanusi, 2010, Sanusi, 2011). This further increased the authorities' distrust of banking and financial innovations, e.g. mobile banking, have come under close scrutiny (OPM, 2011).

Box 3

The Nigerian banking sector consolidation

In 2004/2005 the CBN mandated a steep increase of minimum bank capitalisation from 2 to 25 billion Naira (approximately US\$ 195 million), to be completed within 18 months. Banks achieved this capitalisation, which is high even by international standards, by means of equity investment, mergers and acquisitions, resulting in the consolidation of the banking sector from 89 to 25 banks. The aim of this policy was to create internationally competitive banks and increase domestic competition and thus financial depth (Soludo, 2004).

14 It is not clear why, in contrast to the banking crises of the 1990s, the CBN responded to the crisis of 2008/2009 by substantially strengthening its financial stability mandate. One explanation is that Nigeria today is more integrated into the international financial system, which increases the economic and political costs of a banking crisis. Another possible explanation is that, compared to the 1990s, when the country suffered from wider economic crises, the government today is less vulnerable to the demands of Nigerian banks for lax oversight because, after several years of high growth and oil revenues, the government had substantial financial resources at its disposal and IFIs supported the CBN's crisis management.

Central bank independence

The CBN has also been able to place greater emphasis on financial stability, and so improve the balance between its multiple mandates, because of the high degree of independence it enjoys. The Central Bank Act of 2007 strengthened the CBN's formal independence considerably, by lowering the limit on the amount that the CBN might advance to the government, making the Governor's appointment and removal by the Presidency subject to the confirmation of the Senate and clearly expressing the CBN's operational autonomy, for example. It also specified that the CBN was accountable to the Presidency and the National Assembly, but not to the Ministry of Finance (which is, however, represented on the CBN's Board). The increase in the CBN's autonomy in 2007 can be seen as part of the wider economic reforms that the Obasanjo administration (2003-2007) undertook in its second term with the help of a benign economic environment and with political support (Utomi et al., 2007). De facto independence is also likely to have increased in Nigeria: the more sophisticated financial markets become, the more valuable becomes the central bank's macroeconomic and financial market expertise and the greater becomes its policy space (Maxfield, 1997). Nigeria has seen strong financial market development in recent years, and the value of its financial market expertise, which is unmatched by other Nigerian public institutions, is likely to have increased its authority in the monetary and financial policy fields. Both de jure and de facto independence will probably have helped the CBN in its efforts to promote price and financial stability. Resolving the banking crisis, for instance, included action against politically exposed persons in default, which would have been difficult without an independent central bank. Financial independence and strong capitalisation were important in enabling the CBN to play a leading role in the resolution of the banking crisis. For instance, CBN grants – 500 billion Nairas over 10 years funded from the CBN's net profits is envisaged – are crucial for the repayment of AMCON's financial liabilities. Financial independence has also helped the CBN to pursue monetary policy with a view to increasing price stability, since it is able to issue its own t-bills for liquidity management and does not rely on the government to issue them, unlike many other, less well capitalised central banks in Africa. In those countries, t-bills issued for debt are not clearly distinguished from those issued for liquidity management, and

fiscal expansion through domestic borrowing becomes less visible, increasing the threat to price stability.

Leadership

The Nigerian experience is also an indication of the importance of effective leadership in driving progress. Governor Sanusi Lamido Sanusi's leadership was decisive in the resolution of the banking crisis: a professional banker, Sanusi had the insider knowledge needed to detect deficiencies in bank supervision and take quick and firm action. While leadership is an important factor, the CBN's independence, the severity of the financial crisis created a window of opportunity for reform and the political backing of the Presidency (Aminu, 2010) also increased the possibilities for the current Governor to draw on his areas of expertise and improve the balance between the objectives of financial stability and deepening. In fact, just as Chukwuma C. Soludo, Sanusi L. Sanusi's predecessor, was about to leave office in 2009, fragilities in the Nigerian banking sector became known and initial measures were taken. The President thus had the chance to replace the CBN's leader at the onset of the crisis with someone who had insider knowledge and the determination to restore financial stability.

4.2.3 Challenges to sustaining progress towards balancing multiple central bank objectives

While the CBN has made remarkable progress towards striking a balance between its multiple objectives, there are also challenges to sustaining that progress. Policy documents and interview data reveal three major challenges to sustaining progress: the risk of resorting to quick fixes, weak partnerships between the central bank and other domestic stakeholders in promoting financial deepening, and efforts to curtail the independence of the central bank.

Resorting to quick fixes to overcome the lack of financial depth and inclusion

Over the past decade the CBN has made substantial efforts to move beyond the provision of development finance and allocative regulations because of their limited effectiveness in encouraging financial deepening and inclusion. More recently, it has increasingly complemented its traditional development finance functions, including credit

guarantee schemes and lending facilities, with approaches to incentivising banking-sector outreach and institution-building to reduce the transaction costs of financial intermediaries. Examples of this are the licensing of a credit reference bureau (although its coverage is still limited) and the Nigerian Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL). NIRSAL, a scheme for promoting agricultural lending piloted in 2011, has, for instance, a technical assistance facility designed to equip banks to assist producers to borrow and use loans more effectively. NIRSAL also includes a mechanism for rating banks in terms of the effectiveness of their agricultural lending and social impact and a bank incentives mechanism that gives banks the financial encouragement to build capabilities for agricultural lending (CBN, 2011e). These examples indicate the greater emphasis placed by the CBN on the sustainable promotion of financial deepening.

However, a disconnect persists between the needs of the real economy and banking sector activities in Nigeria, posing a serious challenge to economic diversification, which is crucial if Vision 2020 is to be achieved. Nigeria's political leaders are becoming increasingly aware that economic diversification is necessary not only for sustainable growth but also for regime stability, since the uneven distribution of oil wealth has been a source of growing political tension (National Planning Commission, 2009, National Planning Commission, 2004, Ploch, 2012, *The Economist*, 2012).¹⁵ However, although Nigeria's non-oil private sector is becoming increasingly dynamic, the oil business has remained the dominant export activity and primary source of foreign exchange and public finance: in 2010, oil and gas accounted for about 96 percent of total export receipts (AfDB et al., 2011b). Owing to the dominance of the oil sector and the state as the recipient of oil revenues, investors tend to target these two groups, which limits their contribution to the diversification of the real economy. Banks, for instance, prefer lending to the government and oil sector, rather than reaching out to agriculture or other financially excluded groups (CBN, 2010a). Moreover, while Nigeria was the largest recipient of foreign direct investment (FDI) in Africa in 2011 and telecommunications and banking were attracting large amounts of FDI, the Nigerian oil sector continued to receive the majority of FDI (Corporate Guides International/NIPC, 2010,

UNCTAD, 2009). Nigeria's political leaders therefore have major incentives to ensure that public policy, including that on central banking, contributes to the development of the productive sector.

Given the perceived urgency of promoting economic diversification by ensuring that central bank policy facilitates productive sector development, there is a risk that the CBN will resort to quick fixes to overcome the lack of financial depth and inclusion. In response to the need to develop the real economy, the CBN has periodically sought to intervene more directly in financial markets, not only as financier, but also by setting rules to guide banks' investment decisions. More recent examples are the SMEIS and a CBN circular in 2011, requesting all banks to establish an agricultural finance department and lend to agriculture (CBN, 2011c). As demands for economic diversification persist, the CBN continues to feel responsible for productive sector development by intervening in the banking sector, for instance. Yet global experience of allocative restrictions on banks has been at best mixed (De la Torre et al., 2007, Brownbridge et al., 1998). In Nigeria, the SMEISS promoted equity participation rather than kick-starting lending, and interview data suggest that, in response to the CBN circular of 2011, banks simply reclassified their loans. Moreover, pressure to support productive expansion may increase incentives to emphasise financial deepening and neglect stability.

Weak partnerships to encourage financial deepening

In the past decade, the CBN has taken the lead in a wide range of policies to encourage financial deepening and inclusion. In many other developing countries, such tasks are assigned to development finance banks or finance ministries. In Nigeria, the CBN has taken on these activities primarily in an attempt to fill the gaps left by other public and private agencies. Interview data and partnerships of the CBN and donor agencies suggest that, owing to its strong financial base, remarkable governance standards, technical capacity and long history of involvement in financial deepening, the CBN has long been the institution preferred by many stakeholders, including many donors, to lead such activities.

15 Nigeria's uneven distribution of oil wealth, for instance, seems to have contributed to the emergence of militant groupings like Boko Haram, a violent Islamist group.

However, if the CBN leads financial deepening efforts alone and fails to create strong partnerships with other domestic stakeholders, this poses risks for maintaining progress towards balancing multiple objectives.

- The CBN risks spreading already limited personnel and financial resources too thin if it takes the lead in an increasing number of financial deepening activities. Development finance activities, for instance, may put pressure on the CBN's financial resources, since they pose on- and off-balance sheet risks in the absence of appropriate mechanisms.
- If the CBN takes the lead in financial deepening policies without creating partnerships, it increases the risk of central bank policies contradicting each other, since commitments to financial deepening may reduce the flexibility required for policy prioritisation when price or financial stability is challenged. For instance, tightening monetary policy in response to inflation may contradict low interest rates offered to productive sectors as part of development finance schemes. Avoiding such contradictions requires partnerships with actors outside the central bank who can take the lead in financial deepening activities, leaving the CBN to concentrate on its stability objectives when challenges arise.

Thus strong partnerships between central banks and other domestic (public or private) stakeholders are crucial because they enlarge the policy space for central banks. Moreover, strong partnerships are necessary because they allow other stakeholders to develop ownership and because central bank policy is only one part of the policy response to shallow financial markets and cannot be effective unless other policies, e.g. fiscal policies, work in tandem.

Efforts to curtail CBN independence

Recent efforts by the legislature to curtail the CBN's independence are a serious challenge to sustaining progress, since they may limit the CBN's capacity to promote its objective of safeguarding stability. As outlined above, central bank independence was instrumental in improving the balance between the CBN's mandates for price and financial stability on the one hand and financial deepening on the other. However, the Nigerian legislature has recently sought to reduce the powers of the CBN by proposing an amendment to the CBN Act of 2007 (NDIC, 2012, Rice,

2012). The proposed amendment, which at the time of writing is still under consideration in the National Assembly, would curtail CBN independence in three major respects: first, it would require the CBN to submit its annual budget to the National Assembly for approval based on the 2007 Fiscal Responsibility Act, which requires all corporations and public institutions to submit their budgets to the legislature. Second, it proposes that the CBN Governor should cease to be the chairman of the CBN Board. Third, it suggests that the CBN Deputy Governors should no longer act as members of the Board, but be replaced by political appointees. There is broad agreement among experts and such IFIs as the IMF that the proposed bill would undermine recent progress in the promotion of price and financial stability in Nigeria (Uzongu, 2012, Nwachukwu, 2012).

4.2.4 Conclusions

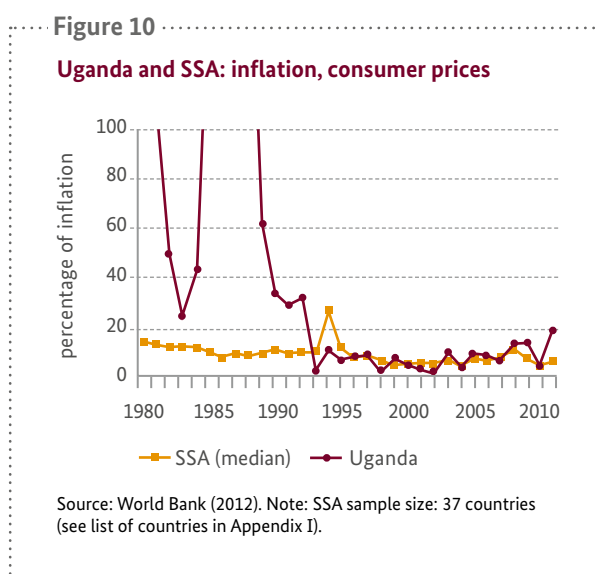
Over the past decade, the CBN has made remarkable progress towards striking a balance between its multiple objectives. This progress has been driven by the recent banking crisis, the CBN's independence and the leadership of the current governor. Key challenges to sustaining progress are the risk of resorting to quick fixes, weak partnerships promoting financial depth and efforts to curtail the CBN's independence. One reason for optimism that progress will be sustained is that the business sector is slowly growing and gaining in importance as a partner of and challenger to the government. Private-sector investment, for instance, increased from US\$ 75 million in 2000 to US\$ 8.1 billion in 2008 (IMF, 2011a). In particular, growth in non-oil sectors is exceeding that in the oil and gas sectors (AfDB et al., 2011b). This development could strengthen the constituency for both stability and growth.

4.3 The Ugandan experience

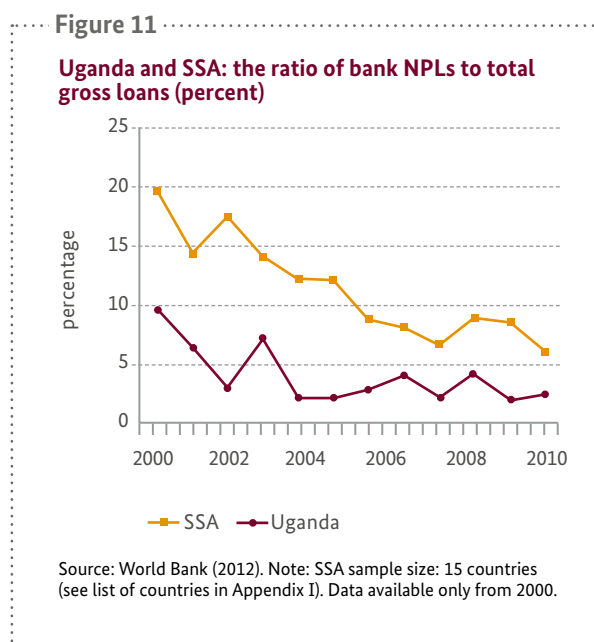
“Emerging markets have become increasingly attractive to foreign investors and the only way to sustain this attractiveness is through deepening and widening the financial markets and managing the economy in a prudent manner through avoidance of policy reversals and maintaining a transparency in economic management.”

Emmanuel Tumusiime-Mutebile (2007)¹⁶

Over the past decade, Uganda has performed well in terms of price and financial stability, and financial markets are slowly deepening. As Figure 10 shows, inflation in Uganda is remarkably low, averaging 7 percent from 2000 to 2011.

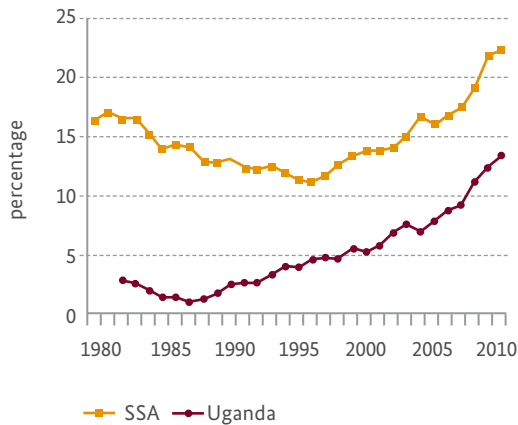


This is an improvement compared to the 1990s, when it averaged 13 percent, but slightly above the African median of 6 percent, owing to recent inflationary pressures. In the first half of the 2000s, inflation in Uganda was below the African median. The ratio of bank NPLs to total loans is also impressive by African standards, as evident from Figure 11. NPLs averaged 4 percent from 2000 to 2011, equivalent to about one third of the African average. As Figure 12 shows, Uganda lags behind in financial deepening, but credit has almost doubled over the past decade, averaging 9 percent from 2000 to 2010, compared to 4 percent in the 1990s. Yet it remains far below the African average of 17 percent. Financial inclusion as measured by account penetration is, at 20 percent of the population, similarly still below the African average of 24 percent, as Figure A1 in Appendix II illustrates. The next section outlines the extent to which the Bank of Uganda (BoU) has sought to contribute to achievements in price stability, financial stability and financial deepening. It highlights the BoU’s stated and demonstrated policy objectives with a view to showing the progress made towards balancing these objectives.



16 Governor of the Bank of Uganda since 2001.

Figure 12

Uganda and SSA: private credit by deposit money banks/GDP

Source: Beck et al. (2012). Note: SSA sample size: 34 countries (see list of countries in Appendix I).

4.3.1 Central banking trajectory and progress in balancing multiple objectives

While the BoU began operations in 1966 with its focus on price and financial stability, financing needs in Uganda at the time of independence soon created a constituency for a central bank focus on financial deepening. The BoU's mission was initially conservative, since the Ugandan government was seeking to create confidence in the currency and to encourage international lending to Uganda (Helleiner, 2003). However, soon after the founding of the BoU, the government's financing needs increased rapidly, partly because of the newly independent state's development needs, but also because war financing strained government budgets. In addition, efforts to develop the Ugandan private sector required substantial external financing, there being few Ugandan entrepreneurs after independence (Moncrieffe, 2004, Kasozi, 1994). As the foreign-owned banking sector was failing to meet Uganda's financing needs, a broad agreement for state-led economic development and a central bank mandate for financial deepening emerged.

From the 1970s onwards, the BoU increasingly emphasised its financial deepening objective at the expense of its price

and financial stability objectives. It began to regulate the allocation of financial resources in the banking sector, by means of interest rate and foreign exchange controls, for instance (Brownbridge, 1998a). It also opened a Development Finance Department in 1986. Prudential regulation and banking supervision remained deficient. In particular, the BoU lacked the legal authority to force banks to improve management and lending practices without support from the Minister of Finance (Brownbridge, 1998a). In addition, the Banking Act of 1969 did not impose clear restrictions on insider lending and was more explicit on allocative than on prudential requirements. Nor did it grant the BoU the authority to force banks to improve management without the backing of the Minister of Finance. Until the 1990s, the BoU provided unconditional liquidity support for distressed local banks (Brownbridge, 1998a), reflecting the government's intention of allocating funds according to its political priorities. The Ministry of Finance also allowed the market entry of undercapitalised banks to support the development of domestic banks (Brownbridge, 1998a).

The central bank policy, which emphasised financial deepening and neglected stability, severely damaged the financial sector and the real economy. Uganda suffered a prolonged economic decline from the 1970s until the mid-1980s, due not only to the civil war, but also to economic mismanagement. As Figure 10 shows, inflation soared in the 1980s: by financing large government deficits, the BoU helped average inflation to rise to 111 percent in the 1980s (World Bank, 2012). Negative real interest rates depressed saving and lending. Local banks became increasingly distressed from the 1980s onwards due to the tightness of financial markets, fraud, the lack of managerial capacity and the weakness of internal controls and the regulatory framework (Brownbridge, 1998a). As Figure 12 reveals, this environment was also difficult for the productive sectors, which continued to be excluded from bank finance because of tight liquidity, foreign banks' conservative lending policies and the channelling of subsidised credit to individuals with political connections. As a result, bank lending to the private sector averaged only 2 percent of GDP in the 1980s.

In 1986, Yoweri Museveni, the leader of the National Resistance Movement (NRM), ended the civil war and, on taking power, promised economic growth and political

stability. In the first decade of his rule, President Museveni changed the general stance of economic policy. Supported by the donor community, the new regime launched a stabilisation programme and, in 1993, a financial sector adjustment programme. Uganda soon earned a reputation among donors as ‘a pioneer of macroeconomic stabilisation and structural adjustment in sub-Saharan Africa’ (Collier and Reinikka, 2001: xiii). As part of its stabilisation programme, the government repaid a substantial amount of its debt to the banking system from 1992 to 1994 (Brownbridge, 1998a), and inflation fell from 111 percent during the 1980s to 13 percent in the 1990s. As a result, real interest rates became positive, increasing banking sector liquidity and profitability. By the end of the 1990s, financial reforms had removed allocative and interest rate controls and liberalised the capital account and the foreign exchange market. Reforms at the end of the 1990s further improved bank regulation and supervision, leading, for example, to the central bank gaining more independence from the Minister of Finance in the licensing and regulation of financial institutions, more stringent capital requirements for banks and restrictions on banks as regards insider lending or large credit exposures (Brownbridge, 1998a, Byaruhanga et al., 2010).

Progress towards balancing multiple objectives over the past decade

Uganda has experienced a decade of relative stability since 2000: security has been restored in most parts of the country, its macroeconomic stability has been exceptional on the African continent, and its economy responded to reforms with an average growth rate of 6 percent in the 1990s and 8 percent in the 2000s. Uganda’s banking sector has recovered from a serious crisis in 1997 and 1998: the health of the banking system has improved remarkably following the closure of several distressed banks and further improvements to banking regulation and supervision. The remaining banks are well capitalised, profitable and resilient, with a low level of NPLs, as Figure 11 shows. However, while there has also been an upward trend in private-sector lending, the banking sector lacks competitiveness, focuses on serving the higher end of the market and has invested heavily in low-risk government securities (Beck and Hesse, 2009, Brownbridge and Tumusiime-Mutebile, 2007, Nampewo, 2013).

Stated and demonstrated objectives of central bank policy

Although the BoU has become concerned about the limited degree to which the banking sector meets the financial needs of the weakly developed real economy and has lately placed greater emphasis on financial deepening and inclusion, its main mission is the promotion of price and financial stability (BoU, 2000, BoU, 2012c). The BoU Act of 2000 states that, without prejudice to the objective of promoting economic stability through monetary policy, the BoU “shall, where appropriate, participate in the [Government’s] economic growth and development programmes” and may “participate in development financing” (BoU, 2000). Yet from the BoU’s perspective, maintaining its policy focus on price and financial stability as the precondition for financial depth is the best way to generate sustainable growth (BoU, 2012c, Tumusiime-Mutebile, 2007, Tumusiime-Mutebile, 2011). According to one senior aid official, “more activist policies to promote financial deepening would constitute a reversal of Uganda’s liberal model of governing the financial sector.”

The Central Bank Act calls for the BoU’s activities to pivot on the pursuit of “monetary policy directed to economic objectives of achieving and maintaining economic stability” (BoU, 2000). Interview data confirm that the pursuit of monetary policy with a view to generating low and stable inflation has been the BoU’s policy priority for the past decade. As Figure 10 shows, this commitment is reflected by what are, by African standards, low inflation rates for extended periods. The BoU has targeted an inflation rate of 5 percent in the medium term, initially using a monetary targeting framework and since July 2011 an “IT-lite” regime to increase the transparency of and accountability for monetary policy. Within the IT regime, the BoU sets an interest rate as the operating target of monetary policy at a level consistent with 5 percent inflation as a guide for 7-day interbank interest rates. As in Nigeria, it is agreed that expansionary fiscal policy, an inefficient monetary transmission mechanism and structural constraints pose challenges to the control of inflation.¹⁷ However, while it is acknowledged that the “long-term solution to controlling inflation rests on addressing the structural constraints and increasing productivity”, the Governor considers “controlling inflation in the short-term extremely crucial

17 This also became evident when inflation, which was close to zero in autumn 2010, increased sharply, reaching almost 30 percent by December 2011. The main drivers are supply-side shocks, which have increased the prices of food and fuel, and the significant growth of credit, both to the private sector and to the government in the context of the presidential elections in April 2011.

to stimulating this long term economic growth". The BoU occasionally intervenes to dampen exchange rate fluctuations and seeks to use monetary policy to stabilise output (Kasekende and Brownbridge, 2011, Mugume, 2011) but, as a prolonged monetary policy tightening in 2011 also suggests, the BoU is willing to accept a lower growth rate and reduction in private credit to fight inflation (IMF, 2012b). Moreover, it regards the promotion of price stability as the single most important contribution that monetary policy can make to growth (BoU, 2012d, Tumusiime-Mutebile, 2012).

Since the banking crisis in 1998/1999, the BoU's financial policy has focused more sharply on the financial stability objective with a view to increasing "security, confidence and maintaining strong capitalisation rates" (Dzineku et al., 2009). Progress has been made towards these objectives, as evident from the doubling of deposits from 7 percent of GDP in the 1990s to 14 percent in the 2000s and from the low level of NPLs (Beck et al., 2012, World Bank, 2012). The BoU has made substantial efforts to contribute to these outcomes, as required by its official mandate to safeguard financial stability in the BoU Act, which specifies its bank regulation and supervision responsibilities. Its continuous efforts to strengthen bank regulation and supervision over the past decade are a further indication of the BoU's emphasis on financial stability. One milestone has been the Financial Institutions Act 2004, which lays down, among other things, licensing requirements for financial institutions, increased capital requirements and lending restrictions. Another milestone is the Financial Institutions Regulations 2010, which set out, rules for the consolidated supervision of banking operations. The BoU further strengthened consolidated supervision in 2011, when it issued the Consolidated Supervision Regulation to all banks, and given the strong presence of foreign banks in Uganda, is working to enhance cross-border supervision, by strengthening memoranda of understanding with regulators of parent banks, for example. The BoU has also strengthened its technical capacity for bank supervision, notably by creating a Financial Stability Department in 2007 (see also the BoU's organisation chart in Appendix III). It has also started to seek ways of regulating Uganda's large informal financial sector. A key reform was the regulation of MDIs in 2003. A recent Financial Sector Assessment Programme carried out by the IMF and World Bank found the Ugandan banking sector "more than adequately

regulated and supervised" (BoU, 2012a). Its resilience in the face of the global financial crisis has been attributed to Uganda's high prudential standards and has reinforced the BoU's emphasis on its financial stability objective (Kasekende, 2010).

While the financial policy remains focused on preserving financial stability, the BoU has recently increased its emphasis on encouraging financial deepening and inclusion. This has improved the balance between the three objectives of price stability, financial stability and financial depth. In 2007, the BoU closed its Development Finance Department, a move that was also supported by some donors and IFIs. According to various officials interviewed, it was agreed at that time that the BoU should concentrate on the price and financial stability objectives. In recent years, however, it has increasingly acknowledged the need to look beyond price and financial stability and to promote financial deepening if financial institutions in Uganda are to meet the financial needs of the real economy (Kagenda, 2010, BoU, 2007). This is evident, for instance, from the development of the Five-Year Financial Markets Development Plan 2008-2012 (BoU, 2007) and the BoU's Maya Declaration. In the Maya Declaration the Governor commits the BoU to developing and implementing a Strategy for Financial Inclusion based on four pillars – financial literacy, financial consumer protection, financial innovations (including mobile financial services and agent banking) and financial services data and measurement – by 2014 (AFI, 2011b). Since 2009, the BoU has also administered the Agricultural Credit Facility on behalf of the government. The Facility provides medium- and long-term financing for agricultural projects at a lower than market interest rate. The main dilemma for the BoU in promoting financial deepening and inclusion in recent years has been to find ways of pursuing these goals without increasing the threats to price and financial stability or departing from its model of a liberalised financial sector (Tumusiime-Mutebile, 2007). The BoU's policies for facilitating financial deepening therefore avoid interfering in financial institutions' lending decisions. They rely rather on technological innovation (e.g. mobile money) as a way of reducing transaction costs and seek to facilitate deepening and inclusion with a view to ensuring the safety of savings and increasing confidence in financial institutions, viewing financial deepening and stability as mutually reinforcing. Consequently, financial deepening

and inclusion policies have thus far focused on three areas: first, institution-building; the BoU issued, for instance, a credit reference bureau regulation in 2005 with the aim of improving financial stability, efficiency and deepening by reducing information asymmetries; second, the regulation of financial innovation and informal financial service providers, such as MDIs and mobile money network operators; and third, consumer protection and financial literacy, which can enhance both financial stability and deepening by increasing confidence.

4.3.2 Drivers of progress towards balancing multiple central bank objectives

While the BoU has strongly emphasised the safeguarding of price stability since the 1990s, it has recently increased its focus on financial deepening and inclusion in order to improve the balance between the objectives of price stability, financial stability and financial deepening. What factors have driven this progress? Interview data, policy documents and literature on the political economy of Uganda suggest a combination of three factors: aid dependence, political pressure to promote more inclusive growth, and the global exchange of knowledge.

Aid dependence as the trigger for a series of government-led reforms

In line with the finding of other research on the politics of central banking that central bank policy objectives reflect the interests of those who can position themselves as crucial providers of investment finance, the BoU's present policy stance has partly been shaped by the experience of donor dependence in the past.

After years of compromising financial and price stability objectives by emphasising financial deepening, donors played an important role in improving the balance between central bank objectives by demanding macroeconomic stability. Before 1992, macroeconomic stabilisation seemed elusive owing to the government's failure to reduce budget deficits, and reforms were difficult because the government had strong incentives to preserve existing institutions to meet its own and the private sector's financial needs. In 1992, however, the IMF and a number of other donors suspended aid and demanded reforms, and further resistance to reform therefore became too costly for the government (Dijkstra and Kees van Donge, 2001).

After decades of war and high inflation, peaking at 200 percent in 1987, private investment was minimal and the potential for financing public investment from taxes was limited, making aid the only available source of foreign exchange and investment funds. The prolonged economic crisis in Uganda had thus made the government highly vulnerable to the demands of donors. Consequently, President Museveni, who had once been sympathetic to Marxist development models (Manson, 2011, Kiiiza, 2006, Tumusiime-Mutebile, 2010), responded to aid conditionalities by changing his economic team and implementing stabilisation policies (Dijkstra and Kees van Donge, 2001, Holmgren et al., 2001). Monetary policy then became focused on fighting inflation. After the 1992 Budget Speech, Museveni announced, for instance: "There will be no inflation. Inflation is indiscipline" (Byaruhanga et al., 2010: 58). The focus on stability helped Uganda to achieve remarkable macroeconomic stability, and the economy responded to reforms with an average growth rate of 7 percent in the 1990s.

In the ensuing years, donors continued to play an important role in shaping economic policy. As aid inflows show, donors were content with the Ugandan government's stabilising policies. Aid reached an average of 16 percent of GNI during the 1990s and of 14 percent of GNI from 2000 to 2010, which corresponded to 79 percent of central government expenditure (World Bank, 2012). As key providers of Uganda's investment resources, donors gained political leverage over public policy (Dijkstra and Kees van Donge, 2001). In particular, the BoU seems to have made extensive use of technical assistance (Holmgren et al., 2001). Moreover, owing to the positive economic effects of the donor-prescribed stabilisation policies, donor advice also gained credibility, increasing the government's receptiveness to further reforms (Dijkstra and Kees van Donge, 2001, Mosley, 1996). For instance, financial policy reform, which also started in the early 1990s, was again strongly supported by donors (Tumusiime-Mutebile, 2010, Byaruhanga et al., 2010). However, because of resistance from within the government, reforms intended to strengthen the BoU's financial stability mandate at the expense of financial deepening were limited in scope and effectiveness (Byaruhanga et al., 2010). It was only after a major banking crisis in 1997/1998 that the BoU, supported by donors and IFIs, initiated further reforms to strengthen its financial stability mandate and enacted more stringent prudential regula-

tion (Brownbridge, 1998a, Byaruhanga et al., 2010). Donors and IFIs still have a voice in economic policy-making in Uganda, IFIs especially encourage a central bank focus on price and financial stability (IMF, 2007b, IMF, 2012g). Interview data suggest that they are supported by the banking sector, who welcomes the BoU's emphasis on promoting price and financial stability. However, donors have also become supportive of the idea that central banks have, as regulators, an important role to play in encouraging financial deepening and inclusion (Beck et al., 2011, World Bank, 2009b, World Bank, 2007). There are indications that donor-funded activities helped to raise awareness of this role among central bankers (see below under "Global knowledge exchange") and so supported the BoU's more recent embracing of the financial deepening and inclusion objectives. Donor demands thus seem to have played an important role by triggering a virtuous cycle in which positive effects of previous reforms have strengthened domestic political support for further reform.

Domestic political pressure for more inclusive growth

Domestic political pressure for more inclusive growth has been another driver of the BoU's recent focus on financial deepening and inclusion policies, redressing the balance with stability objectives. The earlier focus of BoU policies on price and financial stability partly reflects the assumption that, with growth and price and financial stability, financial deepening would follow. Yet, while Uganda has an outstanding growth and price and financial stability record, there is a widespread feeling, both in the wider public and in political circles, that more inclusive growth is needed and that liberal economic policies have failed to reduce poverty sufficiently, to deliver jobs and to increase access to financial services for the wider population (NRM, 2011, Ssewanyana et al., 2011). It is widely agreed that, if private-sector development is to be enhanced, access to finance must be enhanced (PSFU, 2010, MFW4A, 2011, World Bank, 2009b, BoU, 2011). Moreover, in interviews central bankers noted that the Finscope Surveys of 2007 and 2009 highlighted the need to attach greater importance to financial inclusion in a context of macroeconomic and financial stability. As one central banker said: "A central bank to facilitate financial sector development is not a first-best solution, but a necessary second-best solution in a country at a low stage of economic development like Uganda, where financial market failures prevail."

Global knowledge exchange

Interview data show that the exchange of ideas about the role of central banks in financial deepening and inclusion has been instrumental in raising awareness of the need and measures to balance the BoU's financial stability and inclusion objectives. In recent years, a consensus has emerged among donors that the role of central banks as regulators in developing countries might go beyond ensuring price and financial stability and include facilitating financial deepening and inclusion (De la Torre et al., 2007, Beck et al., 2011). In Uganda, where donors are important external actors, they have encouraged the BoU to facilitate financial deepening and inclusion without compromising financial stability. Donors have raised awareness, for instance, of the interconnectedness of financial stability, financial inclusion and financial literacy, and in cooperation with the GIZ the BoU has published a financial literacy and consumer protection framework. As interview data show, many Ugandan central bankers consider seminars organised by donors and exposure trips to be important for sharing ideas, peer-learning and benchmarking progress. In interviews central bankers emphasised, for example, that a 2011 seminar supported by the Partnership Making Finance Work for Africa on the reform of international regulatory standards and its implications for Africa was important for raising awareness of the necessity to adapt international financial regulation to domestic capacity and financial-sector development requirements.

4.3.3 Challenges to sustaining progress towards balancing multiple central bank objectives

Responding to political pressure for financial deepening while maintaining stability

While disquiet about financial markets has strengthened the BoU's focus on financial deepening, there is also a danger that growing political pressure on the government for inclusive growth will increase the focus on the financial deepening objective at the expense of the price or financial stability objective.

Political pressure for financial deepening and inclusion as means of generating more inclusive growth may grow in the future because political competition in Uganda has increased in recent years. When President Museveni came to power in 1986, the domestic political class had been

decimated by war and economic collapse. Throughout the 1990s, the political opposition to the NRM was weak, and economic progress strengthened its economic and political support base. This gave the government an opportunity to rule in a technocratic way (Tripp, 2010, Robinson, 2005, Mette Kjaer, 2004), to liberalise markets and to mandate the central bank to focus on the objectives of safeguarding price and financial stability. The political environment today is different, and since the second half of the 2000s in particular, there has been increased political competition and pressure on the government to replicate the outstanding results achieved in economic and financial stability in the areas of poverty reduction and job creation (Tripp, 2010), for which financial deepening and inclusion are important. One attempt to respond to such popular demands was the government's effort to establish savings and credit cooperative (SACCO) in each of the country's sub-counties as part of the rural financial services component of the government programme "Prosperity for all". The risks associated with this initiative were that the SACCOs might become politicised and financial soundness reduced owing to their lack of regulation.

Moreover, efforts to reduce aid dependence might increase the pressure for financial deepening and inclusion. Ugandan bureaucrats and politicians feel an increasingly urgent need to reduce aid dependence, if only to increase domestic policy space in an environment where donors increasingly emphasise the need for governance reforms (Barkan, 2011, Museveni, 2010). The need to reduce aid dependence has given renewed impetus to the promotion of private-sector development and investment (Republic of Uganda, 2010).¹⁸ The government is likely to want to make greater use of public policies to increase financial depth, since access to finance is crucial for private-sector development.

Increased political pressure on the government for financial deepening may make it difficult for the BoU to sustain its progress towards balancing stability and financial deepening.

- If the government responds to this pressure by requiring the BoU to engage in development finance activities or to issue allocative regulations, the BoU, as an institution with operational but not goal independence under the Ministry of Finance, would have little choice but to follow government directives.
- If the government responds to the pressure by increasing its provision of financial services on a large scale or requiring financial intermediaries to provide services to underserved segments at below market rates, the result may be that the BoU, as the guardian of stability, will again confine itself to its price and financial stability objectives. It would then have to forgo the opportunity to use its instruments to promote financial deepening.

In both scenarios, there is the risk of one central bank objective receiving more attention than another in the medium or long term and of progress towards a better balance being reversed.

4.3.4 Conclusions

In the past decade, Uganda has made remarkable progress towards balancing multiple, and at times conflicting, objectives. Aid dependence has triggered a series of government-led reforms of central bank policy designed to promote price stability, financial stability and financial depth. Political pressure to promote more inclusive growth and global knowledge exchange has been important in strengthening the BoU's focus on financial deepening and inclusion. Yet growing political pressure for financial depth is also a key challenge to sustaining progress. Despite this risk, prospects for sustaining progress are good: dynamism in the banking sector has increased in recent years, regional economic integration having helped to diversify financial services providers and products. This increases the likelihood of banks' desire for both stability and an enabling environment for greater outreach being heard.

18 The prospect of potentially large oil revenues being substituted for some aid may reduce such pressures.

5. General conclusions

Across Africa, the need to grow quickly and inclusively is being felt, and the view is gaining ground that African central banks should not limit themselves to the objectives of promoting price and financial stability, but also promote financial deepening (AACB, 2011). This is in line with the emerging consensus in the international community that one of the roles of central banks in developing countries should be to facilitate financial deepening and inclusion (Beck et al., 2011, Ehrbeck et al., 2012, Hawkins, 2011, Gray, 2006, Fry et al., 1996).

However, as there are not only synergies between the objectives of price stability, financial stability and financial deepening, but trade-offs too, striking a balance between different objectives is challenging. Many accounts of central banking in Africa have focused on the difficulties and failures encountered by African central banks when juggling their multiple objectives. In the past decade, however, remarkable progress has also been made in many African countries with respect to price stability, financial stability and financial deepening, and, as regulators and monetary authorities, central banks are likely to have contributed to these achievements (Beck et al., 2011, van Donge et al., 2012, Arbach and Page, 2010).

This report sheds light on some cases of recent progress among African central banks towards striking a balance between their multiple, and at times conflicting, objectives. Taking the cases of Kenya, Nigeria and Uganda as examples, this report explores the extent to which and the ways in which central banks have made progress towards striking a balance between the objectives of price stability, financial stability and financial deepening in the past decade. It also identifies some drivers of progress and challenges to sustaining it. This final chapter summarises the findings and singles out key messages from the case studies.

5.1 Drivers of progress in Kenya, Nigeria and Uganda

Interview data, policy documents and political economy literature suggest that a combination of several factors has driven progress towards an improved balance between central banks' multiple objectives. For Kenya, Nigeria and Uganda these factors include susceptibility to the interests of providers of crucial financial resources for investment,

economic and/or banking crises, political pressure for more inclusive growth, global knowledge exchange, central bank independence and leadership.

Susceptibility to the interests of providers of crucial financial resources for investment

In line with earlier research on the politics of central banking, the case studies show that central bank policy reflects the interests of those who are able to act as essential providers of a country's investment funds.

Kenya's increasingly diversified private investors (including entrepreneurs) seem to have played an important role in improving the balance between the CBK's policy objectives. When a new government came into power after a prolonged economic crisis and a series of banking crises, it needed, in the absence of such alternative sources of finance as aid and natural resources, to attract and raise private investment. The reforms of central bank policy and efforts to strengthen the balance between the CBK's mandate for both stability and financial deepening reflect the government's and CBK's intention to respond to the diverse concerns of a diverse group of investors regarding the focus of central bank policies. Large- and medium-scale investors have a preference for a central bank that focuses on the objectives of price and financial stability. Small-scale investors and banks seeking to reach out to the lower end of the market have a preference for a central bank that also embraces the objective of financial deepening. Responding to each of these interests has been important for the government as it seeks to strengthen its domestic political and economic power base and ensure financial independence from donors.

In Uganda donors helped to improve the balance between the central bank's objectives. By the beginning of the 1990s, Uganda had become aid-dependent and highly susceptible to the demands of donors owing to a prolonged economic crisis and the lack of alternative sources of investment finance. Responding to donor demands, the Ugandan government initiated reforms to stabilise the economy and strengthened the BoU's price stability mandate. As the stabilisation policies prescribed by donors had positive economic effects, their advice also gained credibility. This increased the receptiveness of the government and the BoU, to further central bank policy reforms, as in the late 1990s and the early 2000s, to strengthen the BoU's financial

stability mandate and, later, to embrace the objectives of financial deepening and inclusion. Donor demands seem to have triggered a virtuous cycle in which positive effects of previous reforms strengthened the domestic political support for further reform, improving the balance between the central bank's multiple policy objectives.

Nigeria's situation has been markedly different: it relies heavily on oil revenues as a source of investment finance. Its discretion over oil revenues has provided the government with substantial policy space, and central bank policy has therefore largely reflected the government's own priorities and, where they differ from government preferences, less the interests of the domestic private sector (as in Kenya) or donors (as in Uganda). The CBN's policy change towards a stronger focus on stability was thus mainly triggered by factors other than government susceptibility to the demands of crucial providers of investment funds.

Economic and banking crisis

In all three countries, economic and banking crises were instrumental in shaping policy change. In Kenya, central bank policy increased its focus on price and financial stability while maintaining the objective of financial deepening when economic and financial crises brought in a new government, which could only strengthen its political and economic power base by responding to the interests of a diverse group of private investors. In Uganda, prolonged economic and banking crises had strengthened the influence of donors on economic reform. The positive effects of previous reforms strengthened domestic political backing for further donor-supported reform, including the BoU's greater orientation towards stability and, later, financial-sector development objectives. Nigeria suffered a banking crisis in 2009/2010, which led the CBN to place far more emphasis on its financial stability mandate, improving the balance with its financial deepening objective. In contrast to Kenya and Uganda, the Nigerian government had substantial financial resources at its disposal at the time the crisis hit. This increased the CBN's policy space for crisis resolution and for choosing the tools for supporting the economic recovery.

Domestic pressure for more inclusive growth

Domestic pressure for more inclusive growth may also be an important driver of progress. This is particularly evi-

dent from the Ugandan experience: central bank policy in Uganda has until recently focused on the price and financial stability objectives. Yet while Uganda's growth, inflation and financial stability record is outstanding among least developed countries, there is a widespread feeling, both in the wider public and in political circles, that more inclusive growth is needed and liberal economic policies have failed adequately to reduce poverty and promote private-sector development, employment and financial deepening and inclusion. In response to these challenges, the government has increased its focus on inclusive development, and the BoU has recently stepped up its efforts to find ways of promoting financial-sector development without unduly increasing the risks to which price and financial stability is exposed.

Global knowledge exchange

Central banks' progress towards balancing multiple objectives has also been driven by the global exchange of ideas on the roles they play in promoting financial deepening. Public officials interviewed in Kenya and Uganda considered such international platforms as the regional meetings of the EAC Monetary Affairs Committee to be important fora for peer-learning and benchmarking progress. Seminars or exposure trips to other developing countries that have made progress in financial deepening while preserving price and financial stability are also appreciated as helpful activities for learning and exchange.

Central bank independence

As the case of Nigeria highlights, central bank independence can also be an important driver of progress. Its independence enabled the CBN, for instance, to take quick and firm action to resolve the banking crisis in 2009/2010: it strengthened bank supervision, removed the management of distressed banks and published the names of politically exposed persons in default. Financial independence is also crucial: its strong capitalisation supported the CBN's banking crisis resolution measures. Moreover, financial independence allows central banks to issue their own t-bills for monetary policy purposes, as has been the case in Kenya and Nigeria. In countries where central banks are less well capitalised, there is no clear delineation between securities issued for debt and those issued for liquidity management. Fiscal expansion through domestic borrowing is then less visible, posing threats to price stability.

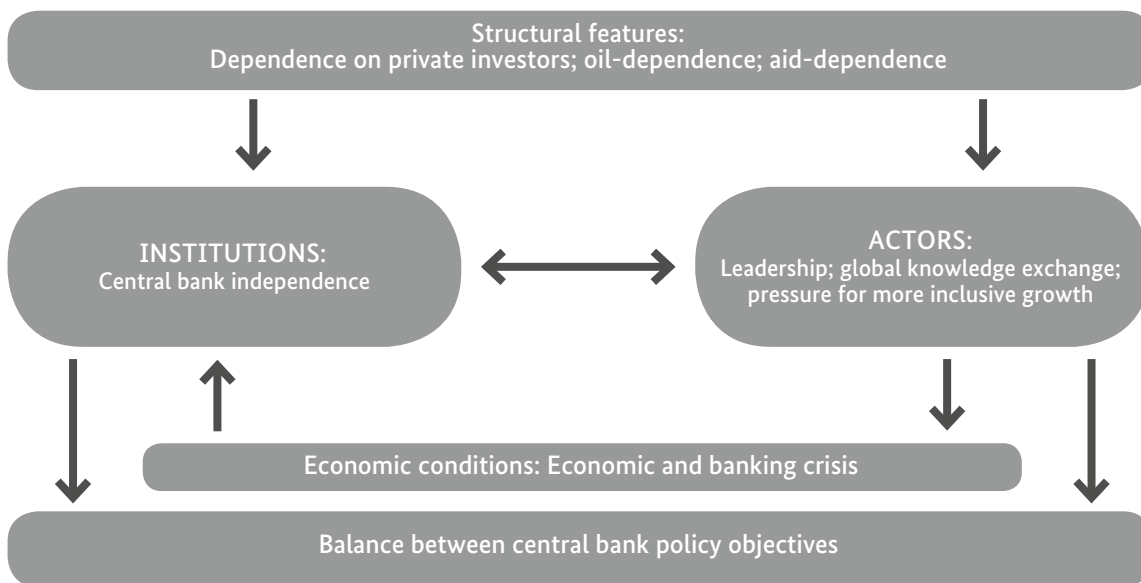
Leadership

The cases of Kenya and Nigeria show that catalytic leadership can be a driver of progress. In Kenya and abroad, the CBK’s governor has earned a reputation as a champion of financial inclusion, in his capacity as leader of Kenya’s Financial Education and Consumer Protection Partnership, for example. In Nigeria, the CBN’s governor has

demonstrated leadership in resolving the banking crisis, using insider knowledge to detect deficiencies in bank regulation and taking quick and firm action. However, as Nigeria’s experience also shows, the government’s political backing is crucial in increasing the policy space enjoyed by governors.

Figure 13

Drivers of progress towards balancing multiple central bank objectives in Kenya, Nigeria and Uganda



Source: Author’s own compilation.

As Figure 13 shows, the drivers of progress emerging from the country case studies fall into three distinct categories. The first driver, susceptibility to the interests of providers of crucial financial resources for investment, reflects a country’s longer-term structural features, making it a long-term determinant of a central bank’s success in balancing the three objectives. The other drivers, which fall into the categories of institutions, actors and economic conditions, exhibit more variance over time and influence a central bank’s ability to adjust the importance they attach to different objectives in the short to medium term.

5.2 Challenges to sustaining progress in Kenya, Nigeria and Uganda

Interview data, policy documents and political economy literature also reveal challenges to sustaining progress, including the regulation of financial innovation, limited flexibility of central bank policy in reacting to changes in the economic environment, political pressure for financial deepening, and weak partnerships between the central bank and other domestic stakeholders when it comes to encouraging financial deepening.

Regulating financial innovation

As the case of Kenya shows, the regulation of financial innovation can be a challenge to sustaining progress. Regulators need to strike a balance between generating a regulatory environment that is open to financial innovation and ensuring the safety and soundness of financial services. The regulation of financial innovation can pose three major challenges: first, regulators have difficulty choosing when to intervene and regulate financial innovations more stringently. Second, financial innovations involving non-bank financial service providers may also require the improvement of coordination with the regulators of such institutions, e.g. telecommunications regulators. Third, financial innovations may require regulators to acquire new skills. Where regulators fail to address these challenges, they risk emphasising the financial deepening goal at the expense of the financial stability goal.

Limited flexibility in reacting to changes in the economic environment

A major challenge to sustaining the progress made towards striking a balance between multiple mandates is the need to maintain flexibility to react to changes in the economic environment. Price and financial stability are a precondition for financial deepening. Consequently, while balancing the stability and financial deepening objectives is important, there is a need to be able to adjust the importance attached to these objectives in response to economic challenges. The Kenyan experience shows, for instance, that, if macroeconomic instability rises, the importance attached to financial deepening needs to be temporarily reduced and that attached to stability temporarily increased, so that financial deepening can be promoted once macroeconomic stability has returned.

Managing political pressure for financial deepening and inclusion

Domestic political pressure to increase financial deepening and inclusion with a view to generating more inclusive growth is a challenge to central banks seeking to maintain a balance between their multiple objectives. In particular, Nigeria's and Uganda's experiences show that, when there is a widespread perception that financial sectors are failing to meet the needs of the real economy and an urgent need to increase dependence on domestic private investment as opposed to aid or oil, governments come under

mounting political pressure to find quick remedies to the lack of financial deepening and inclusion. In Uganda, popular political pressure is thus not only a driver of progress, but also carries with it the risk that the government's response will reverse the progress that central banks have made towards balancing stability and financial deepening.

Weak partnerships in the promotion of financial deepening

As the case of Nigeria shows, weak partnerships between the central bank and other domestic stakeholders in the promotion of financial deepening in a situation where the central bank undertakes a wide range of financial deepening activities may be a threat to sustained progress. They may, for instance, be a drain on the central bank's limited personal and financial resources. In addition, they increase the risk of central bank policies contradicting each other, because medium- and long-term commitments to financial deepening policies reduce the flexibility needed for policy change when challenges to price or financial stability arise. Avoiding such contradictions requires partnerships with actors outside the central bank who can take over the lead in activities to encourage financial deepening, so that the central bank can concentrate on its stability objectives when challenges occur. Partnerships between central banks and other domestic stakeholders are also crucial if other relevant players are to develop ownership. Furthermore, partnerships are important because central bank policy is only one part of the policy response to shallow financial markets and cannot be effective unless other policies work in tandem.

5.3 Taking forward the debate on central bank objectives in Africa

Given the gap between central bank theory and practice, a new framework that guides central bank policy in Africa will be invaluable. As a new framework is established, it is important to learn from the recent experience of African central banks in balancing the objectives of price stability, financial stability and financial deepening. The case studies of Kenya, Nigeria and Uganda contain a number of messages for the future debate on central bank mandates in Africa and such factors as the role of donors and central banks (see Box 4).

1. If central banks embrace the objective of financial deepening, central banking will become more challenging because there are not only synergies but also trade-offs between policies that promote price or financial stability on the one hand and financial deepening on the other. Thus a framework for central banking in Africa which considers all three objectives will lack the clarity of a framework like IT.
2. As pressure on African governments to promote inclusive growth through financial deepening and inclusion, for example, mounts, it is important that central banks acknowledge the importance of financial deepening and inclusion and explicitly address the tensions between their stability and financial deepening objectives. If central banks are perceived as an obstacle to economic growth and inclusive development in an environment where the political pressure to achieve both is growing, they may become political targets and their independence may be at risk (Eichengreen et al., 2011). Central banks should therefore seek to strike a balance between multiple objectives and choose optimal trade-offs between them, while bearing in mind that price and financial stability are preconditions for financial deepening.
3. It is important to address the challenges to striking a balance between stability and financial deepening objectives, and the experience of Kenya, Nigeria and Uganda suggests some ways of doing so. For instance, partnerships between the central bank and other stakeholders formed to encourage financial deepening and inclusion can help other relevant players to develop ownership and enable the central bank to concentrate on its stability objectives when challenges arise. This will also help to avoid “reputational contagion”, i.e. a situation where challenges in one area weaken the central bank’s ability to influence relevant agents’ attitudes in another area (BIS, 2009). Central bank policy communication is an important means of signalling commitment to central bank objectives, justifying policy, ensuring accountability and making it clear that central bank policy is only one part of the public policy response to the challenge of improving economic growth. Clear accountability, monitoring and evaluation frameworks for central bank interventions to promote financial deepening and inclusion are important, given the risks that such interventions can entail for price and financial stability. In addition, the case studies show that, in striking a balance between different objectives, timing and central bank flexibility in the choice of trade-offs are important: if economic challenges arise, central banks need to evaluate and adjust the importance attached to price stability, financial stability and financial deepening, so that the balance may be redressed when economic conditions improve again. Placing greater emphasis on the price stability objective when inflationary pressures occur, for example, will permit greater emphasis to be placed on financial deepening later, when price stability has returned. Finally, ensuring that regulation is proportionate to risks will help to address the tension between policies to enhance financial stability and policies for financial deepening.
4. While African governments, which usually set central banks’ objectives, and central banks themselves are responsible for striking a balance between multiple central bank objectives, other stakeholders can help in this respect. The case studies show, for instance, that a developed private sector is important for driving and sustaining progress towards balancing multiple central bank objectives. There are indications that a more developed and diversified private sector can become a challenge to central bank policies if they place greater emphasis on one objective than another in the longer term. The case studies also suggest that donors can facilitate progress even where they are not its key drivers by supporting product innovation (e.g. by providing seed capital as in the case of M-Pesa¹⁹), conducting research and disseminating the findings (as the FSDK and the Partnership for Making Finance Work For Africa do), facilitating knowledge exchange and peer-learning (as the AFI does, for instance) and providing technical assistance in new areas of central bank policy (as the GIZ in Uganda does in the case of financial literacy, for instance).

19 The United Kingdom’s Department for International Development provided seed funding for M-Pesa trials.

Box 4**Financial deepening in Africa: the roles of central banks and donors**

Recommendations for central banks:

- Acknowledge the importance of financial deepening and inclusion and explicitly address the tensions between stability and financial deepening objectives
- Build partnerships with other public and private stakeholders to encourage financial deepening
- Enhance communication to signal commitment to central bank objectives, justify policy and ensure accountability
- Establish accountability, monitoring and evaluation frameworks for central bank policies to promote financial deepening and inclusion

Recommendations for donors:

- Work with a broad range of partners to promote financial development and inclusion
- Support innovations which reduce the transaction costs of financial service provision
- Conduct research on how central banks might jointly enhance financial depth and stability
- Facilitate knowledge exchange and peer-learning
- Provide technical assistance in the design and evaluation of central bank policies to promote financial deepening and inclusion

The findings of this report provide some starting points for more systematic thinking about opportunities for and challenges to African central banks as they seek to strike a balance between multiple objectives. Clearly, it is not possible to generalise on the basis of three country cases. However, there are some commonalities across Africa as regards the challenges the various central banks face, and adding other case studies and cross-country economet-

rics in the future will help to advance our understanding of the constraints and opportunities central banks face when they seek to facilitate financial deepening without compromising price and financial stability. Such research could help to identify the particulars of a framework to guide central banks, who are under pressure from a variety of stakeholders, institutions and challenges to their economic development.

Appendix I

Country samples for figures

These are the 37 countries included in the calculation of the African median for the indicator “Inflation, consumer prices (annual percent)” (Source: World Bank, 2012): Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Congo Dem. Rep., Congo, Rep., Cote d’Ivoire, Equatorial Guinea, Ethiopia, Gabon, The Gambia, Ghana, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Niger, Nigeria, Rwanda, Senegal, Seychelles, South Africa, Sudan, Swaziland, Tanzania, Togo, Uganda, Zambia and Zimbabwe. The countries included reflect the situation following the exclusion of those on which data are not available for at least two thirds of the data points from 1980 to 2011.

These are the 15 countries included in the calculation of the African mean for the indicator “Ratio of bank non-performing loans to total gross loans (percent)” (Source: World Bank, 2012; data on NPLs in Africa are available only from 2000 onwards): Gabon, Ghana, Kenya, Lesotho, Mauritius, Mozambique, Namibia, Nigeria, Rwanda, Senegal, Seychelles, Sierra Leone, South Africa, Swaziland, Uganda. The countries included reflect the situation following the exclusion of those on which data are not available for at least half of the data points from 2000 to 2011.

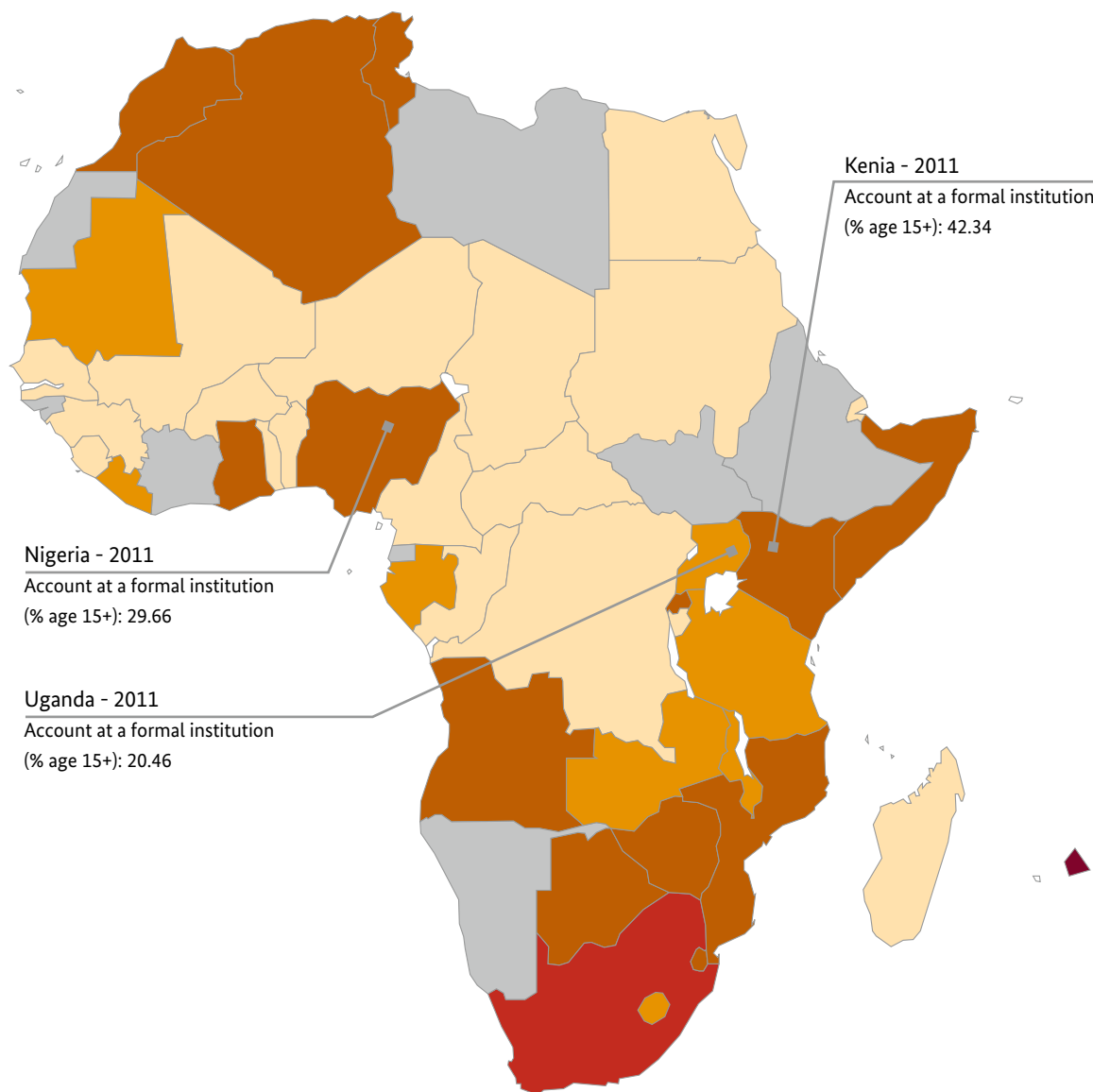
These are the 34 countries included in the calculation of the African mean for the following indicators: “Private credit by deposit money banks as a share of their deposits” and “Private lending by deposit money banks as a share of GDP” (Source: Beck et al., 2012): Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Congo Dem. Rep., Cote d’Ivoire, Equatorial Guinea, Ethiopia, Gabon, Gambia, Ghana, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritius, Niger, Nigeria, Rwanda, Senegal, Seychelles, Sierra Leone, South Africa, Sudan, Swaziland, Tanzania, Togo, Uganda, Zambia and Zimbabwe. The countries included reflect the situation following the exclusion of those on which data are not available for at least two thirds of the data points from 1980 to 2010.

Appendix II

Map of financial inclusion in Africa

Figure A1.

Holding an account at a formal financial institution (percentage age 15+)



Year 2011

No Data
 0-16.5
 16.5-28.5
 28.5-50.3
 50.3-81.2
 81.2-99.8

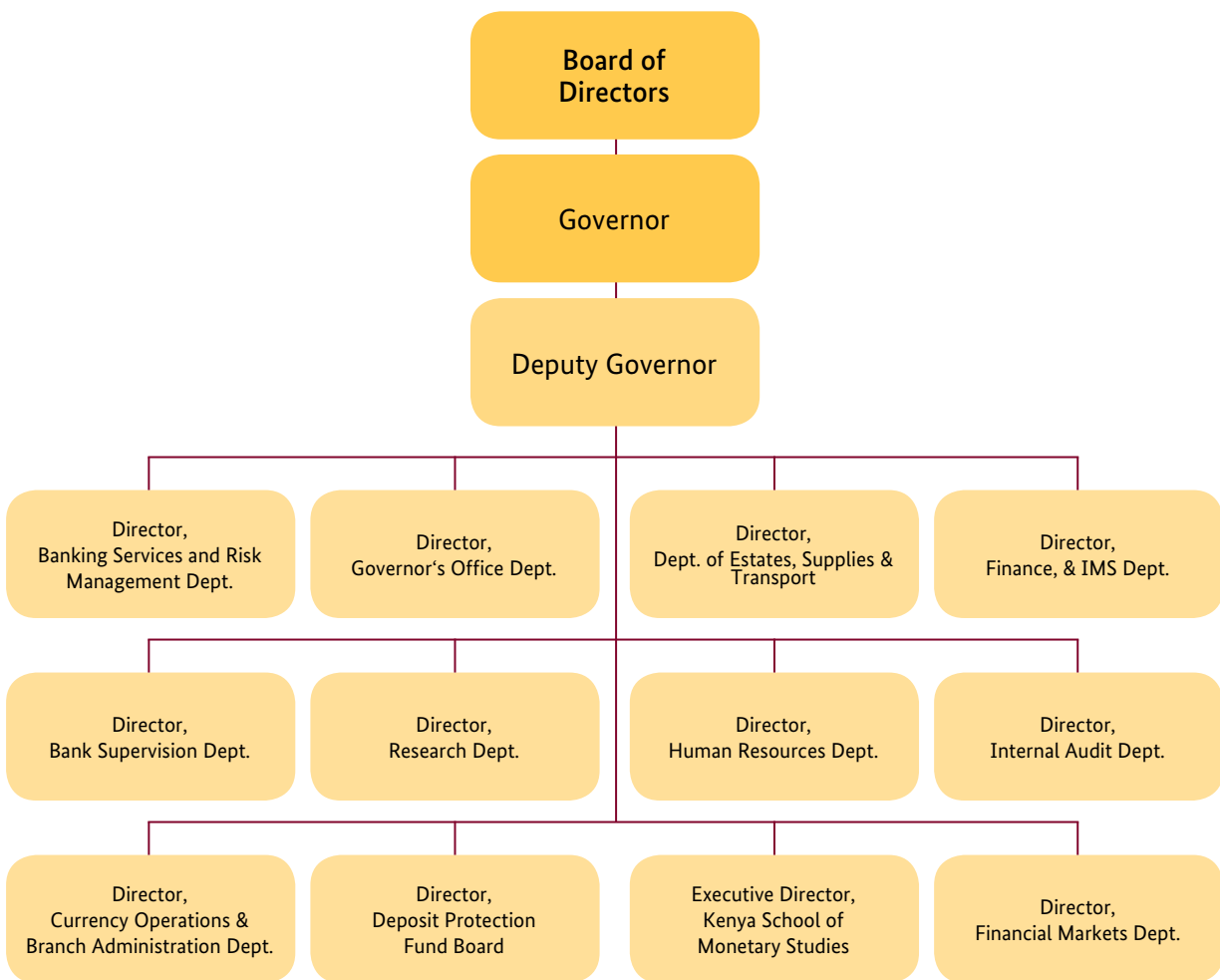
Source: The World Bank (2012)

Appendix III

Central bank organisation charts

Figure A2

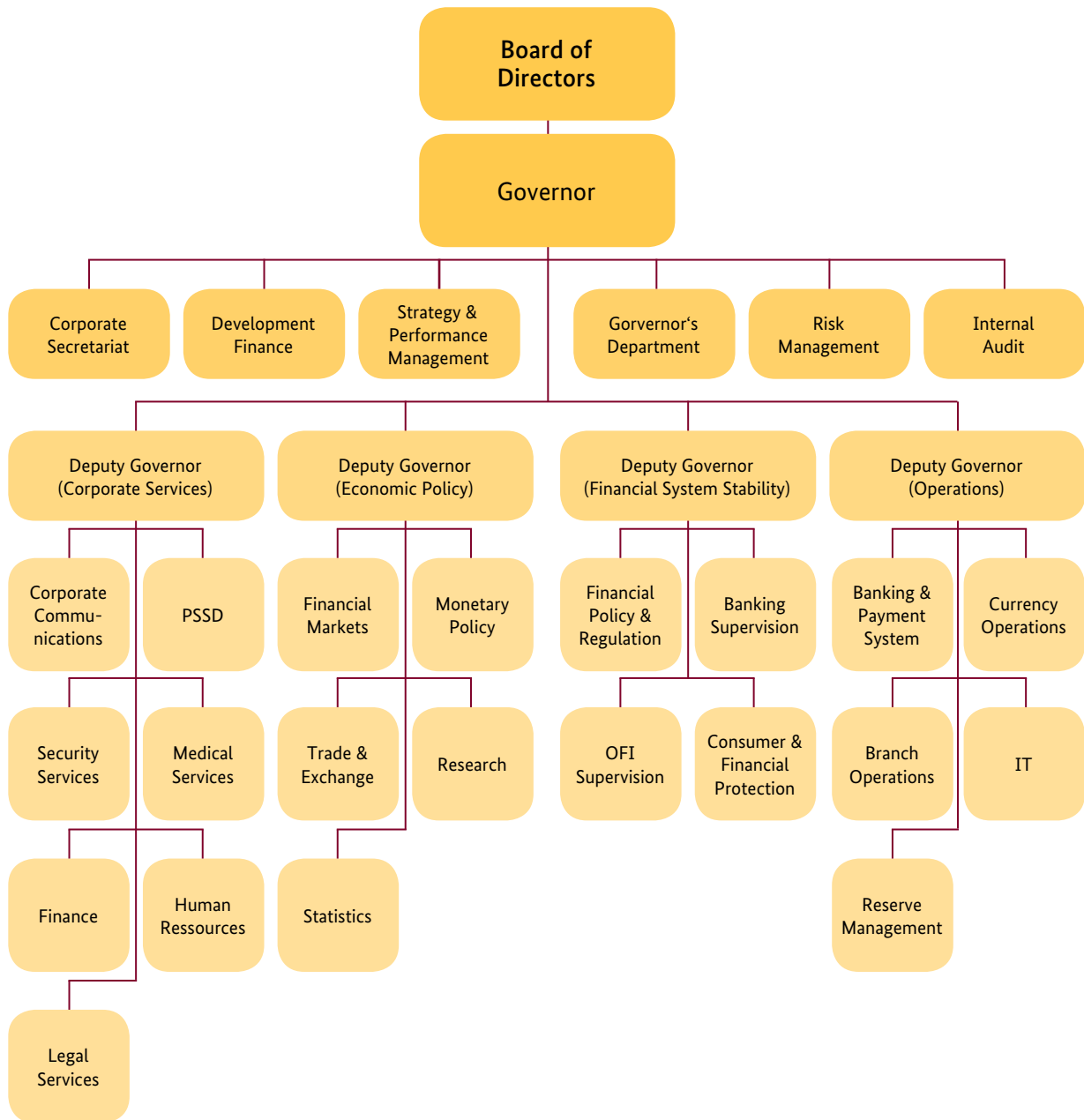
Organisation chart of the CBK as at November 2012



Source: CBK (2012c)

Figure A3

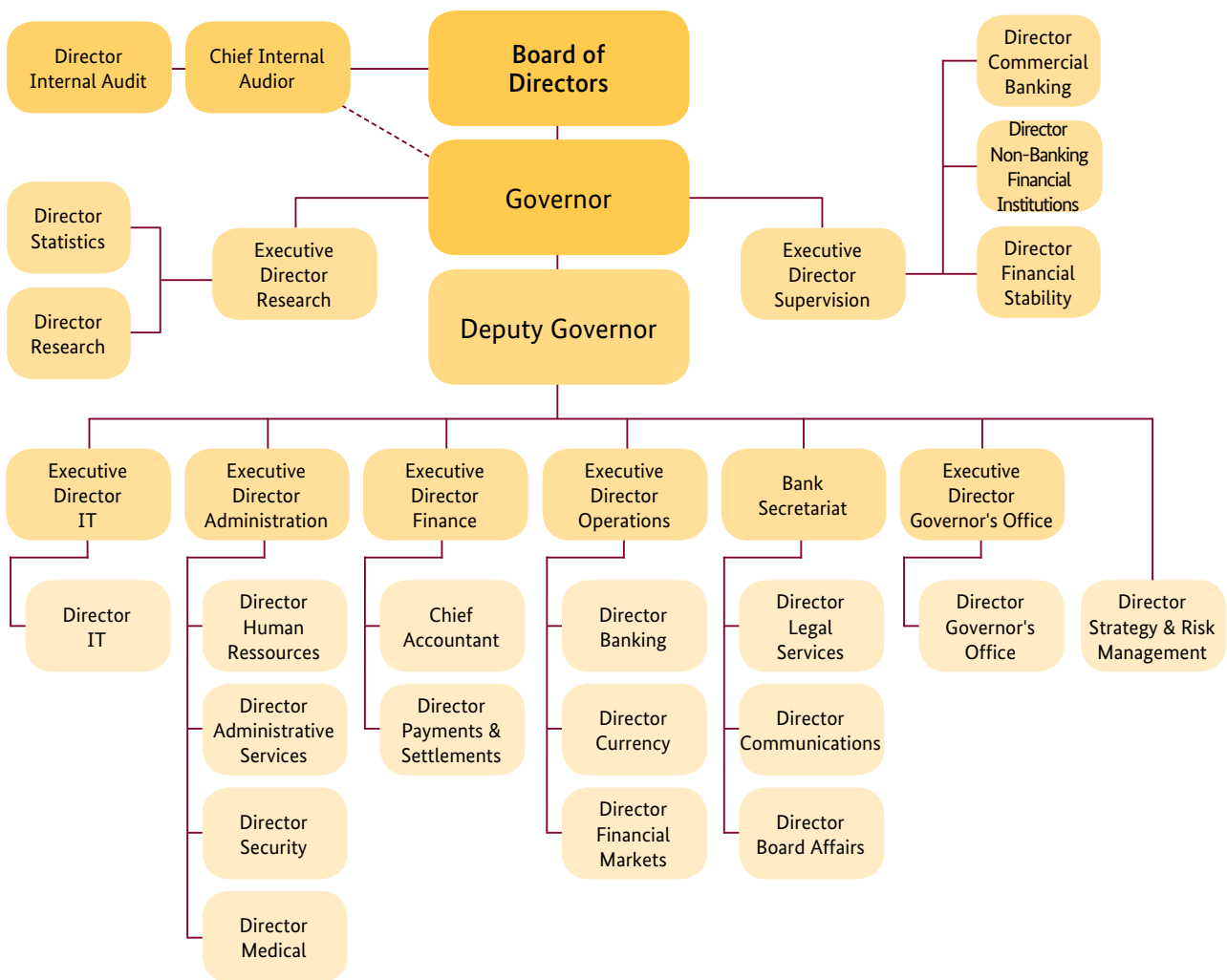
Organisation chart of the CBN as at November 2012



Source: CBN (2012b)

Figure A4

Organisation chart of the BoU as at November 2012



Source: BoU (2012b)

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