OXFORD ANALYTICA

PERMISSIBLE MARKETS PROJECT

MONETARY TRANSPARENCY REPORTS 2003

Prepared for

CalPERS

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MONETARY TRANSPARENCY 2003

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OXFORD ANALYTICA

ARGENTINA

MONETARY TRANSPARENCY

Country Report 2003

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ARGENTINA

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*
Clarity of roles	●●●	●●●
Open decision process	●●●	●●
Availability of information	●●●●	●●●●
Central bank accountability	●●●●	●●●
Score	3.50	3.00

OUTLOOK & COMMENTARY

Argentina will continue to improve its monetary transparency standards. The central bank's current success in shifting from a passive to an active role in designing monetary policy will likely be consolidated in 2004, in order to achieve the goal of having a fully operational inflation-targeting framework by 2005.

Until the inflation-targeting system becomes fully operational, one of the main areas of weakness will remain the continuous changes in the regulatory framework, which may diminish its transparency. Decisions taken by the new Inflation Targeting Committee need to be made available to the public. Equally important, the role of the Financial System Restructuring Unit in banking reform will have to be closely followed to assess if central bank independence is being undermined.

EXECUTIVE SUMMARY

3.50 Enacted

Argentina has made important improvements in its monetary transparency policies in 2003. The Central Bank of Argentina (BCRA) is a self-governing body of the national government, and its objectives and responsibilities are clearly established in its charter and the Financial Institutions Law. Following the 2001 economic crisis, and the abandonment of the currency board, the BCRA has regained an active role in monetary policymaking.

Argentina subscribes to the IMF's Special Data Dissemination Standard (SDDS), and meets its standards for the release of a range of monetary and fiscal information. In 2003, the central bank has improved the periodicity and reliability of its information. The BCRA publishes a monthly *Monetary Report* with information on monetary policy developments and the detailed financial position of the central bank. Information on monetary indicators is also publicly available through the BCRA's daily report.

During this year, the BCRA has been going through a transition period from an exchange rate anchor to a monetary anchor, with the ultimate goal of establishing a fully operational inflation-targeting framework by 2005. In addition, under the newly appointed president, BCRA's autonomy has been reinforced and its capacity to formulate monetary policy has been strengthened.

At present, reform of the banking sector, which was highly affected by the economic crisis, is one of the outstanding reforms to restore the regular functioning of the financial system. The Financial System Restructuring Unit (URSF) was created in 2002, but no progress has been made since then. The URSF will be responsible for defining a strategy for restructuring the financial system, giving it the power to determine how public banks should be restructured and which private banks should remain open and which should be sold or merged.

Argentina's overall score has improved from 3.00 in 2002 to 3.50.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The objectives of the Central Bank of Argentina (BCRA) are set out in its charter, Law No 24,144 of 1992 (with subsequent amendments). Article 3 charges it with preserving the value of legal tender. The BCRA is empowered to regulate the amount of circulating money and the level of lending within the economic system and to issue monetary, financial and exchange rules according to the legislation in force.[1]

The duties of the BCRA are also clearly established in its charter. The central bank has to monitor the performance of the financial market; act as a financial agent for the state; and act as depository and agent for the country in respect of its obligations to international monetary and banking entities. The BCRA stores and manages Argentina's gold reserves, foreign exchange and other external assets; it fosters the development of capital markets; and implements the exchange rate policy.

Prior to the economic crisis of 2001-2002, the central bank acted in a similar way to a currency board, leaving monetary policy essentially passive. The 1991 Convertibility Plan had reformed the exchange rate system, and the central bank's charter. Under the exchange rate reforms the peso was pegged to the US dollar, the stock of monetary liabilities was tied to the stock of foreign exchange held by the central bank, and full convertibility of the peso for both current and capital transactions was established.

In January 2002, however, after ten years of convertibility, the central bank regained an active role in monetary policymaking. The BCRA is involved in exchange rate policy as a market maker in determining rules and restrictions.

The BCRA's Board of Directors aims at building a well-designed monetary policy system. Although predictability and transparency were impaired in 2002, mainly by the political situation, the disclosure of information on monetary policy has improved considerably during 2003. After a decade of fixed exchange rates, the central bank has been focusing on establishing the basis to guide the country's new monetary policy.

The central bank's charter was amended in January 2002, and now imposes on the BCRA the obligation of disclosing a monetary programme before the start of each fiscal year, which should include information on inflation targets and forecasts of total money supply variations. This last objective has been hampered both in 2002 and 2003 by the important amount of provincial bonds in circulation, which undermined BCRA's monopoly on monetary issues. The central bank regarded those quasi-currencies as part of the monetary supply.

In 2003, the BCRA has been praised for its achievements regarding monetary stability. During the first semester of 2003, 42% of provincial bonds have been converted into pesos. The government has set the end of the year as the target to convert all remaining quasi-currencies into pesos. This schedule for monetary reunification is likely to be met, allowing the central bank to prepare more accurate forecasts on the country's money supply variations.[2]

In September 2003, the BCRA charter was modified, in order to reinforce the central bank's exclusive powers to issue legal tender. As a consequence, provincial governments cannot issue bonds to act as quasi-currencies anymore.[3]

Operational autonomy

The central bank charter establishes that it is not subject to any order or instruction given by the country's president as regards the preparation and implementation of monetary and financial policy. Nevertheless, many people in the country believe that the central bank's autonomy was seriously damaged in early 2001, when the president of the BCRA was forced out and the Ministry of Economy succeeded in nominating his replacement. Since early 2002, the BCRA has been trying to regain the autonomy it is meant to have by law.[4]

In December 2002, a new president of the BCRA was appointed. Several analysts perceive him as an independent expert, who has a strong commitment to reinforce the BCRA's autonomy and strengthen its capacity to formulate monetary policy. Even though some tensions between the Ministry of Economy and the BCRA have re-emerged during 2003, mainly over restructuring of the financial and exchange markets, the operational autonomy of the Bank has generally been reinforced.

Institutional relationship between monetary and fiscal operations

Lending to government

During the convertibility years, the BCRA's charter was rewritten tightly to prevent it from financing the non-financial private sector and to limit its scope for providing credit to either the public sector or state-owned banks.

As a general principle, the central bank must not extend loans to the national government, banks, provinces and municipalities. However, following the amendments to its charter in early 2002 and September 2003, there are now exceptions to this principle, and the BCRA may advance funds to the federal government on a temporary basis -- up to 12% of the monetary base or 10% of tax collection. These advances will have to be reimbursed within twelve months. If they are not repaid, the BCRA is barred from using this faculty until reimbursement occurs.[5] Information on the BCRA's loans to the government is publicly available.

Central bank involvement in the rest of the economy

The central bank's involvement in the rest of the economy is minimal. The BCRA is involved only with the banking system -- the Banking Supervisor operates under the BCRA -- but not with the rest of the private sector. The Bank's declared aim is to reduce the size and role of non-privatised provincial banks. However, the *Banco de la Provincia de Buenos Aires (*Bapro*)* -- a major non-privatised provincial bank -- does not recognise the central bank's authority, claiming that Bapro predates the BCRA and is not subject to its norms. In the September 2003 agreement signed with the IMF, the government has agreed that during 2004 it will strategically review the future of both Bapro and *Banco Nacion*, the two mayor non-privatised public banks, with the objective of strengthening the roles and functions of public banks.

In June 2003, the government introduced a system to control inflows of speculative capital, which is to be regulated by the BCRA. The measure is designed to curb sharp short-term increases in the quantity of dollars in the market, which have contributed to exchange rate volatility. Decree 285/03 requires that foreign portfolio investments must be registered with the BCRA, and must remain in the country for a minimum of 180 days. Foreign trade operations, foreign direct investment and capital repatriated by residents are exempt. The BCRA has been charged with establishing and applying sanctions in cases of non-compliance.

Central bank profit allocation

BCRA's profits that have not been capitalised must be allocated to the general and special reserve funds, for up to 50% of the BCRA's capital. Once this limit is reached, the profit that has not been capitalised or allocated to reserve funds can be freely transferred to the National Government Account. Losses borne by the central bank during a fiscal year have to be deducted from the reserves made in previous years and, if this is not possible, they must be deducted from the BCRA capital. In such cases, the Board of Directors may assign any profits that arise from subsequent fiscal years to restore the capital and reserve levels recorded prior to the original loss.

Detailed information on the Financial System International Reserves and Central Bank Financial Liabilities are publicly disclosed on a daily basis on the central bank's website.[6]

Agency roles performed by the central bank on behalf of the government

Under the terms of its charter, the BCRA charges the National Government Account for the amount of the domestic and foreign debt servicing that it carries out, together with any expenses incurred. The central bank assists the Ministry of Economy in controlling the procedure of placing official borrowings and provides the ministry with detailed information about its performance as the fiscal agent of the state.

There is no legal provision establishing the duties of the BCRA as an advisor to the national government in its relations with international organisations. There is, however, an informal committee of the national government that discusses relations with international organisations, and the president of the BCRA is usually part of this committee. In addition, officials of the central bank have been involved in all the post-crisis negotiations with international organisations, alongside representatives of the national government. The president of the BCRA was also part of the negotiations with the IMF to secure the September 2003 agreement.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●● Enacted

The framework, instruments and targets of monetary policy

Framework and monetary targets

From 1991 until 2002, Argentina's institutional arrangements curtailed the central bank's monetary policy role. However, following the 2001-02 economic crisis, several changes in the central bank's charter have been introduced, granting the central bank broader monetary policy powers. As a consequence, the BCRA is now obliged to disclose its monetary programme for each fiscal year.

During 2003, the BCRA has been going through a transition period from an exchange rate anchor to a monetary anchor. The current monetary policy goal is to have a fully operational inflation targeting mechanism in place by 2005, with all the required instruments ready by mid-2004. By year-end, the central bank expects to announce targets and an exchange band for monetary policy[7]. In addition, the conversion of all remaining provincial bonds into pesos will provide the BCRA with a more solid basis to prepare the 2004 monetary programme. Analysts agree on the official time frame to implement a fully operational inflation-targeting mechanism.

The main goal for BCRA's officials, who are in the process of building expertise, is to achieve internal consistency. Different measures are being taken internally to achieve this, including the training of central bank employees to work with an inflation target. During 2003, central bank officials have been trained according to the new role that the BCRA is playing in monetary policy. [8]

The 2003 Monetary Programme attempted to make progress within the limits imposed by Argentina's fragile economic situation. The programme prioritised stable exchange rates and the avoidance of high levels of inflation. The assumptions underlying the BCRA's model were explicitly outlined.

Positive changes in the macroeconomic context, together with the introduction of important measures to help return the financial system to normality and relax controls on capital and exchange markets, allowed the BCRA to release in mid-2003 a revision for its 2003 Monetary Programme. Following this, the central bank estimates that inflation for 2003 will be around 5-6%[9], with a temporary increase during 2004. Both the original 2003 Monetary Programme and its mid-year revision were made publicly available on the central bank's website. The 2004 Monetary Programme is expected to be released before the end of this year, with the BCRA president making a presentation before Congress.

According to the revised 2003 Monetary Programme, the central bank maintains that it is still difficult to make effective forecasts for monetary aggregates. Consequently, it is hard to stick firmly to any specific monetary target, which is why the projections should only be taken as indicative. Furthermore, the BCRA believes that changes generated by the crisis mean that the usual mechanisms of transmitting monetary policy are operating in a limited manner.

In this context, it became clear that the difficulty in making forecasts is not limited to monetary aggregates, as it extends to various key macroeconomic variables, such as activity levels, relative prices and inflation. As progress is made with the normalisation of the banking system, particularly in relation to its role as a financial intermediary, the

ability to forecast the principal economic variables should improve. This is particularly important if the conditions are to exist for the central bank to implement a monetary policy based on inflation targeting.

Transparency practices in monetary policy are playing an important role, as inflation targeting is becoming the primary goal of monetary policy. The disclosure of goals and indicators is widely perceived as transparent and efficient, and the BCRA website provides high quality and reliable information. In addition, BCRA officials have expressed their commitment to transparency of its policies and practices. Clear public rules and thorough reporting will also help to maintain central bank independence.

Monetary instruments

The BCRA is involved in exchange rate policy, as a market maker in determining rules and restrictions. Its objective is to introduce a clear inflation-targeting mechanism as soon as possible. However, effective prediction and adjustment mechanisms are still difficult to be set out. During 2003, the BCRA website has increased the public availability of information on its monetary instruments and objectives. This information is also well reported in some financial dailies (e.g. *Ambito Financiero, InfoBAE*).[10]

At present, decisions on the exchange rate targets are informally taken by a group of advisors close to the BCRA president, but this might change if a Monetary Policy Committee is formed.

Following the experience of 2003, it is expected that the BCRA could improve its capabilities of designing a 2004 monetary programme based on more solid and stable foundations. Until the transition period is completed, the monetary base will continue to be the monetary anchor, within the framework of a floating exchange rate. In future, an administered flotation could possibly be implemented, which would be more 'pure' than the current policy of intervening in the market to increase reserves and take US dollars out of circulation.[11]

The monetary policy-making body

Monetary board

The BCRA is under the charge of a Board of Directors composed of a president, a vice president and eight directors, all of whom are appointed by the national president in agreement with the Senate. The composition, structure and functions of this board are clearly specified in the central bank's charter. The board's powers, duties and responsibilities are discussed in Chapter III of the BCRA's charter. The new president of the central bank received Senate approval in late 2002, and his appointment has been made to complete the six-year period that started in 1998[12]. As a consequence, the parliament ratification is scheduled for September 2004. If he is reappointed by the executive, he will need new approval from the Senate. [13]

The minister of economy, or a designated deputy, is permitted to attend and speak at board meetings, although he/she has no voting rights.

In June 2003, an 'Inflation Targeting Committee' was convened. The main tasks of this committee are to establish adequate inflation targets, and improve the methods by which monetary policy is made publicly available. The creation of a more specific Monetary Policy Committee is also being considered by BCRA authorities.

Advance meeting schedule

The president of the BCRA is obliged to call for board meetings at least once every 15 days. Board members typically hold weekly meetings, usually on Thursdays. Neither an advance meeting schedule, nor records of the meetings are publicly available. Moreover, there is no established practice of issuing press releases of the decisions taken by the Board of Directors, although these can be obtained at request through the Bank's offices. Nevertheless, important decisions are reported in the press.

Public statements on monetary policy

Periodic publications

Since the new president of the central bank took office, the BCRA has improved its communications strategy. The BCRA publishes a monthly *Monetary Report* with information on monetary policy developments and detailed figures on the financial position of the central bank. This report (available online and in English) outlines the core objectives of the central bank's monetary policy. Information on monetary indicators is also publicly available through the BCRA's daily report. During 2003, both the monthly and daily reports have been regularly updated.

The central bank has started releasing information on the monetary base, including explanatory factors and charts. This information allows the public to understand the underlying factors behind changes in the monetary base, including the impact of the so-called 'quasi-currencies' in circulation.

The BCRA's monthly and daily reports contain information on international reserves; the monetary base; foreign currency deposits of financial entities; temporary advances to the government; financial indicators; and interests rates.[14] The Bank's website publishes daily information on the monetary base and monetary operations.

The central bank prepares its own macroeconomic forecasts -- placing particular emphasis on monetary projections -- and sometimes seeks consensus with the forecasts prepared by the Ministry of Economy. Coordination between these two institutions has increased in the past year.

Public hearings

There is a legal requirement for the central bank to report to parliament on its operations and policies every three months. At the height of the economic crisis, following the abandonment of the currency board, information about the changes in monetary policy was scarce. However, a more reliable and timely information system has started to operate. In addition, the BCRA's press office holds regular meetings with members of the media to keep the public informed about new policies.[15]

The BCRA website also contains information regarding the targets agreed with the IMF; analysis of the country's compliance with targets agreed with the IMF; and the proposed sovereign debt restructuring programme.

Regulations on data reporting by financial institutions to the central bank

Through the operations of its Superintendence of Financial Institutions and Exchange Bureaus, the central bank is tasked with promoting the stability of the financial system. It also has responsibility for inspecting financial institutions.

After the 'pesoisation' of dollar-denominated debts in early 2002, the BCRA stopped the publication of information for financial institutions. However, in 2003, the central bank started to update its information system for financial institutions and make it publicly available through its website. Information publicly available on financial institutions now includes their assets and liabilities, accumulated income, memorandum accounts, and audit observations. However, until the reform of the banking sector is undertaken, reliability of the information will remain weak.[16]

The recent economic crisis left the banking system in a difficult situation. At present, the banking reform is one of the outstanding reforms in order to restore the regular functioning of the financial system. The BCRA expects to receive audits of all commercial banks and financial institutions at the beginning of next year, together with their programmes and future business plans. The central bank will review all this information in order to assess their sustainability. Moreover, it will use its authority to improve the efficiency of the banking system and, if necessary, will propose the merger and acquisition of some banks, following the provisions established in the Financial Institutions Law. Once this assessment has been completed, public reporting is expected to improve its efficiency and periodicity.[17]

In late 2002, the Financial System Restructuring Unit (URSF) was created. This unit will determine which banks can be granted up to ten years to pay their debts to the BCRA arising from rediscounts or advances received during the 2001-02 crisis. The unit will include three representatives of both the Ministry of Economy and the central bank. During the first year, the presidency -- and the preferential vote which goes with it -- will be held by the Ministry of Economy.

In the medium term, the URSF will be responsible for defining the strategy for restructuring the financial system, giving it the power to determine how public banks should be reorganised and which private banks should remain open or should be sold or merged. This is seen in the BCRA as undermining its independence *vis-a-vis* the Ministry of Economy: indeed, it is argued that it would represent a violation of the Financial Institutions Law and the Bank's Charter, as it would assign to the URSF responsibilities which are exclusive to the BCRA.

Banking reform to date has been mainly market driven, with some banks themselves beginning to reform by reducing their branch networks, or through mergers and acquisitions. However, rigidities in the legal framework have hitherto complicated this process, and the lack of exit mechanisms for banks will remain a problem. Public banks will continue to increase market share, but deficiencies in corporate governance structure may generate additional problems. In order to avoid posing systemic risks, public banks should be redefined either as commercial banks or as offering specific services with clearer guidelines.[18]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

Argentina subscribes to the IMF's Special Data Dissemination Standard (SDDS), and meets its standards for the release of a range of monetary and fiscal information. Data on the analytical accounts of the central bank are compiled and published under the terms and conditions of the central bank's charter.

The central bank balance sheet

Under the terms of its charter, the BCRA is required to publish annual balance sheets and income statements. In addition, it also publishes a weekly summary statement of its assets and liabilities, with a one-week delay. These data are released simultaneously to all interested parties through a *Summary Statement of Assets and Liabilities* (*Estado Resumido de Activos y Pasivos*) and are available online both in Spanish and English.[19]

Information on emergency financial support, international reserves and liquidity is regularly provided by the central bank, and analysed in detail in its annual balance sheets. Among other information, the central bank's *Annual Report* for 2002 includes information on loans made to the financial system, contributions to international agencies made on behalf of the national government, and funds transferred to the national government for placements by the IMF. It also has detailed information on the monetary base and government securities.

The BCRA accounting records are prepared in accordance with generally accepted standards, following the same general principles that are established by the Superintendence of Financial Institutions and Exchange Bureaus for all financial institutions. The financial statements are comparatively presented with those of the previous fiscal year.

Lender of last resort

Following recent amendments to the central bank's charter, the BCRA has now re-established its powers of lender of last resort. The central bank can now finance the government and banking sector, although there are some restrictions and reporting requirements for both roles. Nevertheless, commentators said that the way in which the central bank uses its powers of lender of last resort will have to be closely watched because over-lending could represent a threat to its credibility.[20]

Public information services

The BCRA's website provides online access to information on diverse matters including the regulatory framework for the financial system; the central bank's *Annual Reports*; descriptions of its operating framework; targets and data on monetary policy, including a daily and monthly *Monetary Report*; text of speeches of officials; financial statements and an index of available publications. Publication of the *Annual Report* is a legal requirement, and the report must be submitted to parliament for consideration.

During 2003, the central bank has improved the disclosure of information on its website. As a consequence, information publicly available is more comprehensive and easier to find. Information is regularly posted and updated both in Spanish and in English. The website has also introduced a 'Financial Panel', in order to have immediate access to BCRA information, including BCRA reserves; monetary base; monetary circulation; current accounts deposits at the central bank; and overdrafts and rediscounts.

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

Pursuant to the central bank's charter and the Financial Institutions Law, the president of the BCRA must submit a report to Congress at least once a year. Each report describes the evolution of the economy and the financial system, as well as the main activities performed by the bank during the period reported. Two reports are usually prepared, one for the first semester and another for the entire calendar year. Annual reports are publicly available on the BCRA's website.

On at least one occasion during the parliamentary term, the president of the BCRA is obliged to attend public sessions of the Budget and Treasury Committees of both chambers of parliament. In addition, these committees may ask the president to attend at any time, in order to brief them on monetary policy implementation, and exchange and financial policies.[21] The BCRA is studying the possibility of introducing further modifications to its charter during 2004, in order to strengthen its accountability to Congress.

Financial statement

Audited financial statement

The BCRA's financial statements, detailing its revenues and expenses, are published as part of the annual balance sheet. As published on the central bank's website, these sheets meet the auditing requirements set out in the central bank's charter. Both the 2001 and 2002 balance sheets have been published with a special section to explain the impact of changes in the regulatory framework resulting from the 2001-02 economic crisis.

External and internal audit

Financial statements produced by the central bank are audited by a trustee appointed by the country's president in consultation with the Senate. Moreover, the central bank's charter requires financial statements to be externally audited. In 2002, KPMG acted as the independent external auditor. Both the internal and the external audit reports are publicly available online.

In addition, following the September 2003 amendment to the central bank charter, external control of the central bank is also conducted by the National General Auditor's office, a technical advisory body of Congress with functional autonomy.[22]

Conduct of officials

The BCRA has an internal code of conduct that establishes the rights and obligations of its staff. This code is distributed to employees but is not publicly available. In addition, the central bank's charter sets out regulations for members of the board of directors in order to prevent conflicts of interest.[23] Officials at managerial level or above must report yearly to the Anticorruption Office about their income and expenses.

According to BCRA officials, the lack of legal protection has been adversely affecting the legitimate performance of duties by central bank directors. This has always been a politically sensitive issue, as protection is generally perceived as impunity. Under the terms of the recently modified Financial Institutions Law, central bank officials now have a certain degree of legal protection, even though their decisions can still be challenged in court when they are taken with evident arbitrariness or deemed unreasonable. [24] The new provision does not grant complete legal immunity[25], but represents an advance that will facilitate decision-making.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Argentina between 11 and 17 November 2003:

Central Bank of Argentina

14 November 2003

Guillermo Escude	Manager	Economic and Financial Research Department

Ministry of Economy (MEcon)

12 November 2003

Mario Saccone	Analyst	National Budget Office

ADDITIONAL INTERVIEWS

11 November 2003

Nestor Lavergne	Analyst	National Statistics Institute (INDEC)
Virginia Lencina	Programme Coordinator	Citizen Power Foundation - Argentine Chapter of Transparency International

12 November 2003

David Prodger	Head of Trade & Investment	British Embassy in Buenos Aires
Andres Borenstein	Economic Officer	British Embassy in Buenos Aires
Luis Cubedu	Resident Representative	International Monetary Fund
Lorenzo Giorgianni	Senior Economist	International Monetary Fund

13 November 2003

Sergio Berensztein	Professor	University Torcuato Di Tella
Paula Gosis	Research Fellow	Latin-American Faculty of Social Sciences (FLACSO)
Daniel Oks	Senior Economist	World Bank Regional Delegation

Jorge Schvarzer	Director	University of Buenos Aires – Economics Research Department
Rodrigo Calderon	Journalist	*Buenos Aires Herald* Newspaper

14 November 2003

Luciana Diaz Frers	Fiscal Policy Programme	Centre for the Implementation of Public Policies Promoting Equity and Growth
Eugenio Raul Zaffaroni	Minister	National Supreme Court
Tom Scheetz	Consultant	United Nations Development Program

17 November 2003

Silvina Vatnick	Director	Centre for Financial Stability
Martin Kanenguiser	Journalist	*La Nacion* Newspaper

NOTES

[1] Central Bank Charter, Chapter I, available at www.bcra.gov.ar
[2] Interviews in Buenos Aires, 11-17 November, 2003.
[3] Central Bank Charter, Article 30, modified by Law 25.780.
[4] Interviews in Buenos Aires, 11-17 November, 2003.
[5] The BCRA's budget includes an item for monthly advances to the central government. At December 31, 2002, the balance of the temporary advances to the national government account was $700,000. Both items had been repaid before the proposed deadline, mainly due to the government current surplus in its accounts.
[6] Central Bank website www.bcra.gov.ar/
[7] The central bank has requested research institutions, universities, banks and consulting firms to provide it with their projections for key 2004 economic indicators, such as inflation, exchange rate, interest rates, and GDP.
[8] Interviews in Buenos Aires, 11-17 November, 2003.
[9] After initial fears that the currency devaluation could raise inflation to high levels, the government and the central bank have succeeded in keeping inflation at reasonable levels (3.4% as to end-November).
[10] Interviews in Buenos Aires, 11-17 November, 2003.
[11] Interviews in Buenos Aires, 11-17 November, 2003.
[12] The new president of BCRA, Alfonso Prat-Gay, is the fifth president since the current six years period started in 1998.
[13] Article 7 of the Central Bank Charter allows the reappointment of the president, vice-president and directors.
[14] Monthly and daily reports available at www.bcra.gov.ar/ingles/i_hm000000.asp
[15] Interviews in Buenos Aires, 11-17 November, 2003.
[16] Interviews in Buenos Aires, 11-17 November, 2003.
[17] Interviews with BCRA officials, Buenos Aires, 21-24 October 2002.
[18] Interviews in Buenos Aires, 11-17 November, 2003.
[19] Annual Balance Sheets and Summary Statements of Assets and Liabilities, available at www.bcra.gov.ar/ingles/institucional/i_in030000.asp
[20] Interviews in Buenos Aires, 11-17 November, 2003.
[21] Central Bank Charter, Article 10.
[22] Central Bank Charter, Article 40, modified by Law 25.780.
[23] Central Bank Charter, Article 8.
[24] Financial Institutions Law, Article 35, as amended by Law 25.780 of September 2003.
[25] Some legal specialists believe that its ambiguity could enable future judicial prosecutions of central bank officials for the legitimate performance of duties.

OXFORD ANALYTICA

BRAZIL

MONETARY TRANSPARENCY

Country Report 2003

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BRAZIL

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●	●●●	●●●●
Open decision process	●●●●	●●●●	●●●●
Availability of information	●●●●	●●●●	●●●●●
Central bank accountability	●●●●	●●●●	●●●●
Score	3.75	3.75	4.25

OUTLOOK & COMMENTARY

The new government of President Lula da Silva has already shown its intention to pursue continuity in monetary policy. Barring an external economic shock, major changes to the structure of Brazil's monetary policy are unlikely in the near future.

Lula's administration has announced plans to embed central bank independence in law and clarify the conditions under which its officials can be removed. However, the government has yet to make a decision on how autonomous or independent the Banco Central do Brasil (BCB) will be, and the political battle is likely to be difficult. Meanwhile, the BCB, which already has a very impressive data dissemination system via its website, is likely to continue to increase the quantity and quality of monetary information disclosed.

EXECUTIVE SUMMARY

3.75 Compliance in progress

No major changes to the framework of Brazil's monetary policy have occurred in the past year. Last December's appointment of Henrique de Campos Meirelles as governor of the Banco Central do Brasil (BCB) finally put to rest widespread speculation that the left-of-centre government of Luis Inácio Lula da Silva would select a governor with a very different monetary policy stance than Meirelles' conservative predecessor. Policy continuity has apparently been preserved, as has the BCB's operational autonomy. The BCB's technical staff has also been left untouched by the new administration.

The BCB still lacks legal independence, and important governance issues—including fixed terms for central bank officials and criteria under which the government may overrule BCB decisions—remain unaddressed in legislation. Lula's administration has announced plans to grant the central bank legal independence and clarify key aspects of BCB governance, but this legislation is not expected to be debated in the Congress until next year.

The central bank has operational autonomy in the conduct of monetary policy under an inflation-targeting framework. Brazil is a subscriber to the IMF's Special Data Dissemination Standard, and the BCB meets its standards for monetary reporting. Its already impressive internet information services continue to improve, as does its extensive series of publications. In November 2002, the BCB started publishing the *Financial Stability Report*, a useful semi-annual report on the condition of the nation's financial and payments systems.

Brazil's overall score is unchanged from last year**.**

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

Brazil's institutional framework for monetary policy is set out in Law No. 4595 of 1964 (as amended) and also in Decree No. 3088 of 1999, which established an inflation targeting framework for Brazil. This Law regulates the Brazilian financial system, and provides the legal foundations of the central bank -- Banco Central do Brasil (BCB) -- and for the National Monetary Council (CMN). As the government's most important economic decision-making body, the CMN is responsible for deciding general monetary policy, including setting the headline inflation rate, as well as foreign exchange and credit policies. The Council also regulates and coordinates the regulation and supervision of financial institutions. Composed of the minister of finance (who serves as its chairman), the minister of planning and budget, and the BCB governor, the body has three voting members. The monetary decisions of the CMN are then implemented by the central bank.

The BCB identifies its principal objective as being to "promote the stability of the purchasing power of the Brazilian currency."[1] This goal, however, is qualified by the need to adjust its money supply and interest rate policies according to the needs of sustainable economic growth and development. The BCB also includes among its duties the provision of adequate liquidity, maintaining sufficient international reserves, promoting savings mobilisation to levels needed to finance domestic investment, and safeguarding the stability of the national financial system.[2]

Within the BCB, the most important body is the Monetary Policy Committee (COPOM). Created in 1996, the COPOM is tasked with setting short-term interest rates in line with the CMN's chosen headline inflation target. The interest rate target set by the COPOM is the target for the SELIC interest rate, the interest rate for overnight interbank loans collateralized by government bonds registered with and traded on the Sistema Especial de Liquidação e Custódia. While it is clear that the CMN has the final say in the setting of monetary policy, it is not clear under what conditions the Council could override COPOM decisions in case of disagreements. Legislation expected to be introduced next year may bring more clarity to override criteria.

Procedures for appointment of central bank officials are specified in Law No. 4595. The governor and deputy governors are appointed by the president with confirmation from the Senate. However, the legislation does not specify any terms of office for high BCB officials, and they can be removed at any time by the president with the Senate's approval.

Operational autonomy

Brazil's central bank is not legally independent, but in practice enjoys substantial operational autonomy. This view was confirmed by an IMF team that assessed Brazil's fiscal transparency in 2001.[3] Since the IMF's visit, two events are worth highlighting.

First, the election of President Luis Inácio Lula da Silva in 2002 and the accompanying change in the ruling coalition marked an historic alternation of power in Brazil. Yet, the new BCB governor selected by the president and approved by the Senate, Henrique de Campos Meirelles, is a man whose monetary policy stance is essentially a continuation of his predecessor's. This suggests that the current administration is keen to see policy continuity at the central bank. Also, the BCB's technical staff was left untouched under the new government, providing an important element of continuity to the BCB's monetary policy.

Secondly, in April 2003 the Lower House of Congress approved Amendment 53 related to regulation of the national monetary and financial system. The amendment relaxes certain procedural restrictions imposed by Constitutional Article 192, thus making any reform to the central bank's legal status easier politically. While the amendment has no legal impact on the status or operations of the BCB, it is a symbolic first step in the government's plans to introduce a bill extending legal autonomy to the central bank. The amendment is now awaiting passage in the Senate.

According to BCB officials, the government is unlikely to introduce the bill until next year at the earliest, as the government is currently focusing its efforts on getting several major reform initiatives approved.[4] Other observers report that the government has not yet settled on a model for central bank independence/autonomy.[5] However, it is known that at least two drafts of legislation affecting the BCB's status have been prepared by legislators, but these are unlikely to be discussed until next year.[6]

Institutional relationship between monetary and fiscal operations

Lending to government

Article 164 of the Federal Constitution forbids the BCB to finance the National Treasury (STN). In particular, the CNC may not grant loans to the treasury, or to any agency or entity which is not a financial institution. Also, it may not buy primary issues of federal debt. In addition, the Fiscal Responsibility Law prohibits the central bank from issuing securities in order to finance federal government debt.[7] STN balances held at the central bank are remunerated at the average interest rate for all government securities in the BCB's portfolio. Outstanding credits, advances, and overdrafts made by the BCB to the government are reported in the BCB's annual accounts.

Central bank involvement in the rest of the economy

The only significant involvement of the BCB in the rest of the economy is through its control of six commercial banks transferred to the BCB for recapitalisation and re-privatisation. Information on the progress of privatisation of these banks is disclosed through press releases whenever there are developments in this area.

Central bank profit allocation

Allocation of central bank profits is specified in Article 7 of the Fiscal Responsibility Law. Under the law, all central bank financial results are classified as National Treasury revenue. Any profits must be transferred within ten business days after the approval of the half-year balance sheets. Any negative results will be classified as a National Treasury liability, and the Treasury will cover the loss within one year of final approval of the balance sheets. Should the Treasury deem it appropriate, and with the concurrence of the BCB's governor, the central bank may retain up to 55% of any profits.[8] The law also requires that the impact and fiscal cost of the central bank's operations be stated quarterly in the federal government's Budgetary Directives Law.

A breakdown of the BCB's balance sheets is reported on its website.

Agency roles performed by the central bank on behalf of the government

The BCB manages the National Treasury account on behalf of the government. The BCB currently issues foreign bonds as the agent of the federal government, but a decision is expected soon on consolidating in the National Treasury all activities related to the issuance of foreign debt securities. This centralization is expected to produce significant efficiency gains, but it is still a point of controversy between the BCB and the STN.[9]

The local and foreign currency accounts used for receipts/disbursement from these organisations are held at the central bank (reported in the *Annual Statement*). In addition, the central bank is in charge of recovering the official credits granted by Brazil to several foreign countries. The BCB also represents the Brazilian government in its dealings with international organisations such as the IMF, the World Bank and the Inter-American Development Bank.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments and targets of monetary policy

Framework and monetary targets

The framework, instruments, and targets of monetary policy in Brazil are clear and publicly available. The BCB's website includes a concise description of the procedures and practices followed with regard to monetary policy instruments. Under Decree No. 3088, Brazil follows an explicit inflation-targeting framework for monetary policy. Under the Fiscal Responsibility Law, the federal government's Budgetary Directives Law (which is sent to the Congress six months before the year's draft budget) must contain an appendix with the objectives of the monetary, credit, and foreign exchange policies as well as the parameters and projections for major aggregates and variables, and inflation targets for the subsequent year.[10]

In practice, managing the value of the currency has been relegated to a secondary role but remains important, since much of the country's domestic and international debt is indexed to the dollar. The BCB has sometimes intervened, but it usually lets the market determine the value of the real.

BCB relationships with counterparties are specified in a series of circulars delivered directly to financial institutions and available on its website.[11]

Monetary instruments

The central bank employs a variety of instruments to achieve its monetary policy objectives, including open market operations and liquidity support loans. Once the headline inflation target has been set by the CMN, the central bank sets the SELIC interest rate, a key instrument for monetary policy.

In addition, the BCB exercises monetary and credit controls by setting reserve requirements for commercial banks and through bank rediscount policies. Interest rate ceilings and mandatory rate reductions have also been used. The government also imposed lending requirements on banks. For example, it requires commercial banks to set aside a portion of their net deposits for agricultural loans. There are additional limitations on credit in the form of reserve requirements on both time and demand deposits and on credit-allocation requirements for small businesses.

The monetary policy-making body

Monetary board

The COPOM is composed of the members of the BCB's board of directors, its governor, and the deputy-governors for Monetary Policy, Economic Policy, Special Studies, International Affairs, Financial System Regulation, Financial Supervision, Bank Privatization and Administration. The governor of the BCB holds the deciding vote in cases where the COPOM is evenly split on a monetary policy decision.

As mentioned above, the COPOM is charged with setting the SELIC interest rate target, which is fixed for the period between regular COPOM meetings. The COPOM can also establish a monetary policy bias at its regular meetings; a bias (to ease or tighten) authorises the governor to alter the SELIC interest rate target in the direction

of the bias at anytime between regular COPOM meetings. If inflation breaches the target set by the CMN, the governor is required to write an open letter to the minister of finance explaining the reasons the target was missed, as well as the measures required to bring inflation back to the target, and the time period over which these measures are expected to take effect.

The BCB's website contains a detailed description of the COPOM's composition, structure and practices.[12]

Advance meeting schedule

Since 2000, the COPOM's regular meetings have been held once per month; the meetings last two days. The meeting begins on a Tuesday and continues on the following day. The BCB's website contains a calendar of COPOM meetings until the end of the current year.[13]

The central bank's website contains a circular that explains COPOM activities in some detail.[14] Eight days after each meeting, the committee releases the minutes via the central bank's website and a press release. The minutes discuss the considerations behind COPOM decisions. Dissenting views are included in the minutes if the decision is not unanimous. As of December 2003, all monthly minutes have been published in the BCB's website.

Public statements on monetary policy

Periodic publications

The BCB has a comprehensive program of regular publications, all of which are available through its website in both Portuguese and English. Data on the monetary base and its components is published in the monthly press release on monetary policy and credit and in the *Bulletin.* At the end of each quarter (March, June, September, December), the COPOM publishes the *Inflation Report*, which provides detailed information on economic conditions, as well as the COPOM's inflation projections from its most recent meeting. Other central bank publications include press releases, the Bank's *Quarterly Monetary Program*, its *Annual Report,* a regular *Report on Bank Interest Rates and Spreads*, and a variety of Working Papers and Technical Notes on specific topics of monetary significance. All are available on the BCB's website.

Since November 2002, the BCB has been publishing an extensive publication entitled the *Financial Stability Report.* The report, which appears to be published semi-annually, reports on the condition of the financial system as a whole, including banking-sector assets and liabilities, exchange rate exposure, and capital adequacy ratios. The publication also describes the condition of the nation's payments system and reports on any changes to the framework of prudential regulation. Stress scenarios and their monetary implications are also outlined.[15]

To generate its forecasts, the BCB uses its own macroeconomic model. While not all the variables and parameters of the model are made public, Working Papers posted on its website provide some detail about the model and the assumptions used.[16]

Public consultations

The BCB is not legally required to conduct public hearings or consultations before monetary policy changes. In practice, however, the Bank meets regularly with economists from the private sector and representatives of various sectors of the economy to discuss their regulatory and monetary-policy views. According to Bank officials, the BCB has an active agenda of seeking commentary from social sectors affected by monetary policy decisions.[17]

Regulations on data reporting by financial institutions to the central bank

The BCB is in charge of monitoring and regulating the nation's financial system, although it shares these responsibilities with other government entities.[18] Its capacities include the regulation, authorisation and monitoring of the activities of mutual funds, leasing companies, real estate credit societies, savings and loan associations, the National Rural Credit System (SNCR), and the Farming Activity Guarantee Program (Proagro).[19]

The BCB produces a Document Catalogue (CADOC), which lists all the documents that institutions are obligated to submit to it. It also publishes an Accounting Plan of National Financial System Institutions (COSIF), which describes accounting records and the different types of accounts to be used by any institution, cooperative, bank, distributor, or broker. Both documents are available by subscription.

One of the two legislative drafts on the central bank written by legislators is known to contain provisions that would transfer the regulatory and supervisory functions of the BCB and other institutions to a single financial watchdog.[20] However, this bill has not yet been debated in Congress.

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

Brazil subscribes to the IMF's Special Data Dissemination Standard (SDDS) and meets its standards for coverage, periodicity, and timeliness of monetary data. An advance release calendar giving one quarter ahead notice of approximate release dates is published on the central bank's website and on the IMF's Dissemination Standards Bulletin Board. A regular notice on the advance release calendar is also published in the monthly *Bulletin*.[21]

Data for the analytical accounts of the central bank are preliminary when first disclosed. Preliminary data are duly identified and are subject to revision. The data become final after the approval of the central bank's board, four weeks after the end of the reference month.

An extensive range of time-series data is available in the *Economic and Financial Information Databank*, available on the BCB's website.

The central bank balance sheet

The central bank publicly discloses its balance sheet in the monthly *Bulletin* and its *Annual Report*. The balance sheet details credits to financial institutions, securities and open market transactions, National Treasury transactions and external liabilities. The methodology used to compile the data is well documented. The BCB also reports daily on the amount and composition of international reserves.

The analytical balance sheet, published in the monthly *Bulletin*, includes the accounts of the BCB (arranged to facilitate economic interpretation), together with a consolidated statement of the foreign assets and liabilities of the public sector, and accounts of the National Treasury. The following assets data are published: foreign assets; credit to the federal government; credit to state and municipal governments; credit to the private sector; credit to deposit money banks; credit to other banking institutions; and credit to non-bank financial institutions. The BCB does not extend credit to non-financial public enterprises.

The central bank has contingent liabilities. For example, it faces risks associated with its 27 billion reais to balance sheet items inherited from other financial institutions under liquidation, and it is facing restitution claims from banks under liquidation for agricultural credits. These liabilities have already been incorporated into the BCB's balance sheet.

Lender of last resort

Whenever the central bank acts as a lender of last resort, it must conform to established rules and reporting in its balance sheet. Such support is given through loans by the BCB to assist financial institutions facing temporary liquidity problems. The loan is granted for one day, through standardised repurchase agreement transactions.

In November 1995, with the creation of the Program of Incentives to the Restructuring and Strengthening of the National Financial System (PROER), the financial system incorporated a liquidity assistance mechanism. However, the Fiscal Responsibility Law precludes its application under the original conditions. Despite this, the central bank guarantees the confidentiality of data relating to specific financial institutions or individuals, in

accordance with the established banking oversight standards set forth in the IMF SDDS.[22] Some aggregate information about the costs of the bank restructuring is included in a recent Working Paper.[23]

Public information services

The Bank's high-quality website contains all the publications listed in the previous section and serves as an important source of information on recent economic developments, monetary and survey data, the minutes of COPOM meetings, and a range of relevant contacts.

In addition, the BCB provides useful monthly below-the-line data on the consolidated operations of the various levels of government and the non-financial public sector. The BCB publishes data on nominal interest payments for different levels of government and their primary balances. It has also begun to publish on a monthly basis statistics on the uses and sources of financing of government operations, for all levels of government and the consolidated public sector. Reports of the external audits of the BCB are also available on its website.

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

Under the Fiscal Responsibility Law, the central bank is required to present, in a joint meeting with the relevant commissions of Congress, the evaluation of compliance with the objectives and targets of monetary, credit, and foreign exchange policies, detailing the impact and the fiscal cost of its operations and the result shown in its financial statements. The presentation must take place within 90 days from the end of each half-year period.[24]

The central bank's *Annual Report* is also submitted to Congress for debate, and the BCB's governor appears before the Congress twice a year. At these sessions, the governor and other officials field questions from the legislators on a range of economic policy topics.

Financial statement

Audited financial statement

Audited revenues and expenses are disclosed in the *Annual Report.* This data is given on a bi-annual basis and compared with results from the previous year. Data includes information on operating revenues, expenditures, and transfers. Methodological notes accompany the released data.

External and internal audit

Financial statements produced by the central bank are audited by both the Internal Comptroller and by the Brazilian Audit Court (TCU), which monitors overall public finances. Since 1999, the BCB has also used an external auditor, although current legislation does not require it. From 2001 to date, KPMG has acted as the external independent auditor and is still performing that function.

Conduct of officials

Ethical standards for public servants are embedded in various pieces of legislation. The 1994 Code of Professional Ethics for Federal Public Servants is publicly available and regulates professional behavioural standards for all civil servants. In addition, the 1990 Statute for Civil Servants, applicable to all public employees, sets out individual rights and responsibilities and establishes disciplinary procedures. Sanctions and penalties for officials are further detailed in the Fiscal Crimes Law of 2000. This law applies to officials from all branches of government and, among other measures, details penalties for individuals who engage in credit operations without due legislative authorisation, who extend loan guarantees without adequate collateral, or who increase personal expenditures in the last 180 days of their period in office.

Also, the government has established a Code of Conduct for senior federal government officials (CCAAF), which is applicable to about 700 government officials who manage public debt. The Code clarifies ethical rules for this category of officials, establishes rules regarding conflicts of interest, and places limitations on professional activities undertaken after leaving office. A Public Ethics Commission (CEP) was set up under the Presidency to implement the CCAAF. Upon entry into service, all public officials must also supply a declaration of assets as required by the CCAAF. A General Corrector's Office (CGU) has also been instituted to investigate any infractions by public officials against federal funds or assets.

The government's proposal for central bank autonomy, which is likely to be introduced next year, is expected to include changes to the legal protection extended to BCB officials.[25]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Brazil between 11 and 14 November, 2003:

Banco Central do Brasil

Luiz Sampaio Malan	Deputy Director	Department of Economics
Katherine Hennings	Advisor	
Eduardo Loyo	Deputy Governor for Special Studies	

Ministry of Planning, Budget, and Management

11 November 2003

José Carlos Miranda	Chief Economic Advisor	
André A. Pompeia Cavalcanti	Project Head	Office for Strategic Investments
Beatrice Valle	Deputy Secretary	Office for Strategic Investments

National Treasury, Ministry of Finance

12 November 2003

Fernando E. de P. Garrido	Head of Department	Department of Public Debt Operations Management
Otavio Ladeira de Medeiros	Deputy Head of Department	Public Debt Strategic Planning Department

ADDITIONAL INTERVIEWS

13 November 2003

Fernando A. Blanco Cossio	Economist	World Bank Brasilia Office
Juarez de Souza	Legislative Consultant	Brazilian Senate
Mauricio Mota Saboya Pinheiro	Economist	Institute for Applied Economic Research
Bolívar Pêgo Filho	Economist	Institute for Applied Economic Research
José Hamilton Bizarria	Economist	Institute for Applied Economic Research
Julieta Verleun	Programme Officer	United Nations Development Programme Government & Technology Unit

14 November 2003

Letícia Schawrz	Advisor	Ministry of Planning, Budget and Management
Matthew Lownds	First Secretary	British Embassy in Brasilia

NOTES

[1] Banco Central do Brasil (2003), Background; www.bcb.gov.br
[2] Banco Central do Brasil (2003), Objectives; www.bcb.gov.br
[3] 'Brazil: Report on Observance of Standards and Codes (ROSC) – Fiscal Transparency Module', International Monetary Fund, December 2001, p.12.
[4] Interviews in Brasilia, November 10-14, 2003.
[5] Interviews in Brasilia, November 10-14, 2003.
[6] Interviews in Brasilia, November 10-14, 2003.
[7] Fiscal Responsibility Law (Supplementary Law 101 of May 4, 2000), Article 34.
[8] Interviews in Brasilia, November 10-14, 2003.
[9] Interviews in Brasilia, November 10-14, 2003.
[10] Fiscal Responsibility Law (Supplementary Law 101 of May 4, 2000), Article 4.
[11] See www.bcb.gov.br/?BUSCANORMA, www.tesouro.fazenda.gov.br/legislacao/download/divida/ato_norm_demab_codip.pdf, and www.tesouro.fazenda.gov.br/legislacao/download/divida/ato_normativo02.pdf.
[12] See www.bcb.gov.br/?SISMETAS
[13] See www.bcb.gov.br/?COPOMCALEND
[14] Circular 3010, 17 October 2000.
[15] Banco Central do Brasil, *Financial Sector Stability Report*, May 2003.
[16] Interviews in Brasilia, November 10-14, 2003.
[17] Interviews in Brasilia, November 10-14, 2003.
[18] Banco Central do Brasil (2003), Background; www.bcb.gov.br
[19] Article 32 of the Fiscal Responsibility Law and Senate Resolution 43 entrusts the Ministry of Finance with monitoring state and municipal debts. The National Monetary Council indirectly controls the public sector's indebtedness by limiting credit provided by financial institutions to the public sector.
[20] Interviews in Brasilia, November 10-14, 2003.
[21] IMF (2003), Special Data Dissemination Site, Brazil; http://dsbb.imf.org
[22] Complementary Law 105, January 2001.
[23] Ilan Goldfajn, Katherine Hennings, and Helio Mori, "Brazil's Financial System: Resilience to Shocks, No Currency Substitution, but Struggling to Promote Growth," Working Paper No. 75, Banco Central do Brasil, June 2003.
[24] Fiscal Responsibility Law (Supplementary Law 101 of May 4, 2000), Article 9, Paragraph 5.
[25] Interviews in Brasilia, November 10-14, 2003.

OXFORD ANALYTICA

CHILE

MONETARY TRANSPARENCY

Country Report 2003

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CHILE

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●●	●●●●	●●●●●
Open decision process	●●●●●	●●●●	●●●●●
Availability of information	●●●●	●●●●	●●●●●
Central bank accountability	●●●●	●●●●	●●●●
Score	4.25	4.00	4.75

OUTLOOK & COMMENTARY

Chile is likely to continue to make steady progress towards meeting the highest international standards for monetary transparency. The availability of information on virtually all areas of central bank operations will continue to improve from an already high level. The country's inflation-targeting framework has helped to increase the resilience of the economy to external shocks.

The main area of weakness will likely remain the government's outstanding six billion US dollar debt with the central bank. In addition, following the 2003 leaking of privileged information to market participants, the continuous assessment of procedures to manage sensitive information will be a key priority.

EXECUTIVE SUMMARY

4.25 Compliance in progress

Chile maintains a high standard of compliance with the IMF 'Code of Good Practices on Transparency in Monetary Policy'. The Central Bank of Chile (BCC) has institutional independence and financial autonomy and enjoys full discretion over monetary, financial, and foreign exchange instruments. The BCC primary objectives, which are clearly defined in its Organic Law, are maintaining the stability of Chilean currency and financial stability. The BCC follows an inflation-targeting framework, in which the objectives, instruments and modes of accountability are clearly explained.

Chile is a subscriber to the IMF's Special Data Dissemination Standard, and the BCC meets its standards for monetary reporting. The BCC's timely and efficient internet information services continue to improve, as does its extensive series of publications. In 2003, the BCC began issuing weekly press releases with economic information, such as monetary aggregates and trade data, increasing the frequency and timeliness of public data releases. In addition, it has also implemented an online service to receive comments on new norms and regulations that are being debated.

Following a 2003 incident of leaking privileged information to market stakeholders, the BCC issued a document on 'Ethical Standards and Secure Information'. Although the Senate plays an important role in reviewing BCC's operations, its technical capacity should be enhanced in order to increase its supervisory role. To further enhance monetary transparency in Chile, the government should reclassify its outstanding six billion US dollar debt with the BCC.

Chile's overall score has improved from 4.00 in 2002 to 4.25.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

The Central Bank of Chile -- Banco Central de Chile (BCC)[1] -- is an autonomous institution governed by Chapter XII of the Constitution of Chile of 1980[2] and its Constitutional Organic Law[3]. There have been no changes to the monetary policy's institutional framework of the BCC during 2003.

Central bank objectives and responsibilities

The objectives of the BCC are clearly defined in Article 3 of the Organic Law, which requires the BCC to maintain stability of the Chilean currency and ensure the normal functioning of the system of internal and foreign payments. BCC's objectives and responsibilities are clearly explained and commented in several publications, available at the BCC website.

It is responsible for regulating financial markets, international capital flows, and foreign exchange. In addition, it has other responsibilities such as the role of fiscal agent, lender of last resort, and the collection and publication of economic data.

The BCC has legal responsibility for international exchange transactions, and its board determines foreign exchange policy. Chile operates a floating exchange rate system, although the central bank retains the right to intervene and to place restrictions on the operation of international exchange.

Operational autonomy

The autonomy of the BCC is protected by the Constitution, which gives it authority to use monetary and exchange rate instruments and effectively shields it from intervention by other branches of government. Article 2 of the Constitution stipulates that the BCC is governed exclusively by the regulations of its own charter, together with certain specific provisions of the General Banking Act.

Article 1 of the BCC's Organic Law establishes its financial, technical, and administrative autonomy, which is strictly observed: at present there are very few concerns that fiscal policies may undermine the effective autonomy of the BCC.[4]

Article 38 of the Organic Law authorises the BCC to keep, manage and use its international reserves, both within the country and abroad. It also has the authority to pledge such reserves as security of compliance with its obligations.

Institutional relationship between monetary and fiscal operations

The BCC conducts monetary policy-making with operational independence from the government and fiscal institutions.

Lending to government

Article 98 of the Constitution limits the ability of the BCC to carry through direct and indirect lending operations to the government, except in cases of a state of emergency. Article 27 of the BCC's Organic Law establishes that it can only grant financing or refinancing to banking entities and financial institutions, and prevents it from acquiring government debt, whether issued by the central government or by any of the government agencies and state-owned enterprises. Using emergency powers -- introduced following the banking crisis of 1982-3 -- the BCC acquired government bonds from ailing financial institutions that currently amount to six billion US dollars. The BCC and the Ministry of Finance have been arranging a change in the debt's denomination to reduce currency mismatches. Since that crisis, the BCC has not carried out any new lending operations with the government or purchased government debt.

Central bank involvement in the rest of the economy

BCC involvement in the rest of the economy is clearly defined in its Organic Law. Article 35 allocates authority to regulate financial markets and foreign exchange on the BCC. In addition to these activities, it may lend to private organisations and trade securities to ensure the stability of the financial and payments system. The procurement process is clearly explained and information is available on the BCC's website.

Central bank profit allocation

The Bank's Organic Law establishes that profits for each fiscal year should be distributed annually. Article 77 allocates up to 10% of the profits to central bank reserves. The remaining amount is transferred to the Treasury, unless a law allocates these resources in full or in part to the BCC's capital or reserves.

Following the banking crisis of 1982-3, the BCC purchased a substantial amount of public debt and other banking assets from ailing financial institutions, which have led it to incur losses of around 1% of GDP. These losses are due to differences between interest payments and interest revenue from government debt servicing, since almost half of the interest loss originates from the government debt with the BCC. Congress has authorised the BCC to change the denomination of the debt from dollars to Chilean pesos, which should align the structure of BCC's credits and liabilities. To improve monetary transparency, the IMF suggested in its 2002 Article IV Consultation Report that the government should capitalise the Bank and that this future capital disbursement be reflected in the government fiscal accounts.[5] During 2003, authorities have announced intentions to recapitalize the BCC, aiming to further consolidate confidence in the independence of monetary policy and allow for a better understanding of fiscal policy.

Agency roles performed by the central bank on behalf of the government

The 1980 Constitution and Article 37 of the BCC's Organic Law clearly define the agency roles performed by the BCC on behalf of the government. These include an advisory relationship on monetary, financial, and foreign exchange matters with the President of the Republic. On request from the Ministry of Finance, the Bank may act as a fiscal agent in the issuing of government domestic and foreign debt. It may also represent the government in dealings with foreign financial and international organisations, including participation in international lending negotiations. It may issue securities and place them abroad, grant credit to foreign states, central banks or international financiers; it may also accept deposits from the government and state-owned enterprises, with a majority approval from members of the board. Interest earned by these deposits may not be above market rates.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●●● Full compliance

The framework, instruments and targets of monetary policy

Since 2000, the BCC has used a standard forecast inflation-targeting framework, within a flexible exchange rate regime. The country's inflation-targeting framework has anchored inflationary expectations and increased the economy's resilience to external shocks, maintaining price stability.[6] Liquidity is managed through open market operations to maintain a stable overnight reference interest rate. Details of this framework are made available on the central bank's website.[7]

Framework and monetary targets

The BCC uses an annual inflation target that is centred on 3% -- slightly more than the OECD average -- allowing a limited scope for volatility within a range of 2% and 4%. The inflation target is measured through changes in the Consumer Price Index (CPI) produced by the National Statistics Institute (INE), although the monetary authorities focus their short-term analysis on a number of underlying CPIs. INE produces an official figure for core inflation that limits seasonal price changes and short-term volatility. The forecast horizon used for projecting inflation at the BCC is two years, with medium to long-term deviations of inflation from 3% triggering monetary policy shifts.

The BCC does not have a base money growth rate target. The BCC conducts monetary policy through a reference overnight interest rate compatible with the inflation target. Interventions are aimed at maintaining the stability of the reference rate. Accountability for the conduct of monetary policy lies within the ambit of the BCC.

Chile has had a flexible exchange rate since 1999, and free capital flows since April 2001. Exchange market interventions are limited to 'exceptional circumstances', which in practice implies situations of considerable volatility, which the board estimates to be outside market trends. Alongside the adoption of a floating exchange rate regime, the BCC committed itself in 1999 to a framework for the communication of the time span, size, and justification of its foreign exchange interventions. Since then, interventions have occurred three times, coinciding with regional financial turbulences.[8]

Monetary instruments

The BCC conducts open market operations using an electronic auction system. Since August 2001, it has used a nominal interest rate -- instead of the traditional real interest rate -- as the reference rate in its open market operations. This reflects the low inflation achieved, while discouraging the indexation of other contracts in the economy, especially in the short end of the yield curve. The BCC also requires financial institutions to meet mandatory overnight deposits of 9% and medium-term deposits of 3.6%.[9]

The monetary policy-making body

Article 6 of the Organic Law of the BCC allocates authority to conduct monetary policy to the board of the BCC.

Monetary board

Articles 6 to 21 of the BCC's Organic Law establish the composition, structure, and functions of the Bank's board. The board has five members appointed by the President of the Republic with the approval of a majority of the Senate. Members of the board are appointed for 10-year terms and are eligible for reappointment.[10] The president of the BCC is the president of its board, and is appointed from among board members. The Ministry of Finance is not a board member, but is authorised by the Organic Law to attend its meetings, entitled with the right to speak but not to vote.[11] The ministry can suspend the application of board resolutions not taken with unanimity, for a maximum of fifteen days, and may in that time ask the BCC president to call for an extraordinary board meeting to review the decision. Beyond that, however, its powers are limited.

Board members are afforded explicit legislative assurances that strengthen independence from short-term political pressures and allow them to give greater weight to price stability. The President of the Republic, with justified reason and the prior approval of the Senate, may remove any or all of the board members. The dismissal may only be based upon the grounds that the concerned member has voted in favour of resolutions representing a material and clear breach of the purposes of the BCC as specified in its Organic Law, and provided that said resolution has been the main and direct cause of a material damage to the economy of the country.

Advance meeting schedule

The BCC's website includes a six-month advance meeting schedule for monetary policy board meetings. The board holds ordinary sessions once a month. The BCC lists dates of all board meetings since 1997, in addition to details of forthcoming meetings. It also provides summary minutes of the meetings, giving a concise outline of the rationale underpinning monetary policy decisions.

Public statements on monetary policy

Bank authorities publish a tri-annual *Monetary Policy Report* (Informe de Política Monetaria) that reviews recent domestic and foreign economic developments, foreign exchange, and financial markets, as well as presenting medium-term growth and inflation forecasts. These reports also explain the policies pursued by the BCC to meet its inflation target based on a two-year period, explicitly describing inflationary risks scenarios. The September report coincides with the constitutionally mandated *Annual Report* to the Senate, which reviews and describes the policies and interventions undertaken by the BCC.

Since April 2003, the summaries of board meetings are made public with a forty-five day lag, shortened from the previous ninety-day lag. These summaries are also released in English and publicly available at the BCC's website.[12] The website also publishes speeches and documents drafted by board members explaining policy decisions implemented during the year. As of September 2003, the tri-annual *Monetary Policy Report* includes a section on the explicit rationale for recent monetary policy decisions.

Periodic publications

The *Monetary Policy Report* is published 3 times a year in January, May, and September and, like the annual reports, reviews monetary policy and inflationary risks.[13] The *Monthly Newsletter* and the *Economic and Financial Report* -- released twice a month -- contain general economic information, as well as a review of monetary aggregates, international reserves, and other macroeconomic data[14]. In addition, the *Daily News* contains monetary and foreign exchange information.

The BCC also carries out a survey of economic expectations. A number of national statistics publications (such as *National Accounts, Balance of Payments and External Debt)* are also available online. In 2003, the BCC has begun issuing weekly press releases with economic information, such as monetary aggregates and trade data, that has increased the frequency and timeliness of public data releases. [15]

Public hearings

Articles 66 to 74 of the Organic Law contain provisions for the publication of BCC's decisions and appeal procedures. Recently, it has implemented an online service for receiving comments on new norms and regulations that are in the process of discussion. This includes the availability online of relevant documents and questionnaires. As of November 2003, these matters include the implementation of a new payments system and real-time settlement of large transactions.

Regulations on data reporting by financial institutions to the central bank

Article 35 of the BCC's Organic Law requires that financial institutions disclose information to the BCC, which is responsible for regulating the financial system and the capital market, and can dictate norms and conditions to banking and financial institutions. Responsibility for inspecting financial institutions, however, lies with the Superintendence of Banks and Financial Institutions (SBIF), whose activities and operational mandate are clearly established.[17] Detailed and up to date information on financial institutions is publicly available through the SBIF website. The number of categories for classifying bank assets will increase from five to ten from mid-2004, and publicly available information will be modified accordingly.

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

Chile subscribes to the IMF's Special Data Dissemination Standard (SDDS), and broadly meets the standards for the release of a wide range of monetary information.[18] Article 53 of the BCC's Organic Law requires the Bank to compile and publish, in a timely fashion, principal national statistics, including monetary and exchange statistics, the balance of payments, and the national debt, as well as other general economic and social indicators. The data covers domestic and international lending, both to the private sector and publicly owned entities. Liabilities are broken down into money, currency reserves and promissory notes. The coverage, periodicity and timeliness of these statistics was established by Agreement Nº 393-07-941207 of the BCC, published in the December 13, 1994 issue of Chile's *Official Gazette*. Information on individual economic agents is considered confidential.

The *Daily News* and *Monthly Newsletter* publications provide detailed information of BCC operations. These include regulations, open market operations, foreign exchange interventions, net and gross reserve levels, lender of last resort operations, monetary aggregates, and trade data. An advance release calendar that provides a quarter-ahead identification of precise release dates is published on the BCC's website.[19] The calendar is continuously updated and is also published in the *Economic and Financial Report*.

The central bank balance sheet

The BCC publishes an annual balance sheet and an annual income statement. Prior to January 31 of each year, the General Manager has to submit to the board for its decision the financial statements for the last fiscal year. Financial statements have to be submitted with an opinion issued by external auditors appointed by the board from among those auditors registered with the SBIF.[20] The BCC also releases monthly balance sheets with detailed information about outstanding liabilities and assets.

Lender of last resort

Article 36 of the BCC Organic Law allows it to carry out lender of last resort operations to financial institutions, with the exception of state-owned enterprises. Operations of this type may extend for up to ninety days. After that, loans can only be renewed with the agreement of the board's majority vote. These decisions are subject to a report from the SBIF. The BCC may lend to state-owned enterprises and the government only under a state of emergency clause. All lender of last resort operations are disclosed in press releases, the *Daily News*, and BCC income statements. Details of outstanding loans are available in the BCC balance sheets.

Public information services

The central bank continues to maintain good public information services and has updated its website during the last twelve months.

A wide variety of informative reports on BCC policies and the Chilean economy, along with a series of economic studies and economic working papers by its staff, are available on the BCC's website. The *Annual Report* and the *Monetary Policy Report*s are available in English. Regulations, circular letters, and resolutions are also readily available. Details of resolutions must be published within five days of their adoption.

Information about the BCC international reserves are publicly available through its website. In addition, since March 2003, the BCC has started to release a report indicating how international reserves are managed.[21]

Early in the year, the local Inverlink financial group admitted stealing financial documents worth over 100 million US dollars from a government agency. Moreover, Inverlink's stockbrokerage arm was revealed to have been buying market-sensitive information from the personal secretary of the former BCC president. The incident has not only damaged market confidence, but also undermined the government's credibility. Pressure on the BCC president to stand down because of his administrative responsibility for the information leaks from that organisation finally succeeded.

As a consequence of the Inverlink case, and the corroboration of the role played by the secretary of the then president of the central bank, Carlos Massad, in stealing market-sensitive information, the BCC has stepped up security, but has also reduced the time it holds market sensitive information before publishing it. Commentators agree in the positive role played by BCC officials in the timely reporting and investigating of the events.[22]

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●●● Compliance in progress

Accountability before a designated public authority

The BCC prepares a report regarding its previous year's activities providing information on the execution of policies and programmes carried out in that period, and including the financial statements. The report is available to the public at the BCC's offices and is also submitted to the Minister of Finance and to the Senate prior to April 30 of each year. Commentators have suggested that the Senate's technical capacity should be strengthened in order to increase its supervisory role.

There is a legal requirement for the BCC board to submit, prior to September 30 of each year, to the Minister of Finance and to the Senate an evaluation of progress made regarding the policies and programmes for the current year, together with a report on proposed policies and programs for the next calendar year, stating the general economic projections on which such information is based and the possible effects they may have on major items in the financial statements for that period. Beyond the legal requirement, the BCC has been submitting reports on evaluation of progress of its policies on a quarterly basis.

Financial statement

The BCC's financial statements, detailing revenues and expenses of the BCC, are published annually as part of the *Annual Report*, and are accompanied by the opinion of external auditors.

Audited financial statement

The central bank's General Manager must produce the financial statement by 31 January of the next fiscal year. Subsequently, an auditing firm carries out the statement's external audit.

External and internal audit

The control and internal supervision of the BCC's accounts, operations and administrative regulations is the responsibility of its General Auditor. The General Auditor must report in writing to the president of the board, with a copy to the rest of its members, the comments and objections he may deem appropriate regarding accounts and operations.[23] These internally audited statements, having been reviewed by the General Manager, are then passed to external auditors designated by the BCC's board.

A firm registered with the SBIF carries out the external audit of central bank accounts. The BCC is also directly accountable to the Superintendence of Banks and Financial Institutions, and must comply with the latter's regulations -- including the disclosure of financial statements.

Conduct of officials

The Organic Law of the BCC governs the code of conduct of employees, including its board. It comprises an extensive list of activities deemed incompatible with the role of board membership, and general staff's conduct

regulations. In 2002, Congress modified the Organic Law to prevent board members from having equity or ownership of financial institutions. Given the fact that the procedures to manage sensitive information became highly important following the Inverlink incident, in March 2003 the Bank issued a document on 'Ethical Standards and Secure Information' that BCC officials have to follow.[24]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Chile between 18 and 20 November 2003:

Central Bank of Chile

20 November 2003

Rodrigo Valdes Pulido	General Manager	Department of Economic Research

Ministry of Finance

20 November 2003

Mario Marcel Cullell	Director	National Budget Office
Jaime Crispi Lago	Head, Research Division	National Budget Office

ADDITIONAL INTERVIEWS

18 November 2003

Axel Buchheister Rosas	Legislative Programme Director	Freedom and Development Institute
Rosanna Costa	Fellow, Economic Programme	Freedom and Development Institute
Diego Grunwald	Deputy Chief Economist	Larrain Vial Consulting

19 November 2003

Enrique Marshall Rivera	Superintendent	Superintendence of Banks and Financial Institutions
Fernando Valdes Ossa	Correspondent	Superintendence of Banks and Financial Institutions
Juan Andres Fontaine	Consultant	Fontaine & Paul Consulting
Paul Taylor	First Secretary	British Embassy in Santiago

NOTES

[1] The Central Bank of Chile (Banco Central de Chile) at www.bcentral.cl
[2] Constitution of Chile of 1980 at www.bcn.cl
[3] Organic Law of the Central Bank of Chile at www.bcn.cl
[4] Interviews in Santiago, 18-20 November, 2003.
[5] 'Chile 2002 Article IV Consultation Report', Country Report 02/155, July 2002, available at www.imf.org/external/pubs/ft/scr/2002/cr02155.pdf
[6] 'Chile 2003 Article IV Consultation Report', Country Report No 03/303, September 2003, available at www.imf.org/external/pubs/cat/longres.cfm?sk=16892.0
[7] Monetary Policy of the Central Bank of Chile: Objectives and Transmission Mechanism at www.bcentral.cl/eng/stdpub/publications
[8] The latest BCC intervention occurred in 2002, as a consequence of regional instability. In that opportunity, the central bank announced a temporary window of exchange market intervention, which was in practice less than the announced limits.
[9] Once the new payments system -- currently under discussion -- enters into force, these figures are expected to decrease.
[10] Article 8 of the BCC's Organic Law discusses the term of the members and establishes limits for their replacement, allowing for one member to be changed every two years.
[11] The ministry has also the right to propose agenda items or specific policy decisions (such as monetary policy, foreign exchange ,and financial regulation) for discussion.
[12] Summaries of the BCC's board meetings, available at www.bcentral.cl/eng/press/communications/
[13] Annual and Monetary Policy Reports, publicly available at www.bcentral.cl/eng/stdpub/publications
[14] *Monthly Newsletter (Boletín Mensual)*, *Economic and Financial Report (Reporte Económico y Financiero),* and *Daily News (Informativo Diario),* available at www.bcentral.cl/esp/estpub/publicaciones
[15] Available at www.bcentral.cl/esp/infoeconomica/coyuntura/
[16] *Daily News (Informativo Diario)* and *Annual National Accounts (Anuario de Cuentas Nacionales)* available at www.bcentral.cl/esp/estpub
[17] Superintendence of Banks and Financial Institutions (*Superintendencia de Bancos e Instituciones Financieras*) at www.sbif.cl
[18] IMF Special Data Dissemination Standards (SDDS) – Chile, at http://dsbb.imf.org/country/chlcats.htm
[19] Available at www.bcentral.cl/Indicadores/calendario/release.htm
[20] Article 76, BCC's Organic Law.
[21] Available at www.bcentral.cl/esp/infoeconomica/fminedd/
[22] Interviews in Santiago, 18-20 November, 2003.
[23] Article 26, BCC's Organic Law.
[24] Available at www.bcentral.cl/esp/politicas/exposiciones/miembrosconsejo/pdf/2003/informe%20seguridad.pdf

OXFORD ANALYTICA

CHINA

MONETARY TRANSPARENCY

Country Report 2003

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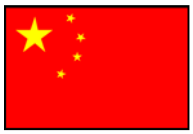
CHINA



COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	••	••	••
Open decision process	•••	••	•••
Availability of information	••	••	••
Central bank accountability	••	••	••
Score	2.25	2.00	2.25

OUTLOOK & COMMENTARY

One of the greatest challenges for the People's Bank of China (PBC) is to strengthen its autonomy from government control. The first year of government by the 'fourth generation' of Chinese leaders has witnessed some isolated changes to reinforce the PBC role, but more comprehensive changes are still pending.

Further advances are expected regarding the amount of publicly available information released by the PBC. Improvements in the central bank's compliance with GDDS are likely to occur, although at a slower pace than expected, while attempts to establish a Centre for Financial Statistics (CFS) could enhance the PBC's data management.

Current efforts to strengthen the banking sector by improving retail banks' badly damaged balance sheets, providing them with new capital, introducing better corporate governance, and fostering competition through more foreign bank operations will all need to be closely monitored.

EXECUTIVE SUMMARY

2.25 Intent declared

The institutional framework of the People's Bank of China (PBC) is set out in the Central Bank Law of 1995, which mandates it to ensure the correct formulation and implementation of state monetary policies. Even though its policy objectives still have to be approved by the State Council, the PBC's experience and credibility in monetary policy have been growing during the past year.

The PBC Monetary Policy Committee, the body which sets interest rates and makes other important monetary policy decisions, has been more active in soliciting advice from private sector experts in recent years. Decisions taken by the Monetary Policy Committee are publicly available. In addition, the PBC has recently started to publish (in English) its quarterly Monetary Policy reports.

In April 2002, China joined the IMF General Data Dissemination System (GDDS), marking a major step towards increased transparency in the reporting of economic data. The central bank expects to enhance its compliance with GDDS requirements during 2004. At present, no information is publicly available regarding the PBC's profit and loss statements. In addition, information on expenses and revenues -- while provided to the National People's Congress -- is not released to the public domain.

Efforts are under way to recapitalise the four major state-owned commercial banks, which currently hold an estimated Rmb 2,000 billion in non-performing loans. These banks have been instructed to speed up their restructuring into shareholding companies and to prepare plans for listing at home, and possibly overseas. In addition, the State Banking Regulatory Commission (SBRC) was created in April 2003. The SBRC was set up to protect the interests of depositors and consumers through prudent and effective supervision, and so increase public confidence in the financial system. The SBRC -- which will soon have its authority enshrined in the first bank supervisory law, now being drafted -- has moved rapidly to institute a series of policies it hopes will result in a more commercial, competitive and stable banking system.

As the need for anti-money laundering efforts has become a pressing issue for the country's financial sector, new *Rules for Anti-Money Laundering by Financial Institutions* have been enacted in 2003. Further regulations are expected to be enacted in the future in order to empower the central bank to take effective action against money laundering.

China's overall score has improved from 2.00 in 2002 to 2.25.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●● Intent Declared

Objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The People's Bank of China (PBC) is the central bank of the People's Republic of China (PRC). Its status and functions were established by the 1995 Law on the People's Bank of China which mandates the PBC to ensure "the correct formulation and implementation of state monetary policies, instituting and perfecting a macro-control system through the central bank and strengthening supervision and administration of the banking industry."[1] The PBC Law declares that the central bank's responsibilities are to formulate and implement monetary policies; issue and administer the circulation of the local currency (renminbi); supervise banking institutions and the financial market; manage the foreign exchange and gold reserves, the treasury, and the payment and clearing system; supply banking statistics; and engage in international banking operations.[2] The stated aim of monetary policies is to maintain currency stability and thereby promote economic growth.

The PBC Law gives to the PBC the authority to use monetary policy instruments to achieve its policy objectives, subject to the approval of the State Council. Foreign exchange management is entrusted to the State Administration of Foreign Exchange (SAFE), a special government agency under the State Council. SAFE is responsible for the monitoring and control of the movement of foreign capital, and it ensures that the foreign exchange resources of the country are maintained at an appropriate level. It authorises and registers all public and private entities that engage in foreign exchange and compiles statistics on foreign exchange, public debt, and investment flows.[3]

In order to address public concerns, the PBC is in the process of enhancing monetary policy transparency. As a consequence, the Monetary Programme is now publicly available (in Chinese and English), and the relationship between policy design and implementation has started to increase. In 2003, in a departure from past practice, the Monetary Programme has been published prior to its implementation.[4]

Operational autonomy

The PBC is not independent of the government in the administrative or operational sense, although it has gained some autonomy in the use of its instruments in recent years. It must always ask the State Council for approval of its interest rate and exchange rate policy.[5] Decisions made by the PBC are generally subject to macroeconomic policies formulated in conjunction with high-level committees of the Communist Party, the Ministry of Finance, and other powerful government agencies, such as the newly-created National Development And Reform Commission, which has taken over the functions of the former State Planning and Development Commission. In 1998, the PBC underwent significant restructuring aimed at reducing the intervention of provincial and local governments in its credit allocation and monetary policy. This was done by replacing the PBC's 31 provincial branches with 9 regional branches.[6]

The major reshuffle of the leadership of the Communist Party, which took place at the 16th Party Congress in November 2002, is likely to reinforce the market orientation of the previous leadership, leading to greater central bank independence over the medium term. The first year of government by the 'fourth generation' of Chinese leaders has witnessed some positive changes to reinforce the PBC role, but no comprehensive change has yet occurred.

The PBC Law states that the governor of the PBC is nominated by the premier of the State Council and affirmed in the nomination by the National People's Congress (NPC). The premier of the State Council also appoints and removes the bank's deputy governors. The law vests responsibility for the conduct of monetary policy in the governor. It also has sanctions against the abuse of power, conflicts of interest, breach of secrecy, embezzlement, bribery, and neglect of duties by officials of the PBC.[7]

Following the reshuffle of the Communist Party leadership, a new PBC governor has been appointed, and he is perceived to be committed to strengthen the central bank's role in monetary policy formulation. His appointment was endorsed by the NPC in March 2003.[8]

Institutional relationship between monetary and fiscal operations

Lending to government

The relationship between the government and the central bank is clearly regulated by the PBC Law. In terms of fiscal autonomy, the PBC Law clearly proscribes the central bank's subscription to primary issues of government debt.[9] This clause was inserted into the PBC Law to eliminate the automatic monetisation of fiscal deficits by the PBC, which had been the case prior to 1995. As a result, the PBC has become more autonomous in the use of its instruments in recent years.

The PBC continues to support the treasury in another way: by asking state banks to extend loans to public projects that are partially funded by government bonds. Such policy lending officially ended when the PBC eliminated the annual credit plan for state banks in January 1998, but it has since been reinstated unofficially to support public spending.[10] The PBC has also asked banks to lend more to farmers, small- and medium-sized enterprises, and consumers purchasing cars and homes. The PBC itself is not permitted to provide loans to governmental bodies or departments, except to those non-bank financial institutions whose borrowing is specifically licensed by the State Council.[11]

The PBC may issue government bonds to banking institutions and organise the exchange of government bonds on behalf of the financial department of the State Council. The PBC may also open accounts for banking institutions as needed, but it may not overdraw such accounts. It may organise or assist in organising banking institutions to settle inter-institutional accounts. It may also determine the amounts, repayment schedules, rates of interest, and forms of loans to commercial banks, although the time limit for such loans cannot exceed one year.[12]

Central bank involvement in the rest of the economy

The PBC's relationship with the four major state-owned commercial banks -- the Construction Bank (CCB), the Industrial and Commercial Bank (ICBC), the Bank of China (BOC), and the Agricultural Bank (ABC) -- is outlined in the PBC Law and the Law on the Commercial Banks of the People's Republic of China, both promulgated in 1995. The latter stipulates that commercial banks need to place the required reserves with the PBC, in addition to having adequate standby reserves. In the past, the PBC employed a credit quota system for the four major state banks. In 1998, it replaced this system with asset liability management. The credit plan had been a powerful tool for controlling the money supply and allocating credit to state-owned enterprises (SOEs) and priority sectors. With the introduction of non-state banks into the banking sector, controlling the total credit of state-owned commercial banks has become less effective as a monetary tool.[13]

Together with the Ministry of Finance, the PBC is working on a programme to recapitalise the currently insolvent four major state-owned commercial banks, which hold more than 60% of the country's banking assets. Taken

together, they currently hold an estimated renminbi (Rmb) 2,000bn in non-performing loans. According to some commentators, the bank recapitalisation will be conducted when the banks are capable of reducing their non-performing loans, and improving their corporate governance structure. The bank recapitalisation remains one of China's most challenging financial reforms.[14]

The four banks have been instructed to speed up their restructuring into shareholding companies and to bring forward plans for listing at home, and possibly overseas. The BOC and the CCB have been earmarked for a public listing in 2005-06, followed by ICBC shortly after. Listing of ABC, which has the largest number of non-performing loans among the four, is as yet uncertain.

Central bank profit allocation

Net PBC profits are transferred to the financial department of the State Council after deduction of expenses and sufficient funds to maintain the bank's general reserves at the level required by the State Council. Losses sustained by the bank are covered by state allocations. According to the PBC Law, the central bank's capital is owned and allocated by the state.[15] Some information on the PBC's financial liabilities and international reserves are publicly available in the *Quarterly Statistical Bulletin*, but this information remains far from being comprehensive.

Agency roles performed by the central bank on behalf of the government

Public debt management is undertaken by three organisations under the State Council, namely the Ministry of Finance, the NDRC and SAFE. The Ministry of Finance has the lead role in the determination, issuance, and management of domestic public debt, and it shares responsibility with the NDRC in authorising the issuance of publicly guaranteed debt. Meanwhile, the Ministry of Finance and the PBC coordinate the quantity, pricing, and maturity structure of domestic debt. With regard to the external public debt, the NDRC and Ministry of Finance jointly authorise new multilateral and bilateral loans in line with development objectives.[16]

The central bank has the duty of advising the government in its relationship with international organisations, and its governor is part of a government committee that discusses relations with the IMF and the Bank of International Settlements (BIS).

The PBC Law mandates the central bank to manage the state treasury and administer the inter-bank payment and settlement system on behalf of the state.[17] Reforms were initiated during the 1990s to establish a modern payments system and develop a national inter-bank money market. The PBC has a national clearing system which provides a local currency payment and settlement service for all banks. It has 1,000 clearing centres covering over 600 cities and towns. The four state banks have their own internal clearing systems that allow intra-city remittances of Rmb 500,000 or less.

The central bank is the supervisory authority for anti-money laundering operations by financial institutions. The need for anti-money laundering efforts has become a pressing issue for the PRC's financial sector following economic liberalization and opening up to the outside world. New *Rules for Anti-money Laundering by Financial Institutions* have been enacted in 2003.[18] Further regulations are expected to be enacted in the future in order to effectively empower the central bank to take action against money laundering, a task formerly undertaken by the Public Security Bureau. In addition, the NPC has ratified the UN Convention Against Transnational Crime, enabling the government to crackdown on money-laundering. These developments constitute considerable progress, making for a much-improved legal framework in this area.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●● Enacted

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The PBC seeks to achieve its monetary objectives through the attainment of publicly disclosed money supply targets. Using the state's Five Year Plan as its strategic basis, the PBC has set an annual target growth of 12-14% for M2 (cash in circulation and money held in all types of savings accounts) and 16-18% for M1 (cash in circulation and money held in demand savings accounts) for the period of 2001-2005. The PBC estimates that this volume of money is necessary to support the Plan's projected annual GDP growth of 7%.

Monetary instruments

The PBC currently uses administrative orders to influence the behaviour of the four major state-owned commercial banks. Albeit called commercial banks, they are wholly owned by the government and have to take orders from the PBC. The close relationship of the PBC and the banking industry is reflected in the fact that deputy governors and other senior managers of the PBC often end up as governors or senior officials of the banks they once supervised.

The PBC Law states that the PBC is the sole body responsible for setting interest rates.[19] The PBC has stated that its long-term goal is to use interest rates to guide the demand and supply of capital. However, interest rates are not very effective in managing monetary policy in China today as capital markets are still underdeveloped. Some experts contend that exports are more effective in controlling the money supply than open market operations.[20] In recent years, the PBC has liberalised the rates of the inter-bank funding market, the bond market, and foreign exchange deposits in excess of US 3 million dollars. It continues to set lending and deposit rates, but allows loans to small- and medium-sized banks to have a 50% range above or below the official lending rates. The PBC also trades in the domestic bond market to help state banks with liquidity problems, rather than to guide interest rates. On average, it has three to four open market transactions each month, but the volume involved is not known.

Recent changes suggest that the bond market is likely to start playing a more important role in the overall money supply. In order to increase the bond market, the PBC has recently decided that more companies should issue bonds. Moreover, changes are underway aimed at creating a bond market index, and this could become operational during the course of next year.

The monetary policy-making body

Monetary board

The PBC has a Monetary Policy Committee whose functions, composition, and working procedures are set out in the Regulation on the Monetary Policy Committee, issued on 20 June 1999. The Monetary Policy Committee is responsible for conducting monetary policy.

The eleven-member committee comprises the governor (chairman of the committee) and two deputy governors of the PBC; a deputy minister of finance; a deputy governor of the NDRC; a member of the Ministry of Commerce; the head of the SAFE; the head of the China Securities Regulatory Commission; governors from two of the major state banks; and one economist. The latter three have a term of two years, while the rest are *ex officio* members. The PBC nominates, in consultation with other government departments, the committee's members, and the State Council makes the formal appointment. The regulations state that committee members should be under 65 years of age, with no criminal conviction, and over ten years of experience in finance.[21]

The monetary policy committee meets in the second week of the first month of every quarter, and the meeting is in quorum with at least two-thirds of committee members. At other times, meetings can be called with the approval of one-third of the members or more. The PBC has created a Monetary Affairs Analysis Team that meets on a monthly basis to review the macroeconomic environment underlying monetary policy.

Monthly meetings are convened to analyse economic and financial developments, and the information generated is passed to government agencies and commercial banks to help them gain a full understanding of monetary and credit policy measures.

Advance meeting schedule

The PBC does not publish an advance meeting schedule.

Public statements on monetary policy

Periodic publications

The Monetary Policy Committee publishes the decisions of its meetings in its official newspaper, the Beijing-based *Financial Times*. In addition, the PBC publishes a two-page report every quarter on the implementation of monetary policy in the *Financial Times* and other leading Chinese newspapers, such as *China Daily*. Annual Monetary Policy reports are also publicly available. During 2003, the PBC has started to publish in English its quarterly Monetary Policy reports. The PBC has also begun to use its Chinese language website to post more timely information about its work. Although the process is gradual, publicly available information has begun to be posted in English.

Public hearings

The PBC submits an *Annual Report* on monetary policies to the Standing Committee of the National People's Congress and makes public statements on its work several times a year in the domestic press. The governor also holds press conferences twice a year. In recent years, the PBC has become more active in soliciting opinions from the public. Two monetary decisions made in late 2002, namely the increase in bank lending to small and medium-sized enterprises and revising upwards the target growth for M1 and M2, were made upon the suggestion of private sector economists.[22]

Regulations on data reporting by financial institutions to the central bank

Under the terms of the PBC Law, the central bank is charged with the supervision and administration of banking institutions.[23] The PBC has the power to demand banking institutions to submit full data on their operations. It is also responsible for the compilation of comprehensive statistics and accounting statements on the national banking system and the publication of such data in accordance with relevant state provisions.[24]

Strengthening the banking sector has been a priority for the government as administered lending by the four major banks to SOEs has led to the accumulation of a large non-performing loan portfolio. Reform of the banking sector is based on a four-pronged strategy. First, the government has reduced its interference in the banking sector by establishing three policy banks in 1994, promulgating the Commercial Bank Law in 1995, and terminating the credit quota system in 1998. Second, the Ministry of Finance issued Rmb 270 billion bank-restructuring bonds to recapitalise the four state banks in 1998, and efforts are under way to launch a new recapitalisation programme in the near future.

Third, the PBC introduced a five-tier loan classification system in 1999, asking all Chinese banks to adopt this regime as of 1 January 2002.[25] Guidelines modelled on international practices for provision against non-performing loans were also drafted in 2002.[26] The new system requires banks to categorise loans into five grades (pass, special mention, sub-standard, doubtful, and loss) according to the borrowers' repayment ability, credit history, and collateral value. On 21 May 2002, the PBC issued new rules requiring Chinese banks with assets of more than Rmb 1 billion or with deposits of more than Rmb 500 million to publish detailed annual information about their financial situation. The PBC also requires these banks to provide balance sheets, statements of income, and statements of owner's equity. They also need to provide details of their risk management and corporate governance, as well as details of major events that took place at the bank during the accounting year. The banks prepare their annual reports in Chinese and publish them within four months of the end of the accounting year.

Finally, the China Securities Regulatory Commission (CSRC) introduced new legislation in 2002 requiring listed banks and banks seeking a listing to appoint two accounting firms, one domestic and one international, for audits. This legislation builds on China's landmark Code of Corporate Governance for Listed Companies, adopted in January 2001 by the CSRC and the former State Economic and Trade Commission. This is designed to strengthen the role of shareholders, boards of directors, and boards of supervisors, and to tighten the requirements for information disclosure and transparency in corporate management.[27]

Parallel to these reform measures, the CSRC introduced a Qualified Foreign Institutional Investor (QFII) programme, modelled after Taiwan's QFII, on 1 December 2002. This programme allows foreign fund management, insurance, securities, and banking institutions with portfolio assets of at least 10 billion dollars to participate in China's domestic capital market. This initiative represents a crucial step in China's liberalisation of its capital account in line with the country's commitment, under WTO accession, to gradually open up its capital market to foreign investment banks.[28]

As part of the government strategy to reform the banking sector, the State Banking Regulatory Commission (SBRC) has been created in April 2003.[29] The SBRC was set up to protect the interests of depositors and consumers by prudent and effective supervision, thereby increasing public confidence in the financial system. It will also promote public education, reduce financial crime, and attempt to maintain financial stability. The SBRC -- which will soon have its authority enshrined in the first bank supervisory law, now being drafted -- has moved rapidly to institute a series of policies it hopes will result in a more commercial, competitive and stable banking system. There are serious problems in nearly all sectors regulated by the SBRC, but it is the non-performing loans among the four large state-owned banks that cause most concern. In December 2003, the SBRC announced a plan to improve retail banks' badly damaged balance sheets, provide them with new capital, introduce better corporate governance, and foster competition through more foreign bank operations.

The SBRC has also moved to liberalise regulation of foreign retail banks, though the changes are still modest. However, the government is planning to raise the limit on foreign ownership of local banks. The ceiling will be raised from the current 15% to 20% for single shareholders and 25% overall. The measure is aimed at encouraging foreign banks to become strategic investors in medium-sized banks.

3. Public Availability of Information on Monetary Policy

●● Intent declared

Release of central bank data

In April 2002, China joined the IMF General Data Dissemination System (GDDS), marking a major step towards increased transparency in the reporting of economic data.[30] In recent years, the PBC has been publishing more financial data on its official website, in its *Annual Report* and *Quarterly Statistical Bulletin*, and the *Financial Times*. These data, released two to six weeks after the reference period, include broad money and credit aggregates, central bank aggregates, interest rates, stock market indices, international reserves, and a depository corporation (banking) survey. Some of the statistics are already based on the IMF's Balance of Payments Manual and the core principles of the Basel Committee.

Since June 2002, the PBC has been publishing more detailed statistics in its *Quarterly Statistical Bulletin*. With its participation in the GDDS, the PBC has made a commitment to prepare an advance release calendar for data release, prepare documentation on the methodology and procedures for compiling monetary and financial statistics, provide more detailed statistics, and use more channels to disseminate data. The PBC expects to enhance its compliance with GDDS requirements during 2004, mainly by improving its resources in terms of trained personnel.[31]

The source data are collected from the PBC's "All Accounts" financial reporting system. This system electronically collects stock data on monetary statistics and banking supervision indicators in an uniform format from banking institutions, which use different accounting procedures. The system allows collection of detailed data for classifying bank accounts by economic sector and financial instrument. Data reporting units are periodically inspected to review implementation of reporting instructions and regulations issued by PBC.

The PBC has developed short-term improvement plans that, once implemented, will strengthen its ability to release data. Plans include the provision of training in compilation and uses of monetary and financial statistics to data compilers and main users. Other plans include the release of documents on methodology and procedures used for compiling monetary and financial statistics.

The PBC is currently working on establishing a Centre for Financial Statistics (CFS), covering the macroeconomy and all financial sectors. Specialists in data collection and computerisation are being recruited and transferred from local branches to help with this work, and the central bank expects to have the CFS operational in 2004.[32]

The central bank balance sheet

The PBC's balance sheet is published monthly, 40 days after the reference date, and is available on the PBC website and in its *Quarterly Statistical Bulletin*. The bank also reports such details to the IMF.[33]

In 1996, the Ministry of Finance introduced a new accounting system, which is also followed by the PBC to prepare its balance sheets.

Lender of last resort

The PBC does not disclose information on emergency financial support. The PBC's relationship with state banks and other financial institutions operates in a highly arbitrary and *ad hoc* manner, hidden from the public eye. State banks look to the central bank for help and other concessions. In the past, failed financial institutions were either allowed to go bankrupt or were supported by funds from local governments and the Ministry of Finance.

The creation of the SBRC has improved the lending mechanisms to financial institutions. In the past, requests for funds from commercial banks were automatically granted by the PBC. Decision-making now requires consultation and discussion between PBC and SBRC, and the overall lending system has been improved.[34]

Public information services

The Chinese version of the PBC website has been gradually increasing the availability of information, and although at a very different speed, some improvement can be seen in the English version. Two government-backed websites, run by the China Foreign Exchange Trade System, have articles in English on monetary issues written by top PBC officials and other useful data on China's money and bond markets.[35] To explain the bank's policies to the public, senior PBC officials appear in question and answer sessions published in the *Financial Times* and broadcast on the national China Central Television.[36] During 2003, the PBC has improved the availability of information in English on its website, which now includes the text of speeches made by PBC officials. Moreover, 2002 figures for monetary survey, exchange rate, gold & foreign exchange reserves, statistics on foreign exchange, and balance sheets of the PBC are also publicly available. Regulations issues by the central bank are also available on the website, in major newspapers, and government gazettes.

4. Accountability and Assurances of Integrity by the Central Bank

●● Intent declared

Accountability before a designated public authority

The PBC Law requires the PBC to submit work reports concerning monetary policies and financial supervision and control to the Standing Committee of the NPC.[37] In addition, summary versions of these reports are available to the general public.

In the past, the NPC was regarded as a rubber stamp of the government. In recent years, it has become more vocal on certain economic issues, although it remains subservient to the Communist Party when it comes to major government decisions. Officials of the PBC are answerable to the State Council and the NPC when called upon to appear, normally on a quarterly basis.

Financial statement

The PBC Law states that the PBC must abide by the state accounting system in managing its revenues and expenditures, and is subject to the auditing and supervision of the China National Audit Office (CNAO) and the financial department of the State Council.[38] It also must abide by the Statistical Law of 1996, under which it is illegal to misreport or tamper with data, or release data without approval.

In the absence of detailed information, it seems likely that the PBC's accounting procedures reflect the drawbacks of China's accounting practices. These are consistent with the spirit of the International Accounting Standards but can be criticised for lacking transparency and a consistent application of standards, timely public disclosure, and accuracy of basic data. The PBC uses a cash-based accounting system, while banking institutions use accrual-based accounting. The latter evaluates fixed assets and other investments at cost, not at market value. Capital is generally inflated by liberal asset revaluations, while provisions made for bad loans are grossly insufficient. The UN System of National Accounts is nominally being adhered to, but the continued application of traditional accounting procedures hinders accuracy. There is, however, a willingness within the central bank to improve the quality of statistics, as required by the GDDS.

Audited financial statement

The PBC publishes its monthly balance sheets, but not its profit-and-loss statement. The central bank is keen to address this problem, but until staff shortfalls are addressed, no improvements can be expected.

The budget of the PBC is incorporated in the central budget after examination and verification by the financial department of the State Council. The PBC submits information on its expenses and revenues to the Ministry of Finance and the NPC, but this information is not publicly available. No independent audit of PBC financial statements is conducted.

External and internal audit

The State Auditor conducts an audit of the PBC every year, but the findings are not publicly available. In addition, the PBC has an Internal Auditing Department that audits the accounts of all levels of the PBC and the financial institutions under its supervision. Information on the central bank's internal governance procedures is not disclosed publicly. Its accounting policies and internal audit arrangements are based on regulations and guidelines issued by the CNAO.[39] The operations of the PBC and banking institutions under its supervision are audited by the CNAO's Department of Monetary Audit.

Conduct of officials

The PBC Law specifies general standards for the conduct of personal financial affairs by officials and staff of the bank. In particular, it details measures relating to the wrongful provision of loans, the provision of financial guarantees to a unit or individual, the unauthorised issue of funds, breach of confidentiality, embezzlement, bribery, malpractice for personal gain, abuse of powers, and neglect of duties. There is no established legal protection for officials and staff of the PBC in the conduct of their official duties.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to China between 10 and 12 November 2003:

People's Bank of China, Beijing

10 November 2003

Wang Zhenying	Director	Macroeconomic Department
Xiang Xiaolan	Analyst	Statistics Department

ADDITIONAL INTERVIEWS

11 November 2003

Bruce Murray	Country Director	Asian Development Bank Resident Mission
Longyun Peng	Economist	Asian Development Bank Resident Mission

12 November 2003

Ray Brooks	Senior Resident Representative	IMF Resident Representative Office
Bao Zhenbin	Senior Economist	IMF Resident Representative Office

In addition, we discussed monetary transparency practices with a delegation from the National Development and Reform Commission that visited Oxford Analytica's Headquarters on November 17, 2003:

Dr Song Li	Director, Associate Professor	Institute of Economic Research, National Development and Reform Commission
Dr. Zuo Chuanchang	Associate Professor	Institute of Economic Research, National Development and Reform Commission
Ms. Liu Guoyan	Assistant Professor	Institute of Economic Research, National Development and Reform Commission

NOTES

[1] The Law of the People's Republic of China on the People's Bank of China (PBC Law), 1995, Article 1, is available in English at the PBC website www.pbc.gov.cn/english/
[2] The PBC Law, Article 4.
[3] "Technical Assistance to the People's Republic of China for Strengthening Public Debt Management", Asian Development Bank, November 2002, p. 2.
[4] Interviews in Beijing, 10-12 November 2003.
[5] The PBC Law, Article 5.
[6] Tenev, S. and Chang, C., "Corporate Governance and Enterprise Reform in China", World Bank, Washington D.C., 2002, p. 18.
[7] The PBC Law, Articles 9, 10, 13, 14, 50.
[8] Interviews in Beijing, 10-12 November 2003.
[9] The PBC Law, Articles 5, 28.
[10] Interviews in Beijing, 11-13 November 2002.
[11] The PBC Law, Article 29.
[12] The PBC Law, Article 24-27.
[13] Tenev, S. and Chang, C., "Corporate Governance and Enterprise Reform in China", World Bank, Washington D.C., 2002, p. 18.
[14] Interviews in Beijing, 10-12 November 2003.
[15] The PBC Law, Articles 8, 38.
[16] "Technical Assistance to the People's Republic of China for Strengthening Public Debt Management", Asian Development Bank, November 2000, p. 1.
[17] The PBC Law, Articles 4, 23.
[18] Available at http://www.pbc.gov.cn/english/jinrongfagui/
[19] The PBC Law, Article 4.
[20] Interviews in Beijing, 11-13 November 2002.
[21] The regulations are available on website of the People's Bank of China, www.pbc.gov.cn
[22] Interviews in Beijing, 11-13 November 2002.
[23] The PBC has traditionally regulated the whole banking sector, resulting in inefficiencies and conflicts of interest.
[24] The PBC Law, Articles 30-34.
[25] China adopted Bank of International Settlements (BIS) standards for the classification of bank loans at the beginning of January 2002. Nevertheless, the banks' reporting and classification of lending behaviour is still perceived as unpredictable and politically motivated.
[26] "Memo on Non-Performing Loans in the People's Republic of China", Asian Development Bank, October 2002, p. 2.
[27] "Code of Corporate Governance for Listed Companies in China", China Securities Regulatory Commission & State Economic and Trade Commission, January 2001.
[28] Anderson, J., "15 Questions on China's QFII", Goldman Sachs Economic Flash, Asia-Pacific Economic Research, November 2002.
[29] The SBRC has said it intends to learn from international experience in carrying out its agenda.
[30] IMF General Data Dissemination System (GDDS) - China, at http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorylist/?strcode=CHN
[31] Interviews in Beijing, 10-12 November 2003.
[32] Interviews in Beijing, 10-12 November 2003.
[33] Interviews in Beijing, 11-13 November 2002.
[34] Interviews in Beijing, 10-12 November 2003.
[35] www.chinabond.com.cn; www.chinamoney.com.cn
[36] Interviews in Beijing, 11-13 November 2002.
[37] The PBC Law, Article 6.
[38] The PBC Law, Article 39.
[39] Website of China National Audit Office, www.cnao.gov.cn

OXFORD ANALYTICA

COLOMBIA

MONETARY TRANSPARENCY

Country Report 2003

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COLOMBIA

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	••••	••••	••••
Open decision process	••••	•••	•••
Availability of information	••••	••••	••••
Central bank accountability	••••	••••	••••
Score	**4.00**	**3.75**	**3.75**

OUTLOOK & COMMENTARY

Colombia's success in fostering monetary transparency will likely remain conditional on the country's economic performance. The government has hitherto struggled to secure congressional approval for several tax increases in order to maintain fiscal deficit targets and investor confidence, following the rejection of fiscal saving measures in the referendum of November 2003. In this context, the temptation to draw on monetary and exchange rate policies might increase as the government's need to achieve its targets grows in future.

In order to allay this concern, the Bank of the Republic (BanRep) is likely to attain future improvements on monetary transparency by increasing its efforts to make available additional statements about monetary policy implementation, and how its operational relationship with the government's executive branch works in practice.

EXECUTIVE SUMMARY

4.00 Compliance in progress

Monetary policy in Colombia remained transparent throughout 2003. The roles and responsibilities of the Bank of the Republic (BanRep) are clearly set out in the Central Bank Law, which provides an appropriate legal framework for establishing the central bank's institutional objectives and its relationship with the government. The BanRep has consolidated its inflation-targeting mechanism, which is complemented by clear monetary and foreign exchange intervention rules.

In early 2003, the executive made a number of calls for the BanRep to secure exchange rate competitiveness to sustain exports and overall employment. This event drew close attention to the BanRep's obligation of coordinating fiscal and monetary policies, as established in the Constitution of Colombia. Initially, there was some concern about the central bank favouring short-term economic growth over price stability and external debt sustainability, but the BanRep remained committed to its chief objectives -- giving further proof of its operational autonomy.

The BanRep observes the IMF's Special Data Dissemination Standard (SDDS) for monetary data within its responsibilities, and produces a comprehensive range of information on monetary policy and overall macroeconomic conditions.

Colombia's overall score has improved from 3.75 in 2002 to 4.00.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

Colombia has a well-established institutional framework that governs the setting of monetary policy. The 1991 Constitution of Colombia provides for an independent Bank of the Republic (*Banco de la Republica* -- BanRep)[1] with the authority to implement monetary policy, and regulate foreign exchange and financial markets. The Central Bank Law (LBR)[2] of 1992 further develops the legal framework contained in the constitution, while the BanRep's own statutes determine internal procedures.

Central bank objectives and responsibilities

The 1991 Constitution of Colombia sets policy objectives for the central bank. Its primary responsibility is to safeguard the purchasing power of the national currency. In this context, the control of inflation is the chief objective of monetary policy.[3] The LBR also requires the use of inflation targets to achieve price stability, with each year's targets typically set below the previous year.[4]

Operational autonomy

The constitution and Article 1 of the LBR provide for an independent central bank with financial, operational and technical autonomy from other branches of the state. The BanRep is subject only to its own legal regime, which is set out in the constitution, the LBR and additional BanRep statutes.

Institutional relationship between monetary and fiscal operations

The constitution and the LBR both call for the coordination of macroeconomic policy between the central bank and the executive branch of government. This coordination is planned every year during the process of designing the overall macroeconomic programme, and the policy framework is then set out in the government's *Annual Macroeconomic Plan*, issued by the Council of Economic and Social Policy (CONPES).[5] However, in the event of conflict between fiscal and monetary authorities and their respective objectives, the LBR stipulates that the objective of price stability should take priority.[6] The minister of finance chairs the BanRep Board of Directors, thereby reinforcing the principle of monetary and fiscal coordination. The minister of finance does not have veto or preferential voting powers.

In Decision C481 of 1999, the Constitutional Court determined that the *National Development Plan* should provide a broad scenario for the coordination of fiscal and monetary policies among the different branches of government.[7] Since the *National Development Plan* is subject to legislative approval, in practice the court's decision brings Congress into the policymaking process. However, the court's ruling also established clear limits to congressional influence on monetary policy by limiting the content of the plan to the broad objectives of policy, and leaving the Board of Directors in control of monetary policy instruments.

Concerns remain as to whether some of the assumptions used in the financial programming exercise, such as the establishment of a target exchange rate level, constrain the BanRep Board of Directors in their monetary and foreign

exchange interventions. This potential conflict of interests was evident in mid-May, when President Alvaro Uribe repeatedly expressed his concern about the strengthening of the peso against the dollar, urging the central bank to secure exchange rate competitiveness in order to sustain exports and overall employment. In turn, BanRep officials stated that the central bank would implement dollar auctions to keep the exchange rate at 'adequate levels', but nevertheless stressed the negative impact that a strong peso would have on debt servicing.

The BanRep, the Ministry of Finance, and the National Planning Department develop independent forecasts and baseline scenarios to set the inflation target and fiscal objectives. Monetary authorities use the projected spending and fiscal results to determine the baseline scenario for monetary policy. The executive does likewise for fiscal policy using the inflation target. If the baseline scenarios for monetary and fiscal policy lack coherence, the technical staff of the BanRep and the government review alternative spending cuts and different inflation, output growth, and exchange and interest rates scenarios. The BanRep Board of Directors then submits the final version of the financial programming exercise for study and approval.[8]

The BanRep is consulted on domestic and foreign public debt operations. The central bank also issues the regulatory framework that governs the participation of all government agencies and entities in the purchase and issue of debt titles, in order to ensure that these transactions are performed according to market principles.

Lending to government

Article 373 of the constitution establishes that the BanRep may only lend to the government with unanimous consent of the Board of Directors. Articles 12 and 13 of LBR establish that the central bank may carry out lending of last resort operations to state-owned financial institutions and that it may guarantee financial operations by the government, respectively. However, the LBR does not establish explicit quantitative ceilings or restrictions on lending to the government which, for example, could be related to a percentage of the federal government's expenses as arranged in the annual budget.

Central bank involvement in the rest of the economy

In order to achieve its inflation targets, the BanRep has the authority to regulate financial markets and manage monetary aggregates, interest rates, and foreign exchange. The BanRep also has authority to act as intermediary between foreign and domestic financial institutions, and to take deposits and carry other financial services with the sole authorisation of the Board of Directors. In addition, Article 36 (b) of the LBR establishes that the Board of Directors is empowered to allocate responsibilities according to which the central bank must contract the acquisition or sale of BanRep assets and the procurement of all types of services.

Central bank profit allocation

Article 27 (d,e) of the LBR sets the principles for the allocation of central bank profits and losses, and the BanRep statutes add further detail.[9] Part of the profits is allocated to a reserve fund aimed at covering any future losses. The remaining profits (or any losses not covered by the reserve fund) accrue to the Treasury. BanRep authorities are required to determine the balance of central bank operations at least once a year, and profits are calculated and distributed during the first quarter of the following fiscal year.[10]

Agency roles performed by the central bank on behalf of the government

The BanRep is authorised to act as fiscal agent in foreign lending operations, and in issuing and administrating public debt titles. The central bank is also authorised by the LBR and its statutes to receive and administer resources owned by the national government and any government entity.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments and targets of monetary policy

Although the BanRep had adopted inflation targets since the 1992 reform, the current framework -- in which the inflation target is the main policy objective -- started in 1999 when a floating exchange rate was adopted. Historically, the central bank had missed its inflation targets, largely because it was working towards several policy objectives, of which the inflation target was only one. However, the monetary policy framework has undergone a gradual transition to a standard inflation-targeting framework, in which the currency floats and monetary interventions are closely focused on a reference overnight interest rate.

Framework and monetary targets

Inflation targeting is focused on changes in the consumer price index. BanRep also monitors core inflation, which excludes products that can be subject to considerable variation owing to environmental changes and cyclical demand. Since 2000, the monetary authorities have adopted a two-year target to better accommodate lags between policy implementation and the effect on inflation, replacing the earlier practice of an inflation point target that had been in use since 1992.[11] Intervention rules for monetary policy are clear and participation of the central bank in the market is disclosed on a daily basis.

Monetary instruments

The most important monetary instrument is the interest rate on the central bank's repo and reverse-repo operations, which is used to control liquidity and signal the monetary stance. The Board of Directors determines the minimum and maximum interest rates for the repo and reverse-repo auctions. In turn, the scale of open market operations is determined every month according to estimates of the demand for liquidity measured by the base money reference line and the supply of base money through expected open market operations, central bank interventions in the foreign exchange market, lender of last resort operations, and the BanRep balance sheet.

There has been a gradual narrowing of the range of the policy rates as the monetary policy strategy has become clearer and has contributed to strengthening the link between the policy rates, the overnight rate and longer term rates. A detailed description of the central bank's monetary framework, instruments, forecast models and reaction strategy is available for public consultation, although only as working papers of the BanRep staff.[12] Monetary transparency would be increased if this information were posted on the website with a separate hyperlink.

The BanRep intervenes in foreign exchange markets and the secondary government bond market to provide liquidity. For interventions in the foreign exchange market, the central bank has three intervention rules; to manage financial liquidity, the BanRep exercises call and put options whenever the spot exchange rate differs from the mobile average of the past 20 days. The central bank can also intervene in foreign exchange markets to reduce volatility whenever the spot rate differs by more than 4% from the mobile average of the past 20 days. The aggregate value of BanRep foreign exchange transactions is disclosed at the end of the day in a press release. Intervention in the government bond market generally follows clear rules, with transactions taking place through the electronic exchange mechanism.[13]

The monetary policy-making body

Monetary board

The BanRep Board of Directors includes the general manager of the BanRep, the minister of finance (who chairs the board), and five members appointed by the president for a period of four years. During a presidential term, the president is entitled to change two members, and is required to replace any member who retires or dies.[14] The previous two administrations both appointed three board members towards the end of their term, who together with the minister of finance now constitute a majority on the board. As such, commentators have argued that this mechanism threatens the operational independence of the central bank, since their tenure coincides with the presidential cycle.[15] Furthermore, the board cannot meet in the absence of the minister of finance, or a delegate who takes the chair in his/her absence. Board decisions must bear the signature of the minister of finance or his representative.

In practice, when board decisions are not taken by overall consensus those members who disagree with the adopted position are able to publish their opinion in the monthly BanRep report or a press release. When the minister of finance differs and holds strong views on monetary policy, the board can be forced to review its decision.[16]

Advance meeting schedule

The BanRep does not produce an advance schedule of board meetings, although it traditionally sits every Friday.

Public statements on monetary policy

The BanRep's website contains regular press releases with information on monetary policy decisions. The BanRep has published minutes of the meetings since the early 1990s, and although these are not periodically released, they are available upon request. In addition to decisions by the board, the central bank releases information on its open market interventions through daily press releases.

Periodic publications

The BanRep produces several periodical publications that provide information on monetary policy, financial and foreign exchange regulation and open market operations. These include the weekly newsletter *Estadisticas Monetarias y Cambiarias*[17] and the monthly magazine *Revista Mensual del Banco de la Republica*[18], which includes articles on topics of general economic interest and details of any regulations issued by the central bank.

The BanRep *Reporte del Emisor* reviews issues of importance for monetary policymaking, while the quarterly *Inflation Reports* explain monetary policy decisions in detail and assess future inflation risks.[19] As established in Article 5 of the LBR, the BanRep also reports to Congress twice a year at the start of the legislative sessions in March and July, and can be called before Congress whenever there is a substantial shift in monetary policy.

Public hearings

There is no formal public consultation mechanism on monetary policy and financial regulation, nor is there an established mechanism for incorporating external reviews or suggestions into the policymaking process. However, the BanRep public relations department does offer courses to interested journalists, in an effort to promote understanding of the methodology and strategy used by the central bank in seeking to achieve the inflation target.

Regulations on data reporting by financial institutions to the central bank

Article 18 of the LBR establishes that financial institutions and intermediaries must provide the central bank with any information it requests -- even information that it would normally give to the Superintendence of Banks. This provides for the central bank to plan open market operations and any intervention in the exchange market. In addition, based on this information the central bank determines the financial institutions' reserve requirements, details of which are made available on its website (in Spanish only).[20]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

The BanRep sells the *Revista Mensual del Banco de la Republica*, which contains statistical information and all recent economic legislation. In addition, the BanRep issues a quarterly report on economic indicators -- *Indicadores Economicos Colombia* -- that contains data on the GDP, balance of payments, trade and foreign direct investment and foreign debt. This publication also provides details of monetary aggregates, price indices, exchange rate and public finances (in Spanish and English).

The BanRep website provides quarterly GDP, employment and inflation data, balance of payments, public finances and financial data, including monetary aggregates, interest rates and stock exchange data.[21] The financial section also includes the analytical accounts of the central bank. Methodological notes on the compilation of data are available from the IMF Special Data Dissemination Standards (SDDS) website.

Release of central bank data

The BanRep releases monetary data in a timely and regular fashion, in accordance with its commitment to the IMF's SDDS. Within the data that the central bank reports, Colombia is taking the extensive branch banking system flexibility for the timeliness of the data on the analytical accounts of the banking sector. Data publication is according to the advance release calendar available on the BanRep and IMF websites.[22]

The central bank balance sheet

In addition to the report to Congress, which includes six-month and annual balance sheets for the past year, the *Bank Review* includes monthly balance sheets for the last 24 months and annual data for the previous five years. The BanRep website provides six-month updates of the central bank balance sheet and statements on revenues and payments.[23]

Lender of last resort

The constitution and Article 12 of the LBR allow the central bank to act as lender of last resort for public and private credit institutions. Specific regulations and BanRep board decisions on lending operations are made available on the website in the sub-section on economic information.[24] Consolidated information on lending and liquidity operations is produced on the central bank balance sheet, as disbursements in the revenue and payment statements. Detailed information on all BanRep operations is also available through press releases published on the website.

Public information services

The central bank website is regularly updated with information, reports, legislation and board decisions, as well as economic and financial data. Additional information can be furnished on request from the research department. The BanRep upgraded its English language website to include translations of the *Inflation Reports* and the board's report to Congress, but additional information on the monetary policy framework would enhance transparency. A webpage with contact details is available, in order to provide users with additional information upon request.[25]

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

The BanRep is accountable to Congress as stated in the constitution and the LBR, and is subject to external control by the executive and the Attorney General, as established in Articles 46 and 48 of the LBR.

Financial statement

The accumulated financial statements of the central bank are available on its website in March and September. These reports are prepared by BanRep staff, and include the profits and losses disaggregated by type of intervention. International reserves and securities held by the central bank are valued at market prices.

Audited financial statement

Financial statements are subject to the audit and supervision of the Attorney General, who reports to the executive, the BanRep Board of Directors, Congress and the public.[26] The *Notes of the Financial Statement* provide details of the auditing process and the accounting practices followed by the central bank.[27]

External and internal audit

The President of the Republic appoints a Central Bank Auditor to audit the financial statement, with the Superintendence of Banks and Financial Institutions responsible for external control and supervision of the central bank. Since the fiscal year 2002, an independent external auditor is also appointed -- Deloitte & Touche's audit report for the 2002 central bank statements is available on the website.[28]

Conduct of officials

Standards for the personal conduct of BanRep officials and staff are outlined in Articles 38-44 of the LBR. These requirements establish that central bank staff must comply with the LBR, bylaws and all internal BanRep regulations while exercising their duties. In addition, there is a disciplinary code (*Codigo Unico Disciplinario*) that applies to all public officials, including members of the central bank. However, the LBR does not explicitly establish the provisions under which BanRep Board members can be removed, except for the general guidelines established in Article 35.

INTERVIEWS

In 2003, Oxford Analytica did not conduct in-country interviews in Colombia for security reasons. Representatives of *Oxford Analytica* interviewed the following individual during a visit to Dubai (2003 Meeting of the Boards of Governors of the World Bank Group and the International Monetary Fund) in September 2003:

Bank of the Republic (BanRep)

23 September 2003

Miguel Urrutia Montoya	Managing Director

IN ADDITION, WE CORRESPONDED WITH:

Sergio Clavijo Vergara	Co-Director of the BanRep Board of Directors

NOTES

[1] Banco de la Republica (BanRep): www.banrep.gov.co/engroot/home4.htm
[2] Law 31 of 1992 on the Banco de la Republica (LBR, in Spanish only): www.banrep.gov.co/junta/l31de1992.pdf
[3] Constitution of Colombia 1991, Title 12, Articles 371-73: www.senado.gov.co/Senado/decripc/Desconst.htm
[4] LBR, Article 2.
[5] LBR, Article 4. See CONPES at: www.dnp.gov.co/03_prod/conpes/Conpes.htm
[6] LBR, Article 4.
[7] '*La autonomia del Banco de la Republica y el reciente fallo de la Corte Constitucional*' in 'Reportes del Emisor No. 6, July 1999': www.banrep.gov.co/docum/pdf/6.pdf
Plan Nacional de Desarrollo 2002-06 (in Spanish only): www.dnp.gov.co/01_CONT/POLITICA/PLAN.HTM
[8] Javier Gómez, José Darío Uribe, Hernando Vargas (2002), "The Implementation of Inflation Targeting in Colombia" Borradores de Economia 202, Banco de la Republica: www.banrep.gov.co/docum/ftp/borra202.pdf
[9] Statutes of the Bank of the Republic (*Estatutos del Banco de la Republica*, in Spanish only), Decree 2520 of 1993: http://juriscol.banrep.gov.co:8080/JUR/BASIS/infjuric/normas/normas/DDD/DECRETO%202520%201993%20MINISTERIO%20DE%20HACIENDA%20Y%20CREDITO%20PUBLICO/DECRETO25201993MINISTERIODEHACIENDAYCREDITOPUBLICO.doc
[10] Article 62 BanRep Statutes and Article 27 of the LBR.
[11] Interviews in Dubai, 23 September 2003. The BanRep adopted an inflation target range of 5-6% for 2004, with a long-term inflation target of 3%.
[12] For example, see 'Monetary and Exchange Rate Policies in Colombia: Progress and Challenges (1991-2002)' www.banrep.gov.co/junta/publicaciones/Clavijo/polmonen0303.pdf
[13] Interviews in Colombia, 21-27 November 2002. In August and September 2002, the central bank intervened to supply liquidity and contain losses suffered by financial agents following a surge in country risk. These interventions did not take place through the electronic action mechanism, but targeted specific types of financial institutions in what was considered to be a breach of intervention rules in the government bond market.
[14] Articles 34 and 35 of the LBR.
[15] Interviews in Colombia, 21-27 November 2002. See also Alesina Alberto, Carrasquilla Alberto and Steiner Roberto (2000) "The Central Bank in Colombia", Fedesarrollo, Working Papers Series. Documentos de Trabajo. No 13: ftp://ftp.fedesarrollo.org.co/pub/documentos/WP13.pdf
[16] Interviews in Dubai, 23 September 2003.
[17] www.banrep.gov.co/estad/rsemscm4.htm
[18] www.banrep.gov.co/prensa/publica4.htm
[19] Quarterly *Inflation Reports* (in Spanish only): www.banrep.gov.co/inflaci/home4.htm
[20] See *Encaje de los establecimientos de credito*, updated June 25, 2003 (in Spanish only): www.banrep.gov.co/reglam/encaje4.htm
[21] Economic Information -- Statistics: www.banrep.gov.co/econome/stats.htm
[22] Advance Release Calendar (in Spanish only): www.banrep.gov.co/economia/calendario-indice.htm
and IMF website at: http://dsbb.imf.org/Applications/web/sddsctycatarclist/?strcode=COL
[23] '*Estados Financieros*' (in Spanish only): www.banrep.gov.co/banco/estados4.htm
[24] *Apoyos transitorios de liquidez* (in Spanish only): www.banrep.gov.co/reglam/atliq-4.htm
[25] Comments and Questions: www.banrep.gov.co/engroot/comments.htm
[26] Attorney General Report (in Spanish only): www.banrep.gov.co/banco/dictamen/dic_2002_2001.pdf
[27] *Notas a los estados financieros* (in Spanish only): www.banrep.gov.co/banco/notas/notasestado2002.pdf
[28] *Informe de los auditores externos* (in Spanish only): www.banrep.gov.co/banco/auditoresexternos/feb2003.pdf

OXFORD ANALYTICA

CZECH REPUBLIC

MONETARY TRANSPARENCY

Country Report 2003

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CZECH REPUBLIC

COMPLIANCE RATINGS

Monetary transparency	*2003*
Clarity of roles	●●●●●
Open decision process	●●●●
Availability of information	●●●●●
Central bank accountability	●●●●●
Score	4.75

OUTLOOK & COMMENTARY

The room for further improving monetary transparency standards in the Czech Republic is limited, given the authorities' unwavering commitment to openness. Czech EU membership and preparations for EMU entry will further consolidate these already high standards.

The main potential area of concern is the high degree of *de facto* collaboration between the National Bank and the government. In spite of the benefits this has provided, it does provide potential for abuse, even if this must be deemed highly unlikely, given the high degree of commitment to integration with the West. While the system of appointments to the Bank Board has worked well, some external checks might be desirable to prevent possible abuse, should the political situation change.

EXECUTIVE SUMMARY

4.75 Full compliance

After revisions to the Act on the Czech National Bank (CNB) in 2002 and legislation passed in preparation for Czech membership in the European Exchange Rate Mechanism and the Eurozone, the Czech Republic meets all of the transparency practices required by the IMF's code of good practices for monetary policy and in some cases even exceeds the standards observed by most West European and North American central banks. The general opinion within the Bank is in favour of publishing as much information as possible, a position that makes it the most transparent of the central banks of the EU accession states.

With the exception of shared responsibility in the area of setting the exchange rate regime, monetary policy is set by an independent central bank whose remit is carefully defined in law. The process of decision-making is highly transparent and the CNB offers extensive resources on its policies and deliberations on its website and through the press. This includes full availability of the minutes of the CNB Board meetings. Improvements could be made in increasing access to the process of modifying monetary policy targets and rules. The CNB remains quite committed to its practice of active interaction with fiscal authorities. While the provisions authorising CNB representatives to attend cabinet meetings and *vice versa* can potentially modify independence, they seem to also reduce confrontation and improve policy coordination. Neither party has formal voting powers at the other's meetings and the CNB insist that the practice has in no way compromised their independence.

The process of auditing has been legally enshrined with both an internal audit department and an external auditor. A great deal of information is provided to the public and the parliament at regular intervals on the financial standing of the bank.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●●●● Full compliance

The objectives and institutional framework of monetary policy

The 1992 Constitution together with the Act on the Czech National Bank (December 1992, revised 2002) establish CNB as the central bank of the country with the responsibility for formulating and conducting monetary policy.[1]

Central Bank Objectives and Responsibilities

The Constitution and the CNB Act charge the central bank with the primary task of ensuring price stability.[2] Since 1998, this policy has been carried out through an explicit commitment to inflation targeting. Without prejudicing its primary goal, the bank is expected to support the government in its efforts to pursue sustainable economic growth. Escape clauses from inflation targeting exist in the event of exogenous price shocks, externally driven major deviations in the exchange rate of the koruna, major agricultural shocks, natural disasters, major changes in regulated prices, and quantum leaps in indirect taxes.

The CNB's other tasks are to set monetary policy, issue currency and manage its circulation, administer inter-bank payments and clearing, improve the safety and efficiency of payments systems, and to supervise the operations of the banking sector.

The CNB, in consultation with the government and without violating its primary policy objective, stipulates the exchange rate regime of the Czech koruna. It holds and manages foreign currency and gold reserves. The bank further trades in gold and foreign currencies and manages payments with other countries.[3]

Operational autonomy

The CNB Act ensures the bank's independence "of any instruction given by the government," which is defined to include all administrative authorities.[4] Any operations apart from those stipulated in the act have to be approved in special legislation. The only area of shared responsibility has to do with the exchange rate regime, but the government has no oversight on the day-to-day exchange rate management beyond scheduled meetings.

However, the CNB and the government are legally required to regularly inform each other of key parameters of economic policy and a largely friction-free relationship of regular interaction now exists between the two bodies. The CNB sends its monthly situation reports, which are used as background materials for the CNB Board meetings, to the minister of finance. More generally, the bank is required to perform an advisory role *vis-à-vis* the government in monetary policy and banking-related matters. The Bank prepares a variety of materials for the government, especially in these areas and has to be consulted on proposed legislation affecting its remit. A recent area of effective collaboration was the speedy government approval of the jointly drafted Euro-Area Accession Strategy in October.[5]

The minister of finance or another government representative may attend CNB Board meetings in an advisory capacity and may submit motions for discussion. However, he cannot be present during voting. Conversely, the

CNB governor or a vice-governor may attend meetings of the government.[6] Such a culture of collegiality may potentially compromise full independence, although neither size has formally defined power to affect the other's decisions. Policy coordination has in the past resulted in beneficial informal arrangements, for example the joint "Economic Policy Strategy in a Period of Increased Capital Flows," approved in 1999, which, among other things, resulted in the creation of a sterilization fund – the so-called "Privatisation Account." A revised "Strategy for Dealing with the Exchange Rate Implications of Capital Inflows from the Privatisation of State Property and from Other Foreign Exchange Revenues of the State" was approved in early 2002.[7]

The appointment process to the Bank Board is viewed as fairly apolitical. All appointments are made by the president of the Republic who has few formal political powers and who typically makes the appointments in consultations with an ad hoc committee. It is unlikely that any president would want to risk an adverse market reaction by politicizing the process.[8]

Past attempts by the government and the parliament to exert pressure on the CNB have been unsuccessful. There is a widespread consensus that interventions that might harm the bank's international reputation or legal status are unacceptable. For instance, an attempt by the Parliament in 2001-2 to revise the CNB Act was ultimately overturned following IMF and EU protests, as well as a decision by the Constitutional Court to declare some of the measures unconstitutional. Amendments passed in January 2001 were abolished in May 2001.[9]

Institutional relationship between monetary and fiscal operations

The government deposits money at the CNB under a special service agreement, the particulars of which have not been disclosed. The interest payments on government deposits are shown on the CNB balance sheet which is published every 10 days.

The CNB's responsibilities for managing domestic and external public debt are defined in legislation. However, the information is not disclosed either in the annual report or on the CNB website. The CNB is responsible for operational debt management, including payments and settlements. The Bank further advises the Ministry of Finance on debt management.

Lending to government

The CNB is not permitted to authorize overdrafts on the government accounts it manages. The CNB Act explicitly forbids the bank to provide financial support to the government or other state-controlled legal entities, including even through the purchase of their securities. A provision permitting short-term financing (totalling at most 5% of the preceding year's government revenues) through the purchase of treasury bills was abolished by an amendment to the CNB Act in January 2001.[10]

Central bank involvement in the rest of the economy

The CNB is responsible for setting up the prudential rules for all banks and other money market participants operating in the Czech Republic. It supervises the activities of the financial sector and is authorized to impose penalties on entities found to contravene the existing legislation.[11]

Due to its commitment to support and maintain the stability of the banking sector, the CNB in the 1990s engaged in a series of interventions with regard to commercial banks which resulted in an increase of bad assets on the CNB

balance sheet. The Czech government in 1997 issued a CzK 22.5bn ten-year guarantee in favour of the CNB to partly cover the exposure arising from these measures.[12]

The CNB is not allowed to own shares in any companies.

Central bank profit allocation

According to the CNB Act, the central bank covers its necessary operating expenses from its income. Bank profits are used to replenish the reserve fund and other funds created from profits "in the budgeted amount." The remainder of the profit is transferred to the state budget.[13] The actual mechanics of profit sharing under the new act have not been tried out in practice because of persistent CNB losses.

Agency roles performed by the central bank on behalf of the government

The CNB has been entrusted by the Ministry of Finance to manage the primary sale of government bonds and treasury bills. The Bank is responsible for selling domestic debt, whereas foreign debt (which is minimal) is handled by private agents. The CNB keeps records of such securities.[14]

During the banking crisis of the late 1990s, the CNB acted as a government agent in arranging guarantees.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments, and targets of monetary policy

Framework and monetary targets

Price stability is deemed to be compatible with a target CPI inflation rate of 2% in the context of a gradually declining target band. The *Report on the Monetary Program and Monetary Policy of the CNB in 1998 and in the Medium Term* lays out how deviations from the target rate of inflation are managed.[15] The details of the inflation targets are published up to the end of 2005. Inflation targeting past 2005 is currently under internal discussion at the CNB.[16] In practice, the inflation target has been undershot during every year of its existence. The credibility of the policy has recently been greatly enhanced by a collaborative relationship between the CNB, the Ministry of Finance, and the trade union movement.[17]

Since the 1997 currency crisis, the Bank has pursued a floating exchange rate with minimal interventions – none have been made in 2003. There is no target rate, although general pronouncements are sometimes made about a range compatible with the inflation target. While the Bank is committed to joining the EMU once the fiscal Maastricht criteria are fully and sustainability met, it wants to limits the period of a managed exchange rate under the ERM2 mechanism to the acceptable minimum of two years. The unofficial target date for Euro-zone membership is 2009-10, but the Bank has indicated that there is no rush to adopt the single currency and membership might well be delayed further if the government's fiscal strategy is not deemed sustainable.[18]

Monetary instruments

The CNB is in charge of setting the interest rates, structures, maturities, and other terms of the transactions it performs under law. The central bank can require other banks to deposit a certain part of their funds on CNB. Double the discount rate is charged on monies falling short of the minimal reserve requirement. The CNB regularly drains excess liquidity from the market through open market operations where CNB bills are issued as collateral. Also government treasury bills can serve as collateral, although the use of CNB bills became predominant during a period of minimal government borrowing. The CNB may grant loans for up to three months to banks.[19] Fine tuning instruments include *ad hoc* foreign exchange and securities operations. Automatic facilities include marginal lending and deposit facilities.[20]

In practice, the main monetary policy instrument are daily two-week repo tenders. With the exception of minor details of the reserve requirement, the use of monetary instruments fully conforms to EU norms.[21]

The monetary policy-making body

Monetary board

The CNB is headed by a board composed of a governor, two deputy governors, and four other members, all of whom are full-time employees at the Bank, even if this is not a legal requirement. They are required by law to have appropriate professional qualifications and background and none of the appointments hitherto have proven controversial. Most members are economists and none have had open political connections. The members of the board are appointed by the President of the Republic for renewable six-year terms. No member is allowed to serve more than two terms. The appointments are not simultaneous. The Board votes by simple majority. Details of the Board members are published on the CNB website.

The Bank Board decides on fundamental monetary policy measures and selects the instruments for implementing monetary policy. It further approved the Bank's budget and determines its organisational structure, as well as determining the types, amounts, and uses of the CNB's funds.[22] The complete minutes of the Board meetings are published on the CNB website 12 days after each meeting.

Advance meeting schedule

The Board convenes once a month. The meeting schedule of the CNB Board is published for half a year at a time along with the dates for the release of Board minutes. The details are available at the bank's website.

Public statements on monetary policy

Periodic publications

The CNB publishes an annual *Financial Report* on its activities – the text of the document submitted to the Chamber of Deputies of the Parliament – on its website. An *Annual Report* covers the bank's financial reports, monetary policy and developments, EU integration-related issues, open market operations, international reserves, the banking sector, economic research, payment system, etc. It is published in printed form, on CD-ROM, and at the website. An annual *Report on Banking Supervisory Activities* is published in the same formats. *Inflation Reports* are released once a quarter. The CNB publishes a wide range of statistical data on the current account, the balance of payments, monetary and economic development indicators, and banking, usually on a monthly basis. In addition, there are various occasional publications pertaining to the activities of the bank.[23]

The macroeconomic model of the Bank is publicly available.[24]

Public hearings

The CNB reports directly to the Czech parliament. The parliament can invite the CNB governor or his authorized deputy to a hearing as it wishes. In practice, the parliament tends to discuss the two legally required submissions with a considerable lag. The CNB governor attends the Budget and Economic Development Committee of the parliament in connection with the submission of the Bank's annual report.

The bank regularly issues press releases and its directors grant interviews which are reproduced on the bank's website.

No formal legal mechanism exists for consultations with interested parties when changes are considered to monetary regulations. However, external experts are brought in by convention. Similarly, the Bank regularly invites parliamentarians, as well as members of industry and interest groups to information sessions and consultations. Regular meetings are held with representatives of the banking sector.

Regulations on data reporting by financial institutions to the central bank

Legally responsible for banking sector supervision, the CNB compiles data provided to it by financial sector institutions. The balance sheet, deposits, loans, and interest rates of commercial banks are presented in the CNB's *Monthly Bulletin*. Similarly, the Bank's *Annual Report* offers data on the structure of banks' assets and liabilities, the structure of classified credits, bank profits, and other developments in the sector. Banking supervision legislation now fully adheres to EU standards. The CNB carries out on-site inspections at individual banks.

Following the banking crisis of the late 1990s, all major Czech banks have become foreign-owned and all international standards are now fully complied with. A working group between the CNB and the Bankers' Associations actively monitors the situation.

3. Public Availability of Information on Monetary Policy

●●●●● Full Compliance

Release of central bank data

Information on the CNB's automatic deposit and credit facilities are disclosed daily on the Bank website. The scale of emergency finance is provided in the Bank's balance sheet (Receivables from domestic banks (assets)). The bank further keeps statistics on basic monetary policy parameters (monetary base, interest rates, etc.), banking, the balance of payments, and inflation. The methodology underlying harmonized statistics is provided. The publication schedule for central bank data is available on the website. All economic and financial data are also presented in accordance with the SDDS classification.

The central bank balance sheet

The CNB reports its balance sheet every ten days with a basic breakdown of all assets and liabilities. An annual consolidated balance sheet is included in the *Financial Report* submitted to the Chamber of Deputies of the Parliament, and, in an abridged form, in the CNB's *Annual Report*.

Lender of last resort

The CNB is charged with the responsibility for ensuring the stability of the banking sector and has on occasion served as a lender of last resort. Under the CNB Act, the CNB may grant loans for up to three months to banks.[25] All lending is fully collateralized, although the rules governing the quality of collateral are less clear-cut.

Public information services

The website of the CNB has a "Media Services" section which provides all CNB press releases, interviews with bank officials, monthly comments on inflation data, articles in the press pertaining to the activities of the bank, schedules of data publications and Board meetings, etc. The Bank reproduces all its working papers in their entirety on their website. Contact information is provided for different types of queries.[26]

4. Accountability and Assurances of Integrity by the Central Bank

●●●●● Full compliance

Accountability before a designated public authority

The CNB is required under the CNB Act to submit a report on monetary developments to the Chamber of Deputies (CoD) of the parliament at least twice a year. The CoD can, if necessary, demand a revised report within six weeks. The reports are submitted by the CNB governor who attends the relevant parliamentary session and must be called upon to speak. The CoD can, if it so decides, request an extraordinary report on monetary conditions which the Bank is required to submit within thirty days.[27]

The CNB is required to inform the public of monetary developments at least every three months, a task currently carried out through the release of quarterly *Inflation Reports*. The CNB regularly releases the minutes of its board meetings and issues frequent statements to the press. In addition, quarterly and annual data on the financial sector as a whole is disseminated by the central bank.[28]

There are no formal consultations in connection with revisions to monetary regulations, but all important changes are announced through press releases and on the CNB website.

Financial statement

The CNB is required to keep accounts in accordance with the Act on Budgetary Rules and other pertinent legislation.

Audited financial statement

The full financial statement of the CNB is submitted to the Chamber of Deputies of the Parliament once a year within three months of the end of the calendar year. The CoD may reject the report, in which case a revised version must be submitted within six weeks.[29] The report is reproduced in its entirety on the bank's website.

External and internal audit

The CNB has its own internal audit division with a professional staff of 14. The activities of the department are laid out in an annual plan of action. In addition to risk-assessment, the department focuses on particular areas of the Bank's activities, including any problem areas identified by external auditors. The Bank Board and the director of the department can also ask the staff to conduct *ad hoc* audits on particular issues. Any recommendations are passed on to the relevant director. A Compliance Unit is currently being set up with the main tasks of ensuring compliance and implementing changes recommended by the external auditors. One option under consideration is decentralizing the compliance function. The Bank Board reviews compliance on a quarterly basis.

The Bank Board and the Ministry of Finance jointly appoint one or more auditors to review the financial statements of the CNB. A tender for a qualified external auditor is held every five years. The tender is organized by the Internal Audit Department. The external auditor at present is PricewaterhouseCoopers.[30]

The Supreme Audit Office has the authority to audit the CNB in the areas of operating expenditures and acquisition of property.[31] However, 2004 will be the first year the SAO will have exercised its right to audit the central bank. The SAO will limit itself to a compliance audit with no financial auditing.

Conduct of officials

Members of the Bank Board are not allowed to engage in other gainful employment and all manner of conflicts of interest are impermissible under the CNB Act. The President has the authority to dismiss Board members who have contravened legal provisions, whose competence to perform legal acts has been compromised, or who have failed to carry out their duties for more than six months.[32] The Act further requires all CNB staff to adhere to strict confidentiality, unless exempted by the governor on public interest grounds. The staff may engage in entrepreneurial activities only with special permission.[33] Otherwise, however, the internal governance procedures of the CNB have not been disclosed. Rules governing conflicts of interest thus remain unknown.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to the Czech Republic between 13-18 October 2003:

Czech National Bank

13 October 2003

Viktor Kotlán	Director	Monetary Policy Division
Petr Procházka	Director	European Union and International Organizations Division; Deputy Executive Director, General Secretariat
Petr Sedláček	Official	European Union and International Organizations Division

17 October 2003

Ivan Matalík	Director	Monetary Analysis Division
Milan Guba	Head of Team, Deputy Director	Monetary Analysis Division

Ministry of Finance

14 October 2003

Drahomíra Vašková	Deputy Director	Department of Financial Policy
Aleš Krejdl	Official	Department of Financial Policy
František Cvengroš	Head	Macroeconomic Forecasting Division

16 October 2003

Jiří Franta	Head	Treasury Division

ADDITIONAL INTERVIEWS

14 October 2003

Miroslav Leixner	Chief Director of Audit Section	Supreme Audit Office (*Nejvyšší kontrolní úřad*)
Michael Michovský	Department of International Relations	Supreme Audit Office
Jan Kinšt	Member of College	Supreme Audit Office
Radek Urban	Director/Asset Management	Česká spořitelna Bank
Adriana Krnáčová	Executive Director	Transparency International Czech Republic

15 October 2003

Oldřich Körner	Deputy Director	Confederation of Industry of the Czech Republic (*Svaz průmyslu a dopravy České republiky*)
Pavel Sobíšek	Chief Economist	HVB Bank Czech Republic
Tomáš Borovička	Acting Manager of Foreign Aid and Financing of Programs	Ministry for Regional Development
Aleš Michl	Economic journalist	*Hospodářské noviny* business daily

16 October 2003

Ludmila Vebrová	Official, National Accounts	Czech Statistical Office (*Český statistický úřad*)
Filip Drapák	Advisor to Chairman	National Property Fund (*Fond národního majetku*)

In addition, we corresponded with:

Tomáš Cahlík	Professor	Institute of Economic Studies, Charles University, Prague
Michal Hlaváček	Professor	Institute of Economic Studies, Charles University, Prague

NOTES

[1] Article 98 of the Constitution of the Czech Republic.
[2] Article 98 of the Constitution of the Czech Republic.
[3] CNB Act, Articles 35, 36.
[4] CNB Act, Article 9.
[5] http://www.cnb.cz/en/pdf/en_eurostrategie_09_2003.pdf. Approved by the government on October 13.
[6] CNB Act, Art. 10, 11.
[7] Ministry of Finance: *The Czech Republic: Pre-Accession Economic Programme*, August 2003.
[8] Mild concerns were expressed by some interviewees that the high political profile of the newly elected President Václav Klaus, a former prime minister, might result in some changes. However, most appear confident that the room for manoeuvre is minimal.
[9] Interviews conducted in Prague, 13-17 October 2002; information provided by the CNB.
[10] CNB Act, Article 24.
[11] CNB Act, Articles 30(2), 44-46.
[12] Interviews conducted in Prague, 13-17 October 2003.
[13] *Roční zpráva o výsledku hospdaření České národní banky za rok 2002*. http://www.cnb.cz/en/ocnb_rocnizpravy.php; CNB Act, Article 47(2).
[14] CNB Act, Article 31; Act No 530/1990 Coll. on Bonds, Art. 19(2).
[15] http://www.cnb.cz/en/c.php; http://www.cnb.cz/en/s5.php
[16] Interviews conducted in Prague, 13-17 October 2002; information provided by the CNB.
[17] Ministry of Finance: *The Czech Republic: Pre-Accession Economic Programme*, August 2003.
[18] Interviews conducted in Prague, 13-17 October 2003.
[19] CNB Act, Articles 23, 25-29.
[20] http://www.cnb.cz/en/d.php.
[21] The rules governing the reserve requirement (which is adjusted very infrequently) will be harmonized with West European standards in connection with Czech EU membership. Ministry of Finance: *The Czech Republic: Pre-Accession Economic Programme*, August 2003.
[22] CNB Act, Articles 5, 6, 7.
[23] http://www.cnb.cz/en/publikace.php.
[24] Warren Coats, Douglas Laxton, and David Rose, *The Czech National Bank's Forecasting and Policy Analysis System*, Czech National Bank, Prague, 2003.
[25] CNB Act, Articles 23, 25-29.
[26] www.cnb.cz.
[27] CNB Act, Article 3.
[28] CNB Act, Article 3 (e), www.cnb.cz.
[29] CNB Act, Articles 30(1), 47(3)-(5).
[30] *Roční zpráva o výsledku hospdaření České národní banky za rok 2002*. http://www.cnb.cz/en/ocnb_rocnizpravy.php
[31] Act No. 127/2002 Coll., Article 3(3).
[32] CNB Act, Article 6 (6), (7), (10)-(12).
[33] CNB Act, Article 50.

OXFORD ANALYTICA

EGYPT

MONETARY TRANSPARENCY

Country Report 2003

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EGYPT

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	••	••	••
Open decision process	••	••	••
Availability of information	•••	•••	•••
Central bank accountability	•••	••	•••
Score	2.50	2.25	2.50

OUTLOOK & COMMENTARY

The Central Bank of Egypt's institutional framework is likely to increase once the provisions of Law no. 88 of 2003, the Unified Banking Law, become fully operational. One of CBE's greatest challenges is to build its institutional capacity to make effective monetary policy decisions, improve the quality of its data, and increase the current low standards of transparency. The future establishment of the Monetary Policy Coordination Council, which will set monetary policy targets, is likely to improve the coordination between monetary and fiscal policies.

Egypt's major short-term challenge is to restore confidence in the management of the exchange rate while increasing the transparency through which it conducts its operations. The main area of weakness will likely remain the lack of credibility in some of CBE's indicators, which in turn could jeopardise policy credibility.

EXECUTIVE SUMMARY

2.50 Intent declared

The institutional framework of the Central Bank of Egypt (CBE) has been strengthened since the recent enactment of Law no. 88 of 2003 of the Central Bank, Banking Sector and Monetary System (Unified Banking Law). The law is wide ranging, and also incorporates five main laws dealing with the banking sector.

During 2003, the CBE has begun to implement a new monetary policy in which inflation targeting is the final goal. In January 2003, the CBE abandoned the managed peg system and floated the pound, introducing new foreign exchange rates. Given the more active role that the CBE will have to play in monetary policy, there is a substantial need for improvements in its institutional capacity. Recent changes to the legal framework could, in the future, increase the CBE's independence, but at present there is a tendency for the president to impose his own ideas on monetary policy,

Progress on the Data Access and Transmission Activity (DATA) project continued during 2003, and commentators have suggested that the country is on course to meet the IMF's Special Data Dissemination Standard (SDDS) requirements in the near future.

The CBE's principal publications include descriptions of many indicators, including reserve money and counterpart assets, net foreign assets, exchange and interests rates, and external and domestic public debts. However, timely information on the CBE's monetary policy decisions and monetary policy overall framework are not publicly available. Moreover, efforts should be made to publish methodological notes on the CBE's statistical techniques and data compilation methods in order to allay concerns about technical interference. The CBE's audited financial statements should be made publicly available.

Egypt's overall score has improved from 2.25 in 2002 to 2.50.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●● Intent declared

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The institutional framework of the Central Bank of Egypt (CBE) is established by law, in particular the Law no. 88 of 2003 on the Central Bank, Banking Sector and Monetary System, which is also known as the Unified Banking Law. Enacted in July 2003, this creates provisions for disclosure and transparency in the central bank's activities. The law is wide-ranging, incorporating the five main laws dealing with the banking sector. It is comprised of seven chapters dealing with: the role of the central bank; the organisation of the banking system; the management of public sector banks; the secrecy of bank accounts; provisions on the mortgaging of assets; the issuance of bank notes and foreign exchange; and sanctions.[1]

The CBE is responsible for issuing currency; formulating monetary, credit, and banking policy and supervising its implementation; maintaining the stability of the Egyptian pound; managing the national gold and foreign exchange reserves; regulating the banking system; managing public debt; and advising the government on loans and credit facilities.[2] Following the 2003 reform to the Banking Law, it has become clearer that exchange rate policy is set by the government, with the CBE solely responsible for its implementation. Following the new legislation, the CBE will essentially set inflation targets. However some commentators have suggested that key monetary policy decisions are in general subject to decisions by the cabinet and the ruling party's Economic Committee.[3]

The central bank has separate monetary policy and foreign exchange units, the latter monitoring the local exchange market and reporting to the cabinet. At present, the monetary policy department is under reform and its conduct of monetary policy is unclear. The split structure has not affected the conduct of monetary policy -- or any other policies -- because policy decisions have not been made at this level. Instead, they are made by the governor with a small group of advisors based in the governor's office. Donors and reformers within the ruling National Democratic Party (NDP), including its Economic Committee, have been pushing for a revamp of the monetary department with skilled staff, so that decisions are made by specialists in a more transparent manner.

Under Egypt's economic reform programme, started in 1991, the exchange rate was the anchor of monetary policy. While this worked initially, the rigidity of maintaining the pound at 3.39 to the dollar led to major problems with the exchange rate regime by the late 1990s. Inflation was curtailed, but foreign exchange reserves were depleted, interbank interest rates rose as high as 17% in early 2000 and the country has suffered since 1999 from a chronic dollar shortage which, in turn, has resulted in an active black market. The pound-dollar peg was abandoned in May 2000 and a 'managed peg' system introduced in January 2001.

In January 2003, the CBE abandoned the managed peg system and floated the pound. One reason for the timing of the January 29 flotation of the Egyptian pound was that adding greater flexibility would give the exchange rate regime greater ability to absorb any external shocks to the economy, while the government would avoid wasting foreign exchange reserves defending the official trading band. With the introduction of the new floating system, the CBE adopted a temporary tight monetary policy. Following the floating of the pound, a daily market developments report is issued by the CBE but with limited circulation.

Operational autonomy

The central bank is no longer under the supervision of any one ministry, as it was in the past, and operates independently of the principal economic and financial ministries, the Ministry of Finance and the Ministry of Foreign Trade. In September 2002, President Mubarak placed the CBE under his direct authority, rather than that of the prime minister.[4] In the longer term, this change should strengthen the Bank's independence, but at present there is a tendency for President Mubarak to impose his own ideas on monetary policy, for example concerning minimum reserve levels and the exchange rate. Both the governor of the CBE and its board are directly appointed by the president. However, there are no statutory rules governing the appointments. In addition, under emergency laws, the president has the capacity to overrule any CBE decision under any circumstances.

Within the CBE, there is a substantial need for improvements in institutional capacity. Investment is required in personnel and skills, particularly at middle levels, in order to support changes being made in monetary policy and management.

The Monetary Policy Unit (MPU) at the CBE is receiving a number of training and education programmes to improve capacity in both of its sub-departments of research and implementation. There is clear recognition of the fact that a move from theoretical issues to implementation has to be achieved swiftly, and to this end the MPU is receiving on-going technical assistance.[5] During 2002, in preparation for applying the new monetary policy framework, the CBE moved the MPU out of the Banking Control Department so that it now reports directly to the CBE governor. The unit is currently undergoing restructuring and rationalisation of staffing levels, with new staff and technical expertise being brought in.

Institutional relationship between monetary and fiscal operations

Lending to government

There continues to be no official definition of the institutional relationship between monetary and fiscal operations. The central bank remains able to provide loans to the government through the National Investment Bank (NIB) or directly, subject to clear conditions. Under the new Unified Banking Law, government borrowing from the CBE must not exceed 10% of average annual budget revenue during the previous three years. Such loans have to be for a period of three months which is renewable, on the condition that repayment is made within a maximum of twelve months from the date of extending the loans.[6] These loans are reported in the CBE's *Monthly Statistical Bulletin*. Greater clarity about the relationship between monetary and fiscal operations will depend partly on increased transparency about the operations of the NIB.

Central bank involvement in the rest of the economy

The CBE is legally entitled to conduct open market operations in Egyptian government securities. Trading in the government debt market has been made electronic and a primary dealer market for treasury bills has been launched. The central bank uses foreign exchange transactions only to cover its requirements and does not take positions.[7]

Central bank profit allocation

Net profits of the Bank must be transferred to the Treasury after deductions to maintain reserves and for profit bonuses for personnel, decided by the Board of Directors in accordance with rules set by the Bank.[8]

Agency roles performed by the central bank on behalf of the government

The CBE acts as banker and fiscal agent to the government and public institutions. The central bank therefore has the responsibility of guaranteeing loans, credits, and investments obtained by the government and other public entities from foreign banks and international organisations. Nevertheless, the CBE is independent in its decision of the terms and conditions of such guarantees.[9]

In May 2002, Egypt issued the Law on Combating Money Laundering (Law no. 80 of 2002).[10] The law is the first in Egypt to criminalise money laundering. This was originally prompted by the decision of the OECD's Financial Action Task Force (FATF) in June 2001 to include Egypt on a blacklist of non-cooperative money laundering countries. In October 2002, the FATF kept Egypt on its list of non-cooperative countries. The removal of Egypt from the list is a political priority for the government. During the past year, the country has established an independent Money Laundering Combating Unit (MLCU), which is staffed with competent and experienced inspectors seconded from the CBE.

Law 80 of 2002 has undergone thorough review by the FATF, and as a result was amended in June 2003 to clear up ambiguities and omissions. The MLCU appears to have considerable resources, and is headed by a board of trustees, which reports directly to parliament. At the last meeting between the FATF and the MLCU in October 2003, the FATF reported "significant and considerable progress" and the MLCU has submitted a detailed implementation plan to the FATF for review. This will be followed by a further FATF on-site evaluation visit to see the plan in action, with the aim of removing Egypt from the FATF list of non-cooperative countries at the FATF plenary in February 2004.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●● Intent declared

The framework, instruments and targets of monetary policy

Framework and monetary targets

During 2003, the CBE has begun to implement a new monetary policy in which inflation targeting is the final goal.[11] This framework has been put into public discussions as well as discussions with the IMF, in order to come up with a detailed monetary policy structure.

Egypt's new monetary policy marks a move towards refocusing monetary policy away from the exchange rate and towards interest rate targeting. The government is aiming to reduce Egypt's high interest rates in order to ease debt repayment and revive economic activity, and it is expected eventually to add greater flexibility to the troubled exchange rate regime. In the past, the CBE undertook only limited intervention in the market to maintain bank reserve levels. However, while interest rates are to be "market determined", country specialists maintain that the CBE now intends to be much more active in influencing rates -- through the use of new monetary tools -- with the aim of ensuring price stability.

Given the new monetary policy framework, it is important for the country to define the core inflation rate or the targeted inflation rate in addition to other related aspects of inflation targeting.

At this initial stage, it is hard to make an assessment of the new framework. However, there is considerable scepticism amongst both private and public sector specialists regarding the capacity of the CBE to successfully deliver on the new inflation targeting policy.[12] The key problems remain a lack of confidence in institutional capacity, the skills gap and the absence of human resources in the central bank and the poor data -- particularly the Consumer Price Index -- which will hamper any efforts to target inflation. The new monetary policy has led to a widening gap between the official bank rate for the Egyptian pound and the parallel rate, with a lack of resources to spend sufficiently in order to support the currency.

Monetary instruments

Following the CBE move towards inflation targeting, the bank has moved to introduce new monetary policy tools. It lowered its discount rate by one percentage point to 10% on November 2002, the first adjustment since April 2001, and announced that the rate would be subject to continuous assessment.[13] Moreover, the CBE announced the introduction of two new products: overnight lending and deposit systems, to become benchmarks for the overnight interbank market. This follows the launch of two new deposit tools, of one week and two weeks, and the eight-day auction deposit launched on December 31, 2002, aimed at absorbing the excess funds from banks and thereby easing and stabilising interbank rates.

To prepare the short-term money market for the application of the new monetary policy, additional open market tools were developed and introduced including the acceptance of short-term bank deposits by the CBE for one week, 14 nights and 28 days maturity.

The new monetary policy orientation should be beneficial to the management of the economy and to overall transparency, as it coincides with improvements in the CBE's data management and dissemination practices. However, the new policy needs to be supported by improvements in research capacity, principally in the CBE's own research department.

The rules and procedures governing relationships and transactions with counterparties in monetary operations are specified in CBE circulars, which it aims to make available on its website.[14]

The monetary policy-making body

Monetary board

The CBE is headed by a governor who is appointed by presidential decree upon nomination from the prime minister. The governor has two deputies, also appointed by presidential decree. In addition, the CBE board is also made up of the head of the Capital Market Authority, three members representing the ministries of Finance, Planning, and Foreign Trade, and eight experienced persons specialised in monetary, financial, banking, legal, and economic affairs.[15] The composition, structure, and functions of the CBE board are specified in the Unified Banking Law.

The Unified Banking Law gives responsibility for the setting of monetary policy targets to a body to be known as the Monetary Policy Coordination Council (MPCC). Details of its functioning and make-up will be established in the executive regulations of the law, which are yet to be published. It is expected that the MPCC could lead to a greater degree of coordination and coherence between fiscal and monetary policies.

The MPCC is intended to be the body that sets the inflation target, leaving the MPU responsible for implementing the policies necessary to achieve those targets. The MPU will be composed of technical staff at the CBE, whilst the MPCC will be composed of senior CBE members, ministers, and outside experts. However, the precise make-up of the MPCC has not been agreed.

Aside from the governor and a few close aides, concerns remain about the skill levels in the bank to manage the more complex monetary policy that will require greater CBE intervention and therefore improved and timely analysis. Monetary policy is essentially a research task, and there is a need for long-term institutional changes within the bank to ensure this is done in a timely and professional manner.[16]

Advance meeting schedule

According to Article 15 of the Unified Banking Law, the board of the CBE has to meet at least twice a month, upon the invitation of the governor or two-thirds of the board members. Board meetings are not considered valid unless attended by the governor or one of his two deputies, in addition to the majority of its members. Decisions of the CBE board have to be taken with the absolute majority of its members. Neither an advance schedule of meetings nor records of meetings are publicly available.

Public statements on monetary policy

Periodic publications

The CBE's principal publications are the *Monthly Statistical Bulletin*, the *Quarterly Review,* and the *Annual Report*. These publications are available from the CBE, but electronic dissemination through its website remains weak.[17]

The *Monthly Statistical Bulletin* contains up to date information on many indicators, including reserve money and counterpart assets, net foreign assets, exchange and interests rates, and external and domestic public debts.

Other than in the CBE's regular publications, neither the CBE nor the government make many public statements on monetary or exchange rate policy. With the shift in monetary policy, the need for transparency is set to increase. Even though the CBE indicated it intentions to publish a document outlining its new approach to monetary policy, this document is not yet publicly available.

Public hearings

Within three months of the end of the fiscal year, the CBE must prepare its financial statements for the past fiscal year as per Egyptian auditing criteria, which are then signed by the governor and two financial controllers. In addition, the CBE has to prepare a report on its financial position and the results of the activities during the past fiscal year, particularly addressing a review of the economic conditions and financial, monetary, banking, and credit status in Egypt.[18]

The financial statements, the report drawn by the controllers, and the financial status report, have to be presented to the president within ten days of their approval by the CBE board of directors. Copies have to be submitted to the prime minister and parliament within the same period.

Regulations on data reporting by financial institutions to the central bank

Banks are supervised by the Banking Control Department of the CBE and in practice supervision is strong. CBE has made considerable progress in developing its supervisory framework and staff using materials, procedures and techniques obtained from other countries' supervisory systems. CBE complies with most of the Basel Core Principles for Effective Banking Supervision. However, further reforms need to be introduced, like increasing the capacity of the CBE to enforce banking reforms; enhance and monitor corporate governance in all banks; and introduce forward-looking internal rating systems in all banks.

By law, the CBE is entitled to have access at any time to the books and registers of banks in order to obtain data it specifies, and such access must take place at the premises of the bank. However, local banks are reluctant to disclose information beyond what is supplied in their annual reports or to provide income statements. The CBE must report the results of its inspections and its recommendations.[19]

The new Unified Banking Law creates a legal infrastructure suitable for the proper functioning of the banking sector and guarantees its independence. During 2003, all banking supervision arrangements have been comprehensively documented. Such arrangements and prudential regulations have been published and made available to the banking sector in one unified publication. Moreover, banks have been requested to comply with new minimum capital adequacy ratio of 10%. By 31 March 2003, the majority of banks complied with this prudential regulation, including the six state-owned banks.

As the CBE finalized its electronic information network in 2002, banks were instructed to finalize their information network projects connecting their branches electronically with their headquarters before the end of 2003. This information network will help in enhancing and strengthening the credit information system currently managed by the CBE.

In June 2002, the CBE's governor opened its new electronic clearing mechanism. This is also a positive step in modernising the banking system. The new Cairo Clearing House is capable of processing 100,000 cheques per day and is promised to reduce clearing time from 20-25 days to 1-4 days.

3. Public Availability of Information on Monetary Policy

●●● Enacted

Release of central bank data

Under the auspices of a project supported by the US Agency for International Development (USAID), the Data Access and Transmission Activity (DATA) project -- a steering committee that includes CBE representatives -- has been overseeing the gradual introduction of the IMF's Special Data Dissemination Standard (SDDS). The CBE has already been publishing data largely in accordance with the SDDS and publishes the relevant metadata on its website.[20] Some commentators have suggested that Egypt is on course to meet the SDDS requirements by early 2004.[21]

During 2003, the CBE has been publishing data on a monthly basis, seven weeks after the end of the reference month. Information is released in millions of Egyptian pounds, based on the CBE's accounting records, showing reserve money, net domestic claims on public sector, net external position, and net international reserves.

However, the nominal level of data release by the CBE remains compromised by the lack of information on monetary policy formation and by the comparatively inferior data quality and dissemination standards of other financial bodies in Egypt. Independent users of data published by government ministries still treat official data with caution.

The central bank balance sheet

The CBE publishes a weekly statement of its financial position in the *Official Journal*, according to a format agreed by the board and the Ministry of Foreign Trade. It publishes summaries of its balance sheet and the consolidated balance sheet of the banking system in Egypt in its *Monthly Statistical Bulletin* and *Quarterly Economic Review*. Data are reported for reserve money, counterpart assets, domestic liquidity, deposits, domestic credits, and foreign assets and liabilities.[22] These data are accompanied by a limited amount of commentary. An overall balance sheet with aggregate transaction data is published in the Bank's *Annual Report*. However, the CBE's website has only published a brief description of the major policies taken during the fiscal year under consideration.[23]

Lender of last resort

The Unified Banking Law incorporates new tighter lending guidelines. The CBE is legally responsible for providing emergency funds to banks in trouble. Although only 10% of the population are estimated to hold bank accounts, the government appears unwilling to allow any bank to fail, even if preventing collapse means continuing to lose money by keeping a bank going.[24] The government is trying to reform some of the state banks by bringing in new skilled individuals from the private sector, and also allowing mergers between some of the smaller state banks.

Following the enactment of the Unified Banking Law in 2003, the minimum capital requirement for Egyptian banks, -- including joint-venture banks between Egyptian and foreign institutions -- has been raised to E£500m, from the previous E£100m. The aim of the change is to strengthen the banking system by forcing rationalisation and consolidation, a long-standing government goal. A number of the smaller banks are expected to be unable or unwilling to source the extra capital and will therefore seek mergers.

Public information services

Egypt has a special website that releases economic information. *Egyptian Economic Bulletin* (EEB) is a monthly bulletin issued by the Cabinet's Information and Decision Support Center. It provides business policy makers and the public, at various levels, with information concerning overall macroeconomic and sectoral performances of the Egyptian economy. Timely publication of data on monetary indicators, exchange rates and international reserves has improved during 2003.

The CBE website provides details about changes in the lending and discount rates, exchange rate announcements and board decisions. Other information and measures relevant to the banking sector and private businesses are also available on the site. These include information for foreign investors on capital repatriation and, since 2001, new measures for regulating the foreign exchange market.

4. Accountability and Assurances of Integrity by the Central Bank

●●● Enacted

Accountability before a designated public authority

According to Article 28 of the Unified Banking Law, the CBE governor has to submit to the president a periodic quarterly report comprising an analysis of monetary, credit, and banking developments as well as foreign debt balances for the duration covered by the report. Furthermore, the CBE board also has to submit annually to the president, the prime minister and the speaker of the parliament a report covering the monetary and credit status nationwide. While parliamentary scrutiny of economic and financial matters has improved, it is not clear that the Bank's *Annual Report* receives adequate scrutiny, and there are no examples of recent points of discussion that have been publicly raised.

The CBE governor usually participates in ministerial meetings on economic policies and issues. However, there is no public statement of the basis or details of such meetings, or of requirements for explaining policy objectives and describing performance in achieving them.

Financial statement

Audited financial statement

The annual financial statements of the CBE include a profit and loss statement, a balance sheet, and an overall report on its financial position and operations. Since the ministerial reorganisation in November 2001, the CBE board now submits the financial statements to the president and then the prime minister and parliament. Internal audit arrangements are not publicly disclosed.

External and internal audit

Monthly accounts are compiled on a cash basis and annual accounts on an accrual basis. The CBE's operating costs are reported in the *Annual Report*. Two external auditors who are appointed (with their fees fixed) by the Central Auditing Organization (CAO) must review its annual accounts.[25] The CBE's financial year is the same as the financial year of the State (and all public sector banks) and ends in June. Private sector banks in Egypt, however, use the calendar year. The accounting and auditing standards used are Egyptian standards, which draw on international ones.

Conduct of officials

The CBE's internal code of conduct has been in place since its establishment. The board may issue regulations concerning the affairs of personnel, in particular remuneration, privileges and special allowances, as well as rates of allowances for domestic and foreign travel. Bank employees share the same protections as all public sector employees under national employment law. The CBE is subject to the national civil service commission. However, the increasing independence of the governor, coupled with the anticipated new Unified Banking Law, should provide greater freedom in matters of recruitment and salaries.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Egypt between 21 and 23 October 2003:

Central Bank of Egypt

22 October 2003

Samia Turk	Director	Monetary Policy Department
Samir El Shahed	Executive Director	Money Laundering Combating Unit

ADDITIONAL INTERVIEWS

21 October 2003

Frank Szumilo	Chief of Party	USAID DATA project with Ministry of Planning
Moiz Zainuddin	Statistical Methodology Advisor	USAID DATA project with Ministry of Planning
Jamal Al-Kibbi	World Bank Cairo Office	World Bank
Mohamed Abdel Salam	Senior Commercial Officer	British Embassy in Cairo
Hanaa Ramzy	Economic Affairs Officer	British Embassy in Cairo

22 October 2003

Nadeem Ul Haque	Senior Resident Representative	International Monetary Fund

23 October 2003

Hani Geneina	Analyst	EFG-Hermes

IN ADDITION, WE CORRESPONDED WITH:

Doha Mounir	Senior Policy Advisor to the Minister	Ministry of Finance

NOTES

[1] The Unified Banking Law gathers together disparate legislation passed under successive decrees in recent years, and also gives legality to changes the government has made in the banking sector over the past year. This new law unifies five existing laws covering the banking sector: Banking and Credit law (no. 163 of 1957); Central Bank and Banking System Law (no. 120 of 1975); Banking Secrecy Law (no. 205 of 1990); Foreign Exchange Law (no. 38 of 1994); Law on Private Sector Contributions to Capital of Public Sector Banks (no. 155 of 1998).
[2] Article 6, Unified Banking Law.
[3] Interviews in Cairo, 21-23 October 2003.
[4] The new Unified Banking Law formalises the position of the CBE under the president's authority.
[5] In particular, technical assistance is being provided by the US Agency for International Development (USAID) and the IMF. In addition, a mission from the UK Centre for Central Banking Studies is expected before the end of the year.
[6] Article 8, Statutes of the CBE
[7] Interviews in Cairo, 21-23 October 2003.
[8] 'The Bank's Finance', Part IV, Chapter 2, Article 40, Statutes of the CBE
[9] Interviews in Cairo, 21-23 October 2003.
[10] Available at www.cbe.org.eg/public/money%20laundering%20combating%20E.doc
[11] Although the new framework for the CBE's monetary policy was debated during 2002 and beginning of 2003, the actual application of the new framework only started after the enactment of the new Unified Banking Law during the second half of 2003.
[12] Interviews in Cairo, 21-23 October 2003.
[13] In response, the interest on the government's most popular savings schemes -- National Bank of Egypt certificates of deposit and post office savings accounts -- dropped 100 basis points to 10.0-10.5%.
[14] Interviews in Cairo, 21-23 October 2003.
[15] Articles 10-14, Unified Banking Law.
[16] Interviews in Cairo, 21-23 October 2003.
[17] As of end 2003, the latest *Quarterly Review* publicly available on the CBE's website was for the second quarter of 2000/2001.
[18] Article 21, Unified Banking Law.
[19] 'Purposes and Functions of the Bank', Article 20, Part II, Statutes of the CBE
[20] 'Special Data Dissemination Standard' available at www.cbe.org.eg/Metadata.htm, and 'Analytical accounts of the Central Bank', available at www.cbe.org.eg/analytical_accounts%20CBE.htm
[21] Interviews in Cairo, 21-23 October 2003.
[22] See tables in *Monthly Statistical Bulletin*, www.cbe.org.eg/Monthly%20Statstical%20Bulletin.htm
[23] Annual and Quarterly Reports are available at http://www.cbe.org.eg/Publications.htm
[24] Interviews in Cairo, 21-23 October 2003.
[25] 'The Two Auditors of the Bank', Article 36, Chapter 1, Part IV, Statutes of the CBE; and Article 41, Statutes of the CBE.

OXFORD ANALYTICA

HUNGARY

MONETARY TRANSPARENCY

Country Report 2003

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HUNGARY

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2001*
Clarity of roles	●●●●	●●●●●
Open decision process	●●●●	●●●●
Availability of information	●●●●●	●●●●●
Central bank accountability	●●●●●	●●●●●
Score	4.50	4.75

OUTLOOK & COMMENTARY

In spite of recent problems, Hungary is likely to continue its steady progress towards meeting the highest international standards for monetary transparency. The availability of information on virtually all areas of central bank operations will continue to improve from an already high level. EU accession in 2004 and anticipated EMU membership by the end of the decade will ensure convergence with ECB practices.

The main area of weakness will likely remain the lack of information on the Monetary Council's internal deliberations, which could compromise policy consistency in the event of unanticipated shifts in the balance of power. Similarly, a strong commitment to exchange rate stability in the context of a band will likely challenge the inflation targeting regime and pose a threat to policy credibility.

EXECUTIVE SUMMARY

4.50 Compliance in progress

Since the adoption of the *Act LVIII on the Magyar Nemzeti Bank* (National Bank of Hungary, NBH) in 2001, Hungary has essentially adopted the transparency standards and operating principles of the European Central Bank. The only area where the NBH shares the legal responsibility for an aspect of monetary policy with the government is in setting up the basic parameters of exchange rate policy. However, this has to be done without compromising the Bank's primary objective. Day-to-day exchange rate policy is conducted fully by the Bank. Since this year, the government and the NBH also jointly set the inflation targets, which should improve policy coordination.

Hungary has made considerable progress towards fully reporting and explaining monetary policy decisions. The Bank maintains excellent public information services, and produces a variety of reports on its activities and on the broader macroeconomic context. However, the decision-making process itself remains carefully controlled and runs the risk of inconsistency if Monetary Council majorities shift. Similarly, the mechanics of economic forecasting, as well as the Bank's macroeconomic models, are not fully transparent. Information in English, while steadily improving, continues to be relatively limited in certain areas of NBH activities.

The often confrontational relations between the government and the NBH have repeatedly challenged the Bank's credibility, although efforts have begun to be made to better coordinate fiscal and monetary policy in preparation for the EMU. Further problems have arisen from the tensions caused by targeting both inflation and the exchange rate. These have been amplified by confusion over the degree of the Bank's commitment to targeting a narrower range within the official exchange rate band.

Oversight of the monetary policymaking process is well developed, with regular reporting to parliamentary committees by Bank representatives and the employment of an independent auditor. The Bank's activities are further monitored by an internal audit department and the general compliance with laws and regulations in internal operations is assessed by the State Audit Office.

Hungary's rating is revised downwards to 4.50 from 4.75 in 2001.

1. Clarity of roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in Progress

The objectives and institutional framework of monetary policy

The institutional framework for monetary policy in Hungary is defined in the *Act LVIII on the Magyar Nemzeti Bank,* (National Bank of Hungary, NBH) of 2001 which fully complies with EU standards.[1] It improves the transparency of the monetary framework by consolidating the independence of the Bank and its authority in monetary policymaking.

The NBH is headed by a president and 3-5 vice-presidents who are appointed by the president of the Republic on the prime minister's recommendation for a six-year term.[2] Monetary policy is formulated by the Monetary Council of the Bank. A 4-6 member Board of Directors, consisting of the president and the vice presidents, is responsible for implementing the decisions of the Monetary Council.

Central bank objectives and responsibilities

The NBH is responsible for the formulation and conduct of monetary policy with the primary objective of achieving and maintaining price stability.[3]

The Bank is further required to promote the stability of the financial system and to develop policies for its prudential supervision. The NBH has the exclusive right to issue currency. It is further responsible for the management of foreign exchange and gold reserves. It serves as banker to the government and as fiscal agent of the government. It has an advisory function in economic and financial policy and in international cooperation.[4]

The exchange rate regime is set by the government in agreement with the central bank. However, the NBH Act stipulates that this has to be done "without prejudice to the primary objective of the NBH to achieve and maintain price stability."[5] The Bank alone is responsible for the implementation of exchange rate policy under the regime.[6]

Operational autonomy

The NBH's independence is explicitly established in the first Article of the new Act, which states that it shall "neither seek nor take instructions from the Government or any other body."[7] The formal responsibility for appointments to the Bank leadership rests with the largely apolitical president of the Republic who otherwise enjoys few formal political powers, although the government does appear to have some influence on the appointment process. A consultative relationship exists between the NBH and government ministries, in which the NBH is required to "support the economic policy of the government," but only "without prejudice to its primary objective."[8]

The government sets the exchange rate regime in agreement with the NBH, although day-to-day exchange rate policy is purely managed by the Bank.[9] In addition, the Bank and the government have since July 2003 jointly agreed the inflation targets to be pursued, a task previously assigned exclusively to the NBH.[10]

There have been several confrontations between the government and the NBH during the past year, primarily in connection with the negative effects on growth of the Bank's anti-inflationary stance. Tensions have repeatedly come to the open between Governor Zsigmond Járai – a former conservative finance minister – and the present centre-left government. The government attempted to increase its influence on decision-making by re-establishing the NBH's Supervisory Board in October 2002, having abolished it in 2001. The Board consists of political appointees, albeit all major parties are represented and several members are professional economists. The NHB issued a formal protest at the decision claiming that it contravened its independence and constituted a waste of resources, given the existence of other control mechanisms. However, under the NBH Act, the Board is unable to influence the Bank in fulfilling its functions and does not appear to have done so even informally.[11] The Bank has acknowledged in at least one instance that policy was changed in response to a government request, although, involving a change in the exchange rate band, the government-led adjustment was fully within the law and was justified as not posing a threat to the main policy target.[12]

Even as the NBH has generally prevailed in its disputes with the executive, it has shown itself willing to bargain with the government and to offer monetary easing in return for commitments to fiscal rigour. Whereas Járai has on the whole been successful in protecting the Bank's independence, the Bank's stance has at times appeared confusing because of inconsistencies, most notably in exchange rate policy.[13] A recent commitment by the government to fiscal consolidation should, if realised, improve policy coordination and mark a return to a more consensual relationship.[14]

Institutional relationship between monetary and fiscal operations

Lending to government

The relationship between monetary and fiscal operations is explicitly defined in the NBH Act, which states that the NBH may not finance the deficit of the state budget, or any state debt. Accordingly, it is not permitted to purchase securities from state institutions in the primary market. It is explicitly forbidden to issue credit to the government or any other public sector agency. An earlier provision authorising short-term credit for liquidity problems has been eliminated under the new act.[15]

Central bank involvement in the rest of the economy

Representatives of the Bank may express an opinion on the budget proposal after its submission to the parliament, both to the government and to competent parliamentary committees. In addition, the government is required to invite the NBH president to attend meetings where the agenda broaches on issues of relevance to the Bank's remit.

The Bank manages the accounts of the Treasury, the Hungarian Privatisation and State Holding Company, the Government Debt Management Agency, the National Deposit Insurance Fund, the Investor Protection Fund, and some other public sector organisations.

The NMB monitors the financial sector and publishes its findings in the *Report on Financial Stability*. The Bank cooperates with the Hungarian Financial Supervisory Authority.[16]

The NBH may not legally hold any ownership interests in either domestic or foreign business associations not related to the Bank's activities.[17]

Central bank profit allocation

An annual dividend, equal to the average profit from three preceding years, is paid to the Government, with any excess profit transferred to a profit reserve. This reserve is then available to top-up the dividend payment should there be a shortfall in earnings.

Agency roles performed by the central bank on behalf of the government

The NBH serves as the banker to the government. Under the NBH Act, the Bank manages the accounts of the Treasury and other government accounts specified by the Minister of Finance, as well as the accounts of the Hungarian Privatisation and State Holding Company and of the Government Debt Management Agency (*Államadósság Kezelő Központ*, AKK).[18]

The NBH is allowed to act as an advisor and agent to the government in the securities market, and can be consulted before issuing securities on behalf of the state. It may also be mandated to raise loans in foreign exchange and securities, and execute forward transactions (hedging) for the state. Ultimate responsibility for the management of state debt, however, rests with the government.[19] The key institution in this regard is the debt management agency AKK which has since its establishment in 1995 progressively taken over responsibility from the National Bank for the issuing and management of Hungary's foreign debt, to add to its responsibilities for domestic debt. Since its separation from the State Treasury in 2001, the AKK operates as a joint-stock company under the supervision of the Ministry of Finance but with a high degree of autonomy.[20] The NBH now acts as the paying agent for the insurance of foreign-currency denominated debt. Under a contract, which is currently being reconsidered, it conducts swaps on the foreign currency debt at the AKK's request.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments, and targets of monetary policy

Framework and monetary targets

Following a major monetary policy review in 2001, the NBH embraced an inflation targeting framework with a long-term target rate of 2%. Gradually decreasing target ranges are publicly announced and progress towards them monitored. The intermediate target is 3.5% for 2003-4 with a +/-1% band to accommodate shocks. Beginning in 2003, the target is set and announced jointly with the government. The two jointly set a 4% target for 2005 and a 3% ceiling for 2006.[21]

The Bank publishes an inflation forecast in its quarterly *Inflation Report*. This includes an explanation of the relationship between projected inflation and the inflation target. Interest rates are adjusted in response to deviations from the target.[22] However, no formal provisions for accountability and remedial action in the event of the NBH failing to achieve its inflation target exist.

In addition to its primary target, the NBH has since May 2001, following a joint decision with the government, pursued a managed exchange rate with a +/- 15% trading band *vis-à-vis* the euro. More recently, the Bank has targeted a narrower preferred range of 250-260 forints to the Euro.[23] The struggle to reconcile the exchange rate goals with the inflation targeting regime has significantly strained the credibility of Hungarian monetary policy. During much of the year, the NHB has shown itself willing to cut interest rates in order curb the rise and to keep the currency within its limits. More recently, interest rates were increased sharply after the forint depreciated below the preferred range. The commitment to exchange rate targeting has taken precedence over the inflation targets which have been put under further strain because of indirect tax increases.[24] The Bank has sought to convince the public of its commitment to the inflation targeting regime, so as to prevent the higher price increases from feeding expectations of accelerating inflation.[25]

The government is July 2003 set 2008 as the target date for the adoption of the euro.[26] The NBH is fully committed to this date, although 2009 is viewed by many as a more likely date. Meeting the target will presuppose improved policy coordination with the government and an ambitious programme of fiscal consolidation which may be threatened by political cycles. Similarly, more effective control will have to be exercised by the government on wage formation through the National Reconciliation Council.[27]

Monetary instruments

The NBH uses all the standard monetary policy instruments: deposits from credit institutions, collateralized lending, open market operations, security emissions, foreign exchange market intervention, interest rates, refinancing, and minimum reserve requirements. The most widely used instruments is a two-week deposit facility. Through setting its base rate for such deposits, the Bank influences its operative target, the three-month money market rate. To prevent volatility of interbank interest rates, the NBH maintains an overnight interest rate corridor of the base rates

+/-1%. The Bank further uses quick tenders to reduce interest rate fluctuations. The reserve ratio currently stands at a relatively high 5%.[28]

The monetary policy-making body

Monetary board

The NBH Act establishes the Monetary Council as the supreme decision making organ of the NBH with the sole responsibility for all monetary policy decisions. Most importantly, the Council decides on the Bank's monetary policy stance by setting the base rate.[29]

The Monetary Council consists of 7-9 members: the president, the vice presidents, and experts appointed by the president of the Republic and vetted by a relevant parliamentary committtee. All members are required to have "outstanding theoretical or practical professional knowledge related to monetary, financial, and banking activities" and serve as employees of the NBH during their term.[30] The appointments are not simultaneous. The minister of finance, or another duly authorised minister, can represent the government at Council meetings, albeit without voting rights. Voting at Council meetings is by simple majority, with a quorum of five required. The Council's work is prepared by an internal monetary policy committee which typically meets every week to assess recent developments and future prospects. The committee is made up of the Council members, NBH managing directors, and related staff.

Any decisions on monetary policy instruments, including "no change" decisions, along with a brief justification, are announced in a press release after Council meetings. The press release lists the main topics discussed by the Council. More complete discussions of monetary policy are available in the quarterly *Inflation Report*. The Bank has devoted considerable resources to ensuring timely, adequate, and complete dissemination of information on Council decisions. However, the bank does not publish minutes of the Council's meetings nor a voting record. Essentially no information on the opinions of individual Council members is available, other than in the rare instance of resignation over policy differences. This creates the potential risk of policy inconsistency in the event of narrow and shifting majorities in the Council.

Advance meeting schedule

The Council is required to meet twice a month, with additional meetings to be convened as necessary. The schedule is published six months in advance and is available on the Bank's website.[31]

Public statements on monetary policy

Periodic publications

The NBH has a wide-ranging series of periodic publications. The *Annual Report* details the evolving macroeconomic situation and its implications for monetary policy and the exchange rate regime, as well as presenting the Bank's results.[32] It also outlines the Bank's monetary policy agenda, reviews changes in monetary policy instruments, and anticipates future changes, which may include reductions in the reserve ratio and reform of the required reserves system. The semi-annual *Report on Financial Stability* offers data pertaining to efforts to increase and maintain economic and financial stability.[33]

The bank also produces a quarterly *Inflation Report* which contains commentaries on the bank's progress towards its inflation target, inflation projections and considerations bearing on the decisions of the Monetary Council.[34]

The Bank has also published a comprehensive guide to *Monetary Policy in Hungary*. All these materials are translated into English and available through the NBH website.

The macroeconomic models used by the Bank are not publicly available, although the main assumptions and other information are available in the *Inflation Report*.

Public hearings

Decisions by the Monetary Council are publicly announced. The quarterly *Inflation Report* in presented to the public at a press conference. The Bank does offer a variety of mechanisms for interaction with market actors and independent analysis. The publication of the *Inflation Report* is followed by a meeting with independent market analysts. Forecasting models are revised in consultation with experts from the European Central Bank and there is an open academic debate about the Bank's forecasts. However, no mechanism of formal hearings or other attempts to canvass opinions in preparation for policy changes exists. Although the availability of information is both timely and ample, some of the problems surrounding monetary policy credibility have clearly been caused by ineffective and even inconsistent communication by the Bank leadership and this thus represents an area for improvement.

The NBH President appears annually before the Parliament to deliver the Bank's *Annual Report*. Additional appearances may be arranged as appropriate. This is generally deemed to constitute adequate oversight and some of our interviewees expressed scepticism regarding the ability of the Hungarian Parliament to exert greater control effectively, given the polarized and confrontational political culture.[35]

Regulations on data reporting by financial institutions to the central bank

The NBH Act requires that the central bank publish all information related to the operation of the banking system, and provide regular and detailed information to the parliament and the government. The Act also empowers the NBH to request data, reports and balance sheets from financial institutions, and to conduct on-site inspections in the course of its data reporting activities. The Bank is authorised to initiate disciplinary, civil or criminal proceedings against institutions that it deems to have violated the law.[36] The Bank publishes a biannual *Report on Financial Stability* evaluating the situation in the sector.[37]

The NBH assesses systemic risks and monitors at least the largest financial institutions. In practice, however, the responsibility for financial supervision is shared with the Hungarian Financial Supervisory Authority (*Pénzügyi Szervezetek Állami Felügyelete*, PSzAF). PSzAF was created in 1999 (with effect from 2000) and exists as an independent budgetary authority. It has the responsibility to promote transparency and the smooth operation of capital markets. It maintains competitive market conditions through regular supervision and periodic interventions.[38] In practice, there is a high degree of coordination between the NBH and PSzAF involving detailed agreements that lay out the division of labour between the two bodies.[39] There is mutual reporting of findings from all on-site visits and regular joint meetings between the two organizations are held. In addition to the regulatory framework, the high degree of foreign ownership of Hungarian banks is likely to ensure compliance with international standards.[40]

3. Public Availability of Information on Monetary Policy

●●●●● Full Compliance

Release of central bank data

Hungary subscribes to the IMF Special Data Dissemination Standard (SDDS), and meets its specification for the coverage, periodicity and timeliness of monetary data. An advance release calendar is posted at the IMF website.[41]

The analytical accounts of the NBH are derived from the Bank's balance sheet and show gross domestic and foreign assets and liabilities. This includes international reserves and claims on central government. The data are produced monthly, within one week of the reference period. An advance release calendar, giving six months notice, is disseminated through the NBH website.

The central bank balance sheet

The Bank publishes its balance sheet in the *Monthly Report*, together with some information on its monetary operations, including foreign exchange operations. A consolidated balance sheet, together with an assessment by independent auditors, is included in the *Annual Report*.

Lender of last resort

The NBH Act establishes that the Bank may grant extraordinary credit to financial institutions in circumstances that it deems may jeopardise the stability of the financial system. While there are no legislative requirements to do so, the Bank has typically announced the details of such support shortly after the event.[42] All lending is collateralized and any securities used are valued daily. As an alternative measure, the NBH can exempt a bank in difficulties from complying with the standard reserve requirements for a period of three months. Support is always provided in coordination with the Hungarian Financial Supervisory Agency.[43]

Public information services

The NBH maintains high-quality public information services through its website.[44] A comprehensive list of publications and data is available in both English and Hungarian. The bank also disseminates press releases and the text of public statements. The bank has a separate information services department.[45]

Copies of relevant legislation, including English language texts of the Central Bank and Foreign Exchange Acts, are available online, and translations of other relevant legislation can be readily obtained through the Bank's information division.

All bank decisions are announced at a press conference and the Bank operates an internet chat room following the publication of its *Inflation Report*.

4. Accountability and Assurance of Integrity by the Central Bank

●●●●● Full Compliance

Accountability before a designated public authority

The Act on the Central Bank requires the NBH president to appear before the Parliament annually for the purpose of presenting and discussing the *Annual Report*. Either the Parliament or individual parliamentary committees may summon the NBH president at will to discuss matters under his jurisdiction. He must, if so requested, present data on monetary and financial sector developments to the government.

Financial Statement

The Bank's full results are included in its *Annual Report*.

Audited financial statement

Financial statements are included in the bank's *Annual Report*, accompanied by an auditor's statement. A summary statement appears in the published *Annual Report*, while the version submitted to Parliament contains a more comprehensive account.

External and internal audit

The NBH Act stipulates that the Bank's annual report must be audited by an external accounting firm which is appointed under a five-year non-renewable contract. This contracts is currently held by Ernst & Young.

The Bank has its own 16-person Internal Audit Department which is controlled by the Supervisory Board and reports to the Audit Committee and the Board of Directors. The department follows an annual audit plan approved by the Supervisory Board. The plan can involve any area of the Bank's activities, although a potential problem is created by the legal provision that prevents the Supervisory Board from reviewing the main operations of the Bank, including monetary policy, the management of reserves, currency issuance, etc. The Audit Committee issues recommendations which are followed by the adoption of a schedule for implementation. Compliance is verified within a year.

The State Audit Office (*Állami Számvevőszék*) is responsible for tasks related to the inspection of internal NBH operations with the sole objective of ensuring compliance with laws and regulations.[46] It cannot perform a financial audit, not review any activities connected with monetary policy. The SAO may submit proposals to the general meeting of the NBH for the appointment or dismissal of the independent auditor. There is no formal mechanism for follow-up.

Conduct of officials

The NBH Act details the obligation on employees and officials to avoid conflicts of interest, including those arising from political affiliation and relations with credit institutions. Employees sign a confidentiality agreement, and are regarded as public officials from the point of view of applying criminal law.[47] Protection from personal liability is not considered necessary, since under Hungarian law, liability does not extend to employees of public institutions.[48]

The NBH Act lays down rules to govern the appointment and discharge of the Bank's president and vice-presidents.[49]

INTERVIEWS

Representatives of Oxford Analytica interviewed the following officials during a visit to Hungary 6-8 October, 2003 and a visit to London on 29 October, 2003:

National Bank of Hungary

7 October 2003

György Sándor	Managing Director	Monetary Policy Department
András Kármán	Head of Division	Monetary Policy Department
Ágnes Csermely	Head of Department	Economics Department

ADDITIONAL INTERVIEWS

6 October 2003

Péter Pete	Professor	Budapest University of Economic Sciences and Public Administration

7 October 2003

István Madár	Economics Editor	*Világgazdaság* Business Daily
Péter A. Hegedűs	President/Country Manager	ABB/American Chamber of Commerce

8 October 2003

György Kovács	Head of Macroeconomic Research	Budapest Economics
Emil Kemény	Head of Division	State Audit Office
Maria Ocskovszki	Official	State Audit Office

29 October 2003

Imre Tarafás	Economist	European Bank for Reconstruction and Development, previously President, Hungarian Financial Supervisory Authority; Professor, Budapest University of Technology and Economics

In addition, we corresponded with:

Gábor Oblath	Member	Monetary Council, Hungarian National Bank
Árpád Király	Head	Department of International Affairs, Hungarian Financial Supervisory Authority (*Pénzügyi Szervezetek Állami Felügyelete*)
Zsolt Szita	Head	Legal Department, Government Debt Management Agency (*Államadósság Kezelő Központ*, AKK)
András Choma	Official	AKK
Álmos Kovács	Deputy State Secretary	Ministry of Finance
Resző Nyers	Secretary	Hungarian Banking Association (*Magyar Bankszövetség*)

NOTES

[1] Act XVIII on the National Bank of Hungary (2001), passed by Parliament on 19 June 2001.
[2] In practice, the decision on choosing the governor appears to be made by the government and is merely endorsed by the president. The current governor is a former minister of finance. The deputy governors are appointed jointly by the president and the government. Interviews conducted in Budapest, 6-8 October 2003 and in London, 29 October 2003.
[3] NBH Act, Article 1.
[4] Interviews conducted in Budapest, 6-8 October 2003 and in London, 29 October 2003.
[5] NBH Act, Article 11(2).
[6] NBH Act, Article 4(4).
[7] NBH Act, Articles 1 and 3
[8] NBH Act, Article 3(2).
[9] NBH Act, Article 11(3).
[10] http://english.mnb.hu/modulei.asp?id=130&did=2305.
[11] "Hungary: Government/HNB monetary policy tensions," *Oxford Analytica Daily Brief*, January 27, 2003; http://english.mnb.hu/module.asp?id=130&did=433.
[12] Monetary Council, 10 June, 2003; http://www.mnb.hu. For the announcement of the decision, see: http://english.mnb.hu/mnben_sk030304_01 and for the justification: http://english.mnb.hu/mnben_sk030605_02.
[13] "Hungary: Inconsistency threatens NBH credibility," *Oxford Analytica Daily Brief*, June 11, 2003.
[14] http://english.mnb.hu/modulei.asp?id+130&did=2153; Interviews conducted in Budapest, 6-8 October 2003 and in London, 29 October 2003.
[15] NBH Act, Article 19 (3)-(4); "The Role of the Magyar Nemzeti Bank in the EU accession process," http://www.mnb.hu.
[16] NBH Act, Articles 43, 44.
[17] NBH Act, Article 69.
[18] NBH Act, Article 15.
[19] Act on Public Finances (Act XXXVIII of 1992), Article 113/A.
[20] http://www.akk.hu.
[21] http://english.mnb.hu/modulei.asp?id=130&did=2305.
[22] http://english.mnb.hu/module.asp?id=113&did=786.
[23] http://english.mnb.hu/dokumentumok/inf_0308_en.pdf ," p. 8; Hungary: NBH will struggle to boost forint," *Oxford Analytica Daily Brief*, 5 December 2003.
[24] *Quarterly Report on Inflation, August 2003*, http://english.mnb.hu/dokumentumok/inf_0308_en.pdf.
[25] Interviews conducted in Hungary between 6 and 8 October, 2003.
[26] http://english.mnb.hu/modulei.asp?id=130&did=2153.
[27] Interviews conducted in Budapest, 6-8 October 2003 and in London, 29 October 2003.
[28] http://english.mnb.hu/module.asp?id=113&did=1209.
[29] http://english.mnb.hu/dokumentumok/jegybanktorv_en.pdf.
[30] NBH Act, Article 49(3), (5).
[31] http://www.mnb.hu/module.asp?id=92&did=1117.
[32] *Annual Report (Business Report and Financial Statements of the Magyar Nemzeti Bank) for 2002*, http://english.mnb.hu/dokumentumok/eves_jelentes_2002_en.pdf.
[33] http://english.mnb.hu/modulei.asp?id=140.
[34] National Bank of Hungary, *Statement on the new system of monetary policy*, June 12, 2001
[35] Interviews conducted in Hungary between 6 and 8 October, 2003.
[36] NBH Act, Articles 28, 29.
[37] http://english.mnb.hu/dokumentumok/stabil_0306_en.pdf.
[38] http://www.pszaf.hu/english/start.html.
[39] NBH Act, Articles 43, 44.
[40] Interviews conducted in Budapest, 6-8 October 2003 and in London, 29 October 2003.
[41] http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=HUN.
[42] Interviews conducted in Hungary between 6 and 8 October, 2003.
[43] *Hungary: Financial System Stability Assessment Follows-up, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, Securities*

Regulation, Insurance Regulation, and Payment Systems (*IMF Country Report* No. 02/112), June 2002, International Monetary Fund.
[44] http://www.mnb.hu/index-a.htm
[45] http://english.mnb.hu/module.asp?id=2&did=333.
[46] The most recent audit was completed in August 2003: Állami Számvevőszék, *Jelentés a Magyar Nemzeti Bank belső (banküzemi) működésének ellenőrzéséről*, 0328, 2003. augusztus. The relevant legal provision: NBH Act, Article 45.
[47] See Articles 54 – 58 of Act XVIII for provisions on the legal status of NBH employees.
[48] IMF ROSC, 'Hungary: Financial Sector Assessment Programme,' p. 34
[49] NBH Act, Articles 49-52.

OXFORD ANALYTICA

INDIA

MONETARY TRANSPARENCY

Country Report 2003

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INDIA

COMPLIANCE RATINGS

Fiscal transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●	●●●	●●●
Open decision process	●●●	●●●	●●
Availability of information	●●●●	●●●●	●●●●
Accountability	●●●●	●●●●	●●●●
Score	3.50	3.50	3.25

OUTLOOK & COMMENTARY

Important bills currently under consideration in parliament are: the Banking Regulation (Amendment) Bill 2003, the Banking Regulation (Amendment) and Miscellaneous Provisions Bill 2003, and amendments to the Reserve Bank of India Act 1934. If passed the Reserve Bank of India Amendment Bill would increase the separation of debt management from the Bank's monetary policy functions.

Monetary transparency would benefit, *inter alia*, from the publication of information on monetary policy decisions. Monetary transparency would also increase if the RBI would publish an advance meeting schedule, and disseminate the minutes of its board meetings.

EXECUTIVE SUMMARY

3.50 Enacted

Building on recommendations made by its advisory group, the Reserve Bank of India (RBI) has initiated a set of legal changes to reinforce the clarity of its objectives, formal independence, and the division of responsibilities between debt management and monetary policy functions. The Fiscal Responsibility and Budget Management (FRBM) Act, passed in 2003, prohibits the Bank from subscribing to primary issues of government securities effective from fiscal year 2006-07. The Reserve Bank of India RBI Amendment Bill, if passed, would increase the separation of debt management from the Bank's monetary policy functions.

India continues to provide comprehensive, high quality monetary statistics. External debt statistics are now published and India is now fully compliant with the IMF's Special Data Dissemination Standard.

With the aim of adding to transparency and stability in the market, the RBI has begun to produce an issuance calendar for government securities. The Bank issued such a calendar for 2002-03.

Meanwhile, the publication of information on monetary policy decisions and the assumptions that underpin such decisions remain weak. The RBI does not publish an advance meeting schedule, nor does it plan to disseminate the minutes, let alone the voting record, of board meetings.

India's overall score has remained at 3.50.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The Reserve Bank of India Act (RBI Act) of 1934 is perceived as an outdated document that lacks a clear definition of the objectives of monetary policy. In the absence of a legally enshrined mandate for the central bank, the Ministry of Finance and the Reserve Bank of India (RBI) set annual monetary policy objectives jointly, which the RBI then implements. Although not based on a formal arrangement, this regime allows the central bank to set monetary policy objectives as it sees fit, while the government also plays a part in setting monetary objectives and exchange rate policy.

The RBI Act entrusts the Bank with the core tasks of issuing bank notes, managing reserves to ensure monetary stability, and operating the currency and credit system. It also tasks the Bank with responsibility for managing the accounts of the central government (and individual states under separate agreements); managing public debt, the regulating and supervising commercial banks and non-banking financial intermediaries; managing foreign exchange; and formulating and implementing monetary policy.[1] However, it is the government that sets the exchange rate.[2] The RBI Act implicitly gives the Bank the authority to use monetary policy instruments to attain its policy objectives.

There is some concern over the alleged conflict of interests between ownership and regulation, which is leading to a clearer definition of the regulatory role of the RBI.

The central bank is currently aiming to 'increase the operational efficacy of monetary policy, redefine the regulatory role of the RBI, strengthen prudential norms and develop the technological and institutional infrastructure.'[3]

Operational autonomy

The RBI is not formally independent, but enjoys substantive operational autonomy in the use of its instruments and in administrative matters. The central government has the power to appoint and remove members of the central board of directors, the main executive organ of the Bank. Commentators have stated that despite a lack of institutional guarantees, no member of the Bank's senior management has ever been removed for political reasons.[4]

In 1999, the RBI set up an advisory group to review transparency in monetary and financial policies. The group made several recommendations for adapting the formal monetary policy-making framework to international standards, including: granting a single, legally enshrined mandate to the RBI; greater operational flexibility for the conduct of monetary policy; clear demarcation of responsibilities and accountability; and a legal obligation to seek parliamentary approval for annual monetary policy objectives. The RBI has taken some of these suggestions on board and submitted an RBI Amendment Bill to parliament in 2001 to amend the central bank law accordingly.[5] The amendment bill is currently being considered by parliament.

Institutional relationship between monetary and fiscal operations

Lending to government

The RBI is permitted to extend loans and advances to the central government and state governments, provided that such advances are repaid within three months. In addition to lending to commercial and state cooperative banks, the RBI may also grant loans and advances to local authorities, state financial corporations, the Industrial Development Bank, the Reconstruction Bank, and a host of public financial institutions affiliated to the government, provided that such loans are repaid within six months.[6] Consolidated data on such loans are included in the weekly summary financial statements, and the monthly, quarterly, and annual balance sheets that the RBI publishes on its website.[7]

As a result of the Fiscal Responsibility and Budget Management Act passed this year, as of 2005-06 the government will no longer be allowed to borrow from or maintain an overdraft with the RBI.[8] The RBI is also working on improving full disclosure of information concerning government guarantees.

Central bank involvement in the rest of the economy

The RBI's involvement in the rest of the economy is clearly proscribed by the RBI Act. The RBI cannot engage in trade or otherwise have a direct interest in commercial enterprises, and is banned from acquiring shares in banks and corporations.[9] Nevertheless, the RBI does have a financial stake in some of the financial institutions it regulates, such as the State Bank of India and the Securities Trading Corporation of India. However, it has begun to divest these shares in recent years.[10]

Central bank profit allocation

The Bank is required by the RBI Act to pay its profits to the central government after making provisions for non-performing loans, the depreciation of assets, staff salaries and other obligations. Such obligations include an annual contribution of such amounts as the RBI considers necessary to the National Rural Credit Fund and the National Rural Credit Stabilisation Fund.[11] In this capacity, the RBI undertakes quasi-fiscal development functions on behalf of the government.

Agency roles performed by the central bank on behalf of the government

The RBI manages the internal debt and accounts of the central and state governments, regulates foreign exchange transactions in India, performs quasi-fiscal development functions, and regulates the securities market. As the government's debt manager, the RBI is allowed to participate in the primary market for government securities. The procedures for the Bank's participation are clearly defined and publicly disclosed on its website.

There are currently two pieces of legislation that should clarify the division between monetary and fiscal policy. The RBI Amendment Bill, if passed, would increase the separation of debt management from the Bank's monetary policy functions. [12] The Fiscal Responsibility and Budget Management Act prohibits the Bank from subscribing to primary issues of central government securities, effective from 2006-07. However, the RBI will continue however to buy and sell government bonds in the secondary market depending on liquidity conditions, consistent with inflationary prospects. This should work towards strengthening the goal of low and stable inflation. However, under exceptional circumstances, the RBI may subscribe to primary issues in consultation with the government if considered necessary for providing stability.[13]

With the aim of adding to transparency and stability in the debt market, the RBI has begun to announce a calendar for issuing government debt. The Bank issued such a calendar for 2002-03. [14]

In addition to managing the government debt, the RBI regulates the government securities market.[15] The government has established a separate Clearing Corporation of India to improve the clearing and settlement of transactions in government securities.[16]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●● Enacted

The framework, instruments and targets of monetary policy

Framework and monetary targets

From the mid-1980s until 1998, the RBI used a monetary targeting framework focused on interest rates, while at the same time monitoring developments in the real sector. Since 1998 it has widened the framework and begun to pursue a multiple indicator approach. In addition to monitoring interest rates, the RBI now considers indicators such as currency movements, the exchange rate, the inflation rate, capital flows, trade, the fiscal position, and movements in credit. This widening of the scope of variables monitored has encouraged the RBI to develop a more sophisticated econometric model that focuses on short-term movements in the components of reserve money.[17]

The RBI does not use an inflation targeting approach, although it has conducted some research in this area and the advisory group has recommended its introduction. At present the RBI uses the Wholesale Price Index (WPI) as its main inflation indicator, although the WPI does not include services, which make up for more than 50% of GDP. A more comprehensive price index would have to be developed before inflation targeting could be introduced. However, India's unwieldy finances pose another problem to the successful operation of an inflation-targeting framework, and therefore its introduction seems unlikely in the near future.[18]

The monetary policy framework has changed recently as a result of reforms in the financial sector and the export-led economic growth. Monetary policy has aimed to 'enhance the allocative efficiency of the financial sector, preserve financial stability and improve the transmission mechanism of monetary policy by moving from direct to indirect instruments.' [19] Monetary policy will continue focus on the provision of adequate liquidity to meet credit growth while maintaining price stability, and to maintain the present stance on interest rates -- including preference for softer interest rates, giving greater flexibility to the interest rate structure in the medium term.

Monetary instruments

The major monetary policy instruments used by the RBI are the Liquidity Adjustment Facility (LAF) and open market operations. Introduced in June 2000, the LAF allows for the daily modulation of liquidity conditions and the management of short term interest rates through the LAF window. Meanwhile, the Bank signals policy changes through the bank rate, which is the rate at which the RBI is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under the RBI Act. The RBI reactivated the bank rate and introduced a fixed repo rate in parallel to marketising interest rates on government securities in 1997. These two rates are used as an informal corridor in the money market, with the repo rate as the floor and the bank rate as the ceiling.[20]

The monetary policy-making body

Monetary board

The Central Board of Directors is the highest executive organ of the RBI. The board consists of the governor, four deputy governors, fourteen directors and a government representative, all appointed by the government.

Membership of the board is listed in the RBI *Annual Report* and on the Bank's website. The board is required to meet at least six times a year, and at least once in each quarter. However, a committee of the board (which includes the governor, deputy governors, and a number of directors) meets every week to review monetary, economic, and financial conditions and to advise the board on policy action. Much of the data used by this committee is released to the public within a week of the board's meeting.[21]

The advisory group has recommended the formalisation of the central board committee into a permanent Monetary Policy Committee (MPC). However, in practice the board committee already does the tasks that an MPC would do, and therefore the Bank does not see an immediate need for this institutional change. Similarly, it does not consider it necessary to amend the RBI Act to provide institutional guarantees against the arbitrary removal of top management officers, as the government has never interfered in the running of the RBI for political reasons.[22]

Advance meeting schedule

The RBI does not publish an advance meeting schedule of the committee of the central board.

Public statements on monetary policy

The RBI maintains an informative daily press release service on its website and publishes notifications on new regulations on a regular basis. These documents shed some light on the considerations that prompted policy action. However, the central board does not publish summary statements of board meetings or explanations of policy decisions. For this reason, the advisory group has recommended the publication of the minutes of board meetings and the release of voting records at a later stage.[23] The RBI admits that the explanation of monetary policy to the public could be improved, but it has not made a decision on the changes proposed by the advisory group.[24]

Periodic publications

The RBI issues two major monetary policy statements each year: the governor's annual *Statement on Monetary and Credit Policy*, issued in April, and a *Mid-Term Review of Monetary and Credit Policy*, published in October. The governor's annual statement contains a detailed sectoral review of macroeconomic and monetary policy developments in the previous fiscal year and an assessment of the prospects for monetary (and fiscal) policy in the upcoming year. The mid-term review presents a similar review for the first half and an outlook statement for the second half of the fiscal year. Both documents, as well as an advance calendar of the exact disclosure dates, are published on the RBI website. The *Annual Report* of the RBI summarizes these two statements and explains the rationale for, and instruments used in, the Bank's monetary and credit operations during the reference year.[25]

Public hearings

The RBI has recently begun to hold periodic consultations with academics, market participants, and financial intermediaries through various *ad hoc* committees in order to develop the efficiency of monetary policy. Periodic consultations with the Ministry of Finance are employed to coordinate the overall economic policy framework. The Bank also conducts frequent resource management discussions with commercial banks.

Regulations on data reporting by financial institutions to the central bank

Under the RBI Act, the RBI is obliged to publish a consolidated statement showing the aggregate liabilities and assets of all banks that fall under its supervision, based on the financial statements and credit information submitted to it. The Act also empowers the RBI to employ such measures as it deems necessary to collect the required

information. Such information may include financial statements, and data on capital, reserves, liabilities, investments, and the terms of loans provided. However, the RBI is prohibited from disclosing this confidential information to the public.

The advisory group has criticised this aspect of the supervisory function of the RBI and pointed out that the disclosure of supervisory information, such as the imposition of penalties, could be employed as a useful instrument for market discipline. Furthermore, such information may be necessary in the light of the poor disclosure practices of Indian banks. While it is unlikely that the RBI Act will be amended to allow for the disclosure of confidential banking information, the RBI has recently adopted a new prompt corrective action framework to deal with banks with problems of capital adequacy, asset quality and profitability.

Moreover, the RBI has also called for the establishment of a new supervisory body to oversee India's troubled urban cooperative banking sector.[26] The Bank has discussed this issue with the central government, which is considering the proposal. The RBI has set up a Prudential Supervisory Reporting System (PSRS) for Off-site Surveillance (OSS). As part of its efforts to comply with the 'Core Principles for Effective Banking Supervision' drawn up by the Basel Committee on Banking Supervision, the Bank is making efforts to move towards a system on consolidated supervision, for enhancing the role of external auditors, and for increasing transparency and disclosure in the balance sheets of banks.[27] The Bank is implementing prudential norms in a phased manner.

The RBI has established a Central Database Management System (CDBMS), built around an integrated repository of current and historical data. RBI users have been able to access this database since December 2002, but it is hoped that the data will be available on-line by end June 2004.[28]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

As a subscriber to the IMF's Special Data Dissemination Standard (SDDS), India provides a range of macroeconomic, financial, and monetary statistics. Within this framework, the RBI is responsible for the provision of financial data, such as the analytical accounts of the banking sector, the analytical accounts of the central bank, interest rates, the balance of payments, international reserves and foreign currency liquidity, and exchange rates. It also disseminates data on two stock market indices on behalf of the Bombay and National Stock Exchange.

There are two publications relating to reserve assets: the *Gross Foreign Exchange Reserves* of the RBI, released weekly, and the *International Reserves and Foreign Currency Liquidity*, released monthly. The time lag in the publication of the two documents is one week and one month respectively. Data on exchange rates cover spot exchange rates and different forward rates for the rupee against the US dollar. These rates are published daily, within two weeks of the reference date. The data are available on the RBI website and on CD-ROM, and an advance release calendar, giving one-quarter ahead notice of the precise release dates, is posted on the RBI website. Data on external debt are now published quarterly in the *RBI Bulletin*, which contains all the requisite details including short-term, long-term, multilateral, bilateral, government and non-government debt. India has not yet developed a National Summary Data Page. However, once this page is completed, it will be linked to the IMF's Dissemination Standards Bulletin Board website.[29]

The central bank balance sheet

As part of its SDDS commitment, the RBI publishes a summary balance sheet in its weekly *RBI Bulletin*. The monthly *RBI Bulletin* disseminates detailed time series data on the RBI balance sheet, including weekly data for the reference month, monthly data for the four months preceding the reference month, and annual data for the three fiscal years preceding the current fiscal year. The RBI's *Annual Report* publishes data and commentary for the reference fiscal year on the annual balance sheet of the RBI and detailed data on reserve money on a financial year basis. The annual *Handbook of Statistics on the Indian Economy* publishes time series data on the components and sources of reserve money. Moreover, the RBI publishes daily information on money market operations, showing the volume of transactions by banks, primary dealers, and non-bank institutions, daily average interest rates, the status of the liquidity adjustment facility, and the net purchases and sales of the RBI made in connection with its open market operations.[30]

Lender of last resort

The RBI Act empowers the Bank to extend emergency financial support to Indian commercial banks and financial institutions if 'a special occasion has arisen making it necessary or expedient that action should be taken for the purpose of regulating credit.'[31] However, the Act does not specify the terms of emergency loans and advances granted to distressed banks, nor does it require the RBI to disclose details of emergency actions to the public. The Bank indicates that it has not used these powers since 1992.[32]

Public information services

The central bank has established and maintains a public information service of high quality through its website. The site provides a comprehensive, user-friendly publications programme consisting of reports, statistics, primers, press releases, and working papers on a variety of macroeconomic, monetary, and financial issues. Regular publications are classified by frequency of publication under weekly, monthly, quarterly, annual, and occasional headings. Reports of RBI committees as well as speeches and lectures by senior Bank officials are also available on the RBI website.[33]

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

Under the Constitution and the RBI Act, the RBI must submit its *Annual Report* to the Ministry of Finance, which then submits it to parliament. RBI officials are generally summoned before parliamentary committees in cases that have a direct bearing on the operations of the Bank. Under the 1949 Banking Regulation Act, the RBI must also submit its *Report on Trend and Progress in Banking* to parliament and the Ministry of Finance each November. This report summarises the activities of the central bank as banking regulator and supervisor.

The advisory group has criticised this regime and proposed the enhanced involvement of parliament in the setting of annual monetary policy objectives, but it has shied away from calling for the direct accountability of the central bank to the legislature. The Bank considers that the current institutional arrangement guarantees a reasonable amount of accountability to parliament, and therefore does not support a switch to direct parliamentary accountability.[34]

Financial statement

Audited financial statement

The central bank is required by the RBI Act to submit to the government its audited final accounts and a report on its yearly activities within two months of the end of the fiscal year. This report is published on the central bank website as part of the RBI *Annual Report*. The RBI Act commits the government to publish the RBI's audited annual financial statement in the *Gazette of India*.[35]

External and internal audit

The external auditors of the central bank are appointed by the government to examine and report on the RBI balance sheet and financial accounts. While other government agencies are audited by the Comptroller and Auditor General of India (CAG), the accounts of the RBI are audited by private accounting firms on a rotating basis. There is no publicly available information on the central bank's arrangements for internal audits, although this information is available upon request from the RBI.[36]

Conduct of officials

The RBI Act has clear provisions on potential conflicts of interest for employees. Bank staff cannot be simultaneously employed by the RBI and private banks, and they must renounce their directorial functions in private banks prior to joining the RBI. The RBI also publishes staff regulations stating that bank employees must not seek or accept outside employment without the Bank's permission, or accept gifts, engage in commercial business, or speculate in securities. Transactions in real estate also require the consent of the Bank. Officials must report the employment of their children by any financial institution the RBI regulates, to ensure the integrity of appointments.[37] The RBI Act also provides protection for the acts of RBI officials carried out in good faith. No suit or legal proceeding can be brought against bank staff who act in good faith to carry out regulations or directions issued by the RBI, even if their actions have caused or are likely to cause damage.[38]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following officials during a visit to India between 14 and 21 November 2003:

Reserve Bank of India, Mumbai

14 November 2003

D. Anjaneyulu	Executive Director & Principal Monetary Policy Advisor	
Mridul Saggar	Director	Monetary Policy Department
O.P. Mall	Director	Monetary Policy Department
Himanshu Joshi	Director	Monetary Policy Department

Ministry of Finance, New Delhi

17 November 2003

M. Prasad	Joint Secretary	Department of Economic Affairs
Anurada Prasad	Director Budgetary Affairs	Department of Economic Affairs

ADDITIONAL INTERVIEWS, NEW DELHI

17 November 2003

Rita Bhagwati	Economist	International Finance Corporation
Neil Gregory	Country Manager	International Finance Corporation

19 November 2003

Michael Wattleworth	Senior Resident Representative	International Monetary Fund
Sudip Mohapatra	Economist	International Monetary Fund
Dilip Mundle	Economist	Asian Development Bank

21 November 2003

Govinder Rao	Director	National Institute of Public Finance Policy

NOTES

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[2] Foreign Exchange Management Act (1999), http://www.indialawinfo.com/; RBI Act, Chapter III, Section 40.
[3] *Mid-Term Review of Monetary and Credit Policy* for the year 2003-04, November 3, 2003.
[4] Interviews in India, 8-14 October 2002.
[5] RBI Act, Chapter II, Sections 8-11; *Report of the Advisory Group on Monetary Transparency*, Sections 2.4, 3.6, 3.7, 3.9; Reddy, Y., 'Parameters of Monetary Policy in India', RBI, 15 January 2002, p. 12.
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[16] Tahir, M., 'Managing Public Debt - Issues and Challenges', p. 5. 2002
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[18] *Mid-Term Review of Monetary and Credit Policy for the year 2001-2002*, RBI, 22 October 2001, Section 12; Interviews in India, 8-14 October 2002.
[19] Reserve Bank of India, *Annual Report,* August 27, 2003.
[20] Reddy, Y., 'Parameters of Monetary Policy in India', p. 7
[21] For more information on the Board and sub-committees, see Reddy, Y., 'Parameters of Monetary Policy in India', p. 6.
[22] *Report of the Advisory Group on Monetary Transparency*, Sections 3.9, 5.2, 5.7; Interviews in India, 8-14 October 2002.
[23] *Report of the Advisory Group*, Section 5.11.
[24] Reddy, Y., 'Parameters of Monetary Policy in India', p. 5; Interviews in India, 8-14 October 2002.
[25] *Annual Report 2001-2002*, RBI, 29 August 2002.
[26] RBI Act, Sections 43, 45/B/C/E/L; 'Seminar on Banking Reforms and Strategies', p. 4
[27] *Annual Report* 2002-2003, RBI, 27 August 2003.
[28] *Mid-Term Review of Monetary and Credit Policy* for the year 2003-04, November 3, 2003.
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[30] 'Statistics', RBI website, http://www.rbi.org.in/
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[32] Interviews in India, 26 September-1 October 2001.
[33] 'Publications and Speeches', RBI website, http://www.rbi.org.in/
[34] Interviews in India, 8-14 October 2002.
[35] Comptroller and Auditor General of India (CAG): http://www.cagindia.org/audit_latest.htm
[36] RBI Act, Chapter IV, Sections 51, 52, 53; Interviews in India, 26 September-1 October 2001.
[37] Interviews in India, 26 September-1 October 2001.
[38] RBI Act, Chapter IV, Section 58-A.

OXFORD ANALYTICA

INDONESIA

MONETARY TRANSPARENCY

Country Report 2003

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INDONESIA

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●	●●●	●●●●
Open decision process	●●●●	●●●●	●●●●
Availability of information	●●●	●●●	●●●
Central bank accountability	●●●	●●●	●●●●
Score	3.25	3.25	3.75

OUTLOOK & COMMENTARY

The replacement of the disgraced and once-convicted Syahril Sabirin by a new, untainted central bank governor has given Bank Indonesia a fresh start. With distractions concerning the previous governor's legal entanglements over, the Bank's staff should be able to focus on improving reporting systems and policy analysis.

Key for the future of monetary transparency in Indonesia will be the outcome of the two battles raging in the legislature over the Central Bank Law amendment and the establishment of the financial services watchdog. The last battle is unlikely to end badly, although it may be delayed still further. The fight over the Central Bank Law, however, could potentially result in institutional change that jeopardises the Bank's independence, as legislators choose to err on the side of accountability at the expense of BI's autonomy. Given the central bank's disastrous experience with corruption, many legislators believe this would not be such a bad outcome.

EXECUTIVE SUMMARY

3.25 Enacted

Two key issues highlighted in last year's report dominated this year's developments in monetary transparency. The first is amending the Central Bank Act to deal with issues of central bank accountability and independence. No amendments have yet been passed, but debate now centres around the creation of a supervisory board which would monitor the activities of Bank Indonesia (BI)'s top officials. BI supports the idea in principle, but fears that the proposal could undermine central bank independence. There has also been little progress in the creation of a Financial Supervisory Authority Institution, which is supposed to take over all bank supervisory functions from the central bank. Legislators, BI, and the government are currently at an impasse debating the timeline for the establishment of the new financial watchdog.

As these two political battles raged on, there were improvements in monetary transparency at the margins. In May, the central bank welcomed a new governor, Burhanuddin Abdullah, marking the first time a BI governor has been elected by the House of Representatives -- instead of handpicked by the president -- since the Bank became independent. The fact that the new governor has a good professional reputation and has never been tainted by corruption (unlike his predecessor) has improved confidence in the Bank among the public and investors.

Finally resolved is the question of whether the government would pay for Bank Indonesia's liquidity support during the financial crisis; the solution will be a significant challenge for the bank's balance sheet. The Bank's Investor Information and Enquiries (IIE) website has expanded, offering the public more detailed information and analysis on fiscal sustainability and the state of the banking system. In addition, plans have been announced to develop a comprehensive framework on the Bank's lender of last resort function by 2004. If followed through successfully, the framework will help the central bank avoid the extraordinary abuses and opaque transactions that have plagued it since the 1997-98 financial crisis.

Indonesia's overall score is unchanged from last year.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The objectives of Indonesia's central bank, Bank Indonesia (BI), are specified in the Central Bank Act (Law 23/1999). Whereas the previous central bank law prescribed multiple objectives for monetary policy, the 1999 law clearly states that the sole objective of monetary policy (and therefore of the central bank) is to pursue and maintain the stability of the value of currency, the rupiah.[1] Some ambiguity remains, however, as this objective can be interpreted as referring to either exchange rate stability (the value of the rupiah in terms of another currency unit) or price stability (the value of goods and services the rupiah can buy).

In practice, Bank Indonesia has chosen the latter, focusing on the maintenance of price stability while letting the rupiah's exchange rate float freely.[2] Under the current monetary policy framework, the central bank uses base money as its operational target, setting up monthly base money targets.[3] In 2003, the Bank continued to focus on price stability, as is clear from the statements of BI Governor Burhanuddin Abdullah.[4] By 2004, the central bank expects to improve transparency of price stability by formally adopting and implementing an inflation-targeting framework. This will unambiguously make the inflation rate the central target of monetary policy.[5] Some observers, however, are highly sceptical that inflation targeting can be implemented by 2004.[6]

Bank Indonesia is also empowered by the Central Bank Act to prescribe and implement monetary policy, regulate and safeguard the functionality of the payments' system, and regulate and supervise banks.[7] The legislation authorises the use of monetary policy instruments, including open-market operations, setting interest rates and minimum reserve requirements.

Under the Central Bank Act, most of BI's supervisory and regulatory responsibilities were supposed to be transferred to a new institution, along with those currently exercised by the Ministry of Finance and the Capital Markets Supervisory Agency (Bapepam). The transfer to the new Financial Services Authority Institution (FSAI), was to take place by the end of 2002, although BI was expected to retain some broad regulatory powers. However, the deadline has not been met, and legislation chartering the FSAI is under intense debate among legislators, the government, and BI.

According to the draft of FSAI legislation submitted by the government to the House of Representatives, the institution is to be a powerful body, funded with fees collected from financial institutions. The board's seven commissioners—six of whom would be appointed by the president and one by the governor of the central bank—would have the power to regulate and supervise financial institutions and to abrogate their licences when deemed appropriate. The most controversial issue is the timetable for establishing the FSAI. The Asian Development Bank, one of Indonesia's top donors, and the Ministry of Finance want to see the FSAI operating by 2006. However, BI believes that setting up an effective institution would require 5 to 10 years.[10] It is not yet clear when the debate over the FSAI timing will be resolved.

Operational autonomy

A key element of Indonesia's monetary policy framework is the independence of the central bank. According to the Central Bank Act—which was based on the act chartering the German Bundesbank—BI is fully autonomous in formulating and implementing monetary policy. External parties are strictly prohibited from interfering with BI's implementation of its tasks. Moreover, BI has the duty to refuse or disregard any attempt of interference in any form by any party. In order to further assure its independence, the Act confers on BI a special position within the civil structure of the Republic of Indonesia.

However, BI's independence has been a source of political conflict since 1999 over issues of accountability. Some legislators argue that a supervisory board should be created to oversee the actions of BI officials and prevent the corrupt practices that have tarnished the Bank's reputation in the past. Critics (including BI's governor) worry that such a board, if not designed properly or if it becomes politicised, could threaten central bank independence.[11] The issue will remain under debate in the legislature, but it is unclear when it will be resolved.

In May 2003, BI Governor Burhanuddin Abdullah was sworn into office for a term of office to run from 2003 to 2008. This marks the first time a governor has been elected by the House of Representatives (instead of handpicked by the president) since BI became independent.

Institutional relationship between monetary and fiscal operations

When necessary, BI engages in consultative co-ordination with the government. Co-ordination between the Bank and government usually takes place in a cabinet session on economic, banking and financial issues, which are related to the duties of the bank. At such occasions, the government may request BI's opinion on a policy matter. In addition, the bank can also provide input to the government regarding the state budget and other policies relating to its duties and responsibilities. Government officials may attend the BI Board of Governors Meetings but have no voting rights.

Lending to government

As set out in the Bank Act Chapter VIII, BI is barred from providing any credit to the government and is no longer involved in financing development or other spending. Information on the amounts and terms of overdrafts to the government, and on deposits of the government with BI, is disclosed on the Bank's website (in English and Indonesian). The same information can be found in the *Indonesian Financial Statistics*, published monthly by BI and released on its website, and in the IMF's monthly *International Financial Statistics (IFS)*.

A comprehensive plan for a sound financial safety net has been developed by the Ministry of Finance and Bank Indonesia. As expected, the plan provides for the creation of a deposit insurance scheme, lender of last resort capability for BI, and a supervisory and regulatory agency for the financial sector. It defines the primary roles of the various authorities in the safety net, and specifies the sequencing of reforms for an orderly phase-out of the blanket guarantee in due course. The government now intends to prepare legislation in line with this plan for submission to Parliament during the second half of 2003; a joint working group to develop operational modalities has also been established.

Central bank involvement in the rest of the economy

Bank Indonesia is authorised by the Central Bank Act to hold equity in any entities only if it is deemed necessary for the implementation of the tasks of the Bank, and such holdings require the permission of the House of Representatives.

BI holds equity in a number of financial institutions, including the *Bahana Pembinaan Usaha Indonesia* and *Indover Bank*. Although BI was legislatively mandated to divest interests in these institutions during 2002, this has not yet been fulfilled. The current status of this divestment is unclear.[13]

Following the implementation of the central bank regulation No. 2/11/PBI/2000 concerning the Bank Status Determination and Transfer of Banks to the Indonesian Bank Restructuring Agency (IBRA, or BPPN in Indonesian) of March 2000, Bank Indonesia can transfer to IBRA banks with a status predetermined as Banks Under Restructuring (BDP) or Frozen Banks (BBO). The transfer of BDP banks by IBRA back to Bank Indonesia's supervision is carried out after the bank is declared sound. A BDP can also be transferred back to Bank Indonesia under unsound status for liquidation in case the bank fails to show improvements within specified period.

Central bank profit allocation

Under Article 62 of the Central Bank Act, 30% of any central bank profits must be placed in the Special Purpose Reserves account, and the rest of the surplus must be accumulated as a General Reserve account so that the total amount of the capital and the General Reserves reaches 10% of all monetary liabilities. The rest of the surplus is distributed to the government and is exempt from any income taxes.[14]

Information on central bank profits, contained in surplus and deficit reports are prepared and distributed internally. This information is gradually being made publicly available through the BI's website. Moreover, the 2002 Annual Report includes detailed information of BI revenues, expenses, assets, liabilities and equities.

Agency roles performed by the central bank on behalf of the government

The Bank's agency roles for the government are stipulated in the Central Bank Act. Chapters VIII and IX cover all the categories stipulated in the IMF Code, including the Bank's role as account holder of the government, manager of foreign exchange and domestic debt, and advisor to the government on economic and financial policies.

All regulations regarding the BI's role in debt management are disseminated via *the Government Gazette*. Legislation and regulations are publicly available in Indonesian. Moreover, during 2003, the Bank's website has improved the availability of legislation and regulations in English.[15]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments, and targets of monetary policy

Framework and monetary targets

Bank Indonesia has focused on the maintenance of price stability while letting the currency float. Under the current monetary policy framework, the central bank uses base money as its operational target and sets base money targets every month. BI also sets the Bank Indonesia Certificate (SBI) rate.

These targets, set at BI's Board meetings, are announced at the beginning of the calendar year, based on macroeconomic conditions. BI's monetary instruments largely consist of weekly auctions of SBIs (with usually one month to three-month maturity), as well as currency sterilisation to absorb excess liquidity in the economy and reduce exchange rate volatility.

Monetary instruments

The Central Bank Act authorises the central bank to set monetary targets by taking into account the determined inflation rate target, relying on instruments such as open market operations, fixing the discount rate, setting minimum reserve requirements, and regulating credit and financing.[16]

The monetary policy-making body

Monetary board

The Central Bank Act specifies the structure, composition, and functions of the Board of Governors. The Board is charged with the formulation and implementation of monetary policy and meets at least once a month. Criteria for the selection of Board members, rules on the conduct of meetings, and rules for voting and decision-making are also stipulated in the legislation.

Advance meeting schedule

The Bank does not publish an advance meeting schedule for Board of Governors' meetings. However, the board traditionally convenes every second week of the month to assess the economic situation and policy objectives, as well as any developments in previous months. The meetings in July, April and October also assess the corresponding previous quarter, while the meeting in January focuses on the previous fiscal year. Summary minutes of the Board's meetings are released on the same day, and are also disclosed in BI's *Monthly, Quarterly* and *Annual Reports*. Full transcripts of the meetings, however, are not released.

Public statements on monetary policy

Periodic publications

Bank Indonesia posts changes to the setting of monetary policy instruments on its press release webpage, its *Monthly Review on Economy, Monetary*[sic]*, and Banking*, and the *Annual Report*. The Bank discloses its monetary policy objectives and policy considerations to the public by publishing summary minutes of BI board meetings. In addition, the results of BI board meetings are also disseminated through press conferences and are included in supplementary and quarterly reports. All of this information is available on the BI's website.

Periodic press statements are released on matters relating to monetary policy. An annual document on policy evaluation summarises monetary policy objectives (including quantitative targets), relevant instruments and underlying assumptions.

The quarterly publication, *Economic, Monetary and Banking Developments* and the *Future Policy Directions* report provide interim evaluations of monetary policy, and are publicly available on the BI's website. These reports examine current economic conditions, exchange rate and inflation, monetary policy, and banking sector policies. Economic forecasts and indications of future policy directions are also set out in these reports. The Bank's *Annual Report* –in its chapter on 'Monetary Developments'– includes similar information without the prospective emphasis, as well as a summary of monetary developments from the previous year.[17]

Public hearings

Under the supervisory function of the House of Representatives, BI is required by law to submit a quarterly progress report on the implementation of its duties and responsibilities. BI officials have regular meetings with key policymakers (at least once every three months) to discuss BI's decisions and the direction of monetary policy. In particular, they meet regularly with the legislature's Commission IX (in charge with financial matters) and with the Co-ordinating Ministry of the Economy. Less regular discussions are held with the legislature, largely depending on the legislators' schedules.

Meetings with the legislature are usually conducted with one party at a time, and BI pays special attention to briefing the research divisions of the top five political parties.[18] Bank officials also meet with journalists and academics to discuss BI's activities. The Bank, however, does not openly call for comments in writing, nor does it publish written evaluations.

Regulations on data reporting by financial institutions to the central bank

The Central Bank Act establishes the BI's right to request data, information and reports from financial institutions. A summary of banking regulation is included in the *Annual Report* as part of the appendices. *Annual Reports* usually have a special chapter on 'Banks and Other Financial Institutions', where policies and information on banking policies, commercial banks and other financial institutions are reported. The BI's website publishes consolidated statements of the banking sector. Banks are normally required to publish their reports once a year, although 'problematic' banks may have this requirement waived by decision of the central bank. Bank Indonesia also publishes data on the analytical accounts of the banking sector, which cover both BI and commercial banks' operations.

After BI issued a 'know your customers' regulation (No. 3/2001) in June 2001, requiring banks to report suspicious transactions, the Indonesian legislature passed anti-money laundering legislation in March 2002. The Anti-Money Laundering Law (No. 15/2002) outlines measures to control attempts to hide illegally amassed funds. Under the new

law, financial institutions must report to the authorities any suspicious transactions involving more than 500 million rupiah.

In September 2003, the House of Representatives amended the law. The revisions widened the definition of money laundering to include the laundering of proceeds from gambling, prostitution, tax, and environmental crimes. The changes also eliminated the 500 million-rupiah threshold for suspicious transactions. In addition, the types of entities subject to financial transaction reporting obligations have been broadened to include entities providing services related to the financial sector, such as the post office services, as well as those providing financial services. The deadline for reporting suspicious transactions has also been reduced from 14 working days to 3 working days.

The new law also provides for the establishment of an independent Anti-Money Laundering Commission, which will be in charge of enforcing the law along with its operations room called the Financial Transaction and Report Analysis Centre. Theoretically, the commission will be free from political intervention, responsible only to the legislature, and vested with the authority to investigate finance companies and persons suspected of being involved in money laundering crimes. Unfortunately, the commission has not been chartered yet and no funds have been allocated for it.

In March 2002, BI issued Regulation No. 4/2/PBI/2002 requiring non-financial institutions to report their foreign exchange transactions with offshore parties to the central bank. Subject to the regulation will be foreign exchange flows by companies with total assets or an annual sales turnover of at least 100 billion rupiah. The new requirements supplement data on foreign exchange flows already furnished by banks and non-bank financial institutions.

3. Public Availability of Information on Monetary Policy

●●● Enacted

Release of central bank data

Indonesia subscribes to the IMF's Special Data Dissemination Standard (SDDS), and the country meets specifications for coverage, periodicity, and timeliness of data related to the analytical accounts of the central bank and the banking sector as a whole.[19] Information on the analytical accounts of the central bank is provided on a weekly basis (four times per month), and no later than two weeks after the end of the reference week.[20] Weekly released data on Indonesia's aggregate open market transactions can be found on the Bank's website, on the Monetary Indicators page. Moreover, Bank Indonesia periodically publishes Monthly Indonesian Financial and Economic Statistics.

An advance release calendar—giving a one-quarter ahead notice of the approximate release dates—and later a week-ahead notification of the precise release dates are disseminated on the IMF's Dissemination Standards Bulletin Board.[21] The advance release calendar is updated monthly.

Information on foreign exchange reserves is available on the BI's website. The bank's website also discloses its claims on deposit money banks, domestic credit to the public sector, domestic credit to the private sector, gross foreign assets, and gross foreign liabilities. The BI's website also publish information on reserve money, currency in circulation, commercial bank's demand deposits at Bank Indonesia, and non-bank private sector demand deposits.

The central bank balance sheet

Bank Indonesia publishes data based on its accounting records on a weekly basis and no later than two weeks after the end of the reference week. The data is released simultaneously to all interested parties through BI's website, subsequently published in the *Weekly Report* and in the monthly bulletin *Indonesian Financial Statistics*. In addition, the central bank publicly discloses its balance sheet as part of the annual financial statement. The annual statements for 1999, 2000, 2001 and 2002 are available on the website. BI also releases information on central bank's monetary operations.

Bank Indonesia is required to submit its annual budget to the legislature and to the Supreme Audit Board (BPK) for auditing. The results are announced to the public through the mass media. Bank Indonesia is also obliged to prepare a weekly balance sheet for publication in the *State Gazette*.

Lender of last resort

Bank Indonesia's role as lender of last resort was exercised during the 1997-98 East Asian financial crisis, when 16 banks were closed, triggering a run on the banking system. To restore confidence, the central bank lent around 144 trillion rupiah (14 billion US dollars) in emergency support to 48 banks, much of it without proper collateral and with little more than bankers' personal promises of repayment. The nature of these loans, made under the BI's emergency bank liquidity programme (BLBI), created serious concerns over transparency that still today haunt Bank Indonesia.

In July 2003, the House of Representatives finally approved an agreement to settle accounts arising from the emergency loans extended in 1997-98. Under the plan, BI will cover up to 24.5 trillion rupiah of the total liquidity extended, while the government will cover the rest by issuing promissory notes to the central bank.[22] The agreement leaves the Bank paying interest on its own certificates but earning no interest on the government's perpetual promissory notes. According to BI Deputy Governor Anwar Nasution, the arrangement "presents a tough challenge in BI's balance sheet."[23]

The Indonesian Bank Restructuring Agency (IBRA) is charged with restructuring and selling assets acquired by the government under the BLBI scheme in 1998. IBRA has its own website, which contains information on the agency's progress in bank and loan re-structuring and reports on its cash revenue status.[24] This information is published on a monthly basis in the IBRA's *Monthly Report*. In addition, the IBRA website contains the agency's annual report, audited financial statements, and the *Economic Review* -- an occasional publication on economic trends affecting IBRA's restructuring work. These documents are all available in Indonesian and English. Independent analysts consider the IBRA website as one of the best maintained and informative of all Indonesian government websites.[25]

The government is currently considering measures that would greatly improve clarity and transparency of BI's lender of last resort function. By next year, the Financial Safety Net (FSN) team, which consists of the BI and Ministry of Finance, will design a policy and framework of lender of last resort. The framework will include legal provisions on all aspects of lender of last resort functions and include rules and technical guidelines.[26] Eventually, the framework will be incorporated as an amendment to the Central Bank Act.

Public information services

According to the Central Bank Act, the bank has to disclose monetary information to the public.[28] Public information services are comprehensive and include such publications as the BI's Annual Report, quarterly publications on economic, monetary and banking developments, and monthly reviews on monetary policy, among others.

In 1998, BI established a Communications Bureau to relay information to the press and other stakeholders, and in 2002, the bureau was to be promoted in the bureaucratic hierarchy and become the Directorate of Public Affairs and Strategic Planning.[30] This change does not appear to have been made yet, as the "public relations team" remains under the Office of the Governor.[31]

The Bank maintains public information services both through its own website and through the IMF site on SDDS. This includes timely access to a variety of publications, including its *Annual Report*. Moreover, the *Monthly Review on the Economy, Monetary Policy, and Banking* provide information on the BI base money, its liquidity credit and support, open market operations, and the country's foreign exchange assets. Interviews with senior officials and progress reports on banking and monetary policy are also posted on the site. While not all documents are available in English, the BI's website has greatly improved and today is one of the most informative and best-maintained Indonesian government websites. Availability of English information has increased during 2003. At the same time, information on BI's website is now being updated on a regular basis.

The BI's Investor Information and Enquiries (IIE) website[32] is designed to provide complete and accurate information about economic, financial, and banking conditions in Indonesia, as well as investment rules, regulations, and other information relevant for supporting investment decisions in Indonesia. The site is also supposed to establish a communication channel with investors and to counter incorrect or negative information about Indonesia. Since 2002, the IIE website has grown and now offers a variety of documents on topics such as fiscal sustainability, financial sector restructuring, and banking regulation.

4. Accountability and Assurances of Integrity by the Central Bank

●●● Enacted

Accountability before a designated public authority

The Central Bank Act requires that Bank Indonesia must always adhere to the principles of accountability and transparency in implementing its duties, authorities and budget. The central bank is committed to strengthen its internal management through good governance. The accountability and transparency demanded from Bank Indonesia are intended to increase all stakeholders' participation in overseeing every policy taken by the Bank.

In accordance with the Act, the BI's Board of Governors must regularly appear before legislative committees to explain the conduct of monetary policy, its objectives, its performance in reaching those objectives, and other general issues involving the state of the economy. The Board also liaises frequently with other governmental bodies, such as the President, the Co-ordinating Minister of the Economy, the Ministry of Finance, and the Ministry of Trade and Industry.

The BI must submit an annual report examining its monetary policy for the previous year, and presenting policies and targets for the coming year to the legislature, the president, and media. The 2002 Annual Report, including an evaluation of Monetary Policies during 2002 and Policy Directions for 2003, was submitted to the parliament in January 2003.[33] Quarterly and requested reports are also submitted to the legislature. The *Annual Report* is also posted on the Bank's website.

The Supreme Audit Board (BPK) audits BI's annual report and discloses its results to the public. The BPK is constitutionally independent from the government, but not financially independent.

As mentioned above, intense debate surrounds the creation of a supervisory committee or audit board that would supervise the activities of the BI's top officials. The government declared its commitment to establish such a board in the March 2003 Letter of Intent to the IMF.[34] Central bank officials support the idea in principle, but worry that the committee could be used to interfere with central bank independence. BI Governor Burhanuddin recently put it this way: "The intention of setting up the [supervisory] board is good, but what happens in Indonesia is that good intentions are usually transformed into something bad by particular vested interests."[35] BI has requested that the plan to set up an audit committee be postponed by at least five years. Debate in the House of Representatives is likely to run at least until next year.

Financial statement

Audited financial statement

The financial statement for 2002 can be found as appendix D.1 of the *Annual Report 2002*. It confirms the Bank's compliance with the Governance Auditing Standard (SAP), determined by the Supreme Audit Agency, but there is no comment on how these standards relate to internationally accepted principles.

External and internal audit

BI is taking steps to strengthen its control and accounting procedures. BI's 2002 annual audit was conducted by its constitutionally appointed auditor. In matters of accountability and budget, the Supreme Audit Agency may conduct special examination of Bank Indonesia at the request of the House of Representatives if deemed necessary.[36]

Internal governance procedures are partially disclosed in the Central Bank Act, but these are also regulated by internal regulations that are not publicly disclosed. The Internal Audit Directorate (DPI) audits all BI's departments and agencies, as well as its representative offices abroad. These are performance as well as financial audits. Data on expenses and revenues for the Bank can be found in the *Annual Report.*

Conduct of officials

The Central Bank Act prohibits members of the Board of Governors from having any direct or indirect interests in any enterprises, from holding any other position concurrently in other entities, except where their tasks require them to hold such position, and from holding membership or a management position in a political party.[37] Article 71 of the Act specifies the penalties to be imposed should a BI official illegally disclose confidential information, while Article 72 authorises the Board of Governors to impose sanctions on employees who fail to perform their obligations.

The BI's Act establishes that employees of the bank are appointed and removed by the Board of Governors. Article 45 of the Act provides legal protections for officials and staff in the conduct of their official duties. This article stipulates that the Governor, Senior Deputy Governor, and any other BI official cannot be punished for decisions taken or policies implemented in accordance with the tasks and authority as prescribed in the Act, as long at these policies are conducted with good faith.

Last year, BI Governor Sabirin Syahril was sentenced by a Jakarta District Court for violating banking principles during the disbursement of Bank Indonesian liquidity support (BLBI) in 1997. Sabirin remained in office until the Supreme Court acquitted him of all charges five months later. The issue of how to deal with convicted officials has not been resolved and has unfortunately become less pressing with the replacement of Sabirin by Burhanuddin Abdullah as BI governor.

Even though he is a career central banker, Governor Burhanuddin has never been implicated in the allegations of corruption that tainted many of his colleagues and predecessor. Meanwhile, a third former BI director was convicted in April 2003 by a district court for his involvement in the BLBI scandal. All three former central bank officials remain free pending appeal.[38]

The State Finance Law passed in April 2003 strengthens existing legislation on standards for public servants. In particular, Article 35 of the bill makes government officials personally responsible state funds under their control. If the new law is enforced, officials will face jail terms for embezzlement and mismanagement, and they will be forced to personally reimburse the state for any misused or embezzled public money. The law makes all civil servants subject to equal punishment for the same fiscal crime, regardless of rank. Although the law does not provide for a clear enforcement mechanism, the implementing regulations and the State Treasury Law, which is still under debate at the DPR, will reportedly address the issue of enforcement.[39]

INTERVIEWS

In 2003, Oxford Analytica did not conduct in-country interviews in Indonesia for security reasons. Written questions were submitted to Bank Indonesia and the Ministry of Finance, but their responses had not been received by the time the report was finalised. Representatives of Oxford Analytica interviewed the following individuals during a visit to Dubai (2003 Meeting of the Boards of Governors of the World Bank Group and the International Monetary Fund) in September 2003:

Bank Indonesia

20 September 2003

Hartadi Sarwono	Deputy Governor	
Halim Alamsyah	Director	Research Department

IN ADDITION, WE HAD A CONFERENCE CALL ON 4 DECEMBER 2003 WITH:

Dr. William Wallace	Consultant	Ministry of Finance

NOTES

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[28] Article 58, Central Bank Act.
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[37] Article 47, Central Bank Act.
[38] "Third former BI director convicted", *The Jakarta Post*, 5 April 2003.
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OXFORD ANALYTICA

ISRAEL

MONETARY TRANSPARENCY

Country Report 2003

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ISRAEL

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●●	●●●●	●●●●
Open decision process	●●●	●●●	●●●
Availability of information	●●●●	●●●●	●●●●
Accountability	●●●●	●●●●	●●●●
Score	3.75	3.75	3.75

OUTLOOK & COMMENTARY

Amending the Central Bank Law remains the most important potential legislative change in the coming 12 months. It is thought that appointment of a new central bank governor, due in late 2004, could provide an opportunity for an initiative to revise the Central Bank Law.

In May 2004, the OECD will conclude discussions on inviting new members to the organisation. There is a high probability that Israel will be invited to join. If Israel decides to accept the invitation, the results for monetary transparency will be very positive. In addition to inclusion in comparative OECD-wide studies, Israel will second key research staff to the organisation and benefit from cross-fertilisation in this area. A host of legislative and regulatory changes, many of them directly positive for transparency, will also be required of Israel, albeit on a gradual timetable.

The tension between Bank of Israel and the Ministry of Finance looks set to continue in the near future at least.

EXECUTIVE SUMMARY

3.75 Compliance in progress

The Bank of Israel (BoI) is regarded as a credible and professional organisation and meets most of the IMF's Code of Good Practices on Transparency in Monetary Policy. Israel has a sound legal framework and the Bank adequately discloses monetary policy data. The central bank has high standards in terms of quality of research and operations.

This past year the government has resuscitated the Monetary Policy Advisory Committee, a government-appointed committee comprised of leaders in the business and academic communities, to discuss policy on a regular basis. Although the committee has no power to decide policy, its deliberations can be expected to increase the transparency of the governor's decision-making process.

In October of this year, the Bank of Israel joined the Bank for International Settlements (BIS), arising from the first such invitation issued by the organisation in more than a decade. It recognises Israel's maturation in the financial and central banking spheres. Israel's monetary transparency should benefit from BIS membership, both from the opportunity to participate in BIS research studies and from the direct participation of Bank of Israel staff at the BIS on secondment.

The Bank from 2003 has more comprehensive forecasts of inflation and other macroeconomic variables, including 'fan chart' projections of inflation.

The national budget for 2004 was not a co-production of the Bank of Israel and the Ministry of Finance (MoF), due to continued tension between the BoI and the MoF.

Improvements are still needed in the publication of the transcript of question-and-answer sessions following the central bank governor's addresses to the Knesset (Israel's legislative body). The transcript is available in the minutes of the Knesset Finance Committee session, archived at the Knesset library, and only in Hebrew. Additionally, only those discussion papers written originally in English appear in English. Hebrew-language discussion papers are not at present translated.

Israel's overall has remained at 3.75.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The Bank of Israel Law ("the Law") sets out the functions and responsibilities of the Bank of Israel (BoI). The Law places special emphasis on the independence of the Bank.

Israel maintains a flexible exchange rate regime. The central bank does not intervene in the foreign exchange market except for very minor 'smoothing' operations typical of all free-floating currency regimes. The authorities' determination to let the currency depreciate in the face of macroeconomic shocks was demonstrated in mid-December 2001, when the shekel fell nearly 20% in nominal terms. True to its mandate to deliver price stability, and given the impact of the dollar-denominated housing price index on the consumer price index and the high pass-through of exchange-rate changes to domestic prices, the central bank, rather than accommodate the shock, tightened interest rates markedly.

The shekel appreciated 6% between 1 January and 29 October 2003. The appreciation stems in part from the large and positive interest rate differential between Israel and world interest rates, and has pushed inflation close to zero (in 'core' terms) or below zero (in 'broad' terms, which includes house prices). Bank of Israel governor David Klein has accordingly come under intense criticism for keeping policy too tight. Partly as a result, the government has resuscitated the Monetary Policy Advisory Committee, a government-appointed committee comprised of leaders in the business and academic communities, to discuss policy on a regular basis. Although the committee has no power to decide policy, its deliberations – expected to be published ex-post – can be expected to increase the transparency of the governor's decision-making process.

The BoI's resuscitated Advisory Committee and Advisory Council are viewed as rubber-stamp authorities for the BoI's monetary policies. They consist principally of representatives from major economic sectors and the banking community, who advise the BoI and the governor on economic and monetary policy. The monetary policy was directed at achieving the inflation target. Inflation has at times been above the target, while at other times below it.

Operational autonomy

Since the 1980s, when reforms to address the crisis of hyperinflation won the central bank its independence, Bank governors have consistently demonstrated the BoI's operational autonomy from government policy through their control of inflation to levels that are well below government-set targets. Specific events in 2002 likely contributed to the conservative bias in monetary policy in 2003. First, the governor and the finance minister in 2002 agreed that the former would reduce interest rates in return for the government reducing its deficit. In the event, the governor cut rates but the government was unable to reduce the deficit. The government then attempted (but failed) to change the BoI Law in a way that would have effectively turned the Bank into a department of the Ministry of Finance.

Part IV of the BoI Law stipulates the procedures for appointments, terms of office, and the criteria for removing the heads and members of the central bank's governing body.

Institutional relationship between monetary and fiscal operations

The Bank operates in the primary and secondary markets for government securities. The lending rate for required reserves at the central bank (the 'auction rate') is the primary tool of monetary policy. Open market operations are conducted in government securities for minor liquidity adjustment.

Monetary and fiscal operations are normally co-ordinated through formal and informal meetings between the governor, the minister of finance, and other senior staff from the BoI and the Ministry. After a difficult year in 2002, when such meetings virtually came to a halt, the ministries have increased discussions in 2003. For example, the MoF cooperated fully with the Bank's request for data to feed its macroeconomic model of fiscal policy. However, this is at management level; the rift between the Finance Minister and central bank governor remained wide.

Lending to government

According to the Law, the Bank must not provide loans to finance government expenditure.[1] However, the Bank is permitted to finance limited cash shortfalls, lend to finance excess expenditures in foreign currency, and provide loans for the repayments of government debt to the Bank. The Bank's monthly balance sheets disclose the amounts of credits, advances, or overdrafts to the government.[2]

Central bank involvement in the rest of the economy

The Bank is not involved in equity ownership, membership on governing boards, procurement or provision of other services for a fee.

Central bank profit allocation

In accordance with the BoI Law, the Bank must transfer its net profits to the government within 60 days from the expiration of each fiscal year. Since 1991, the Bank and the Ministry of Finance have agreed to register part of these profits, known as 'realised real profits', as current income in the government budget.

Agency roles performed by the central bank on behalf of the government

The Law clearly defines the role of the Bank as sole fiscal agent and banker to the government.[3] Normally, the Bank plays an important consultative role in setting the government's budget and in suggesting areas for new economic and regulatory legislation.

The Bank acts as the manager of foreign exchange reserves. The Ministry of Finance manages the public debt, accounts of which are published by the Bank. The Bank is responsible for arranging auctions through which tradable government bonds are sold to the public, issuing non-traded bonds for pension funds and insurance companies for the government.

The Financial Action Task Force (FATF) has noted that Israel has made significant progress in dealing with money laundering practices over the last year. In June 2002, Israel was removed from the list of non-cooperative countries and territories (countries defined as 'having critical deficiencies in their anti-money laundering systems or a demonstrated unwillingness to co-operate in anti-money laundering efforts').[4]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●● Enacted

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The inflation target is the main objective of the monetary policy framework.[5] The Bank's *Inflation Report* details explanations of the interest rate and the monetary instruments used to achieve the inflation target. The report often contains models that help to explain how monetary-policy instruments affect inflation.[6]

A major problem for outside analysts, however, is that the governor has never indicated the weighting he gives to each of the in-house models or to each of the various economic indices at his disposal when making his decision on interest rates. As a result, it can be difficult to predict the Bank's behaviour.

The Bank from 2003 has more comprehensive forecasts of inflation and other macroeconomic variables, including 'fan chart' projections of inflation. New for 2003, the projections are for the coming 12-month period, rather than for the calendar year. The Bank in 2003 also provided, for the first time, a detailed explanation, in English and Hebrew, of the methodology behind its inflation projections. There is no explicit weighting given to any one indicator of inflationary pressure. [7]

Monetary instruments

The BoI Law details all monetary policy instruments.[8] The interest rate on the BoI's lending and auctions for deposits from banks serve as important instruments. The Bank's major monetary policy tool in recent years was deposit auctions conducted with the commercial banks. However, in 2002 the Bank embarked on a programme to increase the use of the monetary auctioning tradable paper, which is known as *makam*, after the limit on *makam* was eliminated in December 2001.[9]

The monetary policy-making body

Monetary board

The Monetary Policy Forum, headed by the governor, is an informal policymaking body responsible for monetary policy decisions. The Forum advises the governor on monthly monetary plan decisions and consists of directors and senior staff from the Research Department, the Monetary Department and the Foreign Exchange Activity Department.[10]

However, monetary policy decisions still appear to be made by the governor alone. Although the governor presents monthly interest rate recommendations to the advisory committee, the committee's deliberations are not publicly disclosed. Thus, the committee continues to be viewed as a rubber stamp for the governor's decisions. The governor also controls all public reporting, giving the appearance of BoI unanimity for all decisions. Differences of opinion and internal disputes only emerge once a senior official resigns and voices such differences to the media.

Amending the Central Bank Law remains the most important possible legislative change in the coming 12 months. The Bank is on record as supporting the recommendations of the 1996 Levin Commission on revising the Central Bank Law. A main provision of the recommendations is the creation of a board of governors to vote on monetary policy, replacing the unilateral authority of the single governor as presently arranged. Such a change would have a positive bearing on transparency. It would diversify the range of opinions present in the Bank, and widen the scope of research undertaken by bank staff. It would presumably force more clear explanations in defence of policy decisions. It is thought that appointment of a new central bank governor, due in late 2004, could provide an opportunity for an initiative to revise the Central Bank Law.

Advance meeting schedule

Following the monthly meetings of the Monetary Policy Forum, monetary policy decisions, focusing particularly on the interest rate for the month ahead, are published on a pre-announced schedule by press release.[11] The Bank does not publicly disclose advance meeting schedules for the Forum's monthly meetings.

Public statements on monetary policy

Periodic publications

By law, the BoI must publish certain reports that make it accountable for its actions. The Bank must publish a weekly report in the official gazette, *Reshumot*, showing amounts of currency in circulation and details of assets as cover for liabilities. The BoI Law also specifies the various reports that need to be prepared: the governor must submit an *Annual Report*, including a balance sheet, to the government and the Finance Committee of the Knesset; the governor must also present a monthly report to the government containing discussions and resolutions of the BoI's advisory committee and advisory council.[12]

Changes to the setting of monetary policy instruments have mainly involved the replacement of administrative instruments by market-oriented ones. The governor must consult the advisory committee on proposed changes in monetary policy instruments. These are announced immediately after a decision is made and disclosed in the *Annual Report*, the *Inflation Report* and on the BoI's website. The Bank publishes a bi-annual *Inflation Report* that examines monetary developments and the policies needed to achieve the inflation target. At any time when the money supply increases by 15% or more, the BoI is required to send a special report to the government.

The Bank failed to publish its *Annual Report* for 2001 as a result of an internal dispute between the governor and worker's committee. The discrepancy was remedied in 2002.[13] The *Annual Report* for 2002 was published on time, but as a series of assessments, rather than as a single document. The report contains important data from fiscal 2000 that is necessary for comparative purposes.

In addition, for the first time in decades, in 2002 the BoI and the Ministry of Finance (MoF) did not jointly produce a *National Budget*, the primary macroeconomic prediction document for the forthcoming year. The main dispute between the two bodies centred on whether the growth projection should be point-specific, as demanded by the MoF, or a range, as demanded by the BoI.[14] The national budget for 2004 was not a co-production of the Bank of Israel and the MoF either. As in 2002, each will produce separate reports. This was not seen as a concern either by the Bank or the MoF during interviews. Both the MoF and the BoI continue to publish official macroeconomic predictions.[15]

The Bank has created a multi-year budget, based on budget trends and actual legislation, and published it for the first time in the 2002 *Annual Report*. It was updated in March 2003 to reflect the passage of more than 200 new

measures. It is currently being updated to reflect the 2004 national budget. The Bank's multi-year budget study is a 70-page report listing each separate budgetary component and each assumption that goes into it.

There is some dispute among economists at the BoI and elsewhere as to whether it is logical for the central bank to produce inflation predictions, one or two years ahead, that are different from the target. The monetary department claims that if the initial prediction varies from the target, it means that the policy should be changed in such a way that the revised prediction will coincide with the target.[16]

Increasingly, the governor has used speeches and press releases as his preferred means of communicating with the public. This further centralises the governor's control over the flow of information from the Bank and circumvents the requirement that he hold an ongoing dialogue with the Finance Ministry.

Regulations on data reporting by financial institutions to the central bank

In accordance with the BoI Law, financial institutions must report to the BoI on their assets, liabilities and capital.[17] On the request of the governor, each bank must also submit a report on its liquid assets, which is done on a daily, weekly and monthly basis.

In 2003, the Bank began surveying banking sector participants on their attitude about future conditions, using the results to inform policy decisions. The results of these surveys might be made public in future, akin to the US Federal Reserve's '*Beige Book*' survey.[18]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

Israel is a subscriber to the IMF Special Data Dissemination Standard (SDDS), and meets its specifications for the coverage, periodicity, and timeliness of financial sector data.[19]

The central bank balance sheet

The Bank publishes monthly balance sheets with a lag of two to three weeks from the end of each reporting calendar month.[20] Annual balance sheets, including a profit and loss account, must be submitted to the government and the finance committee of the Knesset within five months from the end of the Bank's business year. These are posted on the Bank's website and are available in the *Annual Report*. Balance sheets are prepared according to Israeli accounting standards.[21]

The BoI provides details of aggregate market transactions through its written reports to the legislature. Loans or deposits to commercial banks are undertaken through an auction process.[22] The Bank publishes information on this process in the monthly monetary plan for the next period.

Lender of last resort

There are no regulations or policies that govern the Bank's role as lender of last resort. The Bank supervises major credit institutions.

Public information services

The BoI has a special unit that provides comprehensive information to the public and media on a regular basis. It is, however, totally subservient to the governor. Bank press releases are invariably designed to highlight only those points that the Bank wishes the public to recognise. Dissenting interpretations of the data are never included in the summaries.

The BoI has begun a process to enhance the public's understanding of the inflation process by presenting different economic scenarios. However, the process is far from complete. The issue of presenting different economic scenarios based on differences in growth predictions lay at the heart of the dispute between the BoI and the MoF that led to the failure to produce a joint *National Budget*.[23]

Public information notices are now posted on the Bank website in real time. Only some of these are translated into English, on a discretionary basis.

Improvements to transparency via the Bank's web site include the cataloguing of 400 publications, searchable by name, topic, author and other parameters. The Hebrew and English versions of this database should be accessible on the website as of end 2003. Directives and legislation on money laundering in 2003 were posted on the website, with

English translations. This includes Supervision of Banks legislation (in English) with the order on money laundering. 2003 also saw faster translation of *Recent Economic Developments* reports, which previously were translated and posted with a six-month lag. In 2003, the Shekel exchange value time-series, dating from Independence in 1948, was made available on the website. A further 100 time series data items will be available in an interactive format on the website in December 2003. A website search engine is in 'beta testing' mode and will soon be made available on the public site. In 2003, the email addresses of all senior management were posted on the website.[24]

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

The Knesset's Finance Committee summons the governor to discuss any matters related to the activities of the Bank. This normally occurs three or four times a year. In particular, these meetings are held following the publication of the BoI's *Annual Report* or interim assessments of inflation for the current year that indicate significant changes in trends. The governor often authorises the appearance of other officials before this committee and other institutional bodies.

Financial statement

Audited financial statement

The annual audited financial statement of the Bank is disclosed two months after the end of the financial period. An independent, private sector auditor audits the financial statement. Significantly, detailed information on the expenses and revenues of the Bank are not publicly disclosed.[25]

It is unclear as yet how the recent decision to force all Israeli companies to adopt nominal accounting by 2004 will affect the central bank; and whether old reports will be updated to accommodate the new form of data reporting.

External and internal audit

While internal governance procedures are not publicly disclosed, and therefore are not part of the media debate on the Bank's operations, the state comptroller does have access to the Bank's internal audit reports and can publish its own reports, subject to secrecy constraints.[26]

Conduct of officials

Rules that regulate the conduct of officials are based on the BoI Law and other documentation.[27] In particular, the rules specify how Bank employees should deal with issues such as secrecy and work processes. Legal protection exists for all BoI officials and is covered by the legal code used for all public employees.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following officials during a visit to Israel between 27 and 29 October 2003:

Bank of Israel

28 October 2003

David Elkayam	Chief Economist, Monetary Department
Sigal Ribon	Research Department
Adi Brender	Senior Economist, Head of Public Sector Analysis, Research Department
Avner Halevi	Head of International Affairs Department

29 October 2003

Moshe Bar-Natan	Head of Internet Information Unit

Ministry of Finance

27 October 2003

Israel Kaplan	Senior Director, International Department

Central Bureau of Statistics

28 October 2003

Soli Peleg	Senior Director, Macro Economics Department
Aharon Blekh	Deputy Senior Director

NOTES

[1] Bank of Israel Law, 5714-1954 in Israel's Banking Legislation, July 1996, Article 45(a)
[2] See Bank of Israel website under 'Information and Data' at www.bankisrael.gov.il
[3] Bank of Israel Law, 5714-1954 in Israel's Banking Legislation, July 1996, Article 57(a)
[4] http://www.fatf-gafi.org/NCCT_en.htm
[5] 'About the Bank of Israel', Bank of Israel website at www.bankisrael.gov.il. See also IMF, 'Code of Practices on Transparency in Monetary and Financial Policies – Follow-up Questions for Israel FSAP', July 2000, p. 27.
[6] http://www.bankisrael.gov.il/publeng/publeng_pb.htm
[7] Interviews in Jerusalem, 27-29 October 2003.
[8] Bank of Israel Law, 5714-1954 in Israel's Banking Legislation, July 1996, Parts 8-10.
[9] Interviews in Jerusalem, 11-13 November 2002.
[10] IMF, 'Code of Practices on Transparency in Monetary and Financial Policies – Follow-up Questions for Israel FSAP,' July 2000, p. 29.
[11] See the 'Press Releases' page on the Bank of Israel website at www.bankisrael.gov.il
[12] Bank of Israel Law, 5714-1954 in Israel's Banking Legislation, July 1996, Article 24
[13] Interviews in Jerusalem, 27-30 October 2001.
[14] Interviews in Jerusalem, 11-13 November 2002.
[15] Interviews in Jerusalem, 27-29 October 2003.
[16] Interviews in Jerusalem, 27-29 October 2003.
[17] Bank of Israel Law, 5714-1954 in Israel's Banking Legislation, July 1996, Article 56(a)
[18] Interviews in Jerusalem, 27-29 October 2003.
[19] See the IMF's SDDS website at http://dsbb.imf.org for the country site of Israel.
[20] Bank of Israel Law, 5714-1954 in Israel's Banking Legislation, July 1996, Article 58. These are published in *Reshumot*, the government gazette and are posted on the Bank of Israel website under Bank of Israel Annual Financial statements and end of month balance sheets (monthly update) at www.bankisrael.gov.il
[21] IMF, 'Code of Practices on Transparency in Monetary and Financial Policies – Follow-up Questions for Israel FSAP,' July 2000, p. 40
[22] See 'Monetary Department Auctions' at www.bankisrael.gov.il
[23] Interviews in Jerusalem, 11-13 November 2002.
[24] Interviews in Jerusalem, 27-29 October 2003.
[25] IMF, 'Israel: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency; Banking Supervision, Securities Supervision; and Payment Systems,' 10 August 2001.
[26] IMF, 'Code of Practices on Transparency in Monetary and Financial Policies – Follow-up Questions for Israel FSAP,' July 2000, p. 50. See also the Basic Law on the State Comptroller at www.israel-mfa.gov.il.
[27] 'Re: code of conduct for central bank employees in Israel', Bank of Israel Human Resources and Administration, 11 June 2001, p. 1

OXFORD ANALYTICA

JORDAN

MONETARY TRANSPARENCY

Country Report 2003

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JORDAN

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●	●●●	●●●
Open decision process	●●	●●	●●
Availability of information	●●●	●●●	●●●
Accountability	●●●	●●●	●●●●
Score	2.75	2.75	3.00

OUTLOOK & COMMENTARY

Improvements are underway that contribute to monetary transparency in Jordan. The Central Bank of Jordan (CBJ) is implementing a number of changes in order to comply with the IMF's Special Data Dissemination Standard. It plans, for example, to establish a new unit for balance-of-payments compilation in the near future. It is also improving the regulation and supervision of the banking system. The CBJ also plans to start publishing its statistics according to the fifth edition of the Balance of Payments Manual (BPM5) and the international reserve template by March 2004.

Jordan would particularly benefit from increasing the transparency of its monetary policy-making process, and from strengthening its provisions for public accountability. The publication of advance release calendars would also improve transparency. However, there is no indication that these improvements will be made in the near future.

EXECUTIVE SUMMARY

2.75 Enacted

Jordan has made further progress towards adopting the IMF standards on good practices for monetary transparency. The Central Bank of Jordan (CBJ) continues to consolidate its independence and its reputation for effective monetary management. Meanwhile, improvements have been made to the framework for economic and monetary data, helped by changes in the Department of Statistics. A new Statistics Division was established in late 2002 and began working actively in 2003 in accordance with recommendations in the IMF Report on the Observance of Standards and Codes (IMF Government Financial Statistics 2001). The CBJ is still aiming to meet the requirements of the IMF's Special Data Dissemination Standard within the next two to three years, and is currently implementing the recommendations made in the recent IMF ROSC, Data Module report as part of this process.

There is still a lack of transparency in the process for formulating monetary policy and its framework and targets. Although transparency of monetary policy has been boosted by the regular disclosure of communications to the IMF, public scrutiny of monetary policy remains weak, as do provisions for public accountability.

The Bank has established a new balance of payments department and it plans to create a new unit for balance-of-payments compilation in the near future. The Electronic Payment System has now been fully implemented.

Jordan's overall score is unchanged from last year.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The Central Bank of Jordan (CBJ) remains the central institution for monetary policy and management in Jordan. The CBJ was established in 1964 by Special Decree and is subject to the Jordanian Central Bank Law No. 23 of 1971.[1] This law states that the CBJ is "the government bank and its financial agent". The Bank is the principal monetary authority in Jordan and is legally independent. Its stipulated objectives are the maintenance of monetary stability and convertibility of the Jordanian dinar, and the promotion of economic growth in accordance with general government economic policy.[2]

The CBJ has continued to rely on open market operations to provide the market with the appropriate level of liquidity. It has aimed to preserve monetary stability -- entailing a low inflation rate, a stable exchange rate and an appropriate interest rate structure. The CBJ is making efforts to enhance the efficiency and competitiveness of the banking system in accordance with international accounting standards. The Electronic Payments System has now been fully implemented.[3]

There is currently a dispute between the Bank and the Taxation Department on the issue of taxation on bad loans. It is not clear if the CBJ or the Taxation Department takes precedence.

Operational autonomy

The Bank continues to consolidate its independence and reputation for effective monetary management. The renewal in 2002 of a standby agreement with the IMF provided additional support for efforts to strengthen the Bank's autonomy. This has been complemented by the apparent commitment of King Abdullah to increase cabinet and civil service efficiency and to improve overall economic management in Jordan.

Nonetheless, in accordance with the Central Bank Law, exchange rate policy remains the prerogative of the cabinet, which continues to set the exchange rate for the Jordanian dinar against the gold price or Special Drawing Rights after consultation with the CBJ.[4] In effect the dinar has been pegged to the US dollar since 1995, though this has not led to severe overvaluation problems.

The King appoints the governor of the central bank. The Central Bank Law stipulates that the board of the Bank is accountable for the Bank's operations and for the conduct of monetary policy. Legislation related to the Bank does not specify whether the government has the authority to override Bank policy decisions. However, this is now of less concern than in the past, when uncontrolled government borrowing was a problem for the Bank. In addition, a sense of respect for the Bank's independence, and the meaningfulness of its independence, appears to be growing.[5]

Institutional relationship between monetary and fiscal operations

Lending to government

In July 2001, in addition to the release of a new public debt law, a 'memorandum of understanding' was signed between the CBJ and the Ministry of Finance to clarify the institutional relationship between monetary and fiscal operations. These measures effectively supersede the provision of the 1971 Central Bank Law, which allowed the Bank to grant the government interest-free loans to cover temporary revenue shortfalls, provided that such loans did not exceed 20% of budgeted local revenues.[6] As of the end 2003, the Central Bank Law had not yet been updated to reflect this change. The new debt law and the memorandum of understanding, however, are important steps in separating monetary and fiscal operations. Furthermore, in 2002 the CBJ and the Ministry of Finance began to receive technical assistance to improve fiscal and monetary separation in day-to-day operations.[7]

Central bank involvement in the rest of the economy

The government expects to reduce its borrowing in domestic and external capital markets to less than 60% of GDP by 2006, and at the same time to reduce total borrowing to less than 80% of GDP. Other than this, the CBJ's participation elsewhere in the economy consists of membership of the boards of the Jordan Loan Guarantee Corporation, the Jordan Mortgage Refinance Corporation, Royal Jordanian Airlines, the Jordan Phosphate Mines Company, and the Deposit Insurance Corporation. The governor is also a member of the Economic Consultative Council, though his participation in this is not specific to monetary issues.[8] The CBJ is also involved in the enhancement of the investment climate through monetary stability; measures to stimulate the capital market; and measures to encourage companies to issue bonds

Central bank profit allocation

Provisions covering profits and losses by the Bank remain unchanged. The Bank retains 20% of any net profits, with the remainder being paid to the government after any deductions necessary to repay government debts to the central bank.[9]

Agency roles performed by the central bank on behalf of the government

The CBJ acts as a banker and fiscal agent to the government and public institutions, fulfilling the normal roles of a central bank, from managing the supply of banknotes and coins to regulating the quantity, quality and cost of credit, and maintaining the national gold and foreign exchange reserves. It maintains the revenue and expenditure accounts of government and public institutions, makes transfers, opens letters of credit, manages and implements loan and trade agreements, and extends credit to the treasury.

The CBJ manages the domestic and external public debt and acts as a banker to licensed banks, specialised credit institutions and public institutions in Jordan.[10] It is also responsible for supervising licensed banks to ensure financial soundness and to protect the rights of depositors and shareholders. This is in accordance with the Banks Law of 2000, the earlier Basel Accord and general international banking supervision standards.[11]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●● Intent declared

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The Bank does not declare a specific monetary policy framework or targets, nor are these specified in the Central Bank Law. However, for some years now the main aim of monetary policy has effectively been to maintain the stability of the Jordanian dinar against the US dollar. The Bank recently rejected a recommendation from the IMF to consider abandoning the use of the exchange rate peg. In the current climate of regional political and economic uncertainty, it is unlikely to attempt to float its currency.

Monetary instruments

The Bank remains conservative on its interest rate policy, setting rates to track the US Federal Reserve rate with a steady premium. The Bank's overnight deposit rate is the base rate for interbank rates. It also publishes separate repo and discount rates.[12]

Probably the most important monetary instrument are Certificates of Deposit (CDs).

The Bank describes as part of its general role in Jordan's economic development the creation of monetary and financial institutions that are capable of mobilising savings for development projects.

The monetary policy-making body

Monetary board

The Board of the CBJ is the Bank's permanent monetary policy-making body, as well as the body responsible for managing the Bank's general affairs. The governor is responsible for the implementation of the Bank's policies and represents the Bank in all its relations with other parties.[13] The board's official responsibilities include: determination of overall CBJ policies; setting up Bank regulations; appointment of consultants for fixed terms and on conditions decided by the Board; and approval of the annual balance sheets and profit/loss reports for the Bank. The Board receives a monthly internal report on the Bank's monetary position and operations.[14]

The composition of the board and the terms of appointment of its members are specified by law. It is made up of the governor, two deputy governors, and five further members. The cabinet appoints the governor and deputy governors for a five-year term, which can be renewed by royal approval. The cabinet also appoints members for a three-year term, which can be renewed. Licensed banks and specialised credit institutions are represented together by no more than one member each.[15]

The cabinet sets the salary and benefits of the governor and deputy governors. Criteria for removal from office of heads or members of the board are specified in the Central Bank Law.[16]

Advance meeting schedule

Meetings of the board are called by the governor and must be held at least once a month.[17]

Public statements on monetary policy

Periodic publications

Increased disclosure of Jordan's Article IV Consultations with the IMF, and its letters of intent and memorandums of economic and financial policy submitted to the IMF, have boosted the transparency of monetary policy in recent years. Domestically, the governor communicates monetary policy through mandatory appearances before a parliamentary financial committee, in public statements and speeches, and via the CBJ's press releases and publications, such as its *Monthly Statistical Bulletin.*

Public hearings

The governor is legally required to ensure that the Bank communicates its policies and measures to the public, although no schedule is stipulated for this. As of 2003, no advance release calendars were yet being disseminated.[18] The governor does include information on policy and planned future steps when he gives public lectures.

There is still a lack of formalised requirements for public scrutiny of rationale, quantitative targets, instruments or underlying assumptions used for setting monetary policy objectives. Major changes in the methodology for monetary data gathering are reported in the Bank's publications after implementation.[19] However, there is no formal requirement for public consultations for substantive technical changes to the structure of monetary regulations.

Regulations on data reporting by financial institutions to the central bank

Financial institutions are required by law to provide data on their operations to the CBJ, when and as stipulated by the Bank.[20] Such institutions are required to publish their financial statements and audit reports in two national daily newspapers within six months of the end of the fiscal year. A new exchange commission law has now strengthened the capacity of the Jordan Securities Board to enforce reporting requirements and penalties if they are not met. Standards of reporting by banks have improved.

A recent scandal has brought the subject of banking supervision under public scrutiny. In 2002, reports emerged that senior officials in Jordan's General Intelligence Department (GID) had corruptly borrowed around 70 million Jordanian dinars (JD) in loans from a number of Jordanian banks. The CBJ took a strong line on the case, stating publicly that it would not bail out the banks involved, and stressing that this would impose no risk to the overall banking system. The case was concluded in September 2003. Questions have been asked about whether the CBJ could have acted sooner. It has also been suggested that the Bank's failure to spot what was happening at the GID is symptomatic of a weakness in its banking supervision, which is seen to focus excessively on micro-details at the expense of seeing the 'larger picture'.[21]

The Law on Economic Crime has been amended to make penalties more severe but at the same time making it possible to settle cases more quickly. One particular amendment offers criminals who settle before the case and return the money defrauded, complete exoneration in exchange. The law was passed as a temporary law, in order to deal with the GID case. Some of the defendants took advantage of its provisions, and an estimated JD 40 million of the JD 70 million outstanding has now been recovered. Although this regulation perhaps goes too far, the amendment is temporary and it is doubtful that it will be ratified.[22]

Improvements are certainly needed in Jordan's financial regulatory and supervisory legal framework, but new measures have been introduced, such as a law to combat money laundering passed in 2001. The CBJ appears to have handled the case of the GID loans scandal better than it might have done in the past, and in a manner consistent with its supervisory role.

The CBJ has introduced a number of measures to improve regulation and supervision of the banking system. The Bank is implementing measures to broaden ownership in the banking system, and reporting requirements are being strengthened to provide more timely and systematic information on the banking system.[23]

The CBJ is imposing a Minimum Capital Requirement of JD 40 million for commercial banks by the end of 2007. The time frame in which it is to be introduced ensures it will not cause a shock to the markets.

3. Public Availability of Information on Monetary Policy

●●● Enacted

Release of central bank data

Jordan continues to produce and disseminate data and information in accordance with the IMF's General Data Dissemination System (GDDS) and is aiming to meet the requirements of the Special Data Dissemination Standard (SDDS). The Bank has signed a letter of intent with the IMF on SDDS and, along with other ministries, it aims to improve dissemination practices in line with the standard. There is no specific schedule for meeting the SDDS but following a favourable IMF Report on the Observance of Standards and Codes (ROSC) in 2002, the Bank is aware of the areas in which improvements are needed.[24] Improvements are particularly needed in the areas of data coverage for central government operations and balance of payments, especially for investment income and financial accounts, and the producer price index.[25] The Bank is receiving technical assistance in the area of balance of payments. The CBJ has established a new separate balance of payments department, and is to create a new unit for balance-of-payments compilation. The CBJ also plans to start publishing its statistics according to the fifth edition of the Balance of Payments Manual (BPM5) and the international reserve template by March 2004.[26]

The reserve template is due by April 2004, but this target will not be met. An expert is however assisting with the calculation of the investment fund position and the reserve template.[27]

Meanwhile, improvements have been made to the framework for economic and monetary data, helped by changes in the Department of Statistics. The Department has now completed the introduction of a 'Central Product Classification' system and is using standard international product classifications.[28] The Bank itself is independent in determining its data compilation methodology and dissemination practices, but co-ordinates with the Department of Statistics and the Ministry of Finance on data issues. Data submitted by banks and other financial institutions are confidential and are managed in accordance with IMF guidelines.

Independent data users consider that the quality of the Bank's data and publications has continued to improve. However, while monetary and banking data in the Bank's *Monthly Statistical Bulletin* are usually up to date, in some areas such as price indices the *Bulletin* shows only preliminary data for the eighteen months up to the *Bulletin*'s reference date. The basis of some data or estimates is also sometimes doubtful.

The central bank balance sheet

The Bank publishes its balance sheet and details of its aggregate market transactions in the *Monthly Statistical Bulletin*. The balance sheet shows the breakdown of foreign and domestic assets, including the make-up of claims on central government, public entities, banks, other financial institutions and the private sector. Liabilities are shown broken up by deposit type (bank, demand, quasi-monetary, central government), and as foreign liabilities, capital, reserves and allowances, and unclassified liabilities.[29]

Lender of last resort

The CBJ remains the lender of last resort. However, it appears less willing to extend emergency financial support than in the past, as demonstrated by its response to the GID loans scandal in 2002. Furthermore, the 2001 public debt law has reduced the scope for lending to government. Any emergency financial support now extended to local banks or other financial institutions is likely to be restricted to assistance for restructuring. Such financing is reported as an aggregate figure in the *Monthly Statistical Bulletin* and fuller accounts are given in the Bank's *Annual Report*.

Public information services

The CBJ continues to consolidate its services for publishing and disseminating monthly and annual data through its publications, its website and the National Information System (managed by the National Information Centre).[30] The Bank has indicated that it intends to assign a public relations or liaison officer for its website and for the *Monthly Statistical Bulletin*.

The Bank's principal publications are the *Monthly Statistical Bulletin* and *Annual Report*. Improvements in the *Bulletin* have meant that users now find it more valuable. However, the limited level of commentary on monetary policy remains a source of some dissatisfaction.

A number of laws and circulars issued by the Bank -- also relevant to its operations -- are available on its website.[31] These include laws on money exchange, public debt and banking, and foreign exchange regulations. The anti-money laundering law is available only in Arabic. The Bank also distributes general national information and guidelines (in Arabic) on customs, labour, trade and other economic matters through its website.

4. Accountability and Assurances of Integrity by the Central Bank

●●● Enacted

Accountability before designated public authority

Under Article 61 of the Central Bank Law, the CBJ is required to deliver its *Annual Report* to the Ministry of Finance within three months of the end of the financial year (the same as the calendar year). The governor is accountable before a parliamentary committee assigned to oversee the Bank's affairs and laws related to its operations.[32]

Financial statement

Audited financial statement

The CBJ has an internal audit department, in addition to which the Jordan Audit Bureau (JAB) has permanent representatives at the Bank who are entitled to report independently to parliament. The Bank publishes its audited annual financial statements in its *Annual Report*. Law establishes that this must be distributed publicly.

External and internal audit

The JAB produces its own annual report on the Bank, as does an external auditor. Between 1999 and 2002, the external audit was conducted by Saba & Co, a Jordanian firm.[33] The audit report for 2001 was delivered at the end of March 2002 and highlighted two sets of assets where recoverability is doubtful. These are 225.7 million Jordanian dinars of advances extended to banks under liquidation (since the Petra Bank collapse in 1990), and 813.6 million dinars in claims on Iraq.[34] Over the years, some of the advances to banks have been recovered. Neither of these constitutes a problem for the Bank's long-term position.

Significant accounting policies are indicated in the *Annual Report*. Since 2001 the Bank has been preparing its financial statements on an accrual basis.[35] There are no independent assurances of the integrity of CBJ data. However, independent academic and research institutions have been making increasing use of the Bank's data and have expressed increased confidence in the data.[36]

Conduct of officials

The Central Bank Law sets out basic guidelines on dealing with conflicts of interest and confidentiality of information, and outlines the benefit entitlements of Bank employees.[37] Employees are subject to internal employment rules and the protections of the national labour and social security laws. In June 2002, a new civil service by-law was issued that sets out a code of conduct and requirements for transparency in employment practices. The Ministry of Administrative Development is also implementing a programme of civil service job classifications and service directories, which aims to support reform processes in ministries and institutions like the CBJ.[38]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Amman, Jordan between 13 and 22 October 2003:

Central Bank of Jordan

13 October 2003

Hasan Abu Rashed	Head of Research
Walid Zinati	Head of Balance of Payments Division
Hassan Barakat	Head of Monetary Division
Shibli Abdelhakim	Senior Economist
Nedal Azzam	Economist, Monetary Division

Ministry of Finance

15 October 2003

Ismael Zaghloul	Head of Research & Studies Directorate
Issa Saleh	Head of Statistics Division

ADDITIONAL INTERVIEWS

14 October, 2003

Salem Al-Khazaleh	President of Audit Bureau	Jordan Audit Bureau
Mamdoh M. Oran	Director of Economy & Finance Department	Jordan Audit Bureau
Mr Abbadi	Director of Studies Directorate	Jordan Audit Bureau

21 October 2003

Dr Hussein Shakhatreh	Director General	Ministry of Statistics

22 October 2003

Dr Mohammed Nabulsi	Chairman and CEO (Former CBJ Governor)	Jordaninvest
Basam Sakhija	Representative	Transparency International

NOTES

[1] Jordanian Central Bank Law, No. 23, 1971 (referred to below as 'Central Bank Law') http://www.cbj.gov.jo/docs/circulars.html
[2] See 'Central Bank of Jordan: A Brief Outlook', www.cbj.gov.jo/docs/cbj_english.doc; and the Central Bank Law.
[3] CBJ Annual Report, 2002.
[4] Article 25, Central Bank Law.
[5] Interviews in Amman, 2-6 October 2002
[6] Article 49, Central Bank Law, http://www.cbj.gov.jo/docs/circulars.html
[7] Interviews in Amman, 2-6 October 2002.
[8] Interviews in Amman, 2-6 October 2002.
[9] Article 9, Central Bank Law; and 'Jordan Monetary Transparency', Oxford Analytica, December 2001, p. 109.
[10] 'Jordan Monetary Transparency', Oxford Analytica, December 2001, p. 110.
[11] Interviews in Amman, 2-6 October 2002.
[12] Interviews in Amman, 2-6 October 2002.
[13] 'Central Bank of Jordan: A Brief Outlook,' www.cbj.gov.jo/docs/cbj_english.doc
[14] Interviews with CBJ officials, 3 October 2002.
[15] Feedback from Central Bank, 12 September 2002; and see Article 10, Central Bank Law.
[16] Feedback from Central Bank, 12 September 2002; and see Article 18, Central Bank Law.
[17] Article 11, Central Bank Law.
[18] 'Data Integrity and Access by the Public – CBJ', GDDS report, http://dsbb.imf.org/gddsweb/country/jor/jordiaiacbk.htm
[19] 'Data Integrity and Access by the Public – CBJ', GDDS report, http://dsbb.imf.org/gddsweb/country/jor/jordiaiacbk.htm
[20] Article 45, Central Bank Law.
[21] Interviews in Amman, 2-6 October 2002.
[22] Interviews in Amman, 13-22 October 2003.
[23] IMF - Jordan—Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, June 19, 2003.
[24] 'Report on the Observance of Standards and Codes (ROSC), Jordan: Data Module', IMF, October 2002, www.imf.org/external/pubs/cat/longres.cfm?sk=16123.0; and interviews with CBJ officials, 3 October 2002
[25] Executive Summary, 'Report on the Observance of Standards and Codes (ROSC), Jordan: Data Module' and *passim*, www.imf.org/external/pubs/cat/longres.cfm?sk=16123.0
[26] IMF, Jordan—Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, June 19, 2003.
[27] Interviews in Amman, 13-22 October 2003.
[28] Interviews in Amman, 2-6 October 2002.
[29] 'Balance sheet of the Central Bank of Jordan', www.cbj.gov.jo/docs/bul_1_e.html
[30] See 'Economic Information Net', National Information System, www.cbj.gov.jo/docs/nis_m_e.html
[31] CBJ laws and regulations are accessible at www.cbj.gov.jo/docs/circulars.html
[32] Article 61, Central Bank Law.
[33] CBJ Annual Report, 2001, www.cbj.gov.jo/docs/main_m_e.html
[34] Auditor's Report on CBJ for 2001, Saba and Co, www.cbj.gov.jo/docs/annual_e/general.doc
[35] Feedback from Central Bank, 12 September 2002.
[36] Interviews in Amman, 2-6 October 2002.
[37] Article 11, Central Bank Law; and 'Jordan Monetary Transparency', Oxford Analytica, December 2001, p. 115.
[38] Interviews in Amman, 2-6 October 2002.

OXFORD ANALYTICA

MALAYSIA

MONETARY TRANSPARENCY

Country Report 2003

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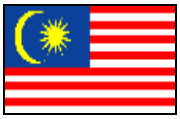
MALAYSIA



COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●	●●	●●●
Open decision process	●●●	●●	●●
Availability of information	●●●●	●●●●	●●●●
Accountability	●●●	●●●	●●
Score	3.25	2.75	2.75

OUTLOOK & COMMENTARY

Monetary policy transparency has gradually increased as government officials have recognised that greater clarity is needed in order to fend off pervasive economic difficulties, as experienced during the 1997-98 Asian financial crisis. In this context, the Bank Negara Malaysia (BNM) has increased its efforts to make available additional statements about monetary policy and financial data. Future progress should be made in providing more details on policy implementation and the BNM's objectives and responsibilities, perhaps by clearly distinguishing monetary targets regularly.

The main weakness will likely remain the lack of clarity with regard to policy coordination between the central bank and other government institutions. In order to allay this concern, additional information should be provided on the BNM Management Committee's tasks by making publicly available its composition and the minutes/voting records of its meetings.

EXECUTIVE SUMMARY

3.25 Enacted

The Bank Negara Malaysia (BNM) maintains good and improving public information services, and continues to meet the requirements of the IMF's Special Data Dissemination Standard (SDDS). The central bank now has in place a structure of three technical and informative publications: the *Annual Report,* the *Quarterly Bulletin*, and the *Monthly Statistical Bulletin.*

However, significant opacity remains in the mechanisms and targets of monetary policy, since the BNM does not have a single-measure target for monetary policy. In addition, the lack of statutory independence for the BNM continues to raise doubts about its operational independence, particularly in times of crisis. The conditions under which the government can overrule monetary policy decisions are not specified in legislation, and the precise nature of policy coordination between the central bank and the Ministry of Finance is imprecise.

The new *Monetary Policy Statement*, a publication aimed to explain the considerations underpinning BNM's decisions, is a welcome development. Nevertheless, the publication would benefit from a more detailed treatment of monetary policy objectives and implementation, and it should be readily available for public consultation.

Public accountability and accountability to parliament remains weak as a result of the highly centralised political system, but the central bank's initiative to discuss monetary policy in public consultations is a positive step towards greater monetary policy transparency.

Malaysia's overall score has improved from 2.75 in 2002 to 3.25.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

Malaysia's monetary policy framework is officially set out in the Central Bank Act of 1958 (revised 1994). The legislation enumerates the principal objectives of the central bank, Bank Negara Malaysia (BNM), which are to issue currency and safeguard the value of currency, to act as a banker and financial adviser to the government, to promote monetary stability and a stable financial structure, and to influence the credit situation to Malaysia's advantage. The BNM has also highlighted its contributions to Malaysia's national development goals.[1] The Bank Act does not identify any priority between these goals and provides little guidance on how to reconcile conflicting objectives. According to the central bank, its ultimate policy goal is economic growth and price stability.[2]

The responsibilities of the BNM are listed under Section V of the Central Bank Act. These include issuing currency, maintaining estimates of foreign exchange reserves and the balance of payments, issuing securities, and accepting deposits. BNM duties relating to the supervision and regulation of the financial system are outlined in Article 30 and the Islamic Banking Act of 1983, the Takaful Act of 1984, and the Banking and Financial Institutions Act of 1989.

In November 2003, the Payment Systems Act came into effect. The Act defines the central bank's role, on behalf of the government, in the regulation and supervision of Malaysia's payments system. Under this new law, the BNM will have the power to designate payment instruments and to exercise oversight of the payments system.[3]

Operational autonomy

In 1998, after a public dispute with the prime minister over monetary policy, the governor of the bank (Ahmad Don) and an assistant governor resigned. Another official -- formerly in the Economic Planning Unit of the Prime Minister's Department -- then headed the bank temporarily and changed monetary policy to bring it in line with that proposed by Dr Mahathir Mohamad. Commentators have argued that the operational independence of the central bank has been unclear since then, although central bank officials maintain that it has remained unaffected.[4]

When disagreements arise, the Central Bank Act gives the Ministry of Finance considerable weight over monetary policy decisions. According to Article 34, if the minister of finance disagrees with the BNM Board on any policies, the minister may "issue directives to the Board relating to such policies, and any such directive shall become binding on the Board, which shall forthwith take all steps necessary or expedient to give effect thereto."[5] If the Board objects to the minister's directive, it may submit its objections and its reasons to the House of Representatives.

However, the Act does not specify whether the House of Representatives is empowered to overrule the BNM or the minister of finance. BNM officials have asserted that disagreements leading to submission of complaints to the legislature have hitherto not occurred[6], and that they conduct monetary policy in coordination with other government institutions and receive suggestions from the prime minister. In this context, BNM officials have stressed that the central bank remains operationally autonomous.[7] For example, during the period when the prime minister publicly threatened to raise capital adequacy ratios (CAR) to pressure commercial banks to increase lending and promote economic activity, the BNM made no changes to these requirements.[8]

Institutional relationship between monetary and fiscal operations

Lending to government

Article 33 of the Central Bank Act allows the BNM to grant temporary advances to the government, which cannot amount to more than 12.5% of the estimated government receipts for that financial year. These must be paid back no later than three months after the end of the financial year in which they were granted. The BNM is free to determine the interest rates of these advances. However, this provision has never been exercised.[9]

Central bank involvement in the rest of the economy

The Bank Act allows the BNM to carry out various fiscal or quasi-fiscal activities, many of which have never been implemented. Section 30 of the Act allows the set up of a Special Investment Fund -- with the approval of the BNM board and the minister of finance -- for the purpose of economic development using funds from commercial banks' statutory reserve ratios. This fund cannot exceed the amount of the BNM's General Reserve Fund.[10] The BNM can also purchase, sell, discount, and hold securities of any government or public authority and, more specifically, corporations set up with government approval to develop financial markets and finance development.[11]

At present, the BNM still owns 79.3% of the Credit Guarantee Corporation's share capital. This firm was set up in 1972 to assist viable small- and medium-sized enterprises, particularly those without collateral or with inadequate collateral to obtain credit facilities from financial institutions by providing guarantee cover on such facilities.

The BNM also owns 20% of *Cagamas*, the government's main housing mortgage agency and a major supplier of domestic bonds. *Cagamas* bonds play a key benchmarking role for the local bond market, a market that the BNM's operating legislation encourages it to develop. A deputy governor of the BNM is chairman of *Cagamas*. For development purposes, the BNM issues broad lending guidelines to all banking institutions operating in Malaysia to ensure that certain economic sectors, deemed by the government to be of primary importance, have continuous access to credit. In 1998, the BNM was the lead agency in establishing the bank re-capitalisation special vehicle, *Danamodal*, headed by a central bank assistant governor on secondment.

Central bank profit allocation

The Central Bank Act details conditions for the allocation of BNM profits. The amount to be placed in the General Reserve Fund (GRF) is determined by the minister of finance in consultation with the BNM Board, and the remainder is paid to the government. If at the end of the financial year the GRF is less than half the paid-up capital of the central bank, then all profits are transferred into the GRF. If the fund accumulates more than half (but less than twice the paid-up capital) then at least 30% of the net profit is transferred to the GRF.[12]

Agency roles performed by the central bank on behalf of the government

The Central Bank Act designates the BNM as the banker and financial adviser to the government. The Development Financial Institutions Act 2002 brings six financial institutions for development controlled by different agencies under the scrutiny of the BNM. However, the central bank holds no equity stakes in any of these institutions. The BNM regularly issues treasury bills and both conventional and Islamic bonds, under the Treasury Bills (Local) Act of 1946 (revised 1977), the Loan (Local) Ordinance of 1959, and the Government Investment Act of 1983, respectively.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●● Enacted

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The BNM's *Annual Report* provides a general description of monetary policy, and the Central Bank Act outlines monetary policy objectives from which targets can be derived. The BNM has no plans to move to a single-measure monetary policy (such as inflation targeting), and has historically oscillated among several objectives. In this context, commentators argue that the lack of clear and published annual targets has substantially diminished monetary policy transparency.[13]

BNM officials indicate that the central bank uses interest rates as the main monetary target.[14] The policy of non-internationalisation of the ringgit, adopted since the 1997-98 financial crisis and enforced through limited capital controls, has allowed Malaysia to set domestic interest rates while keeping the exchange rate stable.

Monetary instruments

The BNM is authorised to use a variety of instruments to pursue monetary policy, as outlined in Article 30 of the Central Bank Act. These include the purchase, sale and discount of government securities, foreign bonds, and currencies. With regard to exchange rate policy, the Central Bank Act states that the parity of the ringgit is to be determined by the Ministry of Finance with guidance from the BNM.[15]

Along with changes to interest rates and open market operations, the BNM regulates the liquidity reserve ratio and statutory reserve ratios as monetary policy instruments. The central bank provides the latest information on changes to monetary policy instruments in its press releases, *Monthly Bulletin, Quarterly Bulletin,* and *Annual Report.* These are available on the BNM website. The BNM publicly discloses the rules and procedures for its relationship and transactions with counterparts mainly through its Circular and Letter-Circulars.

The monetary policy-making body

Monetary board

The Central Bank Act provides for a Board of Directors responsible for implementing monetary policy and the general administration. However, the BNM Board (which includes four ex-officio members and four directors drawn from the private sector) has delegated many of its responsibilities to the Governor of the BNM.[16] In practice, the BNM Board deals only with administrative and some strategic policy issues.

The BNM Governor and the central bank's Management Committee carry out most daily operations, including the setting of monetary policy instruments. The Management Committee -- whose membership is not publicly disclosed, but consists of the Governor and a selection of Deputy and Assistant Governors -- plays the leading role in monetary policy decision-making. It receives input from the BNM's Monetary Policy Group, which consists of an assistant governor (acting as chairman) and other department officials.

Advance meeting schedule

The Management Committee meets once a week, and the calendar of meetings is only disclosed internally. Minutes or reports of these meetings are not publicly available, nor are voting records. However, statements about the main considerations guiding monetary policy are made available through the central bank's *Annual Report* and *Monetary Policy Statement*, the latter being published quarterly since August 2003.

As mentioned above, the BNM makes policy in close coordination with other government ministries. Much of this coordination takes place through the National Economic Action Council and the Macroeconomic Inter-Agency Planning Group (one of many inter-departmental committees) that meet regularly to coordinate fiscal and monetary policy responses across agencies.[17] The group consists of representatives from the Ministry of Finance, the BNM, the Economic Planning Unit, and the National Economic Action Council.[18]

Public statements on monetary policy

Section VIII of the Central Bank Act requires the BNM to publish a return of its assets and liabilities twice a month and submit annual accounts certified by the Auditor General and an annual report to the Senate and the House of Representatives.

Periodic publications

The BNM issues press releases on its website announcing changes in monetary policy, the three-month *Intervention Rate*, and the range and settings of monetary instruments. These provide the rationale for changes and the time span for implementation. BNM officials regularly make statements about monetary policy in speeches, many of which can be found on the central bank's website. Upon the release of the BNM *Annual Report*, the governor holds explanatory briefings for a variety of sectors, including foreign ambassadors, analysts, business chambers, and Malaysian government officials.

Malaysia's central bank releases a variety of regular publications. The *Monthly Statistical Bulletin* contains updated information on monetary and financial aggregates and includes the BNM's updated statements of assets and liabilities. Data on certain financial intermediaries, including the Employees Provident Fund and the National Savings Bank are also provided. Additional GDP statistics and data on federal government debt are found in the *Quarterly Bulletin*.

The *Quarterly Bulletin* provides statistics and analysis on economic, monetary, and financial developments, as well as special features on specialised topics. The fortnightly *Reserves Statement* describes factors affecting capital flows and the state of the country's foreign exchange reserves. The *Financial Sector Master Plan* is a document that outlines the central bank's long-term strategy and vision for the financial sector. Finally, the BNM *Annual Report* provides a detailed sectoral breakdown of the Malaysian economy and a description of monetary and fiscal developments. It includes all BNM annual accounts, and the annexe provides information on exchange control policies, funds administered by the BNM, and a list of licensed banking institutions.

Starting 27 August 2003, the BNM has started publishing the quarterly *Monetary Policy Statement*, which contains the central bank's analysis of macroeconomic indicators and the suitability of current interest rates. However, commentators said that, at four short paragraphs in length, the statement lacks detail and substantive analysis.[19] In addition, it is not easily accessible on the BNM's website.[20]

The *Financial Sector Masterplan* is a strategy document on the future direction and development of Malaysia's financial sector. The central bank also publishes occasional and discussion papers, a variety of consumer education booklets, and the *Takaful Annual Report* and the *Insurance Annual Report*, both of which deal with the insurance industry.

Public hearings

The BNM is not required by law to hold public hearings before major changes to monetary policy or supervisory regulation. However, the central bank holds consultations with the private sector on a variety of monetary and regulatory issues.[21] In addition, after the release of the BNM *Annual Report*, the governor holds a series of briefings for various audiences, including foreign ambassadors, financial analysts, chambers of commerce, and government officials.

Regulations on data reporting by financial institutions to the central bank

The 1989 Banking and Financial Institutions Act (BAFIA) provides for financial institutions' data reporting to the central bank. This law and subsequent regulations require both commercial banks and non-banking financial institutions to report to the BNM. Since the 1997-98 financial crisis, the BNM has issued new circulars tightening some of the reporting requirements.

The Development Financial Institutions Act of 2002 (DFIA) has strengthened reporting requirements for the six institutions governed by the law. Under the DFIA, the central bank is responsible for monitoring the activities and financial performance of Malaysia's six Development Financial Institutions (DFIs). These institutions are required to submit their monthly reports and financial indicators to the BNM as part of the supervisory process. The central bank also conducts both off-site surveillance and regular examinations of the DFIs using the risk-based supervision approach, which covers the effectiveness of internal audit functions, financial analysis, and examination of information systems.[22]

In 1998, the BNM relaxed the definition of a non-performing loan from the international standard of three months of no interest paid to six months, although the new definition applies only to loans with repayment periods of three months or less.[23] Banking institutions with more stringent rules may adopt the existing three-month classification rule. Industry numbers on non-performing loans calculated using both the three-month classification and the six-month classification rules are published in the *Monthly Statistical Bulletin* and *Annual Report*.

A copy of *Guidelines for Financial Institutions* can be purchased from the central bank.

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

As one of the first subscribers to the IMF Special Data Dissemination Standard (SDDS), the central bank meets most of the SDDS specifications for coverage, periodicity and timeliness. Malaysia has taken the flexibility option for the timeliness on reporting the country's international investment position, allowing for a delay of more than six months.[24] Nevertheless, BNM officials had previously mentioned that efforts are being made to meet the six-month requirement but were unsure when this would be achieved.[25]

An advance release calendar is available on the BNM's website, which provides the expected release dates for data described in the IMF's Dissemination Standards Bulletin Board (DSBB). The Department of Statistics publishes advance release calendars one quarter in advance in its *Quarterly National Product and Expenditure Accounts*.

The BNM announces more precise release dates at least one week prior to the release of the data through its website. As specified in the SDDS' *Detailed Disclosure of International Reserves Requirement*, the BNM provides additional information on international reserves, including forward-looking information on likely inflows/outflows for the next twelve months.

The central bank balance sheet

The BNM releases its analytical accounts on a monthly basis, within two weeks of the reference period, on its website. In agreement with Article 47 of the Central Bank Act, the central bank also publishes bi-weekly *Statements of Assets and Liabilities*.[26] Information concerning the value of BNM's shares in other institutions is not publicly disclosed. The *Monthly Statistical Bulletin* provides a brief description of overall liquidity operations, and data on these are provided in the monthly balance sheet. An analytical breakdown of BNM's official reserve assets is published bi-weekly and is available on the BNM's website. There are no plans to report data on gross international reserves on a weekly basis.

Lender of last resort

The Bank Act and the Banking and Financial Institutions Act (1989) specify the BNM's capability as lender of last resort. Article 42 of the Bank Act provides the BNM with emergency powers to lend money or provide advances to financial institutions, in order to safeguard monetary stability and financial system viability. Furthermore, the Emergency (Essential Powers) Act 1979 and Essential (Protection of Depositors) Regulations 1986 strengthen the BNM's supervisory powers in accordance with its lender of last resort operations.

Instead of issuing emergency loans to individual banks, during the Asian financial crisis the BNM established *Danamodal*. This is a special purpose vehicle to raise funds through the sale of government bonds in the domestic market to inject into troubled local financial institutions, in return for regular voting shares or preferential shares in those banks. As a strategic shareholder, *Danamodal* appointed nominees in the institutions concerned, thus enabling it to implement reforms and facilitate a mergers programme. The BNM is a shareholder in *Danamodal*, but the latter is a separate company with its own governing body.

Danamodal's re-capitalisation schemes and the progress/terms of repayment were published regularly in local newspapers during the crisis, but this disclosure recently ceased. Central bank officials asserted that the cause of this reporting suspension is that no positions have changed, and therefore there is nothing to report.[27] Information on *Danamodal's* outstanding capital disbursements and repayments is available on its website.

The BNM's blanket guarantee for local bank deposits is still in place, but its implications for contingent liabilities are not clearly reported. According to the BNM, now that financial institutions have been restored to a strong, profitable position, the BNM's residual exposure to contingent liabilities under the guarantee is minimal.[28] Nevertheless, progress is being made towards replacing the 100% guarantee with a deposit insurance scheme. The BNM has outlined the public policy objectives and some of the main features of the proposed deposit insurance system in its 2002 Annual Report. The banking industry was also briefed in August on the specific features of the system.[29] A substantial part of the law drafts for the deposit insurance system has been developed, and officials expect to submit it to the legislature next year.[30]

Public information services

The BNM has a comprehensive website that stores statistical outputs, press releases and speeches (from 1996 onwards), all available in English and Bahasa Melayu. The website also provides details on how local and overseas clients can purchase publications, with a price list of available documents. Only the latest issue of each major document (*Monthly Statistical Bulletin, Quarterly Bulletin, Annual Report*) is freely available on the website -- past issues can be purchased.

The range of publications is extensive, including historical works, occasional research papers, and detailed information sources on all areas of BNM supervision -- from Islamic banking to the *Takaful* industry. Visitors to the BNM, with authorisation, can also use the library to look up specific legislation, circulars, and *Gazettes*, often only summarised or not mentioned on the website.

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●● Enacted

Accountability before a designated public authority

Under the Central Bank Act, the annual accounts, certified by the Auditor General, as well as a report by the BNM Board on all annual central bank operations, must be sent to the Senate and the House of Representatives.

Since independence in 1957, Malaysia has been ruled by a one-party coalition, with the minister of finance coming from the dominant party, the United Malays National Organisation (UMNO). Hence, relations between the central bank and the government are largely based on relations between the prime minister, the BNM, and the minister of finance, with little explicit role for parliament. The BNM has never exercised its right to appeal to parliament over monetary policy disputes with the minister of finance. Central bank officials noted that the BNM officially reports to the Ministry of Finance twice a year (with around 6-month intervals).[31]

Financial statement

Audited financial statement

As required by law, the BNM publishes its annual accounts within three months of the end of its financial year, which follows the calendar year. The accounts include a summary of the BNM's contingent liabilities. Article 48 of the Central Bank Act requires the accounts to be certified by the Auditor General and published in the *Government Gazette*. The accounts must be sent to the minister of finance, who presents them along with the *Annual Report*, to both the House of Representatives and the Senate.[32] National accounting standards and Government Circulars guide the BNM's financial reporting framework.

External and internal audit

The BNM has appropriate internal governance procedures to ensure the integrity of its operations. These are established by the Board of Directors and subject to the scrutiny of the Auditor General, but are not publicly disclosed. The BNM's Internal Audit Department enforces internal government procedures and, in concurrence with the National Audit Department, reviews all reports. In addition, the central bank has a Board Audit Committee. Three members of the BNM Board sit on this committee, which is chaired by an independent auditor.

Conduct of officials

Article 9 of the Central Bank Act specifies procedures for appointment and removal of central bank officials. Under the Act, the monarch selects the BNM governor, while the minister of finance appoints the deputy governors. Their term cannot exceed five years and are eligible for reappointment. The monarch may terminate the appointment of the governor or any other director if the official resigns, becomes incapable of carrying out his duties, becomes bankrupt, is convicted by a court of law of any offence involving dishonesty, is guilty of serious misconduct in relation to his duties, or fails to comply with obligations to fend off conflicts of interests.[33]

The Public Authorities Protection Act of 1948 does not prevent legal action being taken against public officials, but it shortens the limitation period for bringing lawsuits. Section 114 of the Banking and Financial Institutions Act of 1989, Section 117 of the Development Financial Institutions Act of 2002, and Section 77 of the Anti-Money Laundering Act of 2001 legally protect BNM officers. These sections do not prevent persons from bringing lawsuits, but state that no legal process can be taken against persons for an act performed pursuant to the relevant legislation and done in good faith.

The Central Bank Act details the legal responsibilities of the governor, directors, and general staff, including the disclosure and/or processes concerning conflicts of interests. Bank officials can move directly into the banking sector after leaving the BNM.[34] Officials are legally proscribed from revealing information gained from their professional duties, except when exercising their duties or when required to do so by a court or law. The BNM can report suspected offences by its own members and supervised institutions to relevant authorities.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Malaysia between 20 and 24 October 2003:

Bank Negara Malaysia

21 October 2003

Datuk Latifah Merican Cheong	Assistant Governor	
V. Vijayaledchumy	Director	Monetary and Financial Policy Department
Lee Yan Li	Senior Manager	Monetary and Financial Policy Department
Farizah Ahmad		Monetary and Financial Policy Department
Abdul Rasheed Ghafur		Bank Regulation Department
Lee Whai See		Legal Department

Ministry of Finance

23 October 2003

Ghazali Mohd. Yusoff	Deputy Secretary	Economics and International Division
Chua Tong Ka	Principal Assistant Secretary	Economics and International Division
Khodijal Abdullah		Tax Analysis Division
Tajol Azhar		MoF (Inc) and Privatization Division
Chua Choon Hua	Assistant Secretary	Loan Management and Financial Policy Div.
Mohd. Zahrain Mohd. Nor		Budget Division
Nik Ab. Kadir Nik Mat		Budget Division
Azah Hanim Ahmad		Procurement Management
Shari bin Mohd. Tahir		Financial Advisory Division

Economic Planning Unit, Prime Minister's Department

22 October 2003

Datuk Dr Victor Wee	Senior Director	Macroeconomic and Planning Division

ADDITIONAL INTERVIEWS

21 October 2003

Mohamed Ariff	Executive Director	Malaysian Institute of Economic Research
Azmi Setapa	Analyst	Malaysian Institute of Economic Research
Tunku Abdul Aziz	President	Transparency International (Malaysia)

23 October 2003

Dr R Thillainathan	Executive Director and COO	Genting Corporation

NOTES

[1] See the Bank Negara Malaysia publications *Central Banking in an Era of Change: Landmark Speeches, 1959-1988* and *The Central Bank and the Financial System in Malaysia: A Decade of Change, 1989-1999.*
[2] Written comments from Bank Negara Malaysia to *Oxford Analytica*, 24 November 2003, p.5.
[3] See press releases section at: www.bnm.gov.my
[4] Interviews in Malaysia, 20-24 October 2003. Written comments from Bank Negara Malaysia to *Oxford Analytica*, November 24, 2003, p.3.
[5] Section VI, Article 34, Central Bank Act of 1958 (revised 1994).
[6] Interviews in Malaysia, 20-24 October 2003.
[7] Interviews in Malaysia, 20-24 October 2003.
[8] In September 2002, Dr Mahathir criticised banks for not lending enough and hinted that the statutory reserve requirement ratio may be raised if banks did not increase their loans. See Alice Chia, "Be project-minded, local financial institutions told", *Business Times*, October 6, 2002.
[9] Interviews in Malaysia, 20-24 October 2003.
[10] Subsection ffff, Article 30, Central Bank of Malaysia Act 1958 (revised 1994).
[11] Subsection fffff-g, Article 30, Central Bank of Malaysia Act 1958 (revised 1994).
[12] Article 7, Central Bank Act of Malaysia 1958 (Revised-1994).
[13] Interviews in Malaysia, 20-24 October 2003.
[14] Written comments from Bank Negara Malaysia to *Oxford Analytica*, 24 November 2003, p.8.
[15] Section III, Article 19, Central Bank Act of 1958 (revised 1994)
[16] Interviews in Malaysia, 20-24 October 2003.
[17] Interviews in Malaysia, 20-24 October 2003.
[18] In November 1997, Dr Mahathir announced the establishment of the National Economic Action Council to overcome the effects of the weakened ringgit and depressed prices on the stock exchange.
[19] Interviews in Malaysia, 20-24 October 2003.
[20] At the time of writing, the *Monetary Policy Statement* was not listed on the website's publications page, and it could only be accessed through the search function.
[21] Interviews in Malaysia, 20-24 October 2003.
[22] Written comments from Bank Negara Malaysia to *Oxford Analytica*, 24 November 2003, p.10.
[23] Interviews in Malaysia, 20-24 October 2003. Written comments from Bank Negara Malaysia to *Oxford Analytica*, November 24, 2003, p.11.
[24] See IMF SDDS website at: http://dsbb.imf.org/
[25] Interviews in Malaysia, 1-5 November 2002.
[26] See www.bnm.gov.my
[27] Interviews in Malaysia, 20-24 October 2003.
[28] Interviews in Malaysia, 20-24 October 2003. Written comments from Bank Negara Malaysia to *Oxford Analytica*, November 24, 2003, p.14.
[29] Written comments from Bank Negara Malaysia to *Oxford Analytica*, 24 November 2003, p.14.
[30] Written comments from Bank Negara Malaysia to *Oxford Analytica*, 24 November 2003, p.15.
[31] Interviews in Malaysia, 1-5 November 2002.
[32] Article 48, Central Bank Act of Malaysia 1958 (revised 1994)
[33] Section II, Article 9, Central Bank Act of 1958 (revised 1994).
[34] Interviews in Malaysia, 1-5 November 2002.

OXFORD ANALYTICA

MEXICO

MONETARY TRANSPARENCY

Country Report 2003

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MEXICO

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2001*
Clarity of roles	●●●●	●●●●
Open decision process	●●●●	●●●●
Availability of information	●●●●●	●●●●
Central bank accountability	●●●●	●●●●
Score	**4.25**	**4.00**

OUTLOOK & COMMENTARY

The Central Bank of Mexico (Banxico) increased the transparency of its monetary policy practices from an already high standard. In 2003, the central bank made several efforts to provide additional information on how monetary policy is implemented in order to attain its inflation target, while data quality and availability were consistently upgraded.

Monetary transparency in Mexico will be increased in future if Banxico decides to pursue inflation targeting by fixing a headline interest rate. The *corto* mechanism has hitherto remained more complex than the instrument(s) used by other countries that also operate under an inflation-targeting framework.

EXECUTIVE SUMMARY

4.25 Compliance in progress

The Bank of Mexico (Banxico) has maintained its high standards of monetary transparency. The Law of the Bank of Mexico clearly sets out the objectives and institutional framework of monetary policy. Banxico publicly discloses and explains how monetary policy instruments are used in a comprehensive range of reports that are available on its website. Further, in compliance with the Federal Law on Transparency and Access to Public Information, the central bank incorporates all changes in monetary policy in periodic publications that are released according to a calendar of announcements posted on its website.

Banxico observes the IMF's Special Data Dissemination Standard (SDDS) requirements in all categories within the scope of its responsibilities.

In order to enhance compliance with the IMF monetary transparency code, Banxico should make available more details on the Board of Governors' deliberations -- such as minutes and voting records -- in order to provide broader information on the assumptions and economic conditions that are being considered when reaching monetary policy decisions.

Mexico's overall score has improved from 4.00 in 2001 to 4.25.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

The objectives and institutional framework of monetary policy are established in Article 28 of the Mexican Constitution and the 1993 Law of the Bank of Mexico (LBM).[1] The former guarantees the operational and administrative independence of the Bank of Mexico (Banxico), and establishes Banxico's primary objective of seeking the stability of the domestic currency's purchasing power.

Central bank objectives and responsibilities

Article 2 of the LBM sets out the broad objectives of monetary policy: to provide domestic currency, to maintain the stability of the purchasing power of the currency, and to promote the sound development of the financial system and the proper functioning of payment systems. In addition, Article 18 establishes that Banxico must maintain a reserve of international assets aimed at supporting the stability of the purchasing power of the domestic currency by offsetting imbalances between the country's foreign currency receipts and disbursements.

Banxico publicly discloses and explains its objectives through both the Monetary Policy Programme and the Monetary Policy Implementation Report (available in English and published in January and September, respectively)[2] and the Annual Report[3], which elaborate on the main objectives and results of monetary policy in comprehensive quantitative terms. Banxico's webpage also makes available the reports submitted to the legislature and other periodic publications in order to improve the quality of information available to the public.

Operational autonomy

Article 1 of the LBM states that the central bank is autonomous in nature. Conditions under which the government can override central bank decisions do not exist. There was concern about the possibility of the government exercising *ad hoc* powers over foreign exchange policy when Banxico introduced (on March 20) a mechanism to reduce the rate of growth in foreign reserves. The mechanism incorporates a set of conditions that allows Banxico to auction a predetermined amount of dollars.[4] In this context, the auctions first appeared as a vehicle aimed at helping reverse the peso's depreciation, which would represent a rupture with the clean-float policy in order to bolster the currency in the medium term.[5] However, the trend followed by the exchange rate has confirmed Banxico's assurance of not pursuing any exchange rate target, and that the mechanism operates independently of the trend and level of the foreign exchange rate.

Nevertheless, Article 21 of the LBM states that in foreign exchange rate matters, Banxico should act in accordance with the guidelines established by the Exchange Commission. Members of the commission include the secretary and undersecretary of finance, and an additional undersecretary of the Ministry of Finance (appointed by the secretary). The governor of Banxico and two more members of Banxico's Board of Governors complete the commission. The law establishes that the officer heading the session will have the decisive vote in case of a voting tie. The secretary of finance takes the board's chair (only in his absence would the Banxico governor preside), which thus grants additional legal leverage to the Ministry of Finance over foreign exchange policy issues.

Institutional relationship between monetary and fiscal operations

The connection between monetary and fiscal institutions has historically been much closer in Mexico than in other Latin American countries, and thus the regulation of this relationship is clearly set out in various laws and statutes.

Lending to government

Article 28 of the Constitution establishes that no authority can oblige the central bank to provide lending. Banxico can grant credit to the federal government as ordained in Articles 7 and 11 of the LBM, subject to the provisions of Article 12. Credit can be granted through the current account held by the Federal Treasury (securities payable by the federal government and owned by the central bank are not considered as credit). The outstanding balance in the current account must never exceed the equivalent of 1.5% of the federal government's expenses as arranged in the annual Federal Budget. This provision may be void if, due to extraordinary circumstances, the temporary difference between public revenues and expenses increases considerably, in which case Banxico can then issue securities payable by the federal government on the market for an equivalent to the balance in excess of the limit. The amounts and terms of credit to the central government are disclosed in the Annual Reports.[6]

In addition, Article 9 of the LBM stipulates that Banxico may not lend securities to the federal government nor purchase securities from it, except when purchases are covered by cash deposits or when the purchases of securities result from bids by the central bank in primary auctions. The amount of these purchases must not exceed the amount of securities payable by the government, owned by Banxico and redeemable on the same date of placement of the securities being auctioned.

Central bank involvement in the rest of the economy

Article 63 of the LBM regulates central bank equity ownership. Banxico is forbidden to provide guarantees; to purchase or lease real estate not required to perform its functions (except under specific circumstances); or to purchase ownership interests in the capital of corporations, excluding those companies providing the required or appropriate services for the performance of central bank functions.

Article 46 (sec. XII) establishes that Banxico's Board of Governors is empowered to issue (subject to the guidelines set in Article 134 of the constitution) the rules according to which the central bank must contract the acquisition or sale of movable property, the leasing of all types of goods, the execution of real estate projects, and the procurement of all types of services. These operations must be effected through public bidding, excluding the provisions set out in Article 57. Banxico's rules on procurement are available on its website.[7]

Central bank profit allocation

Banxico is a non-profit institution and, as established in Article 55 of the LBM, it must hand over to the federal government the full amount of its operating surplus after having provisioned the reserves set forth in the LBM, providing this does not imply reductions in the reserves resulting from the revaluation of assets. Profit allocation takes place no later than April of the financial year following that to which the surplus corresponds.

Agency roles performed by the central bank on behalf of the government

Detailed regulations set out Banxico's role as fiscal agent for the government. Article 10 of the LBM ordains that only the central bank may act as the federal government's agent in issuing, placing, purchasing and selling

government domestic debt securities and, in general, in servicing government debt. Banxico is also responsible for managing international reserves (LBM, Articles 18-23), acting as depository institution, and as issuing agent for sovereign debt on behalf of the government.

The central bank holds the current account of the Federal Treasury, and it may charge the account without authorisation of the Federal Treasurer in order to cover the federal government's domestic debt service. No cheques or any other documents payable to third parties may be drawn on this account.[8]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments and targets of monetary policy

Banxico's framework to pursue its monetary policy objectives and the instruments used to achieve them are explained in legislation, its mission statement and written reports to the legislature, and the central bank's press releases. All are available on Banxico's website.

Framework and monetary targets

The practices governing monetary policy and its instruments are publicly disclosed and explained in the LBM. Procedures that are applicable to specific monetary interventions are published in daily press briefings and compiled in the Annual Report. Banxico's monetary policy instruments and their use are presented in the 'Implementation of Monetary Policy through the Zero-Average Reserve Requirement System' section.[9]

Specific details on how the new *Daily Balances Regime* (implemented on April 10) operates under the zero-average requirement framework are available on the website (in Spanish only), including a comparative statement with respect to the previous *Accumulated Balances Regime*.[10] The report explains how monetary policy is implemented through the '*corto*' mechanism[11] in order to pursue its chief objective of stability of the peso's purchasing power via inflation targeting.

Monetary instruments

Banxico has the authority to use several monetary instruments to meet its objectives. The provisions in Article 7 of the LBM and of Article 28 (Paragraphs 6-7) of the constitution clearly delimit this authority. In relation to the *corto* mechanism, the central bank is entitled to grant credit and receive bank deposits from commercial credit institutions in order to regulate the amount of currency in circulation. Banxico is also entitled to offset any increase in the amount of currency in circulation or in its on-demand liabilities resulting from acquisitions of foreign currency by placing or, if necessary, issuing securities payable by the federal government under the terms established in Article 12 (sec. IV) of the LBM.

The monetary policy-making body

The Board of Governors is responsible for assessing economic developments and ensuring that the central bank achieves its monetary objectives. Article 38 of the LBM addresses the board's composition, structure and functions.

Monetary board

Articles 38-47 of the LBM provide clear guidelines over the appointment requirements and procedures, the terms of the governor and the Board of Governors, their powers and responsibilities, and conditions for removal. The board is made up of five members: the governor (with a six-year term) and four deputy governors (with an eight-year term each). All members may be appointed for more than one term.

Article 40 ordains the term of the governor to start on the first of January of the fourth year of the presidential term. The terms of the deputy governors are staggered, with one starting every other year on the first of January of the first, third and fifth years of the executive's term. This mechanism, in practice, aims at minimising the risk of having conflicts of interest during the political cycle, since their tenure does not coincide with the presidential and legislative terms. Nevertheless, the reappointment process of Governor Guillermo Ortiz was somewhat beset by the political dispute between the ruling party and opposition in Congress.[12]

All board members are barred from participating, as representatives of the central bank, in the activities of political parties. Article 43 of the LBM and Article 28 of the Constitution establish the precise cases under which board members can be removed.

Advance meeting schedule

The Board of Governors holds regular fortnightly scheduled meetings and, in compliance with the requirements of the Federal Law on Transparency and Access to Public Information (LFTAI, enacted in April 2002), it makes available its decisions on monetary policy according to a pre-established schedule.[13]

In addition, the board meets daily to assess the behaviour of domestic and foreign financial markets, where it decides if a change in broad money supply is needed in order to attain the amount of liquidity required by the *corto* mechanism. Their decisions over liquidity intervention are posted daily on the website.[14]

Public statements on monetary policy

Monetary policy decisions are released and explained immediately by announcements to the press, on the website, and then compiled in the Monetary Policy Bulletin and the Annual Report. In addition, the Monetary Policy Programme published each January explains the targets and how the instruments will operate in order to meet those targets. Nevertheless, monetary transparency would be increased if the minutes and voting records from board meetings were made publicly available.

Given Banxico's inflation-targeting framework, additional information is provided to improve the quality of information available and help the market to read the central bank's monetary policy signals correctly. Information includes the Quarterly Inflation Reports[15], the Annual Monetary Policy Implementation Report, a brief explaining how the consumer price index (INPC) is compiled, and the relevance of measuring core inflation.

Periodic publications

In compliance with the LFTAI, Banxico incorporates all changes in monetary policy in periodic publications that are released according to the calendar of announcements posted on its website. These publications include the Monetary Policy Announcements (fortnightly), the Press Releases on Monetary Policy (monthly) and the Inflation Reports (quarterly). The Annual Report compiles most of this information. The central bank also posts on its website a broad range of financial and monetary indicators.[16]

Public hearings

Banxico officials hold consultations with the executive, legislature and various governmental and private sector committees that supervise and help regulate the financial, securities, and banking sectors. However, a legal framework for incorporating public consultation over technical changes in the operation of monetary policy does not exist.[17]

Regulations on data reporting by financial institutions to the central bank

Article 36 of the LBM stipulates clear regulations for financial institutions' data reporting. Financial intermediaries must provide Banxico with the information the latter may request on their operations, as well as the data necessary to evaluate their financial situation and, in general, all information required by the central bank to adequately perform its functions.

Article 37 establishes that Banxico can suspend all or some of its operations with those financial intermediaries that infringe the LBM or the regulations resulting thereof. Legislation and data reporting regulations for commercial banks, equity and foreign currency brokers, credit bureaus, and other financial institutions are available on the website.[18]

3. Public Availability of Information on Monetary Policy

●●●●● Full compliance

Release of central bank data

Banxico is responsible for compiling and disseminating monetary, balance of payments, consumer and producer price statistics. It also disseminates other information and macroeconomic statistics compiled by other statistics-producing agencies, such as the Ministry of Finance and Public Credit (SHCP), the National Statistics Institute (INEGI), and the National Banking and Securities Commission (CNBV). The statistics are regularly updated and most are available in English and Spanish.

Banxico observes the IMF's Special Data Dissemination Standard (SDDS) requirements in all categories within the scope of the central bank's responsibilities. Banxico's data periodicity and timeliness exceed the requirements with respect to the analytical accounts of the central bank and international reserves. Timeliness requirements are also exceeded with respect to the consumer and producer price indices, the balance of payments (including the international investment position), and the trade balance.[19]

Advance release calendars are published in hardcopy, on Banxico's website and on the IMF Dissemination Standards Bulletin Board three months in advance. Data are disseminated simultaneously to all interested parties on the website.

The central bank balance sheet

In compliance with Article 40 of the *Internal Regulations of the Bank of Mexico* (RIBM)[20], the *General Annual Balance*[21] is published 5 working days after the Board of Governors acknowledges receipt from the external independent auditor. The consolidated balance statements (monthly) are released 20 working days after the end of the relevant month. In addition, Banxico publishes weekly preliminary information of its balance sheet, as established by Article 41 of the RIBM.[22]

Article 38 of the RIBM specifies the items that must be included in all balance sheet reports and in the monthly statements. Banxico is obliged to publish the year-end financial balance sheet and a consolidated statement of accounts for the last day of every month. Accounting standards, emergency lending, and disclosure of foreign exchange assets are made available in the balance sheets and in the Annual Report.

Lender of last resort

Article 28 of the Constitution establishes that no authority can oblige the central bank to grant credit, thus protecting Banxico's autonomy with regard to this type of operations. Article 3 of the LBM establishes that Banxico may, under the terms of Article 15 and 16, operate as lender of last resort for credit institutions. Banxico is authorised to grant credit to commercial banking institutions in order to prevent disruptions in the payment systems. In general, financing granted to any credit institution should be guaranteed by deposits of money and securities that these institutions have at Banxico. The amounts and terms of credit to financial institutions are disclosed in press bulletins, if the Board of Governors considers that this information will not jeopardise financial stability.

Public information services

Banxico maintains a thorough public information service. This service includes periodic publications on monetary policy, annual reports, research reports, speeches and other presentations, most of which are available in electronic format. The website also includes a section of frequently asked questions and, if an answer is not found, an electronic inquiry form addressed directly to one of the deputy governors is available.[23]

There is a section of speeches and presentations made by senior officials, and Banxico's staff research documents. There are comprehensive services with access through the library, which also compiles external research documents and other publications relevant to the Mexican economy.[24]

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

Central bank officials attend regular supervisory and regulatory board meetings. Reporting requirements (Article 51 of the LBM) to both the executive and the legislature ensure accountability. In addition, Article 52 of the LBM specifies that either of the two chambers in Congress (Deputies or Senate) may summon the governor to report on the central bank's policies and activities. Given the adequate implementation of monetary policy in past years, it is not customary for board members to be routinely called by Congress to discuss specific issues.

Financial statement

Audited financial statement

In compliance with the LFTAI, the audited financial statements for monthly and annual balances are publicly available on Banxico's website.[25] Both reports follow a pre-announced release schedule that is set by the LBM and the RIBM.

External and internal audit

Article 50 of the LBM authorises the secretary of finance to request from an accountants' collegiate organisation the name of three highly regarded accounting firms, from which the secretary -- with the agreement of the Chamber of Deputies' Finance Accounting Vigilance Commission -- designates and hires an external auditor on behalf of the central bank.[26] In addition, the Federal Audit Office (ASF, a devolved body from the Chamber of Deputies) carries out independent audits as part of its supervision capacities over the federal executive branch.[27] Most reports acknowledge that accounting practices follow those prescribed by the Mexican Institute of Public Accountants. The executive and legislature also receive audit reports on the execution of Banxico's expenditure and physical investment budget from the external auditor (Article 46 of the LBM).

Internal governance and audit procedures are defined in Article 30 of the RIBM, which stipulates that the Internal Comptroller insures compliance with the relevant legislation. The Internal Comptroller also receives and resolves non-conformities related to suppliers, contracts, and public procurements, as well as spearheading modernisation programmes and administrative development. The internal audit report is available on the website.[28]

Conduct of officials

Standards for personal conduct of all central bank employees, and additional requirements for senior officials, are outlined in Article 61 of the LBM. The Board of Governors and all personnel must adhere to the Federal Civil Servants' Responsibility Act and guidelines established in the LFTAI. Board members, officials holding posts of deputy manager or above, and the personnel indicated in the RIBM must submit reports on the value and number of personal assets and property to the Internal Comptroller's Department. Article 43 of the LBM establishes the precise cases under which board members can be removed.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Mexico between 17 and 19 November 2003:

Bank of Mexico (Banxico)

17 November 2003

Alejandro Diaz de Leon	Director of Macroeconomic Analysis

Ministry of Finance and Public Credit (SHCP)

17 November 2003

Alejandro Werner	Head of Unit for Public Finances' Economic Planning
Jesus Serrano	Director of Economic Policy
David Madero	Director of Financial Planning and Head of Investor Relations Office

ADDITIONAL INTERVIEWS

18 November 2003

Mario Rodarte	Director General	Centro de Estudios Economicos del Sector Privado (CEESP-CCE)
Joost Draaisma	Economist	World Bank, Mexico Office

19 November 2003

Isaac Katz	Professor of Economics	Instituto Tecnologico Autonomo de Mexico–ITAM
Helena Hofbauer	Executive Director	FUNDAR

NOTES

[1] The Law of the Bank of Mexico (in English) is available on Banxico's website at: www.banxico.org.mx/siteBanxicoINGLES/aAcercaBanxico/RegimenJuridico/LeyBancoMexico/LeyBancoMexico.html
[2] www.banxico.org.mx/siteBanxicoINGLES/bPoliticaMonetaria/FSpoliticaMonetaria.html
[3] www.banxico.org.mx/siteBanxicoINGLES/gPublicaciones/InformeAnual/inforsi.html
[4] *Mecanismo para reducir el ritmo de acumulacion de reservas internacionales* (in Spanish only): www.banxico.org.mx/bPoliticaMonetaria/FSpoliticaMonetaria.html
[5] Interviews in Mexico, 17-19 November 2003.
[6] See, for example, Annual Report, 2002, p. 120: www.banxico.org.mx/gPublicaciones/InformeAnual/Informes/2000/inforAnual2002/catainf02.html
[7] *Normas del Banco de Mexico en materia de contrataciones* (in Spanish only): www.banxico.org.mx/aAcercaBanxico/Transparencia/marconormativo/marconormativo.html
[8] LBM, Article 12.
[9] www.banxico.org.mx/public_html/dgobc/zero.html
[10] *Conduccion de la Politica Monetaria -- Regimen de Saldos Diarios* (in Spanish only): www.banxico.org.mx/bPoliticaMonetaria/FSpoliticaMonetaria.html
[11] Interviews in Mexico, 17-19 November 2003. The *corto* is the amount of money that Banxico provides daily to the financial system at twice the equilibrium inter-bank interest rate. However, given the marginal amount of money that the *corto* is relative to broad money supply, the mechanism is more powerful via the signal that a change in the *corto* amount sends to the economy.
[12] Interviews in Mexico, 17-19 November 2003.
[13] Calendar of Announcements on Monetary Policy Decisions: www.banxico.org.mx/siteBanxicoINGLES/bPoliticaMonetaria/PoliticaMonetaria/InformeSobreInflacion/2002/TrimestreIII/calendarioingles.html
[14] Interviews in Mexico, 17-19 November 2003. *Intervenciones en el Mercado de Dinero--12.30 horas* (in Spanish only): www.banxico.org.mx/fBoletines/Boletines/FSBoletines.html
[15] Quarterly Inflation Reports: www.banxico.org.mx/siteBanxicoINGLES/bPoliticaMonetaria/PoliticaMonetaria/InformeSobreInflacion/iinfoinflacion.html
[16] www.banxico.org.mx/siteBanxicoINGLES/eInfoFinanciera/FSinfoFinanciera.html
[17] Interviews in Mexico, 17-19 November 2003.
[18] www.banxico.org.mx/dDisposiciones/FSDisposiciones.html
[19] 'Mexico: Report on the Observance of Standards and Codes—Data Module', IMF Country Report No. 03/150, June 2003, www.imf.org/external/pubs/cat/longres.cfm?sk=16581.0
[20] *Reglamento Interior* (in Spanish only): www.banxico.org.mx/aAcercaBanxico/Transparencia/marconormativo/marconormativo.html
[21] The *General Annual Balance for Fiscal Year 2002* is available at: www.banxico.org.mx/eInfoFinanciera/DoctosBM/003718901diciembre2002.pdf
[22] *Informacion financiera contable del Banco de Mexico* (in Spanish only): www.banxico.org.mx/doctosbm/navegacion.jsp?nombre=InfFinancieraContable
[23] www.banxico.org.mx/siteBanxicoINGLES/mTextos/Fscontacto.html
[24] www.banxico.org.mx/siteBanxicoINGLES/hOtrosServicios/Biblioteca/Biblioteca.html
[25] *Informacion Financiera Contable del Banco de Mexico* (in Spanish only): www.banxico.org.mx/doctosbm/navegacion.jsp?nombre=InfFinancieraContable
[26] External Audit for Fiscal Year 2002 -- Auditors: Ruiz Urquiza, y Cía., S. C (in Spanish only): www.banxico.org.mx/aAcercaBanxico/transparencia/auditorias/externo/auditorias2002.html
[27] *Auditoria Superior de la Federacion*, audit reports (in Spanish only): www.banxico.org.mx/aAcercaBanxico/transparencia/auditorias/federacion/AudSupFederacion.html
[28] *Internal Comptroller audit report* (in Spanish only): www.banxico.org.mx/aAcercaBanxico/transparencia/auditorias/contralor/auditorias2002.html

OXFORD ANALYTICA

PAKISTAN

MONETARY TRANSPARENCY

Country Report 2003

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PAKISTAN

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●	●●	●●
Open decision process	●●	●●	●●
Availability of information	●●	●●	●●●
Central bank accountability	●●●	●●	●●●
Score	2.50	2.00	2.50

OUTLOOK & COMMENTARY

The State Bank of Pakistan has made a strong commitment to monetary transparency and the ongoing reforms look set to continue, not least because of the imperatives created by Pakistan's GDDS membership. The authorities have undertaken to reform data collection and dissemination to levels compatible with the IMF requirements.

Some doubts still remain as to the scale and pace of institutional reform. Relations between the central bank and the government remain close and political pressures may yet adversely affect SBP autonomy. Although a great deal has been done to enhance the statutory independence of the Bank, further amendments to the SBP would be necessary to ensure that reversals due to political interference becomes impossible. Similarly, the role of coordination bodies between the government and the Bank should be more explicitly defined.

EXECUTIVE SUMMARY

2.50 Intent declared

The State Bank of Pakistan (SBP) remains fully committed to the series of central bank reforms which began in 1994 by granting the autonomy in its operations. A major milestone on the road to greater transparency was Pakistan's admission to the General Data Dissemination Standard (GDDS) of the International Monetary Fund (IMF) in 2003. Pakistan has now formally undertaken binding commitments to bring its financial statistics in line with international standards.

The SBP's autonomy has been boosted by the freedom given to it in the conduct of monetary policy and the adoption of formal rules governing the dismissal of the governor. While the Bank is committed to operating as a fully autonomous body, relations with the government remain close and, in some cases, ill-defined. In particular, the activities of policy coordination boards remain untransparent. Moreover, a legal provision remains permitting the government to overrule the Bank.

Monetary policy is based in publicly announced money supply targets, although their determination is somewhat opaque. The exchange rate floats with minimal controls but there are periodic interventions designed to prevent major fluctuations.

The SBP has an ambitious publications programme and a highly informative website. However, consultations with the public remain limited. Good relations have been established with the private sector but there are no formal hearings about reforms.

Well-defined and legally codified procedures exist for auditing the SBP's books and the internal audit function in particular has been enhanced in recent years.

Pakistan's rating is increased to 2.50 from 2.00 last year.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The institutional framework for monetary policy in Pakistan is set out in the State Bank Act of Pakistan of 1956 and its subsequent amendments.[1] The Act charges the State Bank of Pakistan (SBP) with maintaining price stability in line with government targets for growth and inflation and recommendations by the Monetary and Fiscal Policies Co-ordination Board (MFPCB). The SBP is further responsible for approving the aggregate credit requirements of both public finance bodies and the private sector, advising the federal government on the impact of monetary policy on the economy, and reporting to the parliament on the state of the economy.[2]

The SBP is responsible for the management of foreign exchange, although the precise rules for foreign exchange management are outlined in the Foreign Exchange Regulation Act of 1947.[3]

Operational autonomy

The SBP was granted full autonomy to regulate and supervise monetary and credit mechanisms in February 1994. Three amendment ordinances to the SBP Act in January 1997 gave the Bank the authority to regulate the banking sector, to independently conduct monetary policy, and to set limits on government borrowings from the SBP.[4]

In spite of considerable progress towards modern standards of central bank independence, the government still retains a degree of influence over the monetary targets and certain other aspects of SBP monetary policy. Of particular concern are several fiscal/monetary policy coordination bodies within the SBP: the Monetary and Fiscal Policies Co-ordination Board (MFPCB) and the National Credit Consultative Council (NCCC). The MFPCB manages and harmonises monetary, fiscal and exchange rate policies to "ensure consistency among macroeconomic targets of growth, inflation and fiscal, monetary, and external accounts."[5] The NCCC draws up the Annual Credit Plan, which determines the credit requirements for both the public and private sector. While these bodies serve a nominal function of transmitting information from the rest of the economy to the SBP and are not policy-making bodies, their lack of transparency are of concern.

The SBP Act gives the government the power to declare the SBP "superseded", if it fails to carry out any of its legal obligations.[6] The government may then confer the Bank's powers to another agency, and must submit a full report to parliament on the circumstances as soon as possible.

Detailed rules for appointment, terms of office, and criteria for removal of the head and members of the governing body of the SBP are specified in the SBP Act.[7] A recently proposed amendment to the 1956 Act, ensuring that the governor could not be removed with just cause before the end of his five-year non-renewable tenure, has been incorporated into SBP legislation.

Institutional relationship between monetary and fiscal operations

Lending to government

The SBP may provide advances to the federal and provincial governments, either through dealing in government securities, or loans repayable within a three-month period.[8] Information on the volume of government borrowing from the SBP is provided in the table of cumulative money flows produced for the SBP's *Quarterly Reports*, as well as being available separately on the Bank website.[9] The SBP is allowed, within limit, to purchase and sell government (both federal and provincial) securities, on the recommendation of the Central Board.[10]

Central bank involvement in the rest of the economy

The SBP is fully owned by the Pakistani government. The Bank is prohibited, under the terms of the Act, from participation in trade or commercial activities. Nor can it own property -- other than its own infrastructure -- or make unsecured loans.[11]

SBP officials are prohibited from sitting on the boards of commercial entities. An exception is made for many state-owned bodies in which the SBP has invested capital, such as the House Building Finance Corporation (HBFC) and the Agricultural Development Bank of Pakistan (ADBP). There are no regulations outlining the limits of their involvement on such boards, with the exception of policies established in 1998 prohibiting SBP officials from nominating board members of these corporations. Regarding procurement in the private sector for its services, the SBP has recently spun off a subsidiary (SBP Services) that performs many of the support services for the SBP, such as currency printing and publications.

Central bank profit allocation

The SBP Act established an Industrial Credit Fund, an Export Credit Fund, a Rural Credit Fund, a Loan Guarantee Fund and a Housing Credit Fund, all of which are part financed by a share of the Bank's operating profit.[12] The federal government may also decree that a part of the Bank's profit be allocated to a Reserve Fund, before any residual (after depreciation and provision for bad debt) is distributed as a dividend to the Bank's shareholder (i.e. the federal government) or directly transferred to the government.[13] The details are provided in the Annual Report.[14]

Agency roles performed by the central bank on behalf of the government

The agency roles entrusted to the SBP on behalf of the government include: acting as banker to the government; performing the role of a fiscal agent including the responsibility for conducting short and long-term government paper auctions; and managing the external debt. In addition, the SBP is also responsible for maintaining all federal government accounts; and making local and foreign currency payments on behalf of the federal government from its various accounts or liquid reserves. [15]

The SBP is entrusted with the management of the public debt and with issuing any new loans.[16] Although the Ministry of Finance (MoF) monitors the government's external accounts, it does not have any significant role in either the primary or secondary markets. Clearance and settlement of government securities is performed exclusively by the SBP. The general debt management framework is outlined in the Debt Management Committee Report of the Ministry of Finance.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●● Intent declared

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The primary objective of monetary policy in Pakistan is to control the growth of the money supply, measured by M2. Growth of M2 is targeted on the basis of an estimated money demand function that incorporates annual economic growth and inflation projections.[17]

Monetary targets are drawn up by the Central Board of the SBP, with significant input from the NCCC and MFCPB, in accordance with the annual National Credit Plan. The Credit Plan makes fund allocations for various sectors of the economy, including the government (for its budget financing and commodity operations) and to the non-governmental sector (including state-owned enterprises). The Credit Plan determines safe limits of monetary and credit expansion during the year considering estimates of growth, inflation and external sector developments.[18]

The process surrounding the Credit Plan falls short of IMF transparency requirements. The full text of the Plan or the minutes of NCCC meetings are not made public. Only broad aggregate figures of credit to the public and private sector are published in press releases. No publicly available document outlines the decision-making structure of the NCCC and the Credit Plan appears to be prepared according to entrenched practice.

A key responsibility of the SBP is to maintain the external value of the currency. The Foreign Exchange Act of 1947 lays out the measures to be taken in order to regulate foreign exchange reserves. Pakistan operates a market-determined floating exchange rate regime and all surrender requirements of foreign exchange receipts have been abolished. However, the Bank is required to prevent major fluctuations in the value of the rupee in order to maintain the competitiveness of Pakistani exports and to ensure the stability of the foreign exchange market.[19]

Monetary instruments

The SBP's monetary operations, as well as updated lists of counterparties (such as primary dealers), are detailed in publicly available circulars. Monetary policy is conducted through open market operations, via regular auctions of T-Bills and the long-term Pakistan Investment Bond (PIB),[20] as well as the use of discount rate and cash/liquidity asset requirements on commercial banks. Although the Ministry of Finance communicates the targets for the Treasury bill auctions, the SBP sets the final target after accounting for the liquidity position of commercial banks and upcoming development in the money market.

The central task of monetary policy in the recent past has been to sterilise substantial foreign currency inflows. During the 2002-03 fiscal year, the government's interventions reduced the rate of reserve money growth from 48.2 to 19.7%.[21]

The monetary policy-making body

Monetary board

The primary governing body of the SBP is the Central Board of Directors. The details underlying the appointment of its members and the terms of office are formalised in legislation.[22] The Central Board comprises the governor of the SBP, representatives from the Ministry of Finance, and directors from each province, all nominated by the federal government. It is obliged to submit a *Quarterly Report* to parliament on the state of the economy with special reference to economic growth, the money supply, credit, balance of payments, and price developments.[23]

There is no explicitly defined monetary policy board, but there are several "consultative" bodies, which serve as co-ordination platforms for monetary policy: the Monetary and Fiscal Policies Co-ordination Board (MFPCB), the National Credit Consultative Council (NCCC), and the Monetary and Exchange Rate Policy Committee (MERPC). Their overlapping responsibilities and memberships, and lack of transparency, is an area of concern.

The MFPCB manages and harmonises monetary and exchange rate policies, as well as fiscal policy. Its task is to "ensure consistency among macroeconomic targets of growth, inflation and fiscal, monetary, and external accounts." The Board includes top-ranking officials from the Ministries of Finance and Commerce, the Planning Commission, and the Finance Division in the government of Pakistan. It meets on a quarterly basis to review the consistency of macro-economic policies and to revise limits and targets set at the time of the formulation of the budget, keeping in view the latest developments in the economy.

While the responsibilities and membership of the MFPCB are specified in legislation,[24] there is very little information publicly available regarding its operations. As it is not a policy-making body *per se*, it does not have a formal decision-making or voting structure. It does not publish any documents such as the minutes of its meetings, although it must respond to any parliamentary queries.

The NCCC formulates the annual National Credit Plan, which sets targets for the expansion of domestic credit. The NCCC includes the SBP governor, representatives from major ministries (Agriculture, Commerce, Finance and Industry), representatives from the provincial governments, and several private sector representatives such as the domestic chambers of commerce, primary dealers, and the Pakistan Bankers' Association (PBA). NCCC meetings, like those of the MFPCB, are held twice a year on a pre-announced schedule. After each meeting, a press release is issued outlining the major decisions agreed to, along with broad estimates of credit to the private sector.

The MERPC is chaired by the Finance Minister, with the deputy chairman of the Planning Commission, the Secretary of the government's Finance Division and the governor of the Bank as members.[25] The MERPC holds at least six meetings in a year. It reviews monetary and exchange rate developments in the economy in relation to inflation and growth, and recommends corrective actions. Minutes of MERPC are not published.

Public statements on monetary policy

Periodic publications

The SBP's publications programme, both in terms of paper publications and information provided on the SBP website, provides timely and comprehensive data on the SBP's activities. The two most prominent central bank publications are the *Annual Report*, and the *Quarterly Reports*. These contain information on macroeconomic

performance, a range of relevant monetary data and economic analysis of leading issues concerning monetary policy and exchange rates. Both these reports can be found on the SBP website.[26]

Other information publicly available includes the monthly *Statistical Bulletin*, a summary weekly *Statement of Affairs* (listing assets and liabilities), a monthly *Export Receipts*, a bimonthly *Pakistan's Balance of Payments*, and an annual *Banking Statistics of Pakistan*.[27] In addition, the Bank publishes a *Quarterly Performance Review of the Banking System* and an annual *Banking System Review*.[28]

Public hearings

While there is little formal consultation with members of the general public for proposed changes to monetary policy and regulations, the diversity of opinions represented at, and the frequency of, private sector meetings has increased substantially in recent years. The SBP Central Board meetings are now held in different cities in turn, and the SBP has made great efforts to consult a wider audience in the financial community, including depositors, borrowers, industry trade groups and other vital stakeholders.[29]

A series of formal and informal meetings are held between the SBP and selected private sector representatives, who are invited to provide feedback on proposed changes to monetary regulations. There are no public announcements of these meetings, nor are any minutes published. The Pakistan Bankers' Association meets quarterly with SBP officials to discuss monetary regulations and conditions in the market. In addition, changes in monetary management are discussed and disclosed to the market via the SBP's network of primary dealers on a monthly basis. For the SBP's current policy debate over a move to an inflation-targeting regime, the involvement of the general public has been largely restricted to announcements in the press.

The SBP generally does not publish draft documents for public feedback. An exception was made with the recent Financial Sector Assessment 1990-2000 (FSA), which has been published on the SBP website in order to generate some private sector feedback. This FSA was drafted in tandem with an advisory committee of financial stakeholders in the economy (both public and private) that meets periodically. While documents from these meetings are not disseminated publicly, however, many documents regarding the FSA are available upon request from the SBP Corporate and Media Affairs Department.[30]

Regulations on data reporting by financial institutions to the central bank

Regulations on data reporting by financial institutions to the SBP are set out in the SBP Act and the 1962 "Banking Companies Ordinance" (BCO) which gives the central bank full authority to supervise and regulate banks and financial institutions.[31] The SBP Act requires corporations with which the SBP has transactions, including all domestic financial institutions, to furnish the bank with returns and sets out the provisions for enforcing this practice.[32]

The SBP has drafted prudential regulations for banks and rules of business for Development Finance Institutions. Two departments of the SBP are charged with supervision of the financial sector: off-site management is the responsibility of the Banking Supervision Department, while the Banking Inspection Department takes charge of on-site monitoring. The Bank reports that its on-site examination capabilities have been "substantially augmented to bring them at par with the expected international standards."[33] This sentiment has been echoed across the private sector. Improvements have been noted in both the SBP inspection staff, in terms of training, preparedness, and professionalism, as well as the Inspection Reports themselves, which were seen as being increasingly balanced, constructive and informed.[34]

3. Public Availability of Information on Monetary Policy

●● Intent declared

Release of central bank data

Pakistan in November joined the General Data Dissemination Standard (GDDS) of the IMF. Consequently, most key SBP data meets IMF standards and the Bank has made a commitment to make any necessary further improvements. The Bank has short-term plans to prepare and publish an advance release calendar, to collect data on the assets and liabilities of deposit money banks on a monthly basis, disaggregate data on non-financial public enterprises and private non-bank financial institutions, and to compile a monthly monetary survey. Medium-term plans have been prepared to collect data on non-bank financial institutions, *modarabas*, investment corporations, etc., in order to facilitate the development of a financial survey. There are short-term plans to further improve data standards on foreign liabilities, credit to the private sector, methodology, the balance of payments, the international investment position, and international reserves.[35]

The Bank intends to improve the timeliness of the monthly data on the net external position, domestic credit, and broad and narrow money from the current 1-3 months to 30 days. Monthly data on the monetary base will appear within 30 days, instead of the current 1-2 months. Interest rate data will be published daily.[36]

The SBP currently publishes a wide range of macroeconomic and monetary data as part of its *Quarterly* and *Annual Reports*, but without an accompanying methodological statement. While the quality of SBP data has improved in the past few years, some data are still published with a considerable time lag.

The central bank balance sheet

The SBP publishes a detailed balance sheet along with profit and loss accounts on a yearly basis in the *Annual Report*. Information on market transactions such as treasury bill auctions and foreign exchange activities is also made available through newspapers and the SBP's publications. In addition, a summary balance sheet is released weekly. The SBP began to prepare its balance sheet according to International Accounting Standards (IAS) in June 2000. Weekly reports are included in the *Statement of the Affairs*.[37]

Market transactions or monetary operations are reported the same day. All information is available online. Aggregate amounts of monetary operations, with the exception of swaps, can be found in the *Annual Report*. The foreign exchange position on the SBP can be found on the SBP website, where the SBP publishes both its own reserves and those of domestic banks. There is, however, no information on the contingent liabilities on SBP reserves.

Lender of last resort

The SBP acts as a lender of last resort to banks and credit institutions in Pakistan, providing a discount window facility to meet temporary liquidity shortages.[38] The SBP is also empowered to provide emergency financial support

to those banks that may need such aid. According to SBP policy, in light of confidentiality considerations and market sensitivity, details regarding the exact amounts disbursed to individual firms are not made public.

Public information services

Both the Corporate and Media Affairs Department (CMAD) and the Publications Department handle all requests for information, from both the press and the general public. The SBP publishes a large volume of information on its website, all of which is available in English. Monetary data, such as the position of foreign exchange reserves, auctions of government Treasury Bills, and monetary developments are published both as press communiqués and online. In addition all the governor's speeches and press releases are reproduced in their entirety.[39]

The Banking Policy Department and the Exchange Policy Department have help desks with electronic query forms.[40]

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●● Enacted

Accountability before a designated public authority

The governor and other high-ranking officials of the SBP appear before the Economic Co-ordination Committee of the Cabinet (ECCC) and make periodic appearances in parliament, although there is no formal legal requirement to do so. The SBP is required to answer any questions from parliamentary members or committees, and unofficial SBP policy requires a written response to any query from the general public. The SBP Act requires the Central Board of Directors of the SBP to submit a *Quarterly Report* to parliament on the state of the economy with special reference to economic growth, the money supply, credit, balance of payments, and price developments.[41]

When the parliament was suspended in October 1999-October 2002, the SBP reported to the Ministry of Finance, although the publications programme continued unabated.

Financial statement

Audited financial statement

Public disclosure of audited financial statements of the SBP's operations is required by the SBP Act.[42] The SBP publishes its balance sheet in its *Annual Report*, which provides details of the Bank's expenses and revenues. This is audited externally by two independent, private sector auditing firms. The *Report of the Auditors* is appended to the *Annual Report*, and is undertaken in accordance with International Auditing Standards.[43] Under the SBP Act, the SBP must hold an annual shareholders meeting, where the shareholders present are entitled to discuss the annual accounts, the report of the Central Board on the working of the Bank throughout the year, and the auditors' report on the annual balance sheet and accounts.[44] All operating expenses and revenues of the SBP are detailed in the *Annual Report*.[45]

External and internal audit

The SBP Act requires the appointment annually of at least two auditors whose remuneration is fixed at the annualgeneral meeting. Somewhat problematically, the auditors may be shareholders, although officers of the Bank are disqualified. Any auditor can be re-elected with no legal limits on the number of renewals.[46] The accounts for 2001-02 were audited by Husain Rahman Chartered Accountants and A.F. Fergusons & Co Chartered Accountants. Theirreport is reproduced in the Bank's *Annual Report*.[47]

The State Bank has an Audit Department which is charged with ensuring that the departments at the Central Directorate and all branch offices comply with rules and regulations issued by the Bank.[48] Internal auditing has been strengthened recently by new management of the Audit Department which reports directly to the governor of the SBP. In the past three years, the Audit Department has inspected both regional offices and departments at the SBP Secretariat.

The Audit Department is responsible for addressing non-compliance with regulatory requirements, for identifying problems and proposing resolutions, and for investigation of "financial bunglings." The Department can assign compliance responsibilities to directors of the departments concerned, chief managers of offices, and – through brief appraisals – to the governor.[49]

Subject to meeting all other pertinent statutory requirements, the federal government may at any time appoint the Auditor General or other auditors of its choice to examine and report on the accounts of the SBP.[50]

According to the SBP Act, every auditor will be supplied with a copy of the annual balance sheet and will be given complete access to the Bank's books and other documents. The auditors will report, as appropriate, to the shareholders or the federal government.[51]

Conduct of officials

The SBP has a formal code of conduct for employees, which is available on the Bank's website. This code -- the State Bank of Pakistan Staff Regulations 2001 -- includes regulations on recruitment, promotion, staff loan policy, discipline (including provisions relating to political participation, speculation in financial markets and confidentiality), punishment and appeal. The code does not provide information for employees on legal protection from litigation arising from the conduct of their official duties.[52]

INTERVIEWS

In 2003, Oxford Analytica did not conduct in-country interviews in Pakistan for security reasons. The information contained in this report was drawn from correspondence with representatives of the State Bank of Pakistan, the Ministry of Finance, and the Federal Bureau of Statistics, experts from the Oxford Analytica global network, and various publicly available sources.

NOTES

[1] The SBP Act is available on the SBP website: http://www.sbp.org.pk.
[2] SBP Act 1956, Article 9.A.
[3] SBP Act 1956, Article 17.B.3(a). The full text of the Foreign Exchange Regulation Act (1947) is available from the SBP website.
[4] SBP Act.
[5] SBP Act 1956, Article 9B, 2(a)-(b).
[6] SBP Act 1956, Article 52.
[7] SBP Act 1956, Articles 10-15.
[8] SBP Act 1956, Article 17.5.
[9] http://www.sbp.org.pk/ecodata/gborrow.pdf.
[10] SBP Act 1956, Article 10(a)-(b).
[11] SBP Act 1956, Article 20.
[12] SBP Act 1956, Articles 17(a)-(e).
[13] SBP Act 1956, Articles 41 and 42.
[14] http://www.sbp.org.pk/reports/annual/arFY02/chap13.pdf.
[15] SBP Act (1956), the Foreign Exchange Regulation Act (1947), and the Public Debt Act (1944).
[16] SBP Act 1956, Article 21.2(a).
[17] SBP Website introduction to the Bank.
[18] Azhar Mahmood, "SBP envisages Rs85bn credit to private sector: NCCC to discuss credit plan on July 4," *The News – Jang Group*, 1 July 2003, http://www.jang.com.pk/thenews/jul2003-daily/01-07-2003/business/b1.htm; "NCCC okays Rs230bn monetary expansion," *The News – Jang Group*, 5 July 2003, http://www.jang.com.pk/thenews/jul2003-daily/05-07-2003/business/b1.htm.
[19] http://www.sbp.org.pk/about/core_functions/index.htm.
[20] The PIB is available in tenures of three, five, and ten years.
[21] State Bank of Pakistan, "Monetary Policy Statement for 2003-04," http://www.sbp.org.pk/m_policy/m_policy.pdf.
[22] SBP Act 1956, Articles 10, 13, 14 and 15.
[23] SBP Act 1956, Article 9.A(f).
[24] SBP Act 1956, Article 9.B(f).
[25] SBP Act No. XXXHI of 1956, Article 9B.
[26] http://www.sbp.org.pk/publications/index.asp.
[27] http://www.sbp.org.pk/reports/stat_reviews/index.htm.
[28] http://www.sbp.org.pk/publications/q_reviews/q_review_june_03.pdf; http://www.sbp.org.pk/publications/others/bksystemreview.pdf.
[29] Interviews in Pakistan, 15-17 October, 2002.
[30] www.sbp.org.pk/publications/fsa/index.htm.
[31] This legislation is available on SBP website.
[32] SBP Act (1956), Articles 36 and 38.

[33] http://www.sbp.org.pk/about/ordinance/supervision.htm; Ishrat Husain, "Regulatory Strategy of the State Bank of Pakistan," Address de;overed at the 18th Annual General Conference of the Pakistan Society of Development Economics, Islamabad, 15 January 2003, *BIS Review* 3/2003.
[34] http://www.sbp.org.pk/about/ordinance/supervision.htm.
[35] http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorysummreport/?strcode=PAK&strcat=Sum1.
[36] http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorysummreport/?strcode=PAK&strcat=Sum2.
[37] http://www.sbp.org.pk/publications/statements/index.htm.
[38] A description of the SBP's LOLR function is available on the SBP website, in "Core Functions of SBP."
[39] http://www.sbp.org.pk/about/speech/index.asp; http://www.sbp.org.pk/press/releases.asp.
[40] http://www.sbp.org.pk/bpd/helpdesk.asp; http://www.sbp.org.pk/epd/helpdesk.asp.
[41] SBP Act 1956, Article 9A (f).
[42] SBP Act 1956, Article 40.
[43] SBP Act 1956, Article 45.
[44] SBP Act 1956, Article 16.1-2.
[45] Annual Report 2000-1, Chapter 11, "State Bank's Accounts for 2000-01", http://www.sbp.org.pk/report2001/chap11.pdf.
[46] SBP Act, Article 43.
[47] http://www.sbp.org.pk/reports/annual/arFY02/chap13.pdf.
[48] http://www.sbp.org.pk/departments/audit.htm.
[49] http://www.sbp.org.pk/departments/audit.htm.
[50] SBP Act, Article 44.
[51] SBP Act, Article 45.
[52] State Bank of Pakistan, Staff Regulations 2001, http://www.sbp.org.pk/about/staff-regu.pdf.

OXFORD ANALYTICA

PERU

MONETARY TRANSPARENCY

Country Report 2003

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PERU

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●●	●●●●	●●●●●
Open decision process	●●●●	●●●●	●●●●
Availability of information	●●●●	●●●●	●●●●
Central bank accountability	●●●●	●●●●	●●●●
Score	**4.00**	**4.00**	**4.25**

OUTLOOK & COMMENTARY

Peru will likely improve monetary policy transparency from an already high standard. The Central Reserve Bank of Peru (BCRP) has sustained its comprehensive provision of data and overall information on monetary policy in order to consolidate the effective operation of its inflation-targeting framework.

Medium-term progress in having an open process for reporting monetary policy decisions should be attained once an overall plan for BCRP internal restructuring is developed. A number of international experts and officials from other central banks are being invited to visit Lima in 2004 to provide technical assistance. In this context, monetary transparency will increase as the BCRP's internal managerial ability improves. Nevertheless, the weakness of having concurrent terms of appointment for BCRP board members and the executive will likely remain.

EXECUTIVE SUMMARY

4.00 Compliance in progress

The Central Reserve Bank of Peru (BCRP) has sustained its high standards of monetary policy transparency in 2003. The consolidation of the inflation-targeting framework, implemented through open market and discount window operations (and the availability of a reference short-term interest rate), has served to consolidate and provide further information on how the BCRP's monetary transmission mechanism operates.

As part of its commitment to the IMF's Special Data Dissemination Standard (SDDS), the BCRP continues to publish data that comply with SDDS coverage, periodicity, timeliness and access requirements. In addition, the Monthly, Weekly and Inflation Reports provide a comprehensive source of information that gives details on changes in monetary policy.

The existing rules for appointments to the BCRP Board of Directors remain a potential drawback for its effective operational autonomy. Although the problems related to the resignation of BCRP President Richard Webb were primarily related to internal conflicts of administration, this event has drawn attention back to the vulnerability problem of BCRP officials throughout political cycles. In this context, monetary transparency would be enhanced if the tenure of board members would not coincide with the presidential and legislative terms, and if the minutes of board meetings were publicly disclosed.

Peru's overall score is unchanged from last year.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

The Constitution of Peru clearly defines the objectives of the Central Reserve Bank of Peru (BCRP -- *Banco Central de Reserva del Peru*) and provides it with the necessary policy instruments to meet them.[1] The 1993 Constitution of Peru also establishes the independence of the BCRP from the different branches of the State.[2] This constitutional framework is further elaborated in the Organic Law of the BCRP (LOBCR).[3]

Central bank objectives and responsibilities

The constitution and the LOBCR both establish that the sole objective of the BCRP is to maintain the stability of the Peruvian currency. The BCRP focuses on inflation targeting to attain its objective, using reference interest rates, daily liquidity interventions, and foreign exchange operations (if necessary, to reduce extreme exchange rate volatility) to influence the trend of inflation. The BCRP is also responsible for regulating financial markets and managing foreign reserves. In this context, the BCRP is prohibited from introducing limits to foreign currency holdings or restrictions to international capital flows, as mandated by Article 64 of the constitution. The BCRP has also the responsibility to manage foreign reserves, and endorse the adequate working of financial markets.[4]

Operational autonomy

The constitution (Article 84) and the LOBCR (Article 1) provide for the complete financial and operational autonomy of the central bank. In July, the BCRP President Richard Webb resigned owing to irreconcilable differences with other BCRP board members. Former Minister of Finance Javier Silva Ruete took over the presidency days later -- a situation that led to widespread speculation about likely political pressure from the government. While commentators asserted that Webb's resignation was caused by internal problems of administration and personnel promotions at the BCRP, the fact that the Board of Directors' appointments coincide with the executive's term and that there are internal disagreements among board members over management issues has nevertheless generated some uncertainty.[5]

Institutional relationship between monetary and fiscal operations

Lending to government

The relationship between fiscal and monetary operations is clearly defined in the constitution and the LOBCR. In addition to the BCRP's institutional independence, both laws rule out any loans to the treasury or to state-owned enterprises, as well as prohibiting the issuance of guarantees. Article 61 of the LOBCR limits purchases of government bonds in the secondary bond market to 5% of the monetary base registered at the end of the previous fiscal year.

Central bank involvement in the rest of the economy

Article 84 of the LOBCR establishes that the BCRP may not buy shares, other than those issued by international financial organisations, or those necessary for refinancing operations of private banking/financial institutions. Moreover, the BCRP cannot own (either directly or indirectly), capital of commercial, industrial or any other kind of

enterprises. There have been no changes to the legal framework and the law has been fully observed during the past twelve months.

In addition, Article 62 of the LOBCR authorises the BCRP to perform open market operations with its own securities and with first-class securities issued by third parties. The BCRP's website includes the text of the Procurement Law and displays adequate information about procurement operations.[6]

Central bank profit allocation

The BCRP determines profits for a given fiscal exercise on an annual basis. Article 92 of the LOBCR allocates 25% of its profits to the treasury, with the remaining 75% allocated to a reserve fund that may be used to cover future losses of the BCRP. Whenever the reserve fund cannot make up for the annual losses, Article 93 determines that the treasury will issue government bonds (equivalent to the remnant loss after the reserve fund) to finance the central bank. However, the law does not explicitly determine the maturity and debt servicing terms of these securities.

Agency roles performed by the central bank on behalf of the government

There have been no changes to laws and regulations concerning the agency roles performed by the BCRP on behalf of the government. These roles are clearly defined and transparently conducted. It is restricted to representing the government in international financial organisations and serving as a deposit agency for government foreign exchange reserves and the treasury account[7]. The BCRP's role as fiscal agent and adviser to the government is limited.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments and targets of monetary policy

Framework and monetary targets

The BCRP has progressively introduced the required changes to use the inflation-targeting framework (introduced in 2002) to fulfil its monetary policy objective. This framework has enhanced the effectiveness of BCRP interventions and increased monetary policy transparency. Among its instruments is the use of a reference short-term interest rate, in order to signal the trend of commercial banks' lending interest rates and inflation expectations. The BCRP has consistently disseminated additional information on how its inflation targets are met, and how the monetary transmission mechanism works.[8]

Monetary instruments

In order to implement changes in monetary policy via a reference short-term interest rate, the BCRP sets credit regulations and overnight deposit requirements for commercial banks (in Peruvian soles and US dollars), and carries out open market operations with its securities, to alter the level of the inter-bank interest rate. In addition to these operations, the central bank can trade foreign exchange, but these transactions have been limited to reducing short-term volatility. The BCRP is fully committed to keep a floating exchange rate regime while ensuring orderly market conditions, consistent with the pursuit of its primary objective of price stability.

The monetary policy-making body

The Board of Directors of the BCRP integrates the monetary policy-making body. The authority of the board and its composition is set out in the constitution and the LOBCR. There have been no changes in the legal framework during the past twelve months concerning the allocation of monetary policy responsibilities of the board.

Monetary board

The Monetary Board of Directors consists of seven members, four appointed by the executive and three appointed by absolute majority in Congress. The executive chooses the president of the board, subject to congressional ratification. This appointment system has raised concern about the BCRP's operational independence in practice. For example, in the first half of this year the board was caught in a damaging series of internal conflicts, with board members challenging the managerial and administrative style of then BCRP President Richard Webb (who resigned in July). Allegedly, a majority of the board forced Webb to remove several of his close management allies, making his position untenable.

The problem partly stems from the fact that the tenure of board members coincides with presidential and legislative terms. The LOBCR establishes that board members can only be removed under specifically defined circumstances, which are limited to violations of the law and severe infringement of conduct guidelines.[9] Although these restrictions on the ability to remove board members protect its independence, the fact that all board appointments match with the political cycle undermines the independence of the BCRP president.

In this context, commentators said that it would be ideal for the Board members' term not to coincide with the term of the president of Peru. However, this proposal is not being discussed as part of the ongoing round of constitutional amendments, and there is no political resolve to start this process. Further, some commentators argued that even if there are no doubts about the BCRP's independence to set monetary policy, potential board members have to be close to the Ministry of Finance in order to be appointed.[10]

At present, two board members also hold positions in other government agencies, one being a vice-minister of finance. The other agency, COFIDE, carries out public financial operations and is regulated by the BCRP. COFIDE also deals in foreign currencies, which may create conflicting incentives in the BCRP Board towards interventions in the exchange market. Commentators said that the aforesaid coincidence of appointment terms is more problematic than the issue of parallel positions; yet regulatory agencies need to be strengthened to ensure that they are technically capable and free from political pressure.[11]

Advance meeting schedule

Although there is no readily available advance meeting schedule, the LOBCR mandates that board meetings must be held at least twice a month. References to proceedings are available on the website, and monthly press releases inform society about the decisions that the board adopts.[12]

Public statements on monetary policy

The BCRP publishes its annual Monetary Programme in January (available in Spanish and English).[13] The Inflation Reports, published three times each year, explain overall changes to the monetary programme. The Informative Notes released by the BCRP on the first Thursday of each month detail changes in monetary policy and monthly interest rates.[14] The daily *Press Releases* provide information on the average commercial inter-bank interest rate.[15]

Periodic publications

In addition to the release of monetary policy statements, the BCRP publishes an Annual Report that includes an evaluation of monetary policy and BCRP targets during the previous year, the BCRP balance sheet and the monetary programme for the following year.[16] The BCRP also publishes a Weekly Report, with statistical tables of net international reserves, exchange rate and inflation, trade balance, public sector accounts and external debt.[17]

Public hearings

The BCRP does not have an established policy of public consultation on technical changes. The BCRP's website does not include any prior public consultation information, and authorities have not established readily available procedures to handle consultations. Nevertheless, BCRP directors and senior staff provide information through seminars and scheduled conferences aimed at raising public awareness about the BCRP and its functions.

Regulations on data reporting by financial institutions to the central bank

Article 74 of the LOBCR allows the BCRP to request information from commercial banks and other financial institutions, although a detailed list of what documents the BCRP can request is not explicitly incorporated in the law. Nevertheless, financial institutions submit their balance sheets on a weekly basis, along with information on foreign currency debts. Information requirements can be found on the website's *Circulares Vigentes* section.[18]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

As part of its commitment to the IMF's Special Data Dissemination Standard (SDDS), the BCRP continues to publish data that comply with SDDS coverage, periodicity, timeliness and access requirements. The overall quality of the statistics and data is adequate, and coverage is extensive. The statistics are regularly updated and usually available in both English and Spanish. The BCRP publishes annual, quarterly, monthly, weekly and daily data on monetary aggregates, interest rates and reserves. The BCRP also releases a quarterly report on its income, expenses, and budgetary execution. There is an advance release calendar for the main macroeconomic statistics and the Weekly Report.

The central bank balance sheet

The BCRP publishes on its website annual and monthly reports that include its balance sheet. Monthly reports have a lag of more than two months. In general, the BCRP uses a close approximation to International Accounting Standards (IAS) for its balance sheet[19]; the Annual Report 2002 includes a note (which is part of the audited financial statements) that explains the main differences between the BCRP accounting practices and IAS.

Lender of last resort

Emergency lending rules are set out in Articles 58 and 59 of the LOBCR. The BCRP may perform lending operations to private financial institutions facing financial distress, when guaranteed with first-class securities and for periods of no more than 30 days. It is forbidden to supply credits to the government or state-owned enterprises outside the scope of those provisions in Article 61 of the LOBCR.

Public information services

The BCRP has comprehensive information services, most of them available through its website. Information on monetary aggregates and foreign currency reserves is available on a daily and weekly basis. Fiscal and other macroeconomic data is released on a monthly and annual basis.

The central bank also makes available official publications and produces a journal of economic studies, although this is not published with a specified periodicity. The BCRP's website contains presentations and speeches made by its senior officials. Specifically, the directors' notes on the monetary programme are also published on the website. Texts including the LOBCR, statutes, resolutions, memos, and legal norms, are also available online. Nevertheless, commentators said that monetary policy transparency would be substantially enhanced if the BCRP would make publicly available the minutes and voting records of board meetings, and a record of the discussions when the monetary policy stance is changed.[20]

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

The BCRP is required to report to Congress on the conduct of monetary policy, policy objectives, and performance in achieving those objectives. Transparency practices include BCRP accountability regarding any deviation from monetary policy commitments. Its financial statements are subject to oversight by the Superintendence of Banking and Insurance (SBS). The central bank is also subject to external oversight by the Comptroller General.

Financial statement

Audited financial statement

The BCRP also has its financial statements audited independently. In 2002, Price Waterhouse Coopers was selected as the external auditor, and its report is available on the BCRP website.[21] Monthly and annual balance sheets and the BCRP financial statements are also available on the website.[22]

External and internal audit

Article 87 of the LOBCR establishes that the Chief of the Internal Control Unit is responsible for the *ex post* control of the central bank's budget and net worth accounting. To this end, the chief must report to the BCRP's Board and the Comptroller General (the office exercising external control) on all matters related to audit operations and supervision of funds and securities. Further, the chief must submit a written report on the financial statements for the previous financial year to the Board of Directors at their last meeting in March. Copies of this report are then dispatched to the Comptroller General and the SBS. Following approval from the Board of Directors, the chief audits and certifies the annual balance sheet and the profit/loss statement, which are subsequently published.

Conduct of officials

The conduct standards for BCRP officials are outlined in Article 13 of the LOBCR. The law establishes that, before assuming office and within thirty days of leaving, all directors must make a sworn statement of their assets and income. The BCRP also publishes work regulations on its website.[23]

Information about legal protections for BCRP officials is publicly disclosed. Article 22 of the LOBCR stipulates that the filing of criminal charges against directors for acts performed or omissions incurred (while in office or subsequently) requires the enactment of impeachment proceedings for high officials, as set out in the constitution.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Peru between 18 and 20 November 2003:

Central Reserve Bank of Peru (BCRP)

19 November 2003

Jorge Estrella	Deputy Director	Public Sector Office
Hugo Perea	Head	Economic Modelling Unit
Adrian Armas	Deputy Director	Monetary Sector Office

Ministry of Economy and Finance

18 November 2003

Bruno Barletti	Director	SIAF-SP
Javier Kapsoli		Economic and Social Affairs

ADDITIONAL INTERVIEWS

18 November 2003

Jorge Guzman	Resident Representative	International Monetary Fund
Guillermo Diaz	Director of Economic Studies	Banco Wiese Sudemaris

19 November 2003

Jaime Vidal Henderson	Chief Adviser	Office of Comptroller General
Javier Nagamine	Senior economist	Superintendence of Banking and Insurance
Lucia Romero	Financial Analysis Department	Superintendence of Banking and Insurance

20 November 2003

Eduardo Moron	Macroeconomics and Political Economy Area	Centro de Investigacion Universidad del Pacifico
Cecilia Blume	Lawyer	Former senior adviser, Ministry of Finance

NOTES

[1] Central Bank of Peru (Banco Central de la Reserva del Perú) at: www.bcrp.gob.pe.
[2] Peru Constitution of 1993 Title III of Economic Institutions at: www.leyes.congreso.gob.pe
[3] Organic Law of the Central Reserve Bank of Peru: www.bcrp.gob.pe/English/WLaw-Regulation/organic-law.htm
[4] Title I, LOBCR: www.bcrp.gob.pe/English/WLaw-Regulation/organic-law.htm#TITLE I
[5] Interviews in Peru, 18-20 November 2003.
[6] *Contrataciones y Adquisiciones* (in Spanish only): www.bcrp.gob.pe/Espanol/WLicitacion/Licitaciones.htm
[7] Articles 61 and 70 of the LOBCR.
[8] Interviews in Peru, 18-20 November 2003. Commentators said that a version of the core macroeconomic model for inflation forecasting will be published in the next edition of the BCRP Economic Research Journal (*Revista de Estudios Economicos*, in Spanish only), which will contribute to the dissemination of information on how the monetary transmission mechanism works. See www.bcrp.gob.pe/Espanol/WPublicaciones/Rev_Est_Econ.htm
[9] See also Article 86 of the Constitution of 1993.
[10] Interviews in Peru, 18-20 November 2003.
[11] Interviews in Peru, 18-20 November 2003.
[12] See Informative Note(s) on the Monetary Programme at:
www.bcrp.gob.pe/English/WPolMon/Prog_Monetary.htm
[13] See for example the Monetary Program for 2002 at:
www.bcrp.gob.pe/English/WPolMon/Monetary%20Program%202002.pdf
[14] These documents are available at: www.bcrp.gob.pe/English/WPolMon/Prog_Monetary.htm
[15] *Novedades* (in Spanish only): www.bcrp.gob.pe/Index.htm
[16] See Annual Report 2002: www.bcrp.gob.pe/English/WPublicaciones/memory2002.htm
[17] Weekly Reports: www.bcrp.gob.pe/English/WInformes/weekly_report_2001.htm
[18] 'Information requirements and penalties' Circular 04-2002-EF/90 (08/02/2002) -- (*Procedimiento para solicitar informacion estadistica y regimen de multas por incumplimiento*, in Spanish only):
www.bcrp.gob.pe/Espanol/normas_legales/Circulares/c-2001/c082001.pdf
[19] Interviews in Peru, 18-20 November 2003.
[20] Interviews in Peru, 18-20 November 2003.
[21] *Dictamen de los Auditores Independientes* (in Spanish only):
www.bcrp.gob.pe/Espanol/Wcontabilidad/Com_Est_Fin.htm
[22] www.bcrp.gob.pe/Espanol/Wcontabilidad/Balancegen.htm
[23] For example, see the Guidelines for Institutional Representatives, Confidentiality and Conflicts of Interests (*Reglamento sobre Representacion Institucional, Confidencialidad y Conflicto de Intereses*, in Spanish only):
www.bcrp.gob.pe/Espanol/normas_legales/Reglamento_Confid/RConfidencialidad.htm

OXFORD ANALYTICA

PHILIPPINES

MONETARY TRANSPARENCY

Country Report 2003

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THE PHILIPPINES

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	••••	••••	••••
Open decision process	••••	•••	••••
Availability of information	••••	••••	••••
Central bank accountability	•••	•••	••••
Score	**3.75**	**3.50**	**4.00**

OUTLOOK & COMMENTARY

The Bangko Sentral ng Pilipinas (BSP) has continued to implement measures aimed at increasing monetary transparency, which have also fostered the effective implementation of its inflation-targeting framework. In addition, the BSP has attained progress in correcting the deficiencies of the statistical techniques and compilation methods used to collate balance of payments data.

Governor Rafael Buenaventura's pending suspension has underlined the need to remove the uncertainty over the BSP's regulatory functions. It has also highlighted the sway of legislative inertia, which has delayed reforms to the 1993 Central Bank Act that would provide adequate protection to central bank employees while performing banking-supervision duties. This weakness will likely remain if Congress does not approve the amendments. Nevertheless, overall monetary transparency should be enhanced once the voting records and more detailed minutes of board meetings are publicly available.

EXECUTIVE SUMMARY

3.75 Compliance in progress

The Central Bank of the Republic of the Philippines (BSP) has sustained its efforts to increase monetary policy transparency. The Philippines remain committed to the IMF's Special Data Dissemination Standard (SDDS), and the BSP observes the SDDS requirements in all categories within the scope of its responsibilities.

The BSP's operational autonomy has remained strong. Despite setbacks in the government's ability to reduce its fiscal deficit, the BSP's appropriate transition plan -- in addition to subdued demand and receding cost-side pressures -- has helped to consolidate the inflation-targeting framework. Further, the BSP makes available a wealth of information on inflation targeting that, in addition to the broad consultation process to get regional feedback on monetary policy implementation, has increased public awareness of the BSP's responsibilities while providing a benchmark to assess its performance.

Substantial progress was achieved in passing regulations that have addressed the main legal deficiencies in the Philippine anti-money laundering regime and the Securities and Exchange Commission rules on commercial banking supervision. However, additional changes should be made to the New Central Bank Act in order to provide clearer instructions and safeguards for the removal of BSP officials, in particular when exercising supervisory duties. These amendments, together with greater disclosure of the central bank's supervisory faculties and the BSP Monetary Board's voting records, should improve overall monetary transparency in future.

The Philippines' overall score has improved from 3.50 in 2002 to 3.75.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The New Central Bank Act of 1993 (NCBA) regulates the activities of the Central Bank of the Republic of the Philippines -- Bangko Sentral ng Pilipinas (BSP). The act establishes the BSP as an independent monetary authority and mandates it to maintain stability of prices conducive to balanced and sustainable economic growth, while aiming also to promote monetary stability and the convertibility of the Philippine currency. The BSP is responsible for the formulation and implementation of policy in the areas of money, exchange rate, banking, and credit, as well as the supervision and regulation of banks, financial institutions, and quasi-banks. The NCBA empowers the BSP to acquire any assets and incur any liabilities that are necessary to attain its policy objectives.[1]

In 1993, the restructuring of the old Central Bank of the Philippines (CBP) into the BSP was made necessary by the CBP's accumulation of around 308 billion pesos in liabilities, as a result of undertaking quasi-fiscal operations on behalf of the government.[2] Under the NCBA, the BSP is granted increased fiscal and administrative autonomy from the central government.[3] As a result, it has largely ceased to engage in quasi-fiscal activities.

The NCBA establishes a clear framework of accountability for BSP officials. Members of the central bank's principal policy-making body, the Monetary Board, and other officials are liable for losses that the BSP or other banking institutions incur as a result of abuse of responsibilities, negligence or imprudence.

In 1998, a bill was drafted to strengthen the supervisory powers of the BSP. The revisions would not modify the underlying objectives or key institutional framework set out by the NCBA. The bill had not been passed by late 2003, and the new administration that takes office after the 2004 election is expected to re-table the bill in Congress.[4]

Operational autonomy

The NCBA made the BSP formally independent. The government does not have the legal authority to override central bank decisions -- it can only apply informal pressure.[5] Board members may be dismissed by the President of the Philippines if they are guilty of fraudulent or illegal behaviour, or become unfit to hold office.[6] This clause is clearly spelled out and all exiting members of the Monetary Board have finished their six-year terms.[7] Nevertheless, it allows for some presidential discretion, and the central bank's earlier record of board dismissals has offered mixed signals about its administrative independence.

The BSP's operational autonomy has remained strong. High fiscal deficits in 2002 and this year did not lead to government pressure on the central bank's monetary policy settings. Despite setbacks in the government's ability to reduce its fiscal deficit, the BSP's appropriate transition plan -- in addition to subdued demand and receding cost-side pressures -- has helped to consolidate the inflation-targeting framework in a relatively benign macroeconomic environment.

Institutional relationship between monetary and fiscal operations

Lending to government

The BSP does not regularly extend credit to the government, but is permitted to buy and sell government securities in the secondary market in connection with its open market operations. The purchase and sale of such debt securities may be made outright or using repurchase agreements. The BSP may also issue, buy, and sell its own securities in cases of extraordinary movements in price levels.[8]

The BSP is permitted to make direct provisional advances (with or without interest) to the government to finance authorised expenditures in the annual budget, provided that such advances are repaid within three months. The aggregate of such advances cannot exceed 20% of the average annual income of the government for the preceding three years.[9] Since the establishment of the BSP, no such advances have been made.

Details of the BSP's loans to the government, as well as government deposits with the central bank, are listed on its monthly balance sheet. This is available on the BSP's website within two months of the end of each month. The data is presented on a consolidated basis and contains no information on the interest rate or repayment period of the BSP's loans to the government.[10]

Central bank involvement in the rest of economy

The BSP's involvement in the rest of the economy is clearly proscribed by the NCBA. The central bank cannot acquire shares or participate in the ownership or management of any firm, whether directly or indirectly.[11] In addition, employees are forbidden from concurrent employment in any institution subject to supervision or examination by the BSP. Members of the Monetary Board are not permitted to hold any other public office or public employment during their period of tenure. Individuals connected with multilateral banking institutions or with a stake in Philippine private banks cannot be appointed to the Monetary Board for one year after renouncing to their external interests. Likewise, members of the Board cannot be employed by private or multilateral banking institutions for two years after the termination of their Board membership.[12]

Central bank profit allocation

The NCBA requires the BSP to calculate its net profits/losses on a monthly basis. In carrying out these calculations, the Bank is obliged to make an adequate allowance for bad accounts. At the end of each fiscal year, it is required to place 75% of its net profits into a sinking fund to help pay off the liabilities of the old CBP. Once these liabilities have been liquidated, the BSP will carry 50% of its net profits as surplus, and remit the remainder to the Treasury at the end of each fiscal year. Profits or losses arising from the revaluation of the Philippine peso against foreign currencies (mainly the US dollar) are included in the calculation of the BSP's annual balance, which is marked to market.[13]

Agency roles performed by the central bank on behalf of the government

The central bank performs several agency roles on behalf of the government. It acts as a banker to the government; represents it in all dealings, negotiations, and transactions with the IMF and the Bank of International Settlement; acts as a financial adviser to government; and is the official depository of the cash balances of all government agencies. For this reason, the BSP operates a general cash account for the Treasurer, in which the liquid funds of the government are deposited.[14]

BSP representatives sit on a range of government committees, including the Investment Coordinating Committee and the Committee on Tariffs and Related Matters. The Development Budget and Coordination Committee (DBCC), which includes the BSP and the chief fiscal agencies of the government, sets the desirable level of revenue expenditure and debt for the annual budget.[15]

The central bank buys and sells government securities in the secondary market for monetary stabilisation using the Securities Stabilisation Fund, administered by the BSP for the account of the government.[16]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The BSP shifted from monetary targeting to explicit inflation targeting as its policy-making framework in January 2002. The central bank has implemented adequate mechanisms to inform the public how the inflation-targeting regime works. In this context, the BSP uses the consumer price index (CPI) or headline inflation (published by the National Statistics Office) as its target for monetary policy. The policy target is expressed in the form of a range for a given year and is set by the national government in coordination with the central bank.[17] The BSP regularly disseminates quarterly inflation reports, reports on monthly inflation, and the minutes of its Monetary Board meetings. In addition, the BSP has launched a consultation process to get regional feedback on its policy framework.[18]

Monetary instruments

BSP's monetary instruments include open market operations (as the main instrument), the special deposit accounts (SDA) facility and, less importantly, the imposition of reserve requirements, and rediscounting transactions. Rules and procedures governing the central bank's relations with financial institutions for the purpose of monetary policy-making are publicly disclosed on the BSP's website and are addressed in the NCBA.[19]

The monetary policy-making body

Monetary board

The Monetary Board is empowered to exercise the powers and functions of the BSP. It consists of seven members -- the governor of the BSP, a member of the cabinet, and five individuals from the private sector -- each one appointed by the president. Information on the composition, structure, and functions of this policy-making body is publicly disclosed on the BSP's website.[20] The NCBA stipulates that the Monetary Board should meet at least once a week, and that the presence of four members constitutes a quorum, provided that the governor or a duly designated alternate is among the four. In case of emergencies where there is insufficient time to call a board meeting, the governor may, with the concurrence of two other members, take decisions.[21]

Advance meeting schedule

The BSP publishes the date for the next Monetary Board meeting as part of the press release that notifies changes in the monetary policy stance.[22]

Public statements on monetary policy

The BSP publishes brief summary statements on the BSP Monetary Board's policy decisions. These statements include the board's assessment of the inflation outlook; macroeconomic conditions; the exchange rate; the world

economic outlook; and production and consumption indicators. The BSP has partial reporting of Monetary Board votes: it only reports when the vote is unanimous.[23] The BSP is also required by the NCBA to report any new rules or regulations to the president and Congress. Moreover, the Monetary Board must submit comprehensive quarterly and annual reports, including an analysis of economic and financial developments (in the quarterly reports), and a review of the policies adopted and the reasons that prompted individual policies (in the annual reports).[24]

Periodic publications

In addition to summary statements on Monetary Board decisions, the BSP publishes a variety of documents, reports, and press statements on a range of macroeconomic and financial issues. These include monthly issues of *Selected Philippine Economic Indicators*; the quarterly and annual *Report on Economic and Financial Developments*; a bi-annual *Status Report on the Philippine Financial System*; monthly balance of payments reports; quarterly inflation reports; and fact sheets on the exchange rate and the inflation-targeting framework. Selected speeches by the governor are also available on the BSP's website.[25]

The BSP publishes a detailed advance release calendar of key statistics, reports, and press releases on its website. The calendar contains information on the data provider, periodicity, availability, period coverage, and the contact details of institutions where further information can be obtained.[26]

Public hearings

There is no legal requirement for public hearings on proposed changes to the monetary policy framework, but the BSP is committed to public consultation (as evidenced by the extensive consultations on the design of the inflation-targeting regime in 2001), including meetings with representatives from industry and labour organisations. In addition, the BSP has been conducting a series of public information campaigns as part of the authorities' effort to promote greater transparency over monetary policy-making.

Regulations on data reporting by financial institutions to the central bank

The BSP has tightened banking supervision in recent years, requiring more extensive reporting, *inter alia* on banks' non-performing loans and transactions with directors, officers, stockholders and related interests (DOSRI). External auditors of commercial banks must report to the BSP on adverse developments and banks are required to raise their accounting practices to international standards. BSP regulators concede that the data they receive from local banks has scope for improvement; where the BSP has identified data of questionable quality, it has pursued improved data.[27]

While the BSP is mandated to audit every bank branch once every twelve months, it is unable to fulfil this requirement due to the large number of branches across the archipelago and the BSP's limited resources. However, rural banks, which pose the greatest regulatory difficulty, only represent about two percent of the banking system in terms of assets. These problems nonetheless suggest that the BSP's supervision of the local banking sector requires further strengthening. Some measures, including increased computerisation and consolidation, are being implemented.

The Financial Action Task Force (FATF) announced on March 13 that it would not to apply any counter-measures to the Philippines (which were previously suggested on February 14), owing to the enactment of the Republic Act No. 9194, which amended the Philippine Anti-Money Laundering Act of 2001. According to the FATF, the new legislation has addressed the main legal deficiencies in the Philippine anti-money laundering regime previously identified, but the Philippines remains on the list of non-cooperative countries and territories. The country will be removed once it has demonstrated that it has implemented effectively its new anti-money laundering legislation.

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

As a subscriber to the IMF Special Data Dissemination Standard (SDDS), the Philippines provide a range of macroeconomic, financial, and monetary statistics. Within this framework, the BSP is responsible for releasing financial data, such as the analytical accounts of the banking sector; the analytical accounts of the central bank; interest rates; the balance of payments; international reserves and foreign currency liquidity; external debt; exchange rates; and the stock market index (in conjunction with the Philippine Stock Exchange).

Data meets the requirements of the SDDS for coverage, timeliness, and periodicity. The BSP makes use of the option to publish the Philippines' international investment position with a time lag of nine months while publishing external debt data on a quarterly basis. The analytical accounts of the banking sector cover data on monetary aggregates, net domestic credit to the public and private sectors, and net foreign assets. The analytical accounts of the central bank cover data on reserve money, net domestic claims on the public and private sectors, and net foreign assets. Both accounts are published on a monthly basis, with a time lag of four weeks for the former and two weeks for the latter. Data on interest rates cover daily BSP policy rates, weekly Treasury bill and bond rates, and monthly BSP rediscount rates.

Balance of payments statistics cover all accounts consistent with the IMF balance of payments manual, and were previously published on a monthly basis within three months of the end of the reference month. The BSP has announced a change in the frequency of release of balance payments figures to quarterly, beginning in the third quarter of 2003.[28] The government has attained considerable progress in regard to the weaknesses found previously by the IMF in the statistical reporting. Technical notes on the revisions to balance of payments data for 1999-2002 are available on the central bank's website.[29]

Data on international reserves and foreign currency liquidity are published on a monthly basis within a week of the end of the reference month. Exchange rate data is published daily and detail the spot exchange rate of the Philippine peso against the US dollar and other currencies. The composite stock market index is published on a daily basis.[30]

An advance release calendar, giving one-quarter notice of precise release dates, is posted on the websites of the BSP and the National Statistical Coordination Board.[31]

The central bank balance sheet

In addition to its monthly SDDS release, the BSP publishes summary analytical accounts on a weekly basis.[32] A more detailed balance sheet is produced quarterly, in the *Report on Economic and Financial Developments*, and annually, in the *Annual Report*.[33] An un-audited balance sheet is made available by the Accounting Department, which cuts the significant time lag from two/three quarters to one quarter -- although the audited version is also published later. Information on the BSP's monetary operations is disclosed in the monthly *Selected Philippine Economic Indicators*, which includes a table on Reserve Money Movements.[34]

Lender of last resort

The NCBA authorises the BSP to extend commercial credits, advances against specified collateral, special credits or loans for liquidity purposes, and emergency loans and advances (consistent with its function as lender of last resort). The NCBA sets out the framework through which such loans can be provided to institutions experiencing difficulties. In particular, Section 84 of the NCBA establishes that emergency loans require the support of five members of the Monetary Board, and should not exceed 50% of the total deposits and deposit substitutes of the receiving institution and must consist of two or more separate disbursements. Additional requirements and provisions on how the disbursements are allocated are also publicly available.[35]

Nevertheless, there is usually little transparency on the condition of banks that receive emergency loans from the BSP for fear that publishing such information would cause further distress in the financial system. The BSP publishes aggregate figures in its *Annual Report*, but no official information is released by the central bank. Under SEC rules, all publicly listed corporations must publish statements of their financial conditions on a quarterly basis.[36]

Public information services

The BSP has established and maintains high quality public information services, particularly through its website. There are links to a comprehensive database of macroeconomic and financial statistics, reports, press releases, and speeches by the governor. New regulations are disseminated as appropriate on the BSP's website. The central bank has clearly placed special attention on the inflation-targeting framework and has made substantial efforts to maintain its public information campaign and briefings on inflation targeting.

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●● Enacted

Accountability to a designated public authority

The BSP is required to submit its written quarterly *Report on Economic and Financial Developments* and its *Annual Report* to the president and Congress.[37] Senior BSP officials brief in Congress as necessary, including when invited to appear, although there is no explicit legal requirement in the NCBA for central bank officials to report before public authorities. The BSP governor meets the president frequently at scheduled cabinet meetings.

Financial statement

Audited financial statements

The BSP publishes a monthly financial statement of consolidated revenues and expenses in its *Selected Philippine Economic Indicators* series, and a review of its financial condition in the quarterly *Report on Economic and Financial Developments*. The central bank must also attach an audited financial statement to its Annual Report.[38]

External and internal audit

The external audit of the BSP is undertaken by an auditor appointed by the chairman of the Commission on Audit (CoA), the supreme audit authority of the Philippines.[39] Under the Administrative Code of 1987 (Article IX-D), the CoA has independent powers to audit all government accounts. Where the internal control system of the audited agencies is deemed inadequate, the CoA may impose measures -- such as temporary and pre-audits -- that are deemed necessary to remedy such deficiencies.[40] There has been no instance of an adverse finding by the CoA against the BSP. The BSP Internal Audit Office is concerned with internal efficiency and practices.[41]

Data on BSP operations is compiled in accordance with CoA rules contained in the Government Accounting and Auditing Manual (GAAM, CoA Circular 91-368). Accounting procedures are prescribed in the Manual on the New Government Accounting System (CoA Circular 2002-002), which replaced the accounting practices established in the GAAM Volume II. Further information on the methodology and sources used is available upon request from the contact person listed on the National Statistical Coordination Board's SDDS metadata website.[42]

Conduct of officials

Recent events concerning a potential suspension on Governor Rafael Buenaventura and four other top central bank officials, with regard to the closure of Urban Bank, has shown how vulnerable BSP officials can be throughout the political cycle. In this context, additional changes should be made to the New Central Bank Act in order to provide clearer instructions and safeguards for the removal of BSP officials, in particular when exercising supervisory duties.

Standards for the conduct of personal financial affairs of BSP officials and staff are set out in Code of Conduct and Ethical Standards for Public Officials and Employees (Republic Act No. 6713).[43] These provisions are explained further in the Employee Handbook (distributed internally). The NCBA also establishes rules for BSP employees over potential conflicts of interest.[44] However, in practice such conflicts have arisen in the past.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to the Philippines between 11 and 12 December 2003, and a visit to Dubai (2003 Meeting of the Boards of Governors of the World Bank Group and the International Monetary Fund) on 23 September 2003:

Bangko Sentral ng Pilipinas (BSP)

23 September 2003

Rafael Buenaventura	Governor
Amando Tetangco, Jr	Deputy Governor

12 December 2003

Editha Alido	Director	Department of Economic Research
Diwa Guinigundo	Managing Director of Research	Department of Economic Research
Iluminada Sicat	Bank Officer	Department of Economic Research
Jonathaniel Principe	Bank Officer III	Investor Relations Office

Department of Finance

23 Septemeber 2003

Jose Isidro Camacho	Secretary of Finance

11 December 2003

Napoleon Micu	Chief, Special Studies Division	Fiscal Policy and Planning Office
Stela Montejo	Chief, Fiscal Policy Division	Fiscal Policy and Planning Office
Visitacion Ugalino	Chief, Planning Division	Fiscal Policy and Planning Office

NOTES

[1] New Central Bank Act, Republic Act 7653 (1993), Chapter I, Article I (objectives and responsibilities); Chapter IV, Article II, Sec. 74 (exchange rate): www.bsp.gov.ph/about_bsp/ncba/ncba_index.htm
[2] Reuters Business Briefing, *Ramos signs law for new Philippine central bank*, 14/06/93, www.business.reuters.com
[3] New Central Bank Act, Chapter I, Article I
[4] Interviews in the Philippines, 11-12 December 2003.
[5] Interviews in the Philippines, 14-16 October 2002.
[6] New Central Bank Act, Chapter I, Article II, Section 10
[7] Interviews in the Philippines, 11-12 December 2003.
[8] New Central Bank Act, Chapter IV, Article V, Sections 91, 92
[9] New Central Bank Act, Chapter IV, Article IV/E, Section 89
[10] www.bsp.gov.ph/Statistics/ifs/IFS-10G.htm; The New Central Bank Act (1993), Chapter I, Article V, Section 39
[11] New Central Bank Act, Chapter VI, Article II, Section 128
[12] New Central Bank Act, Chapter I, Article II, Section 9; Article IV, Section 27
[13] New Central Bank Act, Chapter VII, Section 132 (sinking fund); Chapter I, Article VI, Sections 43, 44, 45. Interviews in the Philippines 11-12 December 2003.
[14] New Central Bank Act, Chapter V, Articles I and III
[15] Administrative Code (1987), Book VI, Chapter 3, Section 13 www.chanrobles.com/administrativecodeofthephilippines6.htm
[16] New Central Bank Act, Chapter V, Article II, Sections 117-122
[17] The government's inflation target for 2003 is 4.5-5.5%, and 4-5% for 2004.
[18] www.bsp.gov.ph/resources/other_docs/inflation_targeting.htm
[19] New Central Bank Act, Chapter IV
[20] www.bsp.gov.ph/about_bsp/about_monet.htm
[21] New Central Bank Act, Article II and III, Section 19
[22] See for example: www.bsp.gov.ph/news/2003-11/news-11202003a.htm
[23] Interviews in the Philippines, 11-12 December 2003.
[24] New Central Bank Act, Chapter I, Article II, Section 15; Article V (publications)
[25] www.bsp.gov.ph/resources/resources.htm; www.bsp.gov.ph/Statistics/stats_SEFI.htm
[26] www.bsp.gov.ph/resources/calendar/release_calendar.htm
[27] Interviews in the Philippines, 11-12 December 2003.
[28] Interviews in the Philippines, 11-12 December 2003.
[29] www.bsp.gov.ph/Statistics/stats_conceptsbop.htm
[30] www.nscb.gov.ph/sdds/meta_financial.htm
[31] www.bsp.gov.ph/resources/calendar/release_calendar.htm; www.nscb.gov.ph/sdds/calendar.htm
[32] www.bsp.gov.ph/Statistics/sdds/SDDS.htm; www.bsp.gov.ph/Statistics/sefi/wmoney.htm
[33] www.bsp.gov.ph/Resources/special_publications/default.htm
[34] www.bsp.gov.ph/Statistics/stats_SPEI.htm
[35] New Central Bank Act, Chapter IV, Article IV
[36] Interviews in the Philippines, 14-16 October 2002 and 11-12 December 2003
[37] New Central Bank Act, Chapter I, Article V
[38] New Central Bank Act, Chapter I, Article V, Sections 40 and 41
[39] New Central Bank Act, Chapter I, Article VII
[40] Administrative Code, Book V, Subtitle B, Chapter 4, Section 11
[41] Interviews in the Philippines, 11-12 December 2003.
[42] www.nscb.gov.ph/sdds/meta_fin_cenbank.asp
[43] Code of Conduct and Ethical Standards for Public Officials and Employees, Republic Act No. 6713 (1989); Anti-Graft and Corrupt Practices Act, Republic Act No. 3019 (1960), http://philippineonation2.tripod.com/
[44] New Central Bank Act, Chapter I, Article II, Section 9, 14; Article IV, Section 27

OXFORD ANALYTICA

POLAND

MONETARY TRANSPARENCY

Country Report 2003

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POLAND

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●●	●●●●	●●●●
Open decision process	●●●●	●●●●	●●●●
Availability of information	●●●●●	●●●●●	●●●●●
Central bank accountability	●●●●	●●●	●●●
Score	4.25	4.00	4.00

OUTLOOK & COMMENTARY

Transparency standards are currently being systematically improved with the revision of the Act on the National Bank of Poland in preparation for EU membership next year. The Bank will be required to appoint an external auditor and the provision allowing a non-voting representative of the Council of Ministers to attend the Monetary Policy Council meetings will be eliminated. Compliance with high transparency standards will be ensured by the expected adoption of the euro in 2009.

The politicisation of the appointment process to the Monetary Policy Council will pose some risk of short-term instability, but the commitment to monetary orthodoxy is widespread enough to rule out any major policy change. Urgently needed fiscal consolidation may increase political pressure on the bank. It is unlikely, however, that the bank's standing would be compromised even if the prospect of especially short-term monetary instability exists.

EXECUTIVE SUMMARY

4.25 Compliance in progress

The National Bank of Poland (NBP) meets nearly all of the international best practice standards for monetary policy transparency. This process has been accelerated and consolidated by the need to meet EU entry requirements and to converge with the standards of the European Central Bank (ECB). Revisions to the NBP Act currently under discussion – and to be adopted by early 2004 – include the appointment of an external auditor and the abolition of the right of a non-voting Council of Ministers representative to attend Monetary Policy Council meetings. The Bank has already published its analytical model, along with a revised version this year, as well as adopting a new practice of publishing quarterly macroeconomic forecasts.

The NBP maintains an exemplary website with a wealth of information on all aspects of monetary policy available in Polish and English alike. The site reflects the Bank's commitment to full and timely dissemination of information pertaining to its activities.

The main institutional problem with monetary policy making has to do with the politicized nature of the appointment process to the Monetary Policy Council, all of whose members are replaced simultaneously. The ability of individual Council members to express their views to the press has been a source of short-term exchange rate fluctuations, an area where the publication of the full minutes of Council meetings might make for more stability and consistency.

Poland's overall rating increases to 4.25 from 4.0 last year.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

The Polish Constitution, together with the 1997 Act on the National Bank of Poland set out the responsibilities, objectives, and institutional structure of the central bank.[1] The act is currently being updated to ensure full compliance with EU standards. The revisions are expected to come into force by the beginning of 2004.

Monetary policy is set by the Monetary Policy Council (MPC) which is headed by the NBP president. The MPC is assisted by the NBP Management Board composed of the bank president, two vice-presidents, and six others. The board members are appointed by the president of the Republic on the NBP president's recommendation. The Bank president can be appointed for up to two consecutive six-year terms. The appointment is made by the *Sejm* (the lower house of the Polish parliament) following a recommendation by the president of the Republic. The president and members of the MPC cannot be removed from office, except under strict legal criteria.[2]

Central bank objectives and responsibilities

The NBP Act singles our price stability as the primary objective of monetary policy. The Bank "shall at the same time act in support of government economic policies, insofar as this does not constrain pursuit of the basic objective of the NBP."[3]

The central bank has the exclusive right to issue currency and to determine monetary policy. The Bank is further legally responsible for organising monetary settlements, managing the foreign exchange reserves, conducting foreign exchange operations, providing banking services to the central government, regulating the liquidity of the banking system and establishing the necessary conditions for its development, compiling data on the balance of payments, including the foreign assets and liabilities of the central government; and managing foreign exchange reserves.[4] Other tasks can be introduced under law.

The NBP is responsible for the implementation of foreign exchange policy formulated in agreement with the Council of Ministers.[5] While there have been some past disagreements on the exact division of labour between the government and the central bank, the NBP has prevailed. The problem was institutionally settled with the creation of a joint NBP-Ministry of Finance Committee for setting the strategy for joining the ERM2.[6] The Polish złoty has been floating freely since 2000 and the Bank has no legal responsibility to intervene in support of it. However, it may do this if it thinks that exchange rate developments may jeopardise its main policy objective.[7]

The NBP is required by law to submit an annual report, and the annual *Monetary Policy Guidelines*, to the *Sejm*.[8] The Bank also submits quarterly reports on the balance of payments to the *Sejm* and the Council of Ministers. Draft monetary policy guidelines along with opinions on the draft budget and balance of payments projections are sent to the minister of finance and the Council of Ministers.[9] However, due to the change of the Bank Act in 2001, the NBP President no longer has the right to participate in the meetings of the Council of Ministers.

Operational autonomy

The NBP conforms to ECB regulations on central bank independence.[10] The only area where the responsibility for monetary policy is shared with another body is in the requirement to set the exchange rate regime jointly with the Ministry of Finance. The Bank together with the MoF last autumn set up an Interdepartmental Working Group for Poland's Integration with the EMU. The Bank is legally required to collaborate with the central government by submitting monetary policy reports and guidelines and by developing the government's financial plans. It is further required to comment on proposed economic policy and banking legislation.[11] Under the revised NBP Act, the right of the Council of Ministers to send a non-voting representative to the MPC meetings will be eliminated.

The simultaneous appointment of all nine MPC members by the two chambers of the parliament and the president of the Republic create the theoretical possibility of political influence and the current MPC has been roughly equally divided between members commonly known as "hawks" and "doves." Even though the NBP Act sets strict professional standards for Council members, there have been several largely political appointees, even if they are legally required to suspend their membership of political organisations on joining the Bank.[12] However, their actions following the appointment have often been quite independent and even unexpected, even if some correlation between voting pattern and the source of the appointment has been observed. Otherwise, government pressure has tended to assume the form of moral suasion with no formal way of influencing the Council's decisions.

A long-running dispute with the government has concerned the use of the so-called Revaluation (Currency Valuation) Reserve, created in 1998 following a sharp increase in the value of the bank's foreign currency reserves as the result of the appreciation of the zloty. An opposition proposal to give the government access to the reserve was defeated by the *Sejm* in connection with revisions to the NBP Act in late November.[13] In general, efforts to exert political pressure on the Bank have been unsuccessful.

Institutional relationship between monetary and fiscal operations

Lending to government

NBP lending to the government for the purposes of covering any part of the budget deficit is constitutionally forbidden.[14] However, the Bank did in 2001 very temporarily lend part of its foreign exchange reserves to the Ministry of Finance to finance a repurchasing of Polish debt owed to Brazil. Such moves will be made impossible as of next year by EU laws.

The NBP can support the government's economic policies through its monetary policy-making activities without, however, jeopardising its basic objective. The NBP is *de iure* entitled to buy and sell treasury securities under open market operations, although it invariably uses its own securities.[15] The balance of government debt held by the NBP is disclosed as part of its balance sheet but information on the maturity of government securities is not included with these data.

Central bank involvement in the rest of the economy

The NBP is responsible for the operations of the banking system through its involvement in the Commission for Banking Supervision which is headed by the NBP president. It supervises the activities of the financial sector and is authorised to impose penalties on entities found to contravene the existing legislation.[16] The decisions taken by the CBS are implemented by the General Inspectorate of Banking Supervision which is an organisationally independent

branch of the NBP which is responsible for ensuring the safety and soundness of the banking system. The NBP organises the interbank settlement system, conducts interbank settlements and is actively involved in the interbank money market.

The NBP was legally obliged to sell all of its holdings in the rest of the economy by the end of 2002 and has fully complied with this requirement.[17] The only exceptions are shares in international financial organisations and entities providing services to the financial sector and the Treasury, such as clearing houses.[18]

Central bank profit allocation

The Bank Act stipulates that a proportion of the annual net profit of the NBP shall be remitted to the government, but does not explicitly establish how much this should be. In practice, after the governmental audit has assessed the operating costs of the NBP, 98% of the profit – as agreed between the Bank and the government – is transferred to the state budget. With the impending revision to the NBP Act, the operating costs will be assessed by an external auditor.

Agency roles performed by the central bank on behalf of the government

According to the NBP Act, the central bank can act as a financial agent to the government for servicing the country's foreign debt and for concluding loan agreements under specific terms in each case. The Bank assumes none of the liabilities of the Treasury in this case. The procedures are specified on a case-by-case basis by agreement between the NBP and the Ministry of Finance.[19]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The NBP is committed to reducing inflation in order to bring about price stability compatible with long-term economic growth. Since 1999, the Bank has pursued a policy of direct inflation targets which are publicly announced and currently stand at 3% p.a. The targets are based on the headline consumer price index and specify a timeframe for achieving them.[20] Given its success in curbing inflationary expectations – with the consumer price index consistently below 1% for a year – the Bank is, as of next year, moving to a new regime of continuous targeting with a basic target rate of 2.5% and a tolerance band of +/- 1%.[21] No penalties are defined for deviations from targets.

Attempts to reintroduce a managed exchange rate, especially by the previous Finance Minister Grzegorz Kołodko, have been unsuccessful and revisions to the floating exchange rate regime are now viewed as unlikely before ERM2 membership. While interventions have been rare of late, the Bank does have the right to operate a dirty float if it so chooses. The NBP is committed to joining the EMU "as soon as possible," but has signalled that it wishes to spend the necessary minimum of two years as a members of the ERM2 system. While 2007 is an unofficial target for Euro-zone entry, 2009 is generally viewed as the earliest realistic date by the markets. The government's programme of fiscal consolidation envisages a public sector deficit of less than 3% of GDP by 2006.[22] While the programme is widely viewed as credible, the government's track record in delivering on comparable plans has been mixed.

Monetary instruments

The NBP applies a series of monetary policy instruments at the operational platform to set short-term interest rates: open market operations, regulatory reserves, and standing credit and deposit facilities. Open-market operations are conducted using NBP money market bills that are sold directly to the public, although the Bank is legally permitted to trade in government securities, as well. The instruments of monetary policy are detailed under Title 6 of the NBP Act.

The monetary policy-making body

Monetary board

The Monetary Policy Council of the NBP is responsible for the conduct of monetary policy. The Council consists of nine members appointed simultaneously for a non-renewable six-year term in equal numbers by the president of the Republic, the *Sejm*, and the Senate. Even though the Constitution specifies a single six-year term, the NBP Act stipulates that when a MPC member is replaced with less than three years left of his term, his replacement can subsequently be appointment for a full six-year term.[23]

Whereas the president of the Republic has been viewed as largely impartial in his appointments, the parliament has been swayed by political pressures. The members appointed by the *Sejm* and the Senate are chosen by the parliamentary majority in either chamber with no formal requirement to heed the views of the opposition. Although the NBP Act stipulates that MPC members should be financial specialists, the standard has not always been heeded in practice and not all appointments have met with widespread approval. However, effective control is exercised by the markets and the press, which significantly limits the members' room for manoeuvre.

The MPC draws up the annual monetary policy guidelines, sets NBP base interest rates, sets the reserve ratio, and determines the principles applicable to open market operations.[24]

Details of current MPC members are publicly available on the NBP website, and their voting record is published six weeks after its meetings. The board votes by simple majority. In the case of equal votes, the vote of the Bank's president is decisive.

The NBP Management Board's primary responsibilities involve implementing the resolutions of the Council, adopting the NBP plan of operations and financial plan, and performing other duties with respect to exchange rate policies.

Advance meeting schedule

The MPC meets monthly, in accordance with the NBP Act. The Bank publishes the date of its next meeting in the accompanying press release on its website.[25]

Public statements on monetary policy

Periodic publications

The NBP publishes a wide range of materials, all of which are available on the Bank's website. Annual publications include the *Annual Report* (which covers general economic conditions, developments in the financial sector, the performance of the central bank, and the Polish balance of payments), the *Report on Monetary Policy*, and the *Report on NBP Operations*. The main quarterly publications are the *Inflation Report* and the *Balance of Payments* accounts. In addition, the Bank produces three journals at least monthly, as well as a variety of other publications. The NBP website has a section of daily information which covers exchange rates, interest rates, and other basic financial sector data. The Bank has released a *Plan of Activity* for 2002-4, as well as a *Monetary Policy Strategy beyond 2003*, following a similar document for 1999-2003. The website also reproduces other articles published about the bank in the press.

In November 2003, the NBP began to publish its economic forecasts for the first time. New forecasts will be released on a quarterly basis. The Bank has also published its revised macroeconomic model.[26]

Public hearings

Press conferences are held after all MPC meetings. The press releases circulated after MPC meetings include an explanation of its monetary policy decisions. The voting record by name of the Council is released six weeks after each meeting. However, there are no plans to issue complete minutes. There are no formal attempts to limit MPC

members' freedom to express their views publicly and several of them have done so, in spite of the short-term volatility this has in some cases caused on the financial markets.

The Bank regularly seeks advice from international financial organisations and domestic experts in connection with various aspects of its operations. Analysts are frequently consulted about their inflation expectations. However, there are no formal consultations or attempts to involve all affected parties in discussions on policy changes.

The NBP president is required to appear at least once a year before the *Sejm* with additional meetings possible as needed. 1-2 appearances a year before the Economics Committee seem to be the norm. Also the Council of Minister can invite the NBP President to its meetings as needed. However, there are no formal public hearings on the US model.

Regulations on data reporting by financial institutions to the central bank

In accordance with the Bank Act, the NBP collates information from banks and other institutions on a monthly basis. These data are used to compile information on monetary policy, the periodic evaluation of the monetary policy stance, the compilation of the balance of payments and international investment position, and the evaluation of risk inherent in the banking sector. These data are publicly disclosed in regular briefs and reports.[27]

Banking supervision is conducted by the Commission for Banking Supervision which is chaired by the NBP president and includes representatives of the Ministry of Finance, the president of the Republic, the Bank Guarantee Fund, the Securities and Exchange Commission, and the General Inspectorate of Banking Supervision (GIBS). Its decisions are executed by the GIBS, which is a separate structural unit within the NBP. The Commission is charged with maintaining prudential standards and is authorized to conduct on-site investigations.[28] Polish standards for banking supervision exceed the Basel requirements, although there are plans to relax them to the international levels in connection with EU membership.

3. Public Availability of Information on Monetary Policy

●●●●● Full Compliance

Release of central bank data

As a subscriber to the IMF's Special Data Dissemination Standard (SDDS), Poland meets its specifications for the coverage, periodicity and timeliness of monetary data. The Bank publishes its analytical accounts on a monthly basis, within one week of the end of the reference month. The information is compiled in the *Information Bulletin* which is fully reproduced on the website. The data covers the balance sheet of the NBP and, among other things, includes details of reserve money, credit to the government and financial sectors, and net foreign assets. The data is presented in a time-series format, usually going back to 1999. A methodological section describes the provenance and methods of compiling the data. Much of this data is available also separately.[29]

The Bank posts an advance release calendar on its website. The calendar for analytical accounts of the banking sector and of the central bank, interest rates, the stock market, the balance of payments, international reserves and foreign currency liquidity, merchandise trade, international investment position, external debt, and exchange rates is also available through the IMF website.[30]

The central bank balance sheet

The NBP publishes a consolidated balance sheet including a breakdown of the Bank's assets and liabilities in the monthly *Information Bulletin.* This publication also details the NBP's open market activities and its reserve money stock.

An annual balance sheet, as well as an income statement, is published in the NBP *Annual Report*. Movements in assets and liabilities are described in detail and details on changes in their structure provided. Similar assessments are provided for the income and loss account. Movements in valuation allowances against financial assets are similarly described. The NBP Act specifies that the accounting principles of the NBP must conform to the International Accounting Standards. Since 1999, the balance sheet has been prepared in agreement with accounting standards of the ECB. The *Annual Report* sets out these standards in detail.

Lender of last resort

Responsible for ensuring the stability of the financial system, the NBP is allowed to act as lender of last resort. The Bank discloses the aggregate amounts it provides as emergency financial support in the NBP *Annual Report*. All last-resort lending is fully collateralized.[31]

Public information services

The NBP maintains a comprehensive provision of information services to the public. In addition to its regular reports, all press releases on the Bank's activities and bulletins are disseminated through the Bank's website. The NBP website has a mailbox for enquiries by the public and a public information section pertaining to EU-related matters.[32]

Press conferences are held after every Monetary Policy Council meeting and members of the Council are frequently interviewed by the press with no formal restrictions on their freedom to express their views. However, observers often complain of difficulty in differentiating between the position of the MPC and the views of its individual members.

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

The Bank is required under the NBP Act to submit the *Annual Report of Monetary Policy* and its financial results to the *Sejm*. The Bank president is required to present quarterly data on the balance of payments and annual data on the assets and liabilities of the state to the *Sejm* and the Council of State.[33]

There are few legal mechanisms for criticizing the bank's reports or requiring changes in them.

Financial statement

The NBP publishes a financial statement containing operational expenses and revenues in its *Annual Report*.

Audited financial statement

The NBP's activities have not up to now been subject to independent audits. Instead, the Council of Ministers appoints a commission that audits and assesses the annual accounts of the NBP. The commission includes two members of the Ministry of Finance (which controls the costs of the NBP).[34]

External and internal audit

The NBP books have up to now been audited by a commission appointed by the Council of Ministers at the request of the Ministry of Finance. The revised Act will remove this provision and require the appointment of an external auditor. It must be in force in time for Polish EU membership in May 2004.

The NBP's 38-member Internal Audit Department is responsible for internal audits of the Bank and its departments. The department prepares an annual audit plan focusing on areas of the greatest perceived risk. Less urgent topics are included in a three-year audit plan. The IAD is accountable to the NBP president. It reports on a quarterly basis to the Management Board on the most important findings, as well as on general progress in implementing its recommendations.[35]

All recommendations by auditors are announced along with a timetable for their implementation which is set up jointly with the auditee. All projects are included in a database and there is a compulsory reporting requirement at the deadline. Auditors are required to monitor the realization of earlier recommendation during their work. Formal follow-up audits can be ordered in areas of importance.

The Bank in 2002 initiated cooperation arrangements with the Bank of Italy and the Federal Reserve Bank of Chicago on bringing internal auditing standards up to international levels. Internal audits cover all areas of the Bank's activities and are submitted to the Board of Managers.

The Supreme Chamber of Control (NIK) has a constitutionally defined right to audit the National Bank.[36] The two primary areas of investigation are the administration of the state budget accounts and the performance of key NBP tasks such as monetary policy, management of reserves, and general finances.

Conduct of officials

The Bank fails to disclose internal governance procedures that prevent conflicts of interests for all NBP staff including members of the MPC.[37] However, rhe Civic Code stipulates standards of conduct for public officials, including employees of the Bank. The NBP Act also prohibits the disclosure of any secret information by staff during and after their employment at the Bank.[38]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Poland on 9 and 10 October:

National Bank of Poland

9 October 2003

Zbigniew Polański	Advisor to the President	Macroeconomic and Structural Analysis Department

10 October 2003

Adam B. Czyżewski	Director	Macroeconomic and Structural Analysis Department

Ministry of Finance

9 October 2003

Mirosław Błażej	Deputy Director	Department of Financial Policy, Analysis, and Statistics
Bożena Borecka	Official	Department of Financial Policy, Analysis, and Statistics
Robert Kozłowski	Official	Department of Financial Policy, Analysis, and Statistics

ADDITIONAL INTERVIEWS

9 October 2003

Sławomir Pawłowski	Economist	BRE Bank

10 October 2003

Jacek Wojciechowicz	Senior Communications Officer	World Bank
Krzysztof Kalicki	CEO – Country Manager	Deutsche Bank Polska
Arkadiusz Krześniak	Chief Economist	Deutsche Bank Polska
Sławomir Morawski	Commercial Officer	British Embassy
Robert Sierhej	Economist	International Monetary Fund
Bohdan Wyżnikiewicz	Vice President	Gdańsk Institute for Market Economics (*Instytut Badań nad Gospodarką Rynkową*)

Stanisław Kluza	Head of Economic Research Professor	Bank Gospodarki Żywnościowej Warsaw University

In addition, we corresponded with:

Dariusz Daniluk	Director	Internal Audit Department, National Bank of Poland
		Supreme Chamber of Control (*Najwyższa Izba Kontroli*)

NOTES

[1] The Act on the National Bank of Poland (NBP Act) of August 1997 is published at the Bank website at www.nbp.pl.
[2] The NBP Act specifies in Article 9 and 12 the only circumstances under which the president and MPC members can be removed from the office. They include: resignation, prolonged illness that does not allow for carrying the duties, court's sentence on the criminal offence.
[3] NBP Act, Article 3.
[4] NBP Act, Article 3(2).
[5] NBP Act, Article 24(1).
[6] Interviews in Warsaw, 9-10 November, 2002.
[7] Interviews in Warsaw, 14-15 November 2002.
[8] " Republic of Poland: Financial System Stability" (Country Report No.01/67), International Monetary Fund, June 2001; www.imf.org.
[9] NBP Act, Article 23.
[10] Interviews in Warsaw, 14-15 November 2002.
[11] NBP Act, Articles 21, 22.
[12] NBP Act, Article 14.
[13] An IMF opinion on the Currency Valuation Reserve can be found at: http://www.mf.gov.pl/index.php?wysw=2&sgl=2&dzial=177. The Bank will be helped by the provisions of the Public Finance Act which stipulates legal corrective mechanisms when public sector debt rises to the 50-60% of GDP range. It is legally not allowed to exceed 60%. "Ustawa z dnia 26 listopada 1998 r. o finansach publicznych," Dz.U. 1998 Nr 155 poz. 1014, Art. 45. On the *Sejm* vote, see: "Sprawozdanie Komisji Finansów Publicznych o rządowym i poselskich projektach ustaw o zmianie ustawy o Narodowym Banku Polskim (druki nr 450, 449, 516 i 772)," *Druk nr 2156*, Sejm Rzeczypospolitej Polskiej: IV kadencja; "Poprawka o rezerwie godzi w niezależność NBP-Balcerowicz," "Sejm przyjął nowelizację ustawy o NBP," "Sejm odrzucił propozycję, by rząd mógł używać rezerwy rewaluacyjnej," *PB.Net (Puls Biznesu)*, 27 November, 2003; "Niezależność banku centralnego obroniono," "Pokusa złego pieniądza," *Rzeczpospolita*, 28 November, 2003..
[14] Constitutions of the Republic of Poland, Article 220(2).
[15] NBP Act, Articles 48, 49.
[16] NBP Act, Articles 30(2), 44-46.
[17] The Bank and the government agreed on such a timetable in a process of phasing in the NBP Act.
[18] NBP Act, Article 5.
[19] NBP Act, Article 52
[20] See *op cit*, IMF Poland report.
[21] The regime change still required the approval of the new Monetary Policy Council which comes into office at the beginning of 2004. "Założenia polityki pieniężnej na 2004 rok," Narodowy Bank Polski – Rada Polityki Pieniężnej, Warszawa, wrzesień 2003.
[22] Project law on the so-called Hausner Plan (after Deputy Prime Minister Jerzy Hausner), presented on October 8, provided by the Ministry of Finance. The NBP is formally involved in discussions of the fiscal situation through its participation in the Public Debt Management Committee which meets once a month.

[23] NBP Act, Article 13.
[24] NBP Act, Article 12.
[25] See the Bank's website at www.nbp.pl.
[26] Ewa Wróbel and Małgorzata Pawłowska, "Monetary transmission in Poland: some evidence on interest rate and credit channels," *Materiały i Studia*, Paper No. 24, Warsaw, October, 2002; Tomasz Łyziak, "Monetary transmission mechanism in Poland: The strength and delays," *Materiały i Studia*, Paper No. 26, Warsaw, December, 2002; Jan Przystupa, "The exchange rate in the monetary transmission mechanism," Bureau of Macroeconomic Research, National Bank of Poland.
[27] NBP Act, Article 23.
[28] NBP Act, Article 25.
[29] *Biuletyn Informacyjny* (*Information Bulletin*), 7/2003, Warsaw, October 2003. Available at www.nbp.pl.
[30] http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=POL.
[31] *Raport Roczny* (*Annual Report*) 2002, www.nbp.pl.
[32] http://www.nbp.pl/kontakt/index.html; http://www.nbp.pl/Euro/index.html.
[33] NBP Act, Article 23.
[34] Interviews in Warsaw, 9-10 October, 2003.
[35] Information provided by the Internal Audit Department of the National Bank.
[36] Constitution of the Republic of Poland, Article 203(1).
[37] "Republic of Poland: Staff Report for the Article IV Consultation," International Monetary Fund, March 2000; www.imf.org/external/pubs/ft/scr/2000/cr0045.pdf.
[38] NBP Act, Article 55.

OXFORD ANALYTICA

RUSSIA

MONETARY TRANSPARENCY

Country Report 2003

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RUSSIAN FEDERATION

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●	●●	●●●
Open decision process	●●●	●●	●●
Availability of information	●●●●	●●	●●●
Central bank accountability	●●●	●●●	●●●●
Score	3.25	2.25	3.0

OUTLOOK & COMMENTARY

The Central Bank of Russia has established a strong reputation for relative independence and competence. Given its commitment to monetary stability and full compliance with international norms, gradual convergence with Western European norms is likely to continue.

The CBR's independence from political influence remains untested at a time when the strong economic performance of Russia has minimized political pressures on it. It is conceivable that the Bank would succumb to external pressure should the economic situation dramatically change. The CBR's involvement in the banking sector, most notably through its control of *Sberbank* remains a serious anomaly of the Russian system and an obstacle to normal banking sector growth. Immediate divestment appears unlikely.

EXECUTIVE SUMMARY

3.25 Enacted

The adoption of a new Central Bank Law last year has considerable enhanced the autonomy of the Central Bank of the Russian Federation (CBR) which is now legally defined as an independent central bank. A potential problem is posed by the long history of a dominant and interfering government which still appears to linger on in informal government pressures on the Bank. Thus far close collaboration with the government does not appear to have significantly compromised the bank's independence, but significant pressures in this respect have been absent due to the country's strong economic performance.

The CBR is fully committed to presenting its monetary data in conformity with the IMF's Special Data Dissemination Standard (SDDS) and CBR data dissemination now meets virtually all SDDS requirements with international reserve liquidity the most recent addition. The Bank has greatly increased the availability of timely information on various aspects of its operations and now boasts one of the most comprehensive and informative websites operated by an emerging market country.

The Bank provides a great deal of information on its monetary policy targets. The monetary policy guidelines now even include different scenarios. However, the implementation of the policy is compromised by potential incompatibilities between the inflation target and a managed floating exchange rate. In addition, monetary policy efficiency is compromised to a degree by a limited number of instruments available to the Bank. This problem is particularly significant at a time when the high oil price has created the need to sterilize large amounts of liquidity.

The CBR's majority stake in the country's dominant bank, *Sberbank*, constitutes a major structural problem in the banking sector. In general, supervision of the sector has improved and it has become significantly more stable, although considerable doubts remain about its resilience in the face of a major crisis.

Russia's overall score increases to 3.25 from 2.25 last year.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

The main document governing the structure and actions of the Central Bank of Russia is the 2002 Federal Law on the Central Bank of the Russian Federation.[1]

The Bank is headed by Chairman who is appointed by the State *Duma* for a four-year term which can be renewed twice. Clear legal provisions govern the dismissal of the chairman.[2] The Bank has a 13-member Board of Directors whose members include four first deputy chairmen, three deputy chairmen, and heads of the Moscow and St Petersburg branches.[3]

Central bank objectives and responsibilities

The Constitution of the Russian Federation singles out the "protection and stability of the ruble" as the main function of the CBR which "it shall exercise independently from other bodies of state power."[4] Additionally, the CBR Law empowers the Bank to ensure the development of the Russian banking system and the efficient and uninterrupted functioning of the settlements system.[5]

The CBR publishes its "Monetary Policy Guidelines" on its website. The main target at the moment is a consistent reduction in inflation with this year's objective set at 10-12%. The Bank pursues a policy of floating exchange rates and does not specify explicit targets for the external value of the rouble.[6]

The CBR fulfils several functions in pursuance of its objectives. It is responsible, jointly with the government, for the formulation and execution of monetary policy, as well as for the issuance of currency, for last-resort lending, for setting the rules to effect settlements and for banking operations, for managing all government budget accounts, for managing foreign currency reserves, for regulating and supervising credit institutions, for registering the issuance of securities, for exercising foreign exchange regulation, for setting the procedures for international settlements, for setting and publishing official exchange rates, for forecasting and compiling the Russian balance of payments, for regulating currency exchanges, for economic forecasts and data publications, as well as other functions as specified by law.[7]

Operational autonomy

The CBR is defined by the Bank Law as an independent institution which should remain outside the influence of the government as it is "not included in the structure of federal bodies of state power and acts as a special institution with the exclusive right to issue money and organise money circulation."[8] The independence of the CBR in protecting and maintaining the stability of the rouble is constitutionally enshrined. However, the Bank is legally accountable to the State *Duma* of the Federal Assembly. The *Duma* has the power to consider the guidelines for monetary policy and to adopt decisions on them. Moreover, the responsibility for the elaboration and execution of monetary policy is shared with the Council of Minister.[9]

Monetary policy decision-making remains a consensual process, shared between the CBR and the Ministry of Finance.[10] Under the CBR Law, the Bank chairman or his deputy participates in meetings of the Government and may participated in *Duma* sessions dealing with economic or financial matters. Conversely, the minister of finance

and the minister of economic development and trade, or an authorised deputy, attend meetings of the CBR Board of Directors "with the right of a consultative vote." The CBR and the Government are required to inform each other of plans of national importance, as well as to coordinate their policies and hold regular consultations.[11] Among other things, the central bank comments on the government's draft budget.

According to some assessments, the degree of independence of the central bank in practice still continues to depend on the personalities involved and its autonomy is openly asserted only in matters of secondary importance. There continue to be personal ties between the Bank and the government, partly as a result of personnel movements from the government to the Bank.[12]

Institutional relationship between monetary and fiscal operations

Lending to government

Under the Central Bank Law, the CBR is forbidden to lend money to the government for the purposes of financing the federal budget deficit or to buy securities, except as "stipulated by the federal budget law." Similarly, lending to extrabudgetary funds, as well as regional and local budgets, is strictly forbidden.[13]

The last time the CBR openly lent money to the government was in 1999 when foreign currency credit was provided for the purposes of foreign debt repayment.[14]

Central bank involvement in the rest of the economy

The CBR Law prohibits CBR ownership interests in credit organisations unless explicitly authorised by federal law.[15] The Savings Bank of the Russian Federation (*Sberbank*) and other, mainly foreign-based banks have been exempt from this provision. Under the CBR Law, the Bank was required to divest from *Vneshtorgbank* last year, when its stake was converted into state treasury bills with a nominal value of 42.1 bn roubles.[16] The CBR is currently discussing plans to divest from five foreign-based banks.[17]

The CBR's effective control of *Sberbank* through a 60.57% stake gives it a dominant position on the household deposit market of which the *Sberbank* controls 65%, in no small measure through its strength in pension deposits. The CBR also holds stakes in the Moscow Interbank Currency Exchange and the National Depository Center, a non-profit partnership.[18]

The continuing control of *Sberbank* significantly distorts the Russian financial market, even as independent banks on the "competitive fringe" of the sector are recording robust growth and beginning to emerge as more serious competitors. A more thorough restructuring of the banking sector is awaiting the adoption of a deposit insurance scheme.[19] However, divestment from *Sberbank* will still presuppose its fundamental restructuring, which may require several years.[20]

Central bank profit allocation

Under the CBR Law, the central bank is required to transfer 50% of its after-tax profit to the federal Government budget. The remainder is placed by the Board of Directors to various funds and reserves.[21] The Bank's *Annual Report* provides details of the Bank's profit allocation.

Agency roles performed by the central bank on behalf of the government

In accordance with the new Central Bank Law, the CBR acts as a banker to the government; services state funds and resources; services the budgets of oblasts and local entities; and manages Russia's international reserves and internal debt position.[22] The extra-budgetary funds served by the CBR include the Pension Fund, the Social Insurance Fund, as well as the Compulsory Medical Insurance Fund and its 500 local funds.[23]

The CBR exercised a statutory role as an agent of the government in the domestic sale of government securities. In practice, it is responsible for organising bond auctions by proposing the method of sale and the seller.[24]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●● Enacted

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The CBR singles out a consistent reduction of inflation and its eventual maintenance at a low level as the main target of its monetary policy. In connection with this objective, a target range for consumer price inflation is established based on fiscal policy projections. The target rate of inflation (as measured by the Consumer Price Index) in 2004 is 8-10% (down from 10-12% this year), a figure that corresponds to core inflation of 5.7-6.7%. The target is set at 6.5-8.5% in 2005 and 5.5-7.5% in 2006. A potential element of uncertainty is created by the still widespread use of regulated prices.[25]

The CBR Law charges the Bank with the task of establishing and supporting the exchange rate of the rouble. The Bank currently pursues a floating exchange rate policy with periodic interventions to avoid large fluctuations. The Bank has an openly announced non-binding ceiling for the annual appreciation of the effective exchange rate which this year is set at 7%. Interventions have been particularly common this year in connection with a large balance of payments surplus. In spite of now prioritising inflation control, the Bank remains committed to maintaining a managed float in the absence of a fully functional stabilisation fund and the vulnerability to changes in oil prices.[26] Although the Bank has permitted the rouble to appreciate faster than planned in order to control inflation, it remains somewhat unclear what exactly the relative importance of the two policy goals is.

Russia has been less successful than most other transition economies in reducing inflationary pressures. Successfully managing the dual targeting regime will require improved and sustained coordination with fiscal policy, so as to contain inflationary pressures which curbing rouble appreciation otherwise might cause. The urgency of addressing the problem has been diminished, and may continue to do so for some time, by the weakness of the US dollar. At the same time, the credibility of monetary policy would benefit from a clear commitment to a full-fledged inflation targeting framework.[27]

Monetary instruments

The CBR uses all the standard instruments of monetary policy: interest rates, required reserve ratios, open-market operations, refinancing credit institutions, currency interventions, money supply growth targets, direct quantitative restrictions, and bond issues. The Bank is allowed to penalize credit institutions failing to meet the reserve requirements. The reserve ratios may not exceed 20% of a credit institution's obligations and cannot be changed by more than five points at a time.[28]

The Bank has been gradually increasing the range of its monetary policy instruments in response to the need to absorb excess liquidity created by high oil prices. In the past, the lack of such instruments has limited the effectiveness of sterilisation operations. Deposit and reverse repo operations are now available also for longer periods of 3, 6, and even more months. Similarly, open-market operations with government securities have been common, although much of the debt portfolio continues to be non-tradable in spite of recent restructuring. In order to tie up liquidity for longer periods, the Bank is also planning to issues bonds with a term of up to one year,

although past experiences with own bonds have met with limited success due to the time lags involved. The Bank is currently reviewing the principles of setting compulsory reserve requirements and the mechanism for depositing them.[29] The continuing outflow of capital from the country helps the Bank in meeting its goal.

The monetary policy-making body

Monetary board

The National Banking Board (NBB) is composed of 12 members of whom two are delegated by the Federation Council from among its membership, three by the State *Duma* from its deputies, three by the president of the Russian Federation, and three by the Council of Ministers. NBB members are not employees of the Bank. The CBR chairman is a permanent member. The NBB meets at least once every three months. It takes its decisions by a simple majority vote with the chairman, if necessary, casting the decisive vote. The minority opinions will be recorded in the minutes at request.[30]

The NBB considers draft monetary policy guidelines and implements the final guidelines, regulates and supervises the banking system, implements foreign exchange regulation and control, decides on CBR involvement in international institutions, appoints the CBR chief auditor, and conducts several other functions.[31]

The CBR's Board of Directors, consisting of the Chairman of the Bank and 12 other members, is the permanent policy-making body.[32] The chairman is nominated by the president and appointed by the *Duma* through a majority vote. The chairman recommends the members of the board, who are appointed for a period of four years by the *Duma*, on the agreement of the president.[33]

BoD decisions require a majority vote, with a quorum of seven attending members. Protocols and decisions of the meetings are published in the Bank's weekly review *Vestnik Banka Rossii*.[34]

The BoD is responsible for elaborating, together with the Government, the monetary policy guidelines. It also approved the CBR's annual financial statements. The BoD sets the main monetary policy variables: compulsory standards for credit institutions, the amount of reserve requirements, changes in CBR interest rates, and limits on open-market operations. It further issues currency.[35]

The Central Bank Committee for Monetary Policy, which is accountable to the Board of Directors, plays an important role in policy formulation and implementation. The Committee is chaired by the CBR chairman and compromises the deputy chairman responsible for foreign exchange and open market operations, as well as directors of seven departments. The Committee main responsibilities are to monitor the implementation of monetary policy, to prepare materials for the Board of Directors, to propose to the Board changes in interest rates and in the composition and valuation of securities used as collateral. The Committee organises credit and deposit auctions, as well as repo and reverse repo operations.[36]

Advance meeting schedule

The Board of Directors is required to meet at least once a month but the Bank does not disclose an advance meeting schedule. [37] The National Banking Board is required to have at least quarterly meetings.[38]

Public statements on monetary policy

Periodic publications

The *Annual Report* provides a survey of the economic situation in Russia, information about government finances and public sector debt, an overview of the financial sector, data on the balance of payments and foreign debt, a discussion of the global economy, and an account of the activities of the CBR, including a section on banking regulation and supervision.[39] The CBR's *Guidelines for the Single State Monetary Policy* is the main publication on monetary policy for the year.

The *Bulletin of Banking Statistics* appears every month. The CBR's weekly review – *Vestnik Banka Rossii* – discloses monetary and economic indicators, analysis of data, and all new legal documents. The Bank provides press releases for any major events, decisions, and meetings.[40] Most of the Bank's publications, with the exception of the *Vestnik* are available in both Russian and English, although the translation sometimes appears with considerable delay.

The main analytical publications are the monthly *Information and analytical bulletin "Russia: Economic and Financial Situation"* (*Informatsionno-analiticheskii biulleten' "Rossiia: Ekonomicheskoe i finansovoe polozhenie*) and the less frequent regional review *Tekushchie tendentsii v Rossiiskoi ekonomike (regional'nyi aspect)* (*Current Trends in the Russian Economy (Regional Dimension)*).[41]

Public hearings

The CBR chairman is required to appear before the *Duma* twice a year and can be required to do so more frequently.

Regular public hearings on monetary policy are not held. Recently the CBR started to invite the representatives of the banking community and external experts to consultations over issues such as the development of financial systems and banking system regulation.[42] Although the process of consultations has no basis in law, it has been formalised and there is frequent interaction between the Bank and the outside expert community. However, the contents of such discussions are not ordinarily published and, for example, the details of the Bank's macroeconomic model are not publicly available.

The CBR Law stipulates a consultative process in connection with major changes to relevant legislation. The Bank is required to cooperate with credit institutions and their associations and "hold consultations with them before taking the most important decisions relation to legislation."[43]

Regulations on data reporting by financial institutions to the central bank

The CBR Law places the Bank in charge of banking regulation and supervision, a responsibility carried out through the Banking Supervision Committee which is a permanent body of the Bank. To this end, the Bank is authorised to request and receive all relevant information from credit institutions. The CBR is further required to publish statistical data on the Russian banking system.[44] The Bank's monthly *Bulletin of Banking Statistics* (*Biulleten' bankovskoi statistiki*), along with other indicators of the situation in the financial sector, is available through the CBR website.[45]

There are a number of regulations on data reporting to the CBR. These include the 1993 provisional instruction "On Compiling General Financial Reports by Commercial Banks;" the 1997 "On the Terms of Compiling and Presenting Credit Organisation Reports to the CBR;" and the 1999 "On Banking Regulation instruction." These regulations are publicly available on request and are posted on the Bank's website.[46]

In connection with its supervisory function, the CBR has far-reaching powers to ensure the stability of the financial system through monitoring, inspection, and penalties. The Bank is actively involved in reforming the legislative framework governing the financial sector. New measures are planned for tightening control over new entrants to the financial market, while other measures will facilitate the restructuring of the sector. Similarly, the adoption of improved and internationally compatible accounting standards in 2004, thanks to a new federal law on accounting, will improve the effectiveness of monitoring.[47]

Even as Russian regulatory standards are close to international norms, the resilience of the banking sector remains untested. While the sector is well capitalised, serious questions pertain to the quality of capital and the adequacy of loan loss provisions. It is unclear that the causes of the 1998 have been fully addressed so as to prevent the recurrence of another crisis should economic conditions change. While the relatively small size of the sector would limit damage, indirect consequences could significantly destabilize the economy. Effective control has to some degree been complicated by a lack of proper financial instruments.[48]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

While Russia is not a member of the IMF's Special Data Dissemination Standard (SDDS), it is fully committed to joining as soon as possible. The CBR already releases macroeconomic, financial, and monetary data that is presented in accordance with the SDDS methodology. A provisional advance release schedule is available on the website.[49] The CBR meets virtually all SDDS requirements, international reserve liquidity being the most recent addition. However, Russian membership is being held up due to problems in the fiscal sphere.[50]

The CBR's *Bulletin of Banking Statistics* also contains monetary data. The Bank's website posts daily a variety of data including the official exchange rate, the Bank's deposit rates, and government securities market rates. The Bank further publishes all main financial and external sector indicators on its website, accompanied by an explanation of the methodology used to obtain them.[51]

The central bank balance sheet

The CBR publishes a consolidated balance sheet on a monthly basis. Most assets are recorded at their initial cost and liabilities when they arise. The Bank's foreign exchange assets and liabilities are re-valued daily at the official rates of exchange. Government securities in the trade portfolio are revalued at the average weighted price. Fixed assets are shown at their residual value.[52] An annual consolidated balance sheet is included in the *Annual Report*.

Lender of last resort

The CBR Law authorises the Bank to act as lender of last resort. The Bank engages in refinancing operations for the purpose of ensuring the uninterrupted effectuation of settlements. The instruments available include daily short-term loans, Lombard loans (fixed rate short-term loans against government securities), and unsecured overnight settlement loans. However, such loans are not yet available throughout the country.[53] The Bank has been developing loans of up to six months backed up a formal collateral in the form of bond or comparable claims. The Bank last year agreed on a unified scheme on internal lending to banks. Details of CBR lending are provided in the *Annual Report*.[54] The CBR is ordinarily allowed to extend loans for up to one year and it can further issue warranties and bank guarantees.[55] At present, the use of last-resort lending has been minimal, given the high level of liquidity of the banking sector in a booming economy.

Public information services

The Bank is under legal obligation to publish monthly data on its balance, cash flow, and overall operations. Its *Annual Report* must be published by 15 July of the following year. The CBR also publishes its major public

document *Guidelines for the Single State Monetary Policy,* on an annual basis. The CBR established a press centre in 2001 and held its first public presentation on its *Annual Report*.

A wealth of information on the Bank's activities, including all its publications is available at the CBR website. A selection of key speeches, public reports, and interviews is reproduced there.[56] There are relative few published materials on the Bank's analytical and research work, apart from the results which are included in the periodic publications. The vast majority of the information at the website is provided in both Russian and English. Contact information is available for public enquiries.

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●● Enacted

Accountability before a designated public authority

The Bank Law stipulates that the CBR is accountable to the *Duma*. The CBR chairman must report to the *Duma* bi-annually and at any other time at the discretion of the *Duma*. The Bank is also legally required to submit its *Annual Report* – containing an audited financial statement – to the *Duma* no later than 15 May of the year following the reporting year. The *Duma* will complete its deliberations by 1 July.[57] The *Duma* holds special hearings with officials from the Audit Chamber of the Russian Federation that is charged with auditing CBR activities. The CBR Law mandates the Bank to submit its draft monetary policy guidelines to the *Duma* by August 26 of the preceding year and the final guidelines – containing projected scenarios for the year – by December 1. The *Duma* decides on the guidelines before passing the federal budget for the year.[58]

Financial statement

Audited financial statement

The *Annual Report* contains the Bank's financial statement. This is published along with the external auditor's statement. There are some lacunae in the CBR's external audit reports due legislation governing state secrets.[59]

External and internal audit

The National Banking Board (NBB) is legally required to select a licensed auditing firm to carry out an audit of the CBR's accounts before the end of a given reporting year.[60] Such appointments are made for a year at a time but can be renewed with no formal limitation on the number of renewals. The current auditors are BDO Iunikon Ruf who in their 2002 report noted the lack of access to certain kinds of data while generally voicing approval of the accounts they audited.[61]

The Accounts Chamber (*Schetnaia palata*) of the Russian Federation is responsible for auditing CBR operations connected with the federal budget, the servicing of government debt by the Bank, and for conducting audits ordered by the State *Duma* on the recommendation of the NBB.[62] The chief responsibility of the Accounts Chamber is to audit the Bank's rouble cash reserves, as well as operations and accounts not open to the external auditor under the federal law "On State Secrets." These include holdings of precious metals and the division serving the Ministry of Defence. The Chamber publishes the conclusions of its findings in the CBR Annual Report.[63]

The internal audit of the CBR is carried out by the Bank's chief auditor's service which is accountable to the CBR chairman. The internal audit division has representatives also in regional branches of the bank. In 2002, 99.7% of the Bank's operations were subjected to some form of internal audit and 44.2% to comprehensive inspections. The CBR's Chief Auditor's division is responsible for ensuring that any shortcomings discovered are eliminated in a timely fashion. The division can recommend punitive action in the event of transgressions. The Internal Audit Department conducts investigations to monitor compliance.[64]

Conduct of officials

The CBR Law imposes few requirements on employee conduct. People on the Bank's payroll are not allowed to engage in other paid employment (outside of teaching and research) and must inform the Bank's board within ten days of any bond or share purchases of any credit institution. CBR employees are forbidden to disclose information about the Bank without the consent of the Board of Directors.[65] The Bank's personnel is guided by the presidential decree "On approval of general principles of official conduct of civil servants" for its employees.[66]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Russia 10-14 November, 2003:

Central Bank of the Russian Federation

11 November 2003

Nadezhda Ivanova	Director	General Economic Department
Ekaterina Prokunina	Deputy Director	General Economic Department

Ministry of Finance

10 November 2003

Oksana Sergienko	Head of Division	Department of Macroeconomic Policy
Vadim Maksimov	Official	Department of Macroeconomic Policy

ADDITIONAL INTERVIEWS

10 November 2003

Vadim Kleiner	Director of Research	Hermitage Capital Management

11 November 2003

Bob Foresman	General Director	Dresdner Kleinwort Wasserstein LLC
Elena Panfilova	General Director	Transparency International – R

Carnegie Foundation Round Table on Tax Reform

Kakha Bendukidze	General Director	United Engineering Works (*Ob"edinennye Mashinostroitel'nye Zavody*)
Arkadii Dvorkovich	Deputy Minister	Ministry of Economic Development and Trade
Evsei Gurvich	Director	Economic Expert Group
Gennadii Lebedev	Vice President	OOO "Vangard"
Ol'ga Mosina	Economist	Centre for Economic and Financial Research CEFIR
Tat'iana Popova	Aide	Federation Council
Natal'ia Komova	Deputy head	Department of Tax Policy, Ministry of Finance

12 November 2003

Aleksandr Surinov	First Deputy Chairman	State Committee on Statistics (*Goskomstat*)
Igor Kolosnitsyn	Senior Manager	Bureau of Economic Analysis
Evgenii Ditrikh	Deputy Director	Law Creation and Methodical Provision Department, Ministry of Property Relations
Valerii Dalin	Consultant	Centre for Fiscal Policy
Leonid Bogdanov	Senior Consultant	Centre for Fiscal Policy

13 November 2003

Aleksei Makushkin	Chief Economist	East-West Institute
Vladimir Ivanov	Project Manager, Fiscal Transparency	East-West Institute
Richard Hainsworth	General Director	Rus Rating
Aleksei Moiseev	Chief Economist	Renaissance Capital
Julian Schweitzer	Country Director	World Bank
Aleksandr Morozov	Senior Economist	World Bank
Paula Perttunen	Lead Financial Specialist	World Bank

14 November 2003

Aleksandr Andriakov	Expert	Economic Expert Group
Aleksandr Pavluchenko	General Director	Carana Corporation, Russia
Peter Westin	Chief Economist	Aton Bank

In addition, we corresponded with:

Katerina Bezgachina	Coordinator	ACRC/Transparency International – Russia

NOTES

[1] http://www.cbr.ru/eng/today/status_functions/print.asp?file=law_e.htm.
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[3] CBR Law, Articles 15; http://www.cbr.ru/eng/today/directors_board/.
[4] Constitution of the Russian Federation, Article 75(2).
[5] CBR Law, Article 3.
[6] http://www.cbr.ru/eng/analytics/standart_system/print.asp?file=policy_e.html.
[7] CBR Law, Article 4.
[8] CBR Law, Articles 1-2.
[9] CBR Law, Articles 4, 5.
[10] Interviews conducted in Moscow, 10-14 November 2003.
[11] CBR Law, Article 21.
[12] Interviews conducted in Moscow, 10-14 November 2003.
[13] CBR Law, Article 22.
[14] Interviews conducted in Moscow, 10-14 November 2003.
[15] CBR Law, Articles 10-11.
[16] CBR Law, Article 8; Central Bank of the Russian Federation, *Annual report 2002*, Moscow, 2003, available at: http://www.cbr.ru.
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[19] Richard Hainsworth and Andrew Keeley, *Russian Banking: Rolling Out Reforms, Revealing Constraints*, Renaissance Capital: Banking Sector, October 21, 2003.
[20] "Russian Federation: Financial System Stability Assessment," *IMF Country Report*, No. 03/147, International Monetary Fund, May 2003.
[21] CBR Law, Article 26.
[22] Article 23, Central Bank Law
[23] Central Bank of the Russian Federation, *Annual report 2002*, Moscow, 2003.
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[27] "Russian Federation: 2003 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion," *IMF Country Report*, No. 03/144, International Monetary Fund, May 2003.
[28] CBR Law, Articles 35-44.
[29] *Osnovnye napravleniia edinoi gosudarstvennoi denezhno-kreditnoi politiki na 2004 god*.
[30] CBR Law, Article 12.
[31] CBR Law, Article 13.
[32] Article 11, Central Bank Law
[33] Article 5, 14 and 15, Central Bank Law
[34] http://www.cbr.ru/vestnik.
[35] CBR Law, Article 18.
[36] Information provided by the CBR.
[37] CBR Law, Article 17.
[38] CBR Law, Article 12.
[39] Central Bank of the Russian Federation, *Annual report 2002*, Moscow, 2003.
[40] Available in Russian at http://www.cbr.ru.
[41] http://www.cbr.ru/today/publications_reports.
[42] Interviews conducted in Moscow, 10-14 November 2003.
[43] CBR Law, Article 77.
[44] CBR Law, Articles 56, 47.

[45] *Osnovnye napravleniia edinoi gosudarstvennoi denezhno-kreditnoi politiki na 2004 god*; http://www.cbr.ru/BBS/bank_bulletin.asp; http://www.cbr.ru/statistics/bank_system; http://www.cbr.ru/analytics/bank_system.
[46] CBR Law, Article 4.
[47] CBR Law, Articles 62-76.
[48] "Russian Federation: Financial System Stability Assessment," *IMF Country Report*, No. 03/147, International Monetary Fund, May 2003; Richard Hainsworth and Andrew Keeley, *Russian Banking: Rolling Out Reforms, Revealing Constraints*, Renaissance Capital: Banking Sector, October 21, 2003.
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[52] http://www.cbr.ru/eng/today/cbr_balance/main.asp.
[53] *Osnovnye napravleniia edinoi gosudarstvennoi denezhno-kreditnoi politiki na 2004 god*.
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[56] http://www.cbr.ru/today/publications_reports.
[57] CBR Law, Article 25.
[58] CBR Law, Article 45.
[59] Central Bank of the Russian Federation, *Annual report 2002*, Moscow, 2003.
[60] CBR Law, Article 93.
[61] Central Bank of the Russian Federation, *Annual report 2002*, Moscow, 2003.
[62] Federal Law "On the Accounts Chamber of the Russian Federation," revised Article 19, 2002; http://www.ach.gov.ru/zakon/fedzakon/19new.shtml.
[63] http://www.ach.gov.ru.
[64] CBR Law, Articles 18, 25, 95; *Godovoi otchet 2002* (Annual Report).
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[66] http://www.transparency.org.ru/CENTER/DOC/ps8.doc.

OXFORD ANALYTICA

SOUTH AFRICA

MONETARY TRANSPARENCY

Country Report 2003

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REPUBLIC OF SOUTH AFRICA

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●●	●●●●	●●●●
Open decision process	●●●●●	●●●●●	●●●●●
Availability of information	●●●●	●●●●	●●●●
Central bank accountability	●●●●	●●●●	●●●●
Score	4.25	4.25	4.25

OUTLOOK & COMMENTARY

South Africa looks set to continue its steady progress towards the highest international standards of monetary transparency. More is being added to the Reserve Bank's already extensive list of publications. The Bank is fully committed to adopting the most up-to-date international accounting standards and looks set to remain actively involved in banking supervision.

The close consultative relationship and reporting requirements to the National Treasury constitute a potential threat to central bank independence, although concrete challenges in this area remain unlikely. It would be helpful to have formal rules governing the dismissal of the governor. Similarly, more should be done to contractualise the relationship between the Reserve Bank and the government.

EXECUTIVE SUMMARY

4.25 Compliance in progress

The South African Reserve Bank (SARB) continues to make gradual progress towards full compliance with the IMF codes on monetary transparency. The Bank is operationally independent from the government. Price stability remains the primary objective of monetary policy. The statements issued by the Monetary Policy Committee have been further refined to explain monetary policy decisions more clearly in the context of the inflation targeting framework and in a more forward-looking way.

The SARB complies with the IMF standards for data dissemination and disseminates a wide range of timely information on the analytical accounts of the bank. The Bank has incorporated the latest data dissemination standards of the IMF and complied with them within the prescribed transition period. The Bank has further implemented the requirements of the IMF's GFSM (2001) in the statistical tables on Government Finance. It continues to provide excellent public information services and is subject to rigorous independent audit.

Further progress has been made by the SARB this year in other areas of monetary policy formulation. The meetings of the Monetary Policy Committee have become more regular. Accounting standards have been improved and the availability of information on the Bank's policy towards banks in financial distress has become clearer. The Bank has adopted a new framework for dealing with banks in distress.

There remains room for further improvement in transparency in connection with the agency roles performed by the SARB on behalf of the government. Similarly, the contents of letters and policy documentation between the SARB and the treasury regarding the coordination of monetary and fiscal policy are still not publicised. More public information could be provided on the Reserve Bank's econometric model and its inflation forecast.

South Africa's overall rating remains unchanged from last year.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

According to the South African Constitution, the responsibility for the formulation and implementation of monetary policy rests with the South African Reserve Bank.[1] The South African Reserve Bank Act, No.90 (1989), recently amended by the SARB Amendment Act, No. 39 of 1997, provides the institutional framework for monetary policy in South Africa.[2]

Central bank objectives and responsibilities

The SARB Act states that "The Primary objective of the Bank shall be to protect the value of the currency of the Republic in interest of balanced and sustainable economic growth in the Republic."[3]

Price stability is historically the principal objective of monetary policy in South Africa. This commitment is viewed, among other things, as a precondition for achieving economic growth. The mission statement of the SARB was last year broadened to include "the achievement and maintenance of financial stability" as a key objective, although one which is seen as being closely related to price stability.[4] The Bank also re-emphasised its earlier view of being "convinced that it is essential that South Africa has a growing economy based on the principles of a market system, private and social initiative, effective competition and social fairness."[5] Despite this, the Bank also expressed the view that price stability has probably received more attention than financial stability in 2003.[6]

Operational autonomy

The SARB Act and the Constitution grant the Bank institutional independence. However, the SARB does continually consult with the Minister of Finance in the interest of policy coordination.[7] For example, the inflation-targeting framework, albeit formally set and announced by the Treasury, is jointly determined with SARB officials. Both sides consequently have a strong commitment to it. While this formally limits the Bank's autonomy in setting monetary policy targets, such collaboration often actually enhances policy credibility.[8]

While the SARB Act stipulates the conditions for the appointment, tenure and conduct of Bank directors, it does not explicitly stipulate criteria for the removal of directors from office. Also the regulations concerning the removal from office of the Bank's governor remain vague. In this regard, transparency would clearly benefit from explicitly prohibiting the dismissal of the governor on political grounds or otherwise formalising conflict resolution between the government and the Bank.[9] Some commentators suggest that, in order to ensure sound corporate governance practices, someone other than the governor or his deputies should be elected as chairperson of the SARB board.[10]

Institutional relationship between monetary and fiscal operations

Lending to government

The SARB Act prohibits the purchase by the Bank of government stocks in excess of its paid-up capital and reserve fund plus one-third of its liabilities to the public.[11] However, the Bank can in principle grant loans and advances to the government. The SARB balance sheet for August 2003 details loans to the public sector worth R503 million and holdings of government securities worth R10,8 billion. The SARB Act does not specify the conditions and terms under which loans and advances may be granted to the government, but it does specify a limit for such loans.[12]

The Reserve Bank does not provide loans to the government in the conventional sense, but the loans and holdings of government securities relate to losses on the oversold forward book of the SARB.[13] According to the SARB Act, any profit or loss on forward exchange contracts entered into by the Bank shall accrue to the government.

Following the progress the Bank made in 2002 in reducing the net open foreign positions by buying foreign exchange in the domestic foreign exchange market, the oversold position on the forward book has been eliminated entirely in 2003. At the end of August 2003 a "surplus" or over-purchased position of $1.4 bn was recorded on the forward book. [14] It appears that the elimination of the over-sold position has been instrumental in creating a much more stable and appreciating trend in the exchange rate of the rand.

Central bank involvement in the rest of the economy

The SARB in recent years built up an outstanding balance on the gold and foreign exchange contingency reserve account (GFECRA), mainly in dealing with losses on the oversold forward book. The National Treasury and the SARB have now agreed that from time to time the SARB will be able to restructure its holdings of interest bearing government bonds, held in its monetary policy portfolio, by way of switching some of these bonds for other Government bonds and/or through the outright sale of certain bonds. [15]

The SARB owns shares in its four subsidiaries: the Corporation for Public Deposits, the South African Mint Company, the South African Bank Note Company, and the SARB Captive Insurance Company.[16]

The SARB Act forbids the purchase of shares of loans in any bank, or granting loans backed by such shares, without the consent of the minister of finance.[17]

Central bank profit allocation

The SARB's shares continue to be privately held.[18] However, the Bank was de-listed from the list of the Securities Exchange South Africa of the Johannesburg Stock Exchange in 2002. The Bank then released explanatory documentation on a new Over-the-Counter Share Transfer Facility to the general public and its shareholders.

Agency roles performed by the central bank on behalf of the government

The agency roles performed by the SARB on behalf of the government are not explicitly described in the Reserve Bank Act. Following the recent recommendations by the IMF, these functions remain posted and described on the SARB's website and include "…participating in the formulation of government debt-management strategies,

administering the auctions of government bonds and Treasury Bills, and assisting the National Treasury with the surveillance of primary dealers in government bonds." The curtailment of the SARB's role as the "government's banker" due to the government holding cash balances with other banks, also remains unchanged and the SARB is still responsible for the movement of government balances to, from and between other banks.[19]

The National Treasury has delegated to the SARB the responsibility for administering exchange rate controls.[20]

No progress has been made in 2003 with plans to institutionalise the process of exchange of letters between the Bank and the Treasury regarding policy issues or to make this process transparent to the public. There therefore remains further scope for the Bank to provide more detailed information on its agency roles.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●●● Full compliance

The framework, instruments, and targets of monetary policy

Framework and monetary targets

In 2000, the South African government and the SARB officially announced the adoption of an inflation-targeting framework as a central plank of monetary policy. The target is formulated as a band for the consumer price index (CPIX). The Minister of Finance recently announced that the target bands for increases in CPIX remain at 3-6%, for 2003, but will be adjusted from 3-5% to 3-6% for 2004-05. There remains no formal target for any variables other than CPIX.[21]

Following the overshooting of the CPIX target in 2002 due mainly to exogenous shocks (11.8 percent in October 2002), the inflation rate moderated to 5.4 percent in September 2003.[22] The SARB believes that inflation targeting has, thus far, been successful in illustrating the Bank's commitment to reducing the long-term inflationary trend in South Africa..[23] The Minister of Finance has made provision for non-achievement of the target due to external shocks such as rises in international oil prices, changes in indirect taxes and international financial contagion. To date, however, no legal specifications for the failure to achieve the target have been made.[24]

The SARB has increased the availability of information on the operation of the inflation-targeting framework since 2002.[25] This includes factors that have a direct influence on inflation, the kind of macroeconomic model used and the transmission mechanism for monetary policy. The *Monetary Policy Review*, for example, analyses the trends in the main inflation indices, the factors affecting inflation and the inflation outlook.[26] In monitoring these factors, the SARB has now moved away from a single large-scale macroeconomic model to a small core model supported by other models. Nonetheless, information on the model itself is not published. Market participants and analysts feel that they would benefit from such information.[27]

South Africa has a floating exchange rate regime and the long-term fluctuation in the value of the rand has been quite considerable. The SARB has avoided intervention in the foreign exchange market as a matter of policy.[28] However, a number of foreign exchange controls are used to reduce short-term volatility.[29]

Monetary instruments

Following the implementation of the repurchase (repo) system of monetary control in 1998, further refinements continue to be made. The Bank announces both the tender amount and the amount allotted after the closure of the tender. It was found in 2003 that the SARB Act did not provide for the direct withdrawal and depositing of additional amounts against the cash reserve accounts, which is necessary for the fluent operation of the repo system. The Act was subsequently amended to this effect.[30]

In addition, the SARB employs standard instruments of monetary policy. The SARB Act requires banks to keep minimum reserves at the Reserve Bank.[31] The Bank is able, as appropriate, to provide financing for banks.

The monetary policy-making body

Monetary board

The SARB act assigns sole monetary policy decision-making authority and responsibility to the Governor's Committee comprising of the governor and the three deputy governors. This committee therefore has the final authority to make decisions on monetary policy. The task of the Monetary Policy Committee (MPC) is to decide on the monetary policy stance with a focus on the inflation targets that must be met. [32]

The MPC now consists of eight members: the governor, three deputy governors and four senior officials of the Reserve Bank. The members are listed on the Bank's website. Although only the governor and deputy governors have voting powers, MPC decision-making continues to be done on a consensus-building basis. MPC meetings are still preceded by in-depth presentations on macroeconomic variables and discussion of the results of economic modelling exercises performed by the Bank's research department.[33]

Since the beginning of 2002, quarterly meetings have been scheduled to coincide with the release of key quarterly data. Bi-monthly meetings were introduced in 2003 to, as it was argued that shorter intervals between meetings were necessary to allow the bank to act in a pro-active way.[34] Since 2002 the MPC statements provide a more detailed explanation of its monetary policy stance, which has been further refined in 2003.[35] This has made the monetary policy decision-making process more transparent.[36]

10 September 2003 saw the first unscheduled special meeting of the MPC to discuss a reduction in the Bank's repurchase rate. Several analysts criticised the decision, instead calling for special meetings only under extra-ordinary circumstances. It is essential that formal explanation should be provided in the event of such meetings being convened.[37]

A formal statement is prepared following MPC meetings. It is released to the press simultaneously with a formal delivery by the governor on national television.[38] The SARB does not publish full minutes of MPC meetings, nor the voting record of Council members. Several analysts have applauded the practice, since awareness of the subsequent publication of such information can affect the voting patterns and discussion contributions of the MPC members.[39]

Advance meeting schedule

The regular meeting schedule of the Monetary Policy Committee is published in advance for a year at a time. The details are available on the Bank's website.[40]

Public statements on monetary policy

Periodic publications

Economic developments and monetary policy actions are comprehensively discussed in the SARB's *Quarterly Bulletin* and *Annual Economic Review*. A *Monetary Policy Review* detailing monetary policy developments and prospects is issued bi-annually. Since 2003, a noticeable change in the lay-out and content of the *Monetary Policy Review* has been a much bigger focus on inflation, its drivers and the inflation outlook, with other economic

developments receiving less attention. The *Review* places monetary policy decisions in the general context of underlying economic conditions and the inflation outlook.[41]

The SARB's *Annual Report* includes broader assessments of underlying macroeconomic trends and of the Bank's progress in meeting the monetary policy target. However, the modelled inflation forecast of the Bank is still not made available. All the SARB publications are reproduced in full on the Bank's website.

Public hearings

Although the main statutory reporting requirement of the SARB is to the National Treasury, the governor, accompanied by senior staff members from the Research Department, appears regularly in Parliament before the Portfolio Committee on Finance.[42] A proposed new development is to create regular meetings between the SARB and economists from the academic and private sector to discuss aspects of the Bank's econometric model and inflation forecast. [43]

The SARB continues to convene Monetary Policy Forums, which give stakeholders in areas of organised trade and industry, the labour movement, academics and the public the opportunity to participate in open discussions on monetary policy and general economic conditions. Although the forums do not have any policymaking power, the ideas and comments raised are recorded and fed back to the Bank. Copies of the latest SARB publications are also distributed at the meetings and an advance roster of meetings for both the Monetary Policy Committee and the Monetary Policy Forums remain published on the SARB website.

Regulations on data reporting by financial institutions to the central bank

The SARB bears the ultimate responsibility of banking supervision in South Africa.[44] Banks are required to report regarly on their activities to the SARB which publishes *Bank Supervision Annual Reports*, as well as a *Financial Regulation* report. In addition, monthly data on banks and mutual banks is released on the SARB website.[45]

A debate has existed for some time now on the possible creation of a single-regulator modelled on the UK's FSA – thereby removing bank supervision from the Reserve Bank's responsibilities.[46] The Treasury, in particular, has been in favour of this proposal. However, SARB Governor Tito Mboweni recently argued that banking supervision should remain part of the SARB functions. An important consideration for the Bank is that stability in the banking sector was integral to the transmission of monetary policy, resulting in a need for the central bank to be involved in banking supervision.[47]

A 2002 IMF assessment of the South African financial system found a high degree of compliance with the Basel Committee's Core Principles for effective banking supervision.[48] The Basel 2 Capital Accord has been accepted by the SARB as international best practice for a capital adequacy framework. There has been constructive debate on the impact of Basel 2 on the financial system, including the credit-risk and operational-risk issues emanating from the prescribed standards. All South African banks will be Basel 2 compliant by 1 January 2007. The Bank Supervision Department is currently developing its Basel 2 implementation strategy. Specific developments around this implementation are listed in the latest annual report of the Bank Supervision Department. [49]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

South Africa subscribes to the IMF's Special Data Dissemination Standard (SDDS) and meets the specifications for the coverage, periodicity, and timeliness of the data and for dissemination of advance release calendars. However, reporting on international reserves could be made more transparent through separating monetary from non-monetary holdings of gold, applying a consistent formula for the valuation of gold at market price, and excluding regional currency holdings from reserves.[50] The SARB valuation at 90 percent of the current gold price has remained unchanged and the Bank views the practice as more conservative and safer than the IMF's approach.[51]

The IMF this year established a transition period of one year for the dissemination of the international investment position (IIP) data category and expanding the SDDS to include the template on international reserves and foreign currency liquidity and a new external debt data category. South Africa complied with the former in less than a year and in September 2003, succeeded also in producing the required quarterly figure for external debt.[52]

The SARB has also adopted the IMF's *Government Finance Statistics Manual 2001*. The more comprehensive disaggregation of information in the statistical tables on public sector activities is an important step forward in ensuring adherence to best practice in the dissemination of government finance statistics. [53]

All analytical accounts are prepared in accordance with Generally Accepted Accounting Principles (GAAP), and include coverage of the SARB's subsidiaries, which constitute its seven regional branches, the SA Mint, the Banknote Company and Corporation for Public Deposits. Recent improvements on accounting standards were introduced to the reporting on financial instruments. A panel was also established to monitor compliance with GAAP.[54]

Accounting standards are becoming more transparent thanks to the adoption in 2003 of new amendments introduced by the International Accounting Standards Board (IASB). Similarly, the so-called *Accounting Standard AC 133* (on the recognition and measurement of financial instruments) became effective as of July 2003.[55]

The central bank balance sheet

The SARB's consolidated monthly statement on its assets and liabilities is made available on the Bank's website. The analytical accounts used for the SDDS releases are derived from this central bank balance sheet, which is published separately as a monthly *Statement of Assets and Liabilities*.

The annual balance sheet continues to provide only the details on aggregate lending and does not specify the provision of emergency funds. The Bank also posts information on its foreign currency assets and liabilities as prescribed by the IMF's Template on International Reserves and Foreign Currency Liquidity on its website.[56]

Lender of last resort

Provision has been made in the SARB Act for granting secured loans and advances to banks facing financial difficulty. In the past, the Bank used an internal set of criteria to deal with such cases. These criteria were not publicly disclosed.

As a result of the problems faced by some small to mid-sized banks during 2002 (the demise of *Saambou* and *BOE*), the SARB adopted a new policy framework for dealing with banks in distress. The scenarios provided for in this policy include: banks with a liquidity problem; solvency due-diligence audits; banks solvent and systemically significant; banks solvent, but not systemically significant; banks not solvent, but systemically significant; and banks neither solvent nor systemically significant.[57] The way in which a bank in distress will be handled in future therefore depends entirely on the particular circumstances. Despite the new policy being only a guideline and the fact that problem cases will be dealt with on a case-by-case basis, the reform does provide much more clarity on the process of dealing with banks facing financial problems and therefore represents an improvement in transparency.

Public information services

The SARB collects, processes, interprets and publishes high quality economic, statistical and monetary policy information for the public. There has also been an ongoing availability of legislation, speeches, research papers, reviews and updates. Easy access to this information is made possible through the Bank's website. The Bank now provides more theoretical and analytical information about monetary policy than before in an effort to increase the public's understanding of its monetary policy.

The SARB's website has continued to create new means of providing information to the public. The Bank has also made its website more user-friendly: new headings were added to provide more information on SARB activities; an e-mail alert system is provided; and there has been a general expansion of the amount of services and information that are distributed via the website, such as information on publications and research, procurement, data delivery and electronic forms. Contact information is provided for the general public.

4. Accountability and Assurance of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before designated public authority

The SARB Act requires the governor of the Bank to present a report on monetary policy to the minister of finance on an annual basis, as well as to publish monthly data on the Bank's assets and liabilities. The Governor of the SARB may be called upon on several occasions (usually quarterly) to appear before the Parliamentary Portfolio Standing Committee on Finance to explain monetary policy and provide information on the central bank's views on financial and economic developments.[58]

The governor has regular discussions with the minister of finance on monetary policy issues. The SARB Act authorises the minister to demand remedial action within a specified time period in the event of the SARB failing to comply with "any provision of the Act or regulation."[59] Recommendations have been made that the SARB should look into the possibility of changing the Act so the board could elect a chairperson from its members, preferably someone other than the governor.[60]

The formal accountability mechanism of the SARB still does not have a penal clause. There have also been no further developments around the proposed formalising of the accountability mechanism, whereby the Bank would account for any *ex post* divergence between actual and anticipated inflation.[61] The Bank argues that the current relationship with the Treasury for the setting of inflation targets and the Bank's mandate in achieving these, remain satisfactory.[62]

Public Disclosure of Audited Financial statements

Audited financial statement

The SARB publishes an independently audited financial statement.

External and internal audits

The SARB Act requires the general meeting of shareholders to elect two firms of public accountants to serve for a year at a time as external auditors of the Bank.[63] The current auditors are still Deloitte, PWC and Nkonki Sizwe Ntsaluba.

The Bank's Internal Audit division is responsible for examining and evaluating the Bank's activities, resultant risks, and compliance. Its task is to provide assistance to the executive management in discharging their responsibilities. The scope of the internal audit function is defined to include "a review of the reliability and integrity of financial and operating information, the system of internal controls and the means of safeguarding assets." The internal auditors conduct also performance audits by evaluating the efficiency of resource management and operational effectiveness.[64]

The chief internal auditor reports to the Audit Committee, which is a subcommittee of the Bank Board and consists of four of its members. The Committee has regular meetings with the internal and external auditors, as well as with SARB management. They "review the financial statements and underlying accounting policies, the effectiveness of management information and other systems of internal control, and the effectiveness of the internal audit function." The Committee is further responsible for assessing risk management procedures and for making recommendations to internal and external auditors.[65]

Conduct of officials

The Bank's staff manual provides a comprehensive code of conduct for SARB employees. It covers *inter alia* general discipline, private financial transactions and dress code and is publicly available on request. According to the SARB Act, all Bank employees and officials are indemnified by the Bank for performing their duties, other than through negligence or dishonesty. According to the Banks Act, the South African Reserve Bank and its staff hold no liability "for any loss sustained by or damage caused by any person as a result of anything done or omitted by such member, the registrar or such other officer or employee in the bona fide performance of any function or duty under the Banks Act."[66]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals in South Africa between 17 September and 25 November 2003:

The South African Reserve Bank

17 September 2003

Johan van den Heever	Deputy Head	Reviews and Statistical Research Department

21 October 2003

Ernie Van der Merwe	Chief Economist and head	Research Department

25 November 2003

Sage de Clerck	Economist	Research Department

The National Treasury

21 October 2003

Kuben Naidoo	Head	Fiscal Policy Section
Neil Cole	Director	Budget Reform

ADDITIONAL INTERVIEWS

University of South Africa

21 October 2003

Philip Mohr	Professor	Department of Economics

Rand Merchant Bank

22 October 2003

Rudolf Gouws	Chief Economist
Etienne le Roux	Economist

NOTES

[1] Current legislation pertaining to the SARB is contained in the SARB Act (Act No. 90 of 1989). See also E.J. van der Merwe , *Monetary Policy Operating Procedures in South Africa*, http://www.bis.org/publ/plcy05I.pdf.
[2] Available on the SARB website: www.resbank.co.za.
[3] SARB Act, Article 3.
[4] "Transparency and the public understanding of Monetary Policy", Address by Mr T.T. Mboweni, Governor of the SARB, 2002.
[5] See www.resbank.co.za.
[6] Interviews conducted in South Africa, 17 September-25 November 2003.
[7] See Monde Mnyande, *Inflation Targeting in South Africa*, Address at the Bank of Mauritius, 11 February 2002, http://bom.intnet.mu/feb2002/SPEECH.htm.
[8] Goal independence is the ability of the Central Bank to set it's own goals for monetary policy. It is maintained that in a democracy, the elected government should set the goals for monetary policy . In this regard, see F.S. Mishkin, *What should Central Banks do?*, Federal Reserve Bank of St Louis, 30 March, 2000.
[9] G.M. Wessels, "Comparing the Evolving Independence of the European Central Bank and the South African Reserve Bank" *South African Journal of Economics*, 70(6), 2002, pp. 955-981.
[10] G.M. Wessels, "Comparing the Evolving Independence of the European Central Bank and the South African Reserve Bank" South African Journal of Economics, Vol. 70(6), 2002, pp. 955-981.
[11] See SARB Act, Article 13 (f).
[12] In terms of Article 13(f), the Bank "may not hold in stocks of the Government of the Republic which have been acquired directly from the Treasury by subscription to new issues, the conversion of existing issues or otherwise, a sum exceeding its paid-up capital and reserve fund plus one-third of its liabilities to the public in the Republic." Interviews conducted in South Africa, 17 September-25 November 2003.
[13] Interviews conducted in South Africa, 17 September-25 November 2003.
[14] Interviews conducted in South Africa, 17 September-25 November 2003.
[15] SARB and National Treasury, "*Strategy for dealing with the outstanding balance on the gold and foreign exchange contingency reserve account,* Joint press statement, 20 October 2003.
[16] South African Reserve Bank, *Annual Financial Statements*, 31 March 2003.
[17] SARB Act, Article 13 (b).
[18] SARB Act, Article 24.
[19] http;//www.resbank.co.za
[20] *Exchange Control Manual*, http://www.reservebank.co.za.
[21] SARB, *Monetary Policy Review*, October 2002, p. 18; South African Reserve Bank, "The revision of the targets: have the Government and Reserve Bank gone soft on inflation?," http://www/reserveban.
[22] SARB, *Monetary Policy Review*, November 2003, p.1.
[23] "Mboweni steadfast on inflation targeting" in *Business Day*, Wednesday, October 9, 2002.
[24] See in this regard: A.J.H. Casteleijn, *South Africa's Monetary Policy Framework*, www.resbank.co.za.
[25] Instruments and targets of monetary policy are publicly explained in a variety of easily accessible sources, all of which are available through the Banks web pages.
[26] SARB, *Monetary Policy Review*, November 2003.
[27] Interviews conducted in South Africa, 17 September-25 November 2003.
[28] "South Africa: 2002 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for South Africa," *IMF Country Report*, No. 03/17, International Monetary Fund, January 2003.
[29] *Exchange Control Manual*, http://www.reservebank.co.za; South African Reserve Bank, *Quarterly Bulletin*, December 2003.
[30] See SARB, *Quarterly Bulletin*, September 2003, p.89.
[31] SARB Act, Articles 10A.
[32] See A.J.H. Casteleijn, *South Africa's Monetary Policy Framework*, www.resbank.co.za, 2001.
[33] Interviews conducted in South Africa, 17 September-25 November 2003.
[34] See also SARB, *Monetary Policy Review*, October 2002, pp. 17-18.
[35] See for example the latest *Monetary Policy Statement*; 16 October 2003, www.resbank.co.za.
[36] Interviews conducted in South Africa, 17 September-25 November 2003.

[37] Interviews conducted in South Africa, 17 September-25 November 2003.
[38] See I. Plenderleith, *Inflation Targeting in South Africa and the UK Presentation*, 5 June 2003. www.resbank.co.za
[39] Interviews conducted in South Africa, 17 September-25 November 2003. See also Remsperger & Worms, *Transparency in Monetary Policy*, CFS Working Paper, No. 16 of 1999, p. 9.
[40] SARB activities: Monetary policy: Monetary Policy Committee meeting dates, http://www.reservebank.co.za.
[41] See SARB, *Monetary Policy Statement*, 16 October 2003, www.Resbank.co.za
[42] See X.P. Guma, *Monetary Policy Transparency and Openness*, 15 October 2002, www.resbank.co.za.
[43] Interviews conducted in South Africa, 17 September-25 November 2003.
[44] SARB Act. Article 10 (c).
[45] Publications & Research: Other publications: South African Reserve Bank: Release of Selected Monthly Data. http://www.reservebank.co.za.
[46] The Committee of Investigation into the Promotion of Equal Competition , proposed in 1992 that both the Registrar of Banks and the Executive Officer of the Financial Services Board (FSB) should report to an independent financial regulation policy board.
[47] Interviews with SARB officials, Pretoria, 5 October 2001. See also the reference to an address by Mr T.T. Mboweni cited in SARB, Bank Supervision Department, *Annual Report*, 2000, www.resbank.co.za
[48] The Banks Act (Act No. 94 of 1990) establishes the leading role of the Reserve Bank with regard to licensing and supervising banking institutions. The activities of the Bank Supervision Department within the Reserve Bank are explained in its Annual Report published on the SARB website. See also Bank Supervision Department of the South African Reserve Bank (1999, 2000). *Annual Report*, Pretoria.
[49] See SARB, Department of Bank Supervision, *Annual Report* , 2002, www.resbank.co.za.
[50] IMF, "South Africa: Report on Observance of Standards and Codes—Data Module; Response by the Authorities; and Detailed Assessments Using the Data Quality Assessment Framework," 2001.
[51] Interviews conducted in South Africa, 17 September-25 November 2003.
[52] Interviews conducted in South Africa, 17 September-25 November 2003.
[53] SARB, *Quarterly Bulletin*, September 2003, pp 79-88.
[54] SARB, Bank Supervision Department, *Annual Report,* 2002, www.resbank.co.za
[55] SARB, Bank Supervision Department, *Annual Report* 2002, www.resbank.co.za
[56] See www.resbank.co.za/Economics/Template/TemplateOct.pdf
[57] SARB, Bank Supervision Department, *Annual Report* 2002, p.12
[58] SARB Act, article 31
[59] See E.J. Van der Merwe, *Monetary Policy Operating Procedures in South Africa*, www.resbank.co.za
[60] Interviews conducted in South Africa, 17 September-25 November 2003.
[61] Interviews conducted in South Africa, 17 September-25 November 2003.
[62] Interviews conducted in South Africa, 17 September-25 November 2003.
[63] SARB Act, Article 30.
[64] South African Reserve Bank, *Annual Report and Financial Statements*, 31 March 2003.
[65] South African Reserve Bank, *Annual Report and Financial Statements*, 31 March 2003.
[66] Banks Act (1990), Article 88.

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SRI LANKA

MONETARY TRANSPARENCY

Country Report 2003

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SRI LANKA

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●●	●●●●	●●●
Open decision process	●●●	●●	●●
Availability of information	●●●●	●●●	●●●
Accountability	●●	●●	●●
Score	3.25	2.75	2.50

OUTLOOK & COMMENTARY

Sri Lanka looks likely to continue to improve its standards of monetary transparency. Progress has been made over the past year with amendments to the Monetary Law Act. The Central Bank of Sri Lanka (CBSL)'s powers of regulation should improve as a result of the amendments, as should its efficiency due to a refocusing of its objectives. The central bank has continued its modernisation process. It now subscribes to International Accounting Standards. Transparency should increase as a result of the increased quantity of information available to the public: targets are now disclosed, for example. Legislative and administrative changes to monitor over the next year include: the enactment of the Public Debt Management Law; the establishment of a Public Debt Management Office; the enactment of a new Banking Act; and the enactment of a new Monetary Law.

Certain reforms may be affected by the recent political instability, although both the president's party and the party of the prime minister are committed to economic reform, so any further political instability is more likely to have only an indirect effect on economic reforms and progress in general, through a general climate of uncertainty, and the consequences for investor and business confidence.

EXECUTIVE SUMMARY

3.25 Enacted

The government continues to be committed to significant economic reforms, including reducing public sector deficits, and a political settlement to the country's long-running internal conflict. It may now be a little more cautious in pushing through some of the more controversial reforms, given the political crisis that broke in November 2003 when, while the prime minister was abroad, the president (from an opposing political party) suspended parliament and took control of three ministries. Following talks upon the return of the prime minister, parliament resumed, though the tension continues. Further political instability is possible.

Monetary policy has been determined primarily by the budget deficit over the past year. Monetary policy continues to focus on: providing adequate liquidity to support economic recovery; containing monetary expansion; and price stability. The central bank continues to place increasing reliance on open market operations in monetary management. The floating exchange rate continues.

The central bank has continued to work hard to improve clarity in monetary policy, both in respect of monetary objectives and the decision-making structure through which policy is made. Amendments to the legislative framework within which the CBSL operates have been passed. A number of reforms to the Bank are underway though the effectiveness of many of the reform measures are difficult to evaluate at this early stage. A new Banking Act is expected to be enacted in 2004.

The Monetary Law Act (MLA) governing the central bank was amended in December 2002 to enable the Bank to focus more clearly on its core objectives of economic and price stability and financial system stability, to improve the flexibility of the Bank's monetary policy and exchange rate policy and to strengthen its regulatory powers. The payments and settlements system was also improved; a Real Time Gross Settlement (RTGS) System and SSS System was introduced. Finally the amendments helped increase the expertise and efficiency of the Bank by expanding its governing board and expanding the Bank's powers of delegation. The board still does not publish the minutes of its meetings. The Monetary Law Act (MLA) contains no provisions relating to reporting by CBSL officials before any designated public authority.

To further increase transparency in monetary management, the overall monetary policy framework and projections are now announced to the market and made available on the Bank's website. The central bank now releases to the public every month a Monetary Policy Review that reviews general economic developments and their bearing on the monetary policy of the Bank. This review is not published on the web in a timely manner, however. The central bank has also begun to publish bankwise interest rates and charges. Other notable progress over the past year includes: the CBSL now subscribes to International Accounting Standards -- hitherto it subscribed only to Sri Lankan Accounting Standards; in August 2003 an automated accounting system was introduced, as part of the modernisation project underway at the central bank; the central bank has announced that it will apply for a sovereign debt rating to help Sri Lanka attract overseas investment; a Contributory Pension Fund Bill was passed February 2003; and work is underway on an anti-money laundering law.

Sri Lanka's overall score has improved from 2.75 in 2002 to 3.25.

1. Clarity of Roles, Responsibilities, and Objectives of Central banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

The functions and legal framework governing the operations of the Central Bank of Sri Lanka (CBSL) are set out in the Monetary Law Act (MLA) (Chapter 442) (Incorporating amendments up to 31 December 1998). However, the CBSL has initiated a comprehensive review of the financial sector legislative framework affecting the central bank, the banking sector and non-bank financial sector as part of its modernisation initiatives.[1] A new Banking Act is expected to be enacted during 2004.

The government scheduled a range of amendments, to cover some 36 pieces of legislation including the MLA. The Monetary Law (Amendment) Act was passed December 2002. The amendments are designed to enable the central bank to deal more effectively with the current economic structure and its needs[2]. They provide the central bank with broader supervisory powers and greater independence. They also improve the flexibility of the Bank's monetary policy and exchange rate policy. An integrated payments and settlements system was also introduced as a result of the amendments; the Real Time Gross Settlement (RTGS) System and SSS System. Finally, the amendments helped increase the expertise and efficiency of the Bank by expanding its governing board and expanding the Bank's powers of delegation. The amendments are intended as a temporary measure to update the MLA until entirely new legislation is drafted.[3] The entirely new monetary law is expected sometime in 2004. There is also widespread government enthusiasm for regulatory overhaul across the public and private sectors.

Central bank objectives and responsibilities

Under the terms of current MLA, the CBSL is charged with: the stabilisation of the value of domestic monetary values (the rupee); the preservation of the stability of the exchange rate; and the encouragement and promotion of the full development of the productive resources of Sri Lanka.[4] The Bank's previous multiple objectives were often in conflict with one another. These objectives have now been redefined and refocused. As a result of the amendments to the MLA - which have now been passed - the CBSL has narrowed its role to two primary objectives, namely maintaining economic and price stability, and financial system stability.[5] However, concerns about the potential for conflicting objectives, the precise aim of monetary policy, and the transparency of the CBSL's policy stance may not be adequately addressed until a new MLA is enacted. This looks likely to be passed before the end 2004.[6]

The Bank continues to implement a comprehensive reform process aimed at enhancing its ability to conduct a more coherent and effective monetary policy. Drawing on financial assistance from the World Bank and the Swedish International Development Agency, the Bank has initiated a modernisation programme to streamline its operations and develop human resources.[7] There is evidence that this process is now well under way. As a result of the scaling down of the Bank's functions, the Bank staff has been reduced through a scheme of voluntary retirement. Automation of several functions has also given rise to a number of redundancies.

Operational autonomy

The CBSL describes itself as "a regulator, an advisor, a market developer and a market player", noting that these are "roles that can sometimes be in conflict".[8] Formally, the CBSL has a high degree of independence in achieving its

objectives. In reality, it is clear that the CBSL works closely with government, particularly the Ministry of Finance. In addition, the Secretary to the Treasury is a member of the monetary board. Under section 116 of the current MLA, the minister of finance may direct the board to adopt government policy, but this clause has been invoked only once, in 1959. The monetary board was expanded in December 2002 to include a further two appointed members from the private sector. This has diminished the government's direct influence on monetary policy, and has increased the board's expertise. This new composition appears to be working well.

Institutional relationship between monetary and fiscal operations

Lending to government

The Bank is permitted to lend to the government, by purchasing treasury bills in the weekly auctions. It was provisionally estimated that by end 2002 the total government debt held by the CBSL would be 8.0% of the total domestic debt or 4.6% of the total public debt (domestic plus external).[9]

Central bank involvement in the rest of the economy

The CBSL has now been divested of many quasi-fiscal activities it previously performed on behalf of the government. Examples include the development of financial activities in rural areas, and operating credit and credit guarantee schemes.

Central bank profit allocation

Any operating profits of the CBSL not set aside to reserves are allocated to the Consolidated Fund of the Government, in accordance with Section 39(c) of the MLA. In the year ending December 31, 2002, the CBSL made a net profit of almost LKR 16 billion (USD 168 billion), but the amount transferred to the Consolidated Fund was not disclosed.[10]

Agency roles performed by the central bank on behalf of the government

The CBSL continues its advisory relationship with the government, acts as the government's banker, and holds responsibility for the management of government debt. Until recently the most prominent of the Bank's non-core activities were the management of the public debt, implementing exchange control regulations and managing the Employees' Provident Fund (EPF), Sri Lanka's largest pension fund. Senior Bank officials however expressed a desire to divest themselves of residual responsibilities for these activities.[11] There has since been a reorganisation of the central bank in order to get rid of its excess functions. The Government is working with the CBSL to set up an independent Public Debt Management Office which will report directly to the minister of finance, with technical support from International Financial Institutions. This should be up and running by mid 2004. The public debt management role of the central bank will be entrusted to this office.[12] This should improve debt management as it is currently the responsibility of a number of organisations and bodies. It should also serve to restrain government borrowing.

Management of the EPF has been removed from the Bank. Improved management of the EPF/ETF has been encouraged through mergers, private fund management, some foreign portfolio investments, improved collection and management reforms to reduce evasion. The government has allowed private pension funds to be launched.

Members of the EPF can choose the fund that they wish to invest in. This will allow Fund managers to behave more responsibly. However, with a mandatory contribution, it still limits people's choices.[13]

Many of the Bank's other functions -- such as clearing agent and lender of last resort -- are now also divested.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●● Enacted

The framework, instruments, and targets of monetary policy

Framework and monetary targets

Hitherto, the lack of legislative clarity about monetary policy objectives and the means of resolving tensions between these had been reflected in Sri Lanka's monetary policy framework. For its part, the CBSL has shown its commitment to a monetary framework that is more explicitly targeted at reducing inflation.[14] An inflation rate target is set out in the budget. From 2005 the inflation target will be set by the CBSL.[15]

The overall monetary policy framework, objectives and projections for the year are now announced to the market and posted on the Bank's website. Changes in policy are communicated to the market in a timely fashion.[16]

Monetary instruments

The Sri Lankan government has maintained its commitment to a free-floating rupee. The CBSL has only intervened in support of the currency on a limited basis. The temporary precautionary measures introduced at the time of transition to a free-floating exchange rate have been phased out, and the CBSL has quickly gained experience under the new exchange rate regime.

The more active open market operations with an interest rate corridor formed by the repo and reverse repo rates, introduced in March 2003, has become the main instrument in monetary policy, and as the main tool to signal a change in monetary stance (with evaluation on regular pre-disclosed basis and decisions announced to the public).[17] The intermediate objective is the influencing of the growth of the monetary base.[18] Detailed retrospective coverage of its activities in this regard is included in the *Annual Report.* The reserve money target and progress in meeting that target are now made public on the CBSL website. This began in March 2003, but from 2004 targets will be released in January.[19]

Given that as of March 2003 there are open market operation, the market, rather than the central bank, determines interest rates. This has eliminated excess volatility in short-term money market rates and aids in achieving the base money targets.[20] Short-term interest rates are no longer a policy instrument.

The monetary policy-making body

Monetary board

The monetary board of the CBSL is charged under the MLA with determining the policies and measures to be adopted by the Bank, and is generally responsible for the Bank's management operations and administration. The board previously included only the governor, the secretary to the Treasury, and a member appointed by the president. Amendments to the MLA have expanded the monetary board from three to five appointed members. This has brought in private sector outside expertise.[21] The new arrangement, which appears to be working well, reduces the government's direct influence on monetary policy.

Advance meeting schedule

The monetary board usually meets fortnightly. The CBSL now produces a schedule of monetary board meetings, but does not publish minutes from these meetings. However, there are plans to publish the minutes from 2005.[22] There is some disagreement within the board and the government as to how open the board needs to be. Not all board meetings are relevant to monetary policy. Announcements from the main monthly board meetings are published however, and an advance release schedule of these announcements is released. The board operates on a consensus basis.[23]

A Monetary Policy Committee and a Financial Stability Committee have recently been created within the CBSL to generate discussion on monetary issues and provide advice to the governor and the monetary board.[24] The former is an internal technical committee that meets monthly to review monetary stance and make appropriate recommendations to the monetary board. The minutes of this committee are not made public. The Financial Stability Committee is developing an early warning system.

Public statements on monetary policy

Publicly available statements on monetary policy can be found in a variety of publications. Decisions of the monetary board are released on the same day via a press release, a posting on the website and through a press conference. The Bank has enhanced public statements on monetary policy by announcing monetary policy targets as of 2003.[25]

The central bank now releases a Monetary Policy Review every month to the public that reviews general economic developments and their bearing on the monetary policy of the CBSL.

Periodic publications

The Bank produces monthly bulletins of important data and also releases some weekly data to the press. However, uploading of monthly bulletins on the Bank's website remains sporadic and unreliable. The *Annual Report* of the CBSL provides detailed coverage of macroeconomic developments and of the operational activities of the Bank. For 2003, the central bank has also published an interim report on *Recent Economic Developments Highlights of 2003 and Prospects for 2004.* This is also available online at the Bank's website.

Regulations on data reporting by financial institutions to the central bank

The Department of Banking Supervision (BSD) within the CBSL is charged with continuous supervision and periodic examination of all banking institutions in Sri Lanka. Under the current MLA, these institutions are required to furnish the Director of the BSD with full details of assets and liabilities. The CBSL is also entitled to (and does) carry out on-site inspections.

There has been concern about weaknesses in the regulatory environment and the capacity of the BSD to supervise effectively the banking system. That said, an overhauled Banking Act should address these concerns and the newly established Financial Stability Committee is an attempt by the CBSL to rectify some of its own weaknesses. In the short term, the amendments to the MLA enhance the powers of the Director of the BSD to examine the books of any financial institution. The amendments extend the applicability of the provisions contained in the MLA in respect of

insolvent Banks, to licensed specialised banks. While the amendments to the MLA have strengthened the supervisory role of the CBSL, the new Banking Act will further tighten the regulatory regime (expected to be introduced in 2004).

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

The CBSL produces and disseminates statistics under the provisions of the Monetary Law Act, Section 35, which requires the Bank to submit data to the minister of finance and to publish a range of economic statistics in an annual report. *The Annual Report* must present, as a minimum, monthly data on money supply, international reserves, wage and other indices, trade figures by volume and value, and movements in Bank accounts, as well as annual figures on balance of payments, and government receipts and expenditures.[26] On the whole the Bank's statistical coverage and data dissemination is very good.

Sri Lanka participates in the IMF's General Data Dissemination System (GDDS) and hopes to subscribe soon to the IMF's Special Data Dissemination Standard (SDDS). The most recent *IMF Reports on the Observance of Standards and Codes* (ROSC) concluded that Sri Lanka has made good progress on meeting most of the SDDS specifications on timeliness, coverage and periodicity of data categories.[27] SDDS is expected to become effective in 2004.[28]

The CBSL has also acknowledged the importance of transparency issues: "In the context of regulation, the provision of information and the observance of internationally accepted standards and codes are assuming ever greater importance."[29] Notwithstanding this commitment, the IMF ROSC recommends the establishment of an advisory body charged with reviewing the quality of monetary statistics.[30] The CBSL has accepted this recommendation, though so far no such body has been set up.

A modernisation project is underway at the central bank. In August 2003 an automated accounting system was introduced, with the appropriate checks and balances, which will help with the timeliness of data dissemination. The central bank introduced an integrated automated payment and settlement system in September 2002. This facilitates large volume transactions and scriptless trading of government securities. The central bank modernisation project will be completed by 2005.

The central bank balance sheet

The MLA directs the CBSL to publish a monthly general balance sheet, giving information on the volume and composition of assets and liabilities. The Bank also produces a yearly balance sheet as part of the *Annual Report*. This provides information on international and domestic liabilities and assets, including details of the Bank's lending to government. Annual accounts are made available on the web straight away.

Lender of last resort

Under Section 87 of the MLA, the CBSL must maintain a bank rate on short-term advances to licensed commercial banks. These activities are coordinated by the Domestic Operations Department. There is no specification of the lender of last resort rate.[31]

Public information services

The central bank seems responsive to individual requests for information, but could nevertheless do more to strengthen its overall reporting of monetary policy and macroeconomic developments. Many of the CBSL's publications are available on its website, but some publications, including the monthly bulletins, are not regularly updated.[32] All data are released simultaneously to the public through press releases or in publications. Greater use is being made of simultaneous release through hardcopy release and posting on the Internet.[33] The research department is also active in the discussion and dissemination of policies and developments.

In June 2002, the CBSL announced a number of enhancements to quarterly estimates of GDP, including the provision of more detailed estimates and the implementation of an advance release calendar, aimed at bolstering public information flows.[34] An advance release calendar is now released. The release of CBSL data is also now accompanied by a media release and/or press conference explaining any revisions.[35]

A sensitivity analysis is carried out by the central bank in order make predictions/forecasts. The underlying assumptions of this analysis were made public in the 2004 Budget Economic and Fiscal Position Report 2004, presented along with the 2004 budget.

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●● Intent declared

Accountability before a designated public authority

The Monetary Law Act (MLA), in its current form, does not contain any provisions relating to reporting by CBSL officials before any designated public authority. The new Public Finances Act is expected to address this.

Financial statement

Audited financial statement

The current MLA stipulates that the accounts of the central bank should be audited by the office of the Auditor General and that an annual report of these accounts should be submitted to the minister of finance, who sets them before Parliament.[36] An audited balance sheet is incorporated into the CBSL's *Annual Report*. The audited financial statement is now produced according to international standards and is available on the web.

External and internal audit

In 2001, an audit committee of the monetary board was set up to improve management and financial procedures within the CBSL, as well oversee financial statements. The management audit department has also recently adopted an internal audit charter. Following a two envelope bidding process involving five international audit firms, an external auditor, Ernst & Young New Zealand, was employed in March 2002 to audit the CBSL accounts for 2001. The same firm was retained to audit the 2002 and 2003 figures.[37] This is a five-year agreement (renewed annually) with Ernst & Young New Zealand. The audited accounts are released one month prior to the release of the CBSL Annual Report. The annual accounts of the central bank are also audited by the Auditor General of Sri Lanka.

Conduct of officials

The MLA contains articles detailing restrictions on CBSL staff, including confidentiality provisions, requirement for co-operation with the auditor general band exemption from liability – unless the damage or loss was caused by misconduct.[38] CBSL employees follow a code of conduct stipulated in the *CBSL Manual*, last published in full in 1992, and must declare their assets annually. Ethical issues are also covered in the training process for new staff. In its efforts to comply with IMF codes, the CBSL has established a Good Governance Committee, headed by the governor.

Confidentiality of reporting is ensured by Section 45 of the MLA, which states that "every officer of the central bank shall preserve and aid in preserving secrecy with regard to all matters relating to the affairs of any banking institution or of any client of such institution".[39]

The Voluntary Retirement Scheme, implemented as part of the World Bank/SIDA restructuring programme, has resulted in the Bank being able to reduce its staff strength from 2,200 to 1,200.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Sri Lanka between 13 and 18 November 2003:

Central Bank of Sri Lanka

14 November 2003

W.A. Wijewardena	Deputy Governor	
P.W.R.B.A.U. Herat	Additional Director	Economic Research Department

Ministry of Finance

14 November 2003

Rose Cooray	Director General	Director General of Department of Fiscal Policy

ADDITIONAL INTERVIEWS

13 November 2003

Jeremy Carter	Senior Resident Representative	International Monetary Fund

14 November 2003

J.C. Weliamuna	Executive Director	Transparency International Sri Lanka Chapter

18 November 2003

Cresenta Fernando	Economist	World Bank, Colombo
Julitta Rasiah	Financial Management Specialist	World Bank, Colombo
Deva Rodrigo	Vice Chairman	Ceylon Chamber of Commerce
Gayathri Gunaruwan	Consultant Economist	Ceylon Chamber of Commerce

NOTES

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[2] *Annual Report 2002,* CBSL.
[3] Interviews in Colombo, 11-14 November 2002.
[4] *Monetary Law Act*, Chapter II, Article 5.
[5] *Monetary Law (Amendment) Bill*, 2002.
[6] Interviews in Colombo, 13-18 November 2003.
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[8] *Annual Report 2001*, CBSL, April 2002, Box 5, p.53.
[9] *Annual Report 2002*, CBSL, p 197.
[10] *Annual Report 2002*, CBSL, Part II, pp V.
[11] *Annual Report 2001*, CBSL, April 2002, Box 5, p.54.
[12] Interviews in Colombo, 13-18 November 2003.
[13] Interviews in Colombo, 13-18 November 2003.
[14] *Annual Report 2001*, CBSL, April 2002, Part 1.10, p.25.
[15] Interviews in Colombo, 13-18 November 2003.
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[17] Interviews in Colombo, 13-18 November 2003.
[18] *Annual Report 2002, CBSL.*
[19] Interviews in Colombo, 13-18 November 2003.
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[23] Interviews in Colombo, 13-18 November 2003.
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[25] Interviews in Colombo, 11-14 November 2002.
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[28] Interviews in Colombo, 13-18 November 2003.
[29] *Annual Report 2001*, CBSL, April 2002, Box 5, p.53.
[30] *Reports on the Observance of Standards and Codes*, IMF Country Report 02/104, May 2002, p.31.
[31] Interviews in Colombo, 13-18 November 2003.
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[33] Report provided by CBSL for IMF GDDS, updated April 2002.
[34] *Media Conference Paper*, CBSL, 28 June 2002, www.centralbanklanka.org/Media_Note_280602.pdf
[35] Interviews in Colombo, 11-14 November 2002.
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[37] *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement- Staff Report*, IMF Country Report No. 02/199, September 2002, p.44.
[38] *Monetary Law Act*, Part VIII, Articles 45-47.
[39] Report provided by CBSL for IMF GDDS, updated April 2002.

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TAIWAN

MONETARY TRANSPARENCY

Country Report 2003

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TAIWAN (REPUBLIC OF CHINA)

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●	●●●	●●●●
Open decision process	●●●●	●●●●	●●●●
Availability of information	●●●●	●●●	●●●
Central bank accountability	●●●●	●●●●	●●●
Score	3. 75	3.50	3.50

OUTLOOK & COMMENTARY

Two major reforms are likely to improve monetary and financial transparency in Taiwan in the near future: the adoption of a new CBC Act and the creation of a unified Financial Supervision Authority which will combine the functions of all existing supervisors.

The new CBC Act is designed to make three main improvements to the existing legal framework: (i) To replace the *ex officio* seats on the current BoD with seven full-time board members. (ii) To establish a new Monetary Consultative Committee composed of representatives from industry, other social groups, and of policy experts. (iii) To elevate ensuring the sound operation of payment system to a central goal of CBC policy. While it may reduce efficiency by weakening the relative position of the governor, it will significantly modernise the present legislation by creating a formal statutory basis for key elements of monetary transparency.

EXECUTIVE SUMMARY

3.75 Compliance in progress

The Central Bank of China operates as a highly independent and transparent central bank. However, the outdated Central Bank of China Act, which was most recently thoroughly revised in 1979, constitutes a problem in as much as its language does not always conform to modern standards of monetary transparency. As a result, many important provisions, while they may be observed in practice, do not have an explicit legal basis. Issues in point include the judicial independence of the Bank and the procedures governing the dismissal of the governor.

The Bank operates a very transparent monetary policy regime based on publicly announced M2 targets. However, the system of exchange rate management appears to be less transparent. In spite of the formal commitment to a floating rate, the Bank appears to intervene periodically and has, in fact, been quite successful in maintaining exchange rate stability.

The CBC produces a wide range of periodic publications on various aspects of monetary policy. The Bank's Board of Supervisors conducts and disseminates an annual audit of the balance sheet and financial statement. The Ministry of Audit also carries out independent audits of government activities. In spite of not being an IMF member, the CBC largely conform to the SDDS practices in disseminating financial statistics.

Delays in the adoption of the new CBC Act have slowed down significant further improvements in transparency standards. However, banking supervision will benefit from the decision to set up a unified national Financial Supervision Council.

Taiwan's overall score increases to 3.75 from 3.5 last year.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●● Enacted

The objectives and institutional framework of monetary policy

The objectives and institutional framework of the Central Bank of China (CBC) are defined in the Central Bank of China Act, promulgated in 1935 and amended in 1979.[1]

Central bank objectives and responsibilities

The CBC Act states that the primary objectives of the central bank are: to promote financial stability; to guide sound banking operations; to maintain the stability of the internal and external value of the currency; and to foster economic development within the scope of the above objectives.[2]

A proposed new CBC law has been locked up in the Legislative Yuan (parliament) having been linked with debates on financing of the Resolution Trust Corporation. The law proposes a reform of the CBC Board of Directors through the appointment of full-time directors. The reform promises to strengthen the independence of the Bank and to increase the transparency of decision-making.[3]

Operational autonomy

The CBC Act was passed and amended long before the adoption of modern standards of monetary transparency. As a result, the terminology it uses does not explicitly address questions such as independence. The Act places the CBC under the jurisdiction of the Executive Yuan (cabinet) and grants the Bank the *de iure* status of a government ministry.[4]

The CBC claims to enjoy complete independence in terms of formulating monetary policy decisions, free of any pressure from the government. In the Taiwanese system of government, the CBC and the Ministry of Finance each have their own prescribed areas of responsibility with the Ministry of Finance in charge of the financial system and the CBC in charge of setting monetary and foreign exchange policy.[5]

Although most observers view the CBC as a highly independent institution, some suggest that this is in part due to the personality of Governor Fai-nan Peng. The CBC Act does not have explicit provisions protecting the status of the governor, for instance no clear stipulation of the terms under which he can be dismissed. In practice, however, no governor has ever been fired. The greatest source of concern is that the Bank's independence is not statutory but rather based on tradition and thus potentially vulnerable.[6]

Political pressure has been applied on the Bank of late, most importantly in connection with President Chen Shui-bian's insistence that the CBC lift quotas on capital imports by qualified foreign institutional investors. While the CBC eventually endorsed the president's position, the decision had been preceded by a long-standing debate between the Bank and the Ministry of Finance. The timing of the intervention may have been coincidental and there is no evidence to suggest that it constituted a threat to CBC independence.[7]

The proposed new CBC Act is designed, among other things to increase the Bank's independence and to create an explicit legal basis for it. Under its provisions, the 15 directorships will be reduced to seven, and the directors will be full-time Bank employees forbidden to participate in political activities or to hold political office.[8]

Institutional relationship between monetary and fiscal operations

Lending to government

Monetary policy in Taiwan is strictly separate from the task of managing the government's debt. The CBC is in charge of the former, while the Ministry of Finance is responsible for the latter. Although the CBC is involved in handling the tenders of central government securities, it is not allowed under the *Guidelines for the Sale of Central Government Bonds* to purchase government bonds in the primary market. The CBC is thus effectively unable to finance budget deficits.[9]

The Ministry of Finance keeps cash balances with the CBC. There is a formal contract between the Ministry of Finance and the Bank for providing an overdraft facility to the central government, provided that there is an unexpected mismatch that depletes the available cash balances. However, this financing facility has never been used.[10]

Central bank involvement in the rest of the economy

The CBC Act states that the central bank may provide temporary advances to banks for periods not exceeding ten days. The CBC may also provide rediscounts of eligible bills, with maturity not exceeding 90 days for industrial and commercial bills, and 180 days for agricultural bills; and refinancing of secured loans not exceeding 360 days.[11]

The CBC is legally responsible for organising and managing the payment system in Taiwan. It operates and regulates the Interbank Fund Transfer System (CIFS).

In addition, the Bank is responsible for the flotation and redemption of government bonds, issued domestically or abroad, and of Treasury bills. However, the Bank may delegate these activities, whenever necessary, to other financial institutions.[12] The CBC Act also affirms that, in order to assist economic development, the CBC may establish various funds using savings deposited by financial institutions and other special funds to provide medium-term and long-term refinancing for banks.[13]

Central bank profit allocation

At the end of each financial year, the CBC sets aside 50% of any net profit as legal retained earnings. If the amount of accumulated legal retained earnings reaches that of the Bank's current capital, the percentage of net profits to be set aside may be reduced to not lower than 20%, subject to the resolution of the Board of Directors and the concurrence of the Board of Supervisors.[14]

Agency roles performed by the central bank on behalf of the government

Under the CBC Act, the Bank effects the operations of the National Treasury and manages the Treasury cash accounts. It further serves central government agencies in other financial matters, such as cash accounts, bills, and securities (including receipts and payments), safekeeping and transfers, and the protection of other asset documents. It may delegate these operations to other financial institutions.[15]

The CBC is allowed to purchase and sell a variety of financial instruments in the open market. These include bonds issued or guaranteed by the government, financial bonds issued by banks, and bills accepted or guaranteed by banks. For the purpose of monetary regulation, the CBC may issue certificates of time deposit savings bonds and short-term bonds, and it may buy and sell these in open market transactions.[16] The CBC Act stipulates that the Bank should receive and maintain reserves against the deposits of other banks. At its discretion, the CBC may modify deposit reserve ratios within various limits for a range of deposit accounts.[17]

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments, and targets of monetary policy

Framework and monetary targets

The CBC is legally required to maintain price stability. In order to meet this goal, the Bank uses the M2 monetary aggregate as its intermediate target variable and monitors the movements of a wide spectrum of economic and financial variables. In executing its monetary policy, the CBC makes quarterly economic projections, sets annual growth rates for the M2 aggregate at the year-end for the coming year, and makes monthly projections of key financial variables that are consistent with the targeted monetary aggregates. The CBC has no plans to adopt inflation targeting.[18]

Although the CBC has since 1979 pursued a floating exchange rate regime, it has openly signalled its willingness to step in "when the market is disrupted by seasonal or irregular factors."[19] Many commentators suspect that such interventions are, in fact, fairly frequent, albeit less so than in the past. Several methods are said to be used to determine the exchange rate. While the details are not known, the basic pattern is observable to market analysts and appears to involve a trade-weighted basket of currencies. The CBC is said to have a deeply ingrained culture hostile to speculation and the Bank appears to intervene in the markets for the purpose of "punishing" speculators. Overall, the Bank has been remarkably successful in maintaining relative exchange rate stability even with the transition to an increasingly pure float.[20]

Monetary instruments

The CBC uses a variety of instruments to manage monetary and exchange rate policy. The most important and commonly used are open market operations with eligible securities. Other measures include a discount window policy for commercial banks, reserve requirements, re-deposits of financial institutions, and selective credit controls.[21] Taiwan possesses large amounts of international reserves (US$202.83 billion at the end of November 2003), which afford considerable leeway in policy implementation.[22]

The need to monitor capital flows has increased markedly since the removal of restrictions on them last year. The CBC has vowed to act to prevent speculative activities.[23]

The monetary policy-making body

Monetary board

The principal body in charge of formulating monetary policy is the Board of Directors (BoD) of the CBC. This board consists of 11 to 15 directors, nominated by the Executive Yuan and appointed by the president. Within the Board, there is an Executive Board, composed of seven executive directors who are selected by the BoD. The governor of the CBC, the minister of finance, and the minister of economic affairs are *ex officio* directors and

executive directors. There is at least one representative on the board from the agricultural, industrial, and commercial sectors.[24]

The CBC Act assigns the BoD a number of responsibilities. The Board can examine monetary, credit, and foreign exchange policies; to examine the adjustment of the Bank's capital; to approve the operational plans of the Bank; to inspect the budget and fiscal reports of the Bank; to examine and approve the major by-laws and regulations of the Bank; to oversee the establishment and abolition of the Bank's branch offices; to deal with the appointment and removal of the Bank's department heads, their deputies, and branch managers; and to examine relevant issues highlighted by the governor. The Board may delegate all or part of these responsibilities to the Executive Board, whose resolutions are reported to the BoD for record and approval.[25]

The revised CBC Act will cut the number of directors to seven, all of whom will be full-time executive directors. In addition, their tenures will be staggered so as to ensure continuity and independence. In order to reduce political interference, members of any one political party cannot make up more than one-half of the board. They will not be allowed to take part in any political activities during their tenure.[26]

Advance meeting schedule

The Board of Directors has scheduled meetings at least four times a year during the last week of March, June, September, and December.[27] It also meets whenever the governor deems it necessary. The dates of quarterly meetings are released in advance. The times of *ad hoc* meetings are released usually after 1 p.m. — when the stock market closes — on the same day the meetings are held. No agenda is released before any of the meetings. The Board is responsible for establishing the rules and regulations of its meetings. Details regarding the convening and proceedings of the BoD meetings are laid down in the Board Meeting Procedures. According to some analysts, BoD meetings very often appear to be little more than conference calls initiated by the governor to gain assent to a pre-decided policy.[28] The effectiveness of the Board's policy-making role is therefore somewhat questionable.

Public statements on monetary policy

Periodic publications

The CBC has a number of periodic publications.[29] The main monthly publication is the *Financial Statistics Monthly*, the release of which is always accompanied by a press statement indicating the actual M2 aggregate growth rate in comparison with its target range. This publication provides statistics on key financial indicators, such as reserve money, monetary aggregates, the interest rate, the stock market index, the balance of payments, and foreign exchange reserves.[30] The *Banking Rules and Regulations* is the Bank's other monthly publication.

The main quarterly publications are the *Central Bank of China Quarterly*, the *Condition and Performance of Domestic Banks*, and the *Balance of Payments Quarterly*.[31]

The Bank's main annual publication is the *Annual Report* which provides a review of economic and financial developments over the year. In addition, the Bank annually releases *Financial Institutions' Major Business Statistics*, the *Flow of Funds in Taiwan Dictrict, RoC*, and the *Survey of the Financial Conditions of Private and Public Enterprises*. All the publications are reproduced on the CBC's website.

Public hearings

The CBC often consulted academics and private sector experts on proposed changes to the monetary policy framework. The purpose of such consultations is to build consensus prior to announcing a new policy. However, they appear to be limited to particular elements of the Bank's operations.[32]

The revised CBC Act plans to set up a Monetary Consulting Committee of nine members recruited from academic and business circles. These consultants will work for the CBC part-time, and their function will be to advise the Board of Directors.

Monetary policy decisions and agreements on future directions are announced and explained through press releases issued immediately following meetings of the Board of Directors. The press releases indicate the main considerations underlying monetary policy decisions.[33] The CBC does not, however, present regular reports on the rationale, quantitative targets, or underlying assumptions of its monetary policies.

Regulations on data reporting by financial institutions to the central bank

The CBC Act charges the Bank with the responsibility for the "examination of the operations of all financial institutions in the country."[34] On its website, the CBC publishes a biannual report on the *Condition and Performance of Domestic Banks*, which lists data on key trends, the consolidated balance sheet, income, guarantees, outstanding derivatives, and the main financial and performance ratios.[35] *Financial Statistics* monthly compiles comprehensive statistics on the banking sector, which are generally considered to be of very high quality. Some problems are created by the fact that Taiwan has yet to introduce a unified compulsory standards on bookkeeping and declaration. At the moment, companies often report incomplete or inaccurate information. The local culture still frowns upon interference with personal property and corporate models based on a separation of ownership and management.[36]

The function of banking supervision is shared between three government institutions, namely the Ministry of Finance, the CBC, and the Central Deposit Insurance Corporation (CDIC), each of which falls under the Executive Yuan. In the case of the banking industry, the Ministry of Finance formulates policy and drafts regulations, while its subordinate agency, the Bureau of Monetary Affairs (BOMA), is in charge of implementation. Its main tasks include bank licensing, reviewing applications for new branches and activities, formulating rules and regulations, disciplinary action, and investigation of banks. It further provides overview statistics, updated monthly, on the banking sector. The CBC instructs financial institutions to conduct improvements in areas where they are called for.[37]

The fragmented structure of financial supervision results in some inefficiency. Institutions are required to compile the same data several times, often in different formats. Also reporting frequencies differ. Similarly, agencies can in principle, and sometimes do, pre-empt each other by issuing conflicting regulations in the same area. An additional problem is created by the use of retroactive rule making.[38]

The Legislative Yuan in July passed a measure to created a Financial Supervision Council (FSC). The FSC will be a unified regulator with cabinet-level authority. It will incorporate all the existing financial regulatory agencies and consist of five main sections – securities, baking, insurance, examination, and logistics. It will come into being on July 1, 2004 when the Coordination Council of Financial Supervision and Regulation will cease operation. Some open questions remain about the exact nature of the new institution and it is likely to take at least a couple of years to become fully established. Even following the establishment of the FSC, the CBC intends to retain a modest financial

supervisory function, motivated in large part by the CBC's role in the payments system, most specifically as a lender of last resort.

Taiwan currently operates two financial monitoring systems, the Early Warning System operated by the CDIC and the CAMEL run by the Bureau of Monetary Affairs. While not formally linked, there is a high degree of coordination and collaboration between the two mechanisms. The two systems are used in conjunction with other surveillance techniques, including on-site inspections.[39]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

Although Taiwan is not a member of the IMF, the central bank broadly complies with the IMF's Special Data Dissemination Standard (SDDS) for the release of financial and external sector statistics.[40] The SDDS data has been posted on the Bank's website since 1998. Monthly financial statistics are presented in a national and an IFS format. According to the CBC, all the IMF-required data are publicly available, albeit not necessarily always in SDDS format.

As a non-member, Taiwan is not allowed to present its SDDS meta-data on the Dissemination Standards Bulletin Board. In accordance with the standard, the Financial Statistics Division of the CBC's Economic Research Department publishes an advance release calendar.[41]

The central bank balance sheet

The Bank's *Financial Statistics Monthly* contains aggregate monetary data and a summary of the CBC's assets and liabilities. Full balance sheets are published in the *Annual Report*. In addition, the *Financial Statistics Monthly* provides a synopsis of the Bank's open market transactions. While the publication does not contain terms of refinance or other facilities, these are announced on the CBC's website. Gains or losses from the Bank's assets or liabilities denominated in gold, silver or foreign currencies, and other forms of international reserves are not listed in its annual profit or loss. This is due to changes in the exchange rate of the national currency or fluctuations in the value of these assets and liabilities relative to the national currency.[42]

Lender of last resort

There is no public disclosure of aggregate information on emergency financial support extended by the central bank to other financial institutions. However, the CBC does provide financial help to banks that require it, in accordance with the CBC Act. For instance, the Bank may provide temporary advances to banks for periods not exceeding ten days. The Central Deposit Insurance Corporation, rather than the CBC, is responsible for refinancing for credit associations and farmers' and fishermen's credit unions.

Public information services

The CBC maintains public information services in Chinese and English, made available through press releases and its website which also provides contact information for the Bank.

In addition to its wide range of regular periodicals, the Bank produces a large number of occasional publications. Furthermore, all press releases and speeches are reproduced on the website with a search function.[43]

4. Accountability and Assurances of Integrity by the Central Bank

●●●● Compliance in progress

Accountability before a designated public authority

The governor appears before the Legislative Yuan in open session on a biannual basis to report the conduct of monetary policy, explain objectives, and describe performance and progress in achieving objectives, as well as to respond to legislators' questions on issues related to the economic situation and monetary policy. He also appears before the legislature once a year to answer questions on issues relating to the Bank's budget. He can also, like any other cabinet official, be summoned to appear before the Legislative Yuan or its committees whenever required, though he cannot be compelled to attend, and he may send a deputy.[44]

Financial statement

Audited financial statement

The CBC's financial data are produced by the Bank's Accounting Department. Information on expenses and revenues is publicly disclosed in the *Annual Report* of the CBC. The fiscal year conforms to the calendar year.

External and internal audits

The Bank has a Board of Supervisors whose powers and functions include investigating cases of alleged violation of the CBC Act and auditing the Bank's accounts. The supervisors examine and approve the annual reports, which are produced at the end of the fiscal year and processed in accordance with the Fiscal Reporting Law.[45]

The Ministry of Audit, the government's supreme supervisory body under the Control Yuan, performs external audits. There is, however, no use of independent private sector auditors. Although plans to use such firms in the future exist, some commentators voiced concern over risks that such a practice might create by opening CBC books to the scrutiny of the Legislative Yuan and the local media. Their actions might compromise the credibility of monetary policy. In particular, many observers deem it unlikely that the Bank would want to give external auditors open access to information about its foreign exchange interventions.[46]

Conduct of officials

In order to prevent exploitation of privileged information and conflicts of interest, all Bank staff are under obligation to follow the *Code of Conduct for Civil Servants*.

Rights and obligations for CBC officials and staff during the exercise of their official duties are defined in the Civil Servants Act. Civil servants are generally protected in Taiwan from dismissal unless it is deemed a necessary punishment for flawed work, this being decided by the Committee for the Discipline of Public Functionaries, a quasi-judicial agency designed specifically for this purpose. Dismissal is very rare; demerit points are more common.[47]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals in Taiwan between 16 October and 18 November 2003:

Central Bank of China, Taipei

13 November 2003

Sue-yar Yue	Senior Specialist	Economic Research Department
Various unnamed representatives		

Directorate-General of Budget, Accounting and Statistics, Taipei

16 November 2003

Li Guo-xing	Inspector	Division 1
Huang Yao-sheng	Researcher	Division 1
Zhuang Zhi-feng	Researcher	Division 2
Cai Hong-kun	Specialist	Division 3
Huang Yong-chuan	Deputy Executive Director	Accounting Centre
Huang Cheng-chang	Editor	Accounting Centre

Ministry of Finance, Taipei

28 October 2003

Patrick Y.P. Cheng	Deputy Director-General	Department of National Treasury
Shelly H.S. Chen	Director	Department of National Treasury
Huang Hsi Chin	Section Chief	Department of National Treasury

7 November 2003

Wen-Siung Lee	Director	Bureau of Monetary Affairs
Bi-jen Yang	Assistant Director	Bureau of Monetary Affairs
Yu-peng Tseng	Section Chief	Division of Internal Banking, Bureau of Monetary Affairs
David Yang	Deputy Section Chief	Division of Internal Banking, Bureau of Monetary Affairs

ADDITIONAL INTERVIEWS

18 October 2003

Richard W. Hartzell	Freelance journalist and legal advocate	

21 October 2003

Jyh-bang Jou	Professor	College of Social Science, National Taiwan University

22 October 2003

Thomas H. McGowan	Attorney at Law	Russin & Vecchi International Legal Counsellors
Peter Kurz	CEO	Insight Pacific

29 October 2003

Guy Wittich	CEO	European Chamber of Commerce

31 October 2003

Andrea S. Lee	Deputy Director	Division of International Affairs, Securities and Futures Commission

3 November 2003

Wu Chung-Shu	Research Fellow	Institute of Economics, Academia Sinica
	Member	CBC Board of Supervisors

NOTES

[1] The Central Bank of China Act (1935, amended 1979), http://www.cbc.gov.tw.
[2] CBC Act, Article 2.
[3] Interviews conducted in Taipei, 16 October -18 November 2003.
[4] CBC Act, Article 1.
[5] Interviews conducted in Taipei, 16 October -18 November 2003.
[6] "Financial Reforms in Taiwan," *Bureau of Monetary Affairs, Ministry of Finance*, April 2003.
[7] Interviews conducted in Taipei, 16 October -18 November 2003.
[8] Interviews conducted in Taipei, 16 October -18 November 2003.
[9] Laws and Regulations, Treasury Regulations, http://www.cbc.gov.tw.
[10] Interviews conducted in Taipei, 16 October -18 November 2003.
[11] CBC Act, Articles 19, 22.
[12] CBC Act, Article 37.
[13] CBC Act, Article 20.
[14] CBC Act, Article 42.
[15] CBC Act, Article 36.
[16] CBC Act, Articles 26, 27.
[17] CBC Act, Article 23.
[18] Interviews conducted in Taipei, 16 October -18 November 2003.
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[21] Monetary and Foreign Exchange Management, http://www.cbc.gov.tw; ~/EngHome/esecretariat/pressrelease/mdate/e921205.htm.
[22] Mundell, "Currency Areas, Exchange Rate Systems and International Monetary Reform."
[23] Joyce Huang, "Capital flows 'need watching'," *Taipei Times*, 7 November, 2003.
[24] CBC Act, Article 5.
[25] CBC Act, Article 6.
[26] Hwang Dar-yeh, "CBC board should be made more professional," *Taipei Times*, 9 June, 2002.
[27] SEACEN report on the CBC, available at http://www.seacen.org.
[28] Interviews conducted in Taipei, 16 October -18 November 2003.
[29] http://www.cbc.gov.tw/EngHome/Esecretariat/Publication/Publications.htm.
[30] http://www.cbc.gov.tw/economic/EBOOK/WWW/cbc_menu_en.htm.
[31] http://www.cbc.gov.tw/EngHome/economic/publications/EP_Imf_bop.xls.
[32] Interviews conducted in Taipei, 16 October -18 November 2003.
[33] "'Monetary Policy Decisions of the CBC Board Meeting," http://www.cbc.gov.tw.
[34] CBC Act, Article 38.
[35] http://www.cbc.gov.tw/EngHome/Ebankexam/Statistics/eubpr/Current/index.htm.
[36] Interviews conducted in Taipei, 16 October -18 November 2003.
[37] *2001 Annual Report of the Bureau of Monetary Affairs*, Ministry of Finance.
[38] The European Chamber of Commerce Taipei, "Banking: 2003," http://www.ecct.com.tw/committees/banking/2003banking.php.
[39] Interviews conducted in Taipei, 16 October -18 November 2003.
[40] Interviews conducted in Taipei, 16 October -18 November 2003.
[41] CBC advance release calendar, http://www.cbc.gov.tw.
[42] CBC Act, Article 43.
[43] http://www.cbc.gov.tw/EngHome/PressRelease.htm; http://www.cbc.gov.tw/EngHome/Eeconomic/Speeches/speeches.htm.
[44] Interviews conducted in Taipei, 16 October -18 November 2003.
[45] CBC Act, Article 8.
[46] Interviews conducted in Taipei, 16 October -18 November 2003.
[47] Interviews conducted in Taipei, 16 October -18 November 2003.

OXFORD ANALYTICA

THAILAND

MONETARY TRANSPARENCY

Country Report 2003

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THAILAND

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●●	●●	●●●
Open decision process	●●●	●●	●●●
Availability of information	●●●●●	●●●●●	●●●●●
Central bank accountability	●●	●●	●●●
Score	**3.50**	**2.75**	**3.50**

OUTLOOK & COMMENTARY

The Bank of Thailand (BoT) has embarked on the process of adopting the new objectives and institutional framework set out in pending amendments to the 1942 BoT Act in order to revamp monetary transparency while fending off legislative inertia. In the short term, these actions will reinforce public perceptions about the central bank's political neutrality and consolidate its *de facto* operational independence to implement monetary policy. Nevertheless, parliamentary approval of the amended BoT Act is needed to bring statutory clarity to all these improvements.

Weaknesses will likely remain in those areas where legislation is a stronger requirement to guarantee clarity and enforcement, such as central bank accountability and regulatory responsibility. However, the BoT's resolve to comply with international transparency guidelines may influence parliament to approve reforms soon.

EXECUTIVE SUMMARY

3.50 Enacted

Thailand has made significant progress overhauling its monetary transparency practices to remedy shortcomings exposed by the regional financial crisis in 1997-98. The Bank of Thailand (BoT) has developed good public information services and continues to meet the requirements of the IMF's Special Data Dissemination Standard.

Pending legislation can be expected to bring statutory force to a new definition of the BoT's core monetary objectives and assert the central bank's independence. Nevertheless, the BoT has not waited for the legislation to be approved; it has adopted the definition of objectives in the draft legislation, reorganised itself around those objectives, and operated independently. The BoT is therefore in the process of building transparency and credibility by its actions. These steps include adopting an explicit inflation target and changing its policymaking arm -- the Monetary Policy Committee (MPC) -- to include external experts and internal professional experts as full members.

The BoT has stated its intention to comply with transparency guidelines and has made considerable progress bringing its practices up to international standards. In this context, the BoT envisages inviting an IMF mission to review its observance of transparency standards and codes after one or two years of further progress.

Thailand's overall score has improved from 2.75 in 2002 to 3.50.

1. Clarity of Roles, Responsibilities and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The Bank of Thailand Act of 1942 and accompanying Royal Decree authorise the central bank to issue bank notes, establish a Financial Institutions Development Fund to develop the financial system, set interest rates, transact commercial bills and government securities, and make loans to government -- all under the general supervision of the minister of finance.[1] A more modern and clear statement of the objectives and institutional framework of monetary policy is set out in pending amendments to the Act that will also grant the central bank statutory independence from the Ministry of Finance (MoF).[2]

However, the BoT has not waited for parliamentary approval of the new act to take on the new arrangements, and has moved to adopt the new objectives and institutional framework with the view that monetary transparency and the credibility of the central bank depend on immediate action. The BoT is organised in accordance with what it specifies as its three main functions: formulating monetary policy; supervising and examining financial institutions; and maintaining a payment system and issuing bank notes. The central bank has adopted the objective of providing a stable financial environment as its core strategic purpose, and it has defined its monetary policy aim as promoting price stability and sustainable economic growth.[3]

Operational autonomy

A chief objective of the reforms -- at least from the BoT's perspective -- is to boost the credibility of the BoT as the key monetary institution by reinforcing its political neutrality and installing more checks and balances.[4] BoT governor M. R. Pridiyathorn Devakula has publicly said that the administration of the central bank will stay under the direction of a Court of Directors, a group of 15 (including the governor) drawn from within the central bank. Members of the Court include 'policy insiders' (the governor and deputy governors) and 'policy outsiders' within the BoT (assistant governors and less senior professionals).[5]

Selection criteria for the Court of Directors and senior BoT staff have a critical bearing on monetary transparency and are one of the more contentious issues covered by the new act. M.R. Pridiyathorn said he wants the court chairman and governor to be appointed directly by parliament or a panel of respected economists drawn from outside the central bank, in order to declare the full operational independence of the BoT. At present, the MoF, on recommendation from the government, chooses the governor.[6]

Monetary policy is currently the responsibility of the Monetary Policy Committee (MPC), set up in 2000-01 as part of the inflation-targeting strategy. M.R. Pridiyathorn wants the MPC and the Financial Institutions Board (FIB) to include experts from outside the BoT. In September 2003 -- before any supporting legislation was passed -- the central bank announced that, in an effort to promote the practice of transparency and good governance, external experts would be included as full members of the MPC. The current seven-member MPC comprises the governor and two deputy governors, two external (i.e. from outside the central bank) financial and macroeconomic experts, and two senior professional experts from the BoT.[7]

Under the current governor, who took office in 2001, the BoT has sought to project a more neutral profile while conforming to the thrust of government policies. The BoT takes account of government policies in MPC deliberations, but is not bound by political directives. It successfully resisted government pressure for the monetisation of debt carried by the Financial Institution Development Fund (FIDF), a lifeboat scheme for ailing commercial banks and finance firms. Instead, the debt is being fiscalised via the FIDF2 bonds.[8] M.R. Pridiyathorn has also rebuked the prime minister for making public statements on exchange policies that might be misconstrued by money markets. He has adopted a stance of the bank being independent in practice and not tolerating interference: M.R. Pridiyathorn has publicly stated that he will not be reluctant to resign should he be subject to political pressure.[9]

Institutional relationship between monetary and fiscal operations

The politicisation of monetary affairs had been previously evident in the vexed relationship between fiscal and monetary agencies. Frictions reached unprecedented levels during the build-up to the 1997 financial crisis, when the central bank was constantly caught between its obligations as the lender of first resort and the responsibility of ensuring stable levels of government debt. Since the financial crisis, the BoT and MoF have worked together successfully to build fiscal sustainability and reduce public debt. The new BoT Act will impose additional restrictions on central bank lending to the government. While details of these curbs have not yet been disclosed, borrowings will likely be restricted to funding emergencies.[10]

Lending to government

The BoT is authorised to borrow on behalf of the government and advance unsecured loans and advances through the MoF for ordinary budget expenditure under the terms of the Royal Decree Regulating the Affairs of the Bank of Thailand (1942) and the Budgetary Appropriations Acts (of 1959 and 1960), which define the relationship between monetary and fiscal operations. The MoF can also draw on an overdraft facility maintained by the central bank. Additional loans may be made if they are guaranteed, while the BoT is authorised to purchase government securities in the primary market and to auction treasury bills as a form of short-term loan. The BoT's website provides concise details of its mandate and outlines the exposure to government debt.

Central bank involvement in the rest of the economy

A secondary aim of the BoT's borrowing programme is debt stabilisation and restructuring under the umbrella of the Financial Institution Development Fund (FIDF). Set up in 1985 as a separate juristic entity of the BoT, the FIDF provides liquidity for under-capitalised financial institutions. The Public Finance Audit Commission (on behalf of the MoF) audits the FIDF. The integrity of the Public Finance Audit Commission has never been questioned, but some commentators have questioned the accountability of the FIDF.[11]

Restructuring of private sector debt is coordinated by the Corporate Debt Restructuring Advisory Committee (CDRAC). Established in 1998, the BoT Governor chairs the CDRAC, but its membership is drawn mostly from the private sector. In recent years, the BoT also assisted in the transfer of bad loans to the state-owned Thai Asset Management Corporation (TAMC). Information on the functions and operations of the FIDF, CDRAC, and TAMC can be obtained from the BoT's website.

A number of additional borrowings are also authorised under the BoT Act for development purposes in support of government economic objectives. These are packaged in a programme of Financial Assistance to Priority Sectors: exports; agriculture; industry/small business; and special development projects. As outlined on the BoT's website, the central bank provides funding through private financial institutions and state development agencies like the Industrial Finance Corporation of Thailand. The BoT processes loans either by purchasing promissory notes from

the relevant institutions or lending to the same institutions. Promissory notes are used as collateral for the latter transactions. Full details of lending practices and capital allocation are listed in the BoT Act.

Agency roles performed by the central bank on behalf of the government

The agency role of the BoT, mandated by the BoT Act (1942), is unlikely to change under the amended legislation.[12] As the government's fiscal agent, the BoT issues, sells and transfers government securities through a primary dealer system, and is authorised to deal in government bills of exchange and shares, control and centralise foreign exchange, and undertake any other government business requested by the MoF.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●● Enacted

The framework, instruments, and targets of monetary policy

Framework and monetary targets

Since August 2000, the BoT has set explicit inflation targeting as the main objective of monetary policy. This replaced a monetary targeting regime that was adopted in the aftermath of the 1997 financial upheaval and the decision to end the fixed currency peg with the US dollar. The switch reflected the BoT's belief that the relationship between money supply and output growth was becoming less stable as the financial sector expanded.

The fourteen-day repurchase rate is set as the key policy instrument, while the headline target is the quarterly average of core inflation. The BoT hosts a press conference after every policy review and is required to explain publicly if it misses the set targets.[13]

Monetary instruments

The legal framework for monetary instruments, which is the same as for monetary targeting, is outlined in the BoT Act. Policy instruments are listed on the BoT website, as are the monthly *Inflation Report* and the central bank's *Annual Accounts.*

The BoT uses a numeric macroeconomic model (available on its website) to analyse the response of the economy to external shocks and policy changes. The model comprises 23 behavioural equations and 28 identities. The equations are published in the quarterly *Inflation Report*, as are any changes to the assumptions and notes on its forecasts.[14]

The monetary policy-making body

Monetary board

Monetary policy is set by the BoT's Monetary Policy Committee (MPC), which was established in late 2001 in place of the Monetary Policy Board (MPB) that had overseen the previous strategy of monetary targeting. Its primary function is to decide the direction of monetary policy in relation to the balance of payments, foreign exchange rates, economic growth, level of investment, industrial production, employment, and other relevant factors.

The amended BoT Act can be expected to bring statutory definition to the MPC's composition, role, and responsibilities for the first time. As mentioned above, since September 2003 the MPC has included external experts and internal professional officers, while changes in the composition of the MPC are now publicly disclosed in press releases and on the BoT website. In securing legal status, the MPC will add statutory independence to its current gain in actual operational independence in the conduct of monetary policy.

Within the central bank, the Monetary Policy Group (MPG) supports the MPC. Some commentators highlighted that the MPG comprises professional technical staff and has a high proportion of a new generation of Thai officials with doctorates from renowned foreign universities, including some recruited from academia.[15]

Public statements on monetary policy

Periodic publications

The BoT website presents an advance calendar for the release of macroeconomic data.[16] Data releases include monthly reports on economic and monetary conditions, a quarterly *Inflation Report*, and a detailed account of interest rate movements. Of these, the most relevant is the *Inflation Report*, which analyses monetary conditions in relation to the broader economy. Macroeconomic data are available through the BoT website, the MoF database and a site maintained by the National Economic and Social Development Board (NESDB), the chief state planning agency.

The BoT website makes available weekly, monthly, and quarterly *Economic Reports,* combining macroeconomic and sectoral data with analysis of growth trends, including monetary and exchange rate trends. All are available in English. Historic data are also available on the website and in the *Annual Accounts*.

Public hearings

The MPC meets with the press after meetings, which are held every six weeks according to a pre-announced schedule. The MPC publishes its forward schedule of meetings, seminars on the macro-economy, press releases, reports on the economy and macroeconomic conditions, economic indices, and its decisions on the BoT website.[17]

Regulations on data reporting by financial institutions to the central bank

Financial institutions are required to report lending practices to the BoT and to meet the Bank of International Settlement's liquidity and capital reserve standards. The BoT also supervises operations of state-owned financial institutions such as the Industrial Finance Corporation of Thailand (IFCT) and the Government Savings Bank.

The pending Financial Institutions Act will restate and bring statutory clarity to the current structure of regulatory responsibility. Commercial banks and finance companies now report to the BoT; state-owned banks report to both the BoT and the MoF. Securities and credit foncier (housing finance) firms report to the MoF, while insurance companies report to the Ministry of Commerce. The former unclear regulatory jurisdiction led to the establishment in 2001 of a Financial Institutions Board (FIB), with a mandate to monitor market conditions, and the adoption of a Commercial Bank/Finance Companies Act that transferred more supervisory powers to the BoT. The current supervisory structure and the relevant laws are detailed on the BoT website.[18]

A Deposit Insurance Act has been drafted and, as with other reforming legislation, was still awaiting parliamentary approval in December 2003. The act will empower the creation of a Deposit Insurance Agency that will provide partial guarantees on bank deposits, up to a defined ceiling. The deposit insurance will be introduced in three phases.[19]

3. Public Availability of Information on Monetary Policy

●●●●● Full compliance

Release of central bank data

As a subscriber to the IMF Special Data Dissemination Standard (SDDS), Thailand conforms to requirements for the coverage, periodicity, and timeliness of monetary data. The dissemination report submitted voluntarily by the BoT indicates full compliance with data on central government debt; analytical accounts of the banking sector; analytical accounts of the central bank; interest rates data; and exchange rates data.

Economic and financial statistics are contained in the databank on the BoT website, with an archive dating back to June 2001.[20] The databank includes the central bank's preliminary statistics, final quarterly *Economic and Financial Statistics*, and links to statistics from other agencies, such as the quarterly GDP figure and the consumer price index (CPI). Secondary non-monetary statistics including population numbers and retail trade indices are also available from the website.

The central bank balance sheet

Accounts are published weekly on the BoT website with a lag of one week as the *Press Release on Economic and Monetary Conditions*, detailing the international reserve (marked to market), net forward position, net claims on government, net claims on domestic financial institutions, and reserve money. The weekly accounts are also provided in the form of a twelve-month review table of the central bank's assets and liabilities.[21]

In order to meet obligations in the Royal Decree regulating the BoT (1942), the BoT also publishes a *Weekly Report*, comprising the returns of each Thursday from its Issue Department and Banking Department, with a lag of three months. The returns of the two departments detail banknotes in circulation and the BoT's money, gold, securities gold holdings and net foreign position. The *Weekly Report* is made available on the BoT website, including historical issues back to 2001.[22]

Following audits by the BoT's internal auditing committee and the independent Public Finance Audit Commission (PFAC), the central bank releases its *Annual Accounts* to detail the BoT's assets and liabilities, and financial statement. The statements and accompanying comments from both auditing committees are included in the report. The most recent *Annual Accounts* and those back to 1998 are available on the BoT website.[23] The *Annual Accounts* is usually released in May after the data are published in the *Government Gazette*.

Lender of last resort

Extensive information on the functions and purpose of the CDRAC and FIDF are carried by the BoT website, including their links with state development banks, the Export-Import Bank and private financial institutions. The site outlines lending options, the type of activity that is eligible for support, and eligibility criteria.[24] Details of the restructuring role played by the TAMC as a central clearing house for non-performing loans are reported briefly on the BoT website and more comprehensively by the MoF, which has overall jurisdiction for restructuring corporate debt. The BoT's primary role in the TAMC was to coordinate the transfer of non-performing loans from public and private banks.

Public information services

Information services have been overhauled since they were identified by the IMF as a contributing factor to poor investment decisions that created the liquidity bubble behind the 1997-98 Asian financial crisis. The BoT responded with a reform programme that re-launched the website and introduced a new culture of openness that has yet to be matched by other government agencies. This was partly to fulfil disclosure obligations under the newly enacted Public Information Act. A comprehensive archive is now available, ranging from background reports to press releases, market analysis and data. The BoT's own activities, including its strategic plans, are also discussed in depth. All coverage is in English and Thai.

4. Accountability and Assurances of Integrity by the Central Bank

●● Intent declared

Accountability before a designated public authority

Senior BoT officials regularly brief the cabinet on specific monetary issues. Depending upon the importance of the matter, the BoT will be represented either by the BoT Governor or his deputies. Senior BoT officials appear in parliament when invited, for instance when parliament is debating issues including non-performing loans and interest rates, but the parliament has no regular reporting requirement.

Financial statement

Audited financial statement

The BoT publishes weekly reports on its financial status and an annual financial statement to comply with the requirements of the Royal Decree. The weekly reports are carried in the MoF's *Government Gazette* and the BoT website. The annual accounts are included in the central bank's *Annual Accounts*, which is available on the BoT website and in a subscription print version. Details are provided of operating costs and revenues of the BoT in compliance with international accounting standards.[25]

External and internal audit

All accounts are audited by the BoT's internal auditing committee and then submitted to the Public Finance Audit Commission (PFAC), formerly known as the Auditor General. The PFAC also reports on the status of BoT currency reserves and the custody and disbursement of monies.

The PFAC functions as an independent body and its integrity has not been questioned. There are no current plans for the auditing to be transferred to a non-government entity. As it relies entirely upon accounts submitted by the BoT, the PFAC is responsible only for checking the central bank's compliance with established policies and guidelines.

Conduct of officials

The BoT Governor is appointed by the MoF, and according to the Royal Decree can only be removed through the same process. Stated grounds for dismissal are "bankruptcy or incompetence". As mentioned above, one governor is regarded as having been forced from office by those associated with the current prime minister. The BoT has incorporated safeguards from political interference in the draft new BoT Act. If these are adopted, either the parliament or a panel of 'wise men' drawn from leaders of the public and private sectors will select the BoT Governor in future (it is unclear whether they would also have the right to dismiss him).[26]

In general, all BoT officials are subject to the BoT's internal code of ethics and the civil service rules of conduct. They can also be cited by the Civil Service Commission (CCC) for any breaches, but are usually punished through loss of entitlements or demotion rather than dismissal. The National Counter-Corruption Commission (NCCC) may recommend dismissal or prosecution if it finds that an officer has taken financial advantage of his post.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Thailand between 8 and 9 December 2003 and a visit to Dubai (2003 Meeting of the Boards of Governors of the World Bank Group and the International Monetary Fund) on 23 September 2003:

Bank of Thailand (BoT)

23 September 2003

Bandid Nijathaworn	Assistant Governor	Monetary Policy Group
Chantavarn Sucharitakul	Director, International Department	Monetary Policy Group

8 December 2003

Atchana Waimquamdee	Senior Director, Domestic Economy Department	Monetary Policy Group
Yunyong Thaicharoen	Senior Economist, Domestic Economy Department	Monetary Policy Group

Ministry of Finance

9 December 2003

Pongpanu Svetarundra	Deputy Director-General	Fiscal Policy Office
Navajit Boonyarattaphun	Economist	Fiscal Policy Office

ADDITIONAL INTERVIEWS

Bureau of the Budget

9 December 2003

Somnuk Pimolsatien	Adviser to the Budget Director
Jiraporn Meeleesawat	Director, Budget Strategy Centre
Dechapiwat Nasonghkla	Budget Analyst Level 8
Nitinai Sirismatthakarn	Economic Adviser
Niphon Jongwichit	Budget Analyst Level 7
Natjaree Anuntasilpa	Budget Analyst Level 7
Thanapat Reungsri	Budget Analyst Level 5

IN ADDITION, WE CORRESPONDED WITH:

Ammar Siamwalla	Thai Development Research Institute (TDRI)	
Pornchai Nuchsuwan	Budget Director	Bureau of the Budget

NOTES

[1] *Bank of Thailand Act*, Government Gazette, vol. 59, Part 30, 5 May 1942: www.bot.or.th/BOThomepage/General/Laws_Notif_Forms/Legal/BOT/BOT-E/BOTAct-E.htm; *Royal Decree Regulating the Affairs of the Bank of Thailand*, Government Gazette, Vol. 59, Part 76, 8 December 1942: www.bot.or.th/BOThomepage/General/Laws_Notif_Forms/Legal/BOT/BOTroyal-E/ROYAL%20DECREE.htm
[2] Interviews in Thailand, 8-9 December 2003. In December 2003, these amendments were still awaiting parliamentary attention. Officers of the central bank were not prepared to speculate on when the amendments would be passed, and recognised that the amendments were listed for attention after higher priority legislation including a Public Debt Management Act and a Financial Institutions Act.
[3] See www.bot.or.th/BOTHomepage/BankAtWork/AboutBOT/StrategicDirection/index_E.htm and www.bot.or.th/bothomepage/BankAtWork/AboutBOT/Organize/Explaination/Explain_E.htm
The aim of monetary policy is stated in, for example, the September 2003 press release announcing the inclusion of external members in the Monetary Policy Committee: www.bot.or.th/BOThomepage/General/PressReleasesAndSpeeches/PressReleases/news2546/Eng/n3046e.htm
[4] Interviews in Thailand, 9-11 October 2002.
[5] Members of the Court of Directors are listed at: www.bot.or.th/bothomepage/BankAtWork/AboutBOT/Chart/Directors/Eng/court_E.htm
[6] Interviews in Thailand, 8-9 December 2003. The Thai press, senior BoT officers, and the public accept that the preceding governor, M.R. Chatu Mongol Sonakul, was forced out of office by forces associated with Prime Minister Thaksin, but not because of any issue associated with monetary policy. See for example, 'Thirachai wins top SEC post', *The Nation* 10 December 2003, p. 1.
[7] BoT press release 30/203 (3 September 2003) announced the inclusion of two outside experts in the MPC. See www.bot.or.th/BOThomepage/General/PressReleasesAndSpeeches/PressReleases/news2546/Eng/n3046e.htm
Previously, outside experts were included in policy-making boards as 'advisers', not full members.
[8] "The Fiscalization of Fiscal Institutions Development Fund's losses", 20 June 2002, www.bot.or.th/BOThomepage/General/PressReleasesAndSpeeches/PressReleases/news2545/Eng/n2245e.htm
[9] Interviews in Thailand, 8-9 December 2003.
[10] Interviews in Thailand, 9-11 October 2002. M.R. Pridiyathorn has indicated that the reforms aim at achieving good central bank discipline and shielding the BoT from political interference.
[11] Interviews in Thailand, 9-11 October 2002.
[12] Interviews in Thailand, 9-11 October 2002.
[13] Interviews in Thailand, 8-9 December 2003. The inflation target was 0–3.5% for 2003.
[14] *Inflation Report*, October 2003, pp. 79–89.
[15] Interviews in Thailand, 8-9 December 2003. The organisation chart of the BoT gives the name and contact details for the Assistant Governor in charge of the MPG and shows the relationship with the MPC, although using the name of the former MPB: www.bot.or.th/bothomepage/BankAtWork/AboutBOT/Chart/Eng/BIG_BOT_E.htm
[16] For 2003, see www.bot.or.th/BOTHomepage/databank/EconData/ARC2003/CalendarE.asp
[17] For the forward schedule in 2003, see: www.bot.or.th/bothomepage/Other/Schedule/Eng/Econ_e.htm
MPC decisions are published as press releases: for 2003, see: www.bot.or.th/BOThomepage/General/PressReleasesAndSpeeches/PressReleases/news2546/ListEng.htm
[18] www.bot.or.th/bothomepage/BankAtWork/Financial_Supervision/FinInThailand/FinInThailandE.htm
[19] Interviews in Thailand, 8-9 December 2003.
[20] www.bot.or.th/BOTHomepage/databank/EconData/EconData_e.htm
[21] www.bot.or.th/BOThomepage/DataBank/Econcond/pressrel/weekly/index_eng_i.asp
[22] See the index at: www.bot.or.th/bothomepage/BankAtWork/AboutBOT/BOTPlan/AnnualAccount_E.htm
[23] www.bot.or.th/BOTHomepage/BankAtWork/AboutBOT/BOTPlan/Yearly_E.htm
[24] For the CDRAC, see: www.bot.or.th/bothomepage/Special/CDRAC/cdrac_e.htm
For the FIDF, see: www.bot.or.th/bothomepage/Special/FIDF/foundation_e.htm
[25] Bank of Thailand *Annual Accounts*, www.bot.or.th
[26] Interviews in Thailand, 9-11 October 2002 and 8-9 December 2003.

OXFORD ANALYTICA

TURKEY

MONETARY TRANSPARENCY

Country Report 2003

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TURKEY

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	●●●●	●●●●	●●●●
Open decision process	●●●●	●●●●	●●●
Availability of information	●●●●	●●●●	●●●●
Accountability	●●●●	●●●●	●●●●
Score	4.00	4.00	3.75

OUTLOOK & COMMENTARY

Turkey looks likely to continue to improve its already high standards of monetary transparency, particularly in relation to the publication of information and data, which is currently very comprehensive. Communication from the Central Bank would benefit from being more regular and scheduled however. Turkey now has another year of experience with the current monetary policy model and Central Bank independence, and the new arrangements seem to be functioning well. The new government looks likely to continue to respect the market and the independence of the Bank. The new internal audit department has now been established and should improve the internal auditing system.

Informal inflation-targeting has been working well, though the date for the introduction of formal inflation-targeting has yet to be decided. There is still no regular schedule for Monetary Policy Committee meetings and the publication of minutes, though this may be introduced following the adoption of formal inflation-targeting.

Communication from the Central Bank would benefit from being more regular and scheduled. The main area of weakness will likely remain the lack of information of the Monetary Council's internal deliberations, which can compromise policy consistency in the event of unanticipated shifts in the balance of power. Similarly, a strong commitment to exchange rate stability in the context of a band may challenge the inflation targeting regime and potentially jeopardize policy credibility.

EXECUTIVE SUMMARY

4.00 Compliance in progress

The government and the Central Bank of Turkey (CBT) share responsibility for setting overall targets and strategy (the CBT decides ultimately on strategy). The CBT's new Monetary Policy Committee (MPC) is given *de jure* responsibility in drawing up monetary policy. This division of responsibilities has been tested for more than two years now and is working satisfactorily. Turkey now has another year of experience with the current monetary policy model and CBT independence, and the new arrangements seem to be functioning well. Under current law, the government has a limited ability to impact the Bank. The new government has proved that it values the market -- there was some concern over this initially -- and is unlikely to pass any laws challenging the Bank's independence.

The openness of the policy-making process, which has been developing since the 2001 amendments to the Central Bank Law took effect, continues to improve. Informal inflation targeting is in place, however no date has yet been set for the introduction of formal inflation targeting. Steps that would help clarify the policy-making process include the announcement of a regular schedule for MPC meetings and the publication of minutes. The composition of the MPC, which is strongly dominated by bank officials, might also be reviewed.

The CBT is externally audited, and reports regularly to the authorities on the basis of clear provisions. A project to further improve internal auditing has now been completed. A new internal audit department has been established with a clearly defined mandate set forth in a regulation. The scope of the audit mentioned in this regulation covers all the functions and activities of the Bank, including the assessment of risk management and the efficiency of the internal control and management processes. CBT staff are well trained and familiar with international norms and practices. There are clear rules governing standards of conduct for employees.

The CBT is responsive, transparent, and communicates well. It produces very comprehensive data and information on its activities and complies with IMF data dissemination standards. However, communication would benefit from being more regular and scheduled. Over the past year the CBT has collaborated with various CBTs around the world in order to exchange expertise. The CBT has since made a concerted effort to conform to international best practice. As a result, indicators published by the CBT have proliferated. The CBT website is very comprehensive and user friendly with ever-increasing data made available on it. Over the past year, the CBT has recruited and trained new staff, and has improved its models.

The BRSA's (Banking Regulation and Supervision Agency) financial and operational independence is being strengthened. The BRSA is to have a separate budget submitted directly to parliament under the new Public Financial Management and Control Law, approved by parliament December 11 2003.[1]

Turkey's overall score has remained at 4.00.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●●●● Compliance in progress

The objectives and institutional framework of monetary policy

Central bank objectives and responsibilities

The duties and powers of the Central Bank of Turkey (CBT) are set out in the Central Bank Law, which was amended extensively through Law No. 4651 of April 2001, following the financial crises of December 2000 and February 2001. The CBT now has full instrumental independence. The Law identifies the attainment and maintenance of price stability as the primary goal of the CBT[2] and introduces a new monetary policy-making framework, which includes the establishment of a Monetary Policy Committee (MPC) within the CBT.

These amendments mean that Turkey meets most of the requirements of the IMF codes in respect of the clarity of roles, responsibilities and objectives of the CBT. In fact, most of the changes in the Law were developed in parallel with the codes, following a consultative process with the IMF.

Under the Law, as widely interpreted, responsibility for setting the dominant strategy and specific targets of monetary policy (assumed to be inflation targeting and inflation targets) is shared by the central bank and the government, though the Bank decides ultimately on strategy. Article 4 states that the Bank is "to determine the inflation target together with the Government." Furthermore, Article 22/A empowers the MPC to establish the exchange rate policy jointly with the government. Turkey now has another year of experience with the current monetary policy model and CBT independence, and the new arrangements seem to be functioning well. Under current law, the government has a limited ability to impact the Bank. The new government has proved that it values the market -- there was some concern over this initially -- and is unlikely to pass any laws challenging the Bank's independence.

Operational autonomy

Within this framework, the Bank enjoys operational autonomy in selecting and applying monetary policy instruments. Article 4 states that the Bank "shall determine on its own discretion the monetary policy that it shall implement and the monetary policy instruments that it is going to use in order to achieve and maintain price stability" and that it is to enjoy "absolute autonomy" in carrying out its duties. Article 22/A also charges the MPC with determining "the principles and strategy of monetary policy in order to achieve and maintain price stability."

The Central Bank Law identifies additional duties falling to the Bank and its powers to achieve them. These include currency stability, acting as lender of last resort, ensuring financial system stability and granting advances to the Savings Deposit Insurance Fund (SDIF).[3]

The procedures for the election/appointment and terms of office of the board members, governor and vice-governors of the CBT and of the members of the MPC, and for the discharge of the governor and vice-governors (in case of involvement in activities incompatible with their positions) are clearly set out in the Central Bank Law.[4] The governor is appointed by the government and the four vice-governors are appointed in conjunction with the government on the recommendation of the governor. Both governor and vice-governors have five-year security of tenure.

Institutional relationship between monetary and fiscal operations

The Central Bank Law prohibits the CBT from extending credit to the Treasury and other public institutions, and from purchasing public debt instruments in the primary market[5]. The only exceptions to this are advances made to the SDIF under extraordinary conditions and when the existing resources of the fund are insufficient. Such advances must be in accordance with the Banks Act and at the request of the BRSA. Open market operations are to be conducted only for monetary policy purposes and not to provide credit to the Treasury or other public institutions.[6] There is no significant CBT involvement in the rest of the economy. The Central Bank Law sets out clearly the manner in which CBT profits are allocated.[7]

Agency roles performed by the central bank on behalf of the government

The CBT's agency roles as financial advisor, fiscal agent and treasurer of the government are clearly set out in the Central Bank Law.[8] The Bank also has responsibility for establishing payment, securities transfers and settlement systems. It also regulates the money and foreign exchange markets. The CBT does not, however, have any responsibility for managing domestic or external public debt.

The CBT manages the holding of auctions for Treasury domestic borrowing, including the settlement system. The CBT also operates and supervises the main (but not the sole) gross clearing system. Banks may hold securities as well as money accounts with the CBT and these may be used for secondary securities market settlement purposes.[9]

The 'intermediary' role of the CBT in the inter-bank money and foreign exchange market has been eliminated.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●●●● Compliance in progress

The framework, instruments, and targets of monetary policy

Framework and monetary targets

Since switching to a floating currency after the February 2001 financial crisis, the CBT has been following a two-pronged monetary policy. On the one hand, it has been abiding by nominal targets for base money, net domestic assets and net international reserves. On the other hand, it has been preparing to implement inflation targeting, and has been actively using interest rates as a policy tool, in line with inflationary targets. Debate continues as to whether inflation targeting is suitable for Turkey. It is commonly argued that inflation targeting may not be appropriate until chronic high inflation, which was 29.7% at the end of 2002, has been further reduced.[10] Informal inflation targeting has been carried out over the last year, though the adoption of formal inflation targeting, initially scheduled to start at the beginning of 2003, has been delayed for what is likely to be at least a year. The CBT has stated that it would like to see "a strong record of programme implementation before introducing formal inflation targeting", including the achievement of primary surplus targets and certain levels of fiscal discipline.[11] There are also the concerns of the markets over debt sustainability to consider. The CBT is however technically ready to introduce formal inflation targeting. The CBT is monitoring closely how market expectations are reacting to implicit inflation targeting - so far there has been a good response from the markets.

The adoption of a floating currency regime, the decision-in-principle to adopt inflation targeting, the specific nominal targets for monetary policy and the official annual inflation targets -- up to and including 2004 -- have all been determined as part of a wider process of negotiation between Turkey and the IMF, with which Turkey has a standby accord. These decisions have been communicated to the public most consistently through the publication of letters of intent to the IMF. The upcoming decision on the timing of formal inflation targeting is likely to be taken in the same way.

Monetary policy instruments

The monetary policy instruments and operations performed by the CBT are disclosed in Part 5 of the Central Bank Law.[12] Accordingly, the Bank may "conduct open market operations against Turkish Lira such as outright purchase and sale of securities, repurchase and reverse repurchase, lending and borrowing securities, and lending and borrowing of Turkish lira deposits." The transactions which the Bank may carry out in respect of foreign exchange and gold are also listed.

The monetary policy-making body

Monetary policy board

The amendments made to the Central Bank Law in 2001 included the establishment of a Monetary Policy Committee (MPC) and detailed its structure and functions.[13] Under the Law, the committee: determines the inflation target in consultation with the government; decides on the principles and strategy of monetary policy in order to achieve and maintain price stability; prepares public reports on monetary policy targets and implementation; takes necessary

measures to protect the domestic and international value of the Lira; and determines the exchange rate policy jointly with the government.

Membership of the MPC overlaps closely with the membership of the other organs of the Bank. The MPC is chaired by the governor and comprises the four vice-governors, one elected member of the CBT board who is elected to the MPC by the board, and one co-opted expert appointed by a joint decree for five years on the recommendation of the governor. It has been suggested that the co-opted member should become a truly independent member who retains an occupation outside the Bank, and that there should be more independent members with shorter terms of office. This would add expertise to the MPC and increase its independence. Against this, it does not seem necessary for all of the vice-governors to be members of the committee. However, any such changes would require an act of parliament.

To outsiders, the MPC is not always easy to distinguish from the board of the CBT (required since the Bank is a joint stock company). In practice, the MPC handles monetary policy matters, with the board responsible for policy implementation.[14] The board has operational functions with regards all duties assigned to the CBT, whereas the MPC may be perceived as a 'decision making unit' or 'strategy setter' with regards to monetary policy related issues.

Announcements made by the MPC are not always explicitly distinguished from other CBT announcements. Once the inflating-targeting process is announced, then there should be a clear distinction between the MPC releases and other announcements.[15] There are criticisms that the MPC meetings should be more regular, and that there should be public access to the minutes of MPC meetings. The CBT has confirmed that the publication of the minutes will take place, and is currently being discussed, but it is not known when this practice will commence. The decision on how and when is being taken in conjunction with the IMF.[16]

The treasury undersecretary, or a nominated deputy, is entitled to take part in MPC meetings, but may not vote. The MPC can therefore also play a role in macroeconomic policy coordination. The Bank and its governor have asserted an independent line in their policy statements, regularly warning the government to abide by strong fiscal and structural reform policies. Occasional pressure from some members of the government for more rapid rate cuts has been resisted without difficulty.

Advance meeting schedule

The MPC has held frequent meetings, but has not announced an advance schedule of meetings. An advance meeting schedule will be made public as soon as -- or possibly even before -- official inflation-targeting going into effect.

Public statements on monetary policy

Periodic publications

The Central Bank Law gives the MPC the duty of informing the public. According to the Law, the committee is to decide which of its decisions should be communicated to the public. Matters which the MPC wishes to publish should be printed without delay in the *Official Gazette*.[17] Over the last two years, the CBT has:

(a) developed a twice-monthly *Survey of Expectations* among analysts from the financial and corporate sectors. The survey covers end-month and end-year expectations for GNP growth, the US dollar exchange rate, money market interest rates and bond yields, end-month, two-month, end-year and twelve-month expectations for consumer price inflation and current account expectations. There are 70-80 respondents, and efforts are continuing to increase this number.[18] This survey is in addition to the regular *Business Tendency Survey*, which

inter alia tests the expectations of about 500 business and industry respondents for short and medium-term wholesale price inflation. The results of both surveys are posted regularly and promptly on the CBT website. The bimonthly *Survey of Expectations* has had a high profile and is very closely followed. It gives good visibility to the actions of the CBT and help banks to follow general sector expectations. The results are usually available within two to three days.

(b) issued regular inflation commentaries within days of the publication of each set of monthly inflation data by the State Institute of Statistics. These commentaries assess the reasons for current levels of inflation. They also consider the prospects for achieving inflation targets given current trends and the results of the Bank's surveys of inflationary expectations. The commentaries highlight the factors likely to affect decisions concerning the Bank's short-term money market interest rates, and have therefore made interest rate moves a little more predictable, in direction and size if not in timing. The CBT's inflation expectations have been well received by the banking sector who has found them to be very useful and reliable.

(c) issued explanatory statements when adjusting short-term money market interest rates. This has sometimes been done in conjunction with the inflation reports mentioned in the preceding paragraph. However, it has not been clear in advance when decisions on interest rates would be taken, and no statements have been issued when it has been decided to leave interest rates unchanged. Minutes and voting records of MPC meetings are not published, apparently so as not to confuse the markets and the public. The practise of publishing the minutes will however take place, as mentioned, above, though it has not been decided when. The MPC has moved from oral to written communication, and will be able to release more information as the Bank's credibility and the market's ability to interpret its announcements improve, and with the adoption of formal inflation targeting.[19]

Other periodic publications include a quarterly *Monetary Policy Report*, a daily *Analytical Balance Sheet* (published daily on the CBT website), a monthly *Balance of Payments Report* published for the first time in 2003, *Company Accounts*, and the *Real Effective Exchange Rate*.

Public hearings

In addition to the above, the CBT has issued explanatory statements via its website and the media when introducing or discontinuing specific practices (such as foreign exchange purchase auctions or Turkish lira deposit auctions). From time to time, it has issued more general statements explaining its policies. On January 2, 2002, it issued a long statement on its expectations and intentions for the year. Such statements may be regularised in future. Finally, the Bank has issued periodic statements about whether the targets for base money, net domestic assets and net international reserves have been achieved. This information can also be ascertained from the CBT's *Weekly Press Bulletin*.

Regulations on data reporting by financial institutions to the central bank

The Central Bank Law authorises the Bank to collect statistics on the financial system and other data necessary to follow a monetary policy aimed at price stability. The CBT produces guidelines for banks on how to collect and categorise data. These can be obtained from the Statistics Department of the Bank.[20]

The CBT would benefit from receiving more timely data on state economic enterprises.[21]

3. Public Availability of Information on Monetary Policy

●●●● Compliance in progress

Release of central bank data

The CBT has long published regular balance sheets and other relevant data. Much of this information is contained in the Bank's *Weekly Press Bulletin* (WPB), which is available on the CBT website. Each WPB contains fresh data on the money supply, the CBT balance sheet, international reserves, exchange rates, transactions in interbank and foreign exchange markets and the deposits, repos, credits and securities portfolios of the banking sector. Information on money market interest rates and the results of auctions for public borrowing instruments are made available immediately to interested parties and are also published in the WPB. The Bank also publishes a *Quarterly Bulletin*, which covers much the same ground as the WPB, and an *Annual Report*. The *Annual Report* includes comprehensive and informative commentary. Both the *Quarterly Bulletin* and the *Annual Report* are available via the website.

Turkey subscribes to the Special Data Dissemination Standard (SDDS) and meets its specifications for the coverage, periodicity and timeliness of CBT accounts and banking sector accounts. However, a flexibility option has been taken for the timeliness of full information on analytical banking sector accounts - some data is published two or even three months after the reference month.[22]

The central bank balance sheet

The CBT releases its summary balance sheet in several formats one week after the reference week as part of its *Weekly Press Bulletin*. This includes information on reserve money, net domestic claims on the general government and the banking sector, open market operations and the Bank's net external position. More detailed information is included in the *Quarterly Bulletin* and *Annual Report*. The latter also contains analysis of the trends in individual balance sheet items and annual information on selected CBT transactions including inter-bank money market transactions and open market operations.

The central bank also publishes details of its balance sheet daily in electronic format.

Lender of last resort

CBT transactions are all included in its balance sheet, which is available to the financial sector and the general public. Officials say that any use of the late window introduced in 2002 would go out on the Reuters page in the same way as other transactions.[23] Statements on the Bank's operations as lender of last resort are issued through financial telecommunication channels (like Reuters) and the Internet. Same day announcement is realised in case of foreign exchange interventions.[24]

Public information services

The CBT website contains a great deal of information in addition to the material mentioned elsewhere in this report. This includes the text of the Central Bank Law, information on the way the Bank is organised, details of payments systems, monthly balance of payments data and frequent press releases, including the text of speeches by the governor and occasional statements explaining the Bank's policies. Governor Sureyya Serdengecti has addressed various gatherings, including meetings of industrialists and businessmen in the provinces, on the role of the CBT and related issues. The CBT has a Communications Department for public relations which informs public opinion with a view to achieving price stability and to increasing the transparency of the CBT's policies.[25]

A wealth of statistical data produced and/or compiled by the CBT is accessible to the public on the Electronic Data Delivery System EDDS -- a data dissemination system available via the Internet. The CBT website has also been redesigned this year and is very comprehensive and user-friendly.

The CBT is responsive, transparent, communicates well, and it produces very comprehensive data and information. However, communication would benefit from being more regular and scheduled. Some commentators noted that the timing of interest rate decisions is not always predictable and the CBT does not have regular meetings to decide on interest rates.[26]

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●●● Compliance in progress

Accountability before a designated public authority

The Central Bank Law requires the MPC to provide the government with information on monetary policy targets and progress towards their attainment. In practice, the Central Bank Governor participates in meetings of cabinet sub-committees including the Supreme Planning Board. The governor can also be asked to attend cabinet meetings. In addition, under Article 42 of the Central Bank Law, the governor must submit a biannual report to the Council of Ministers on monetary policy and the general operations of the Bank every April and October. In practice, the CBT governor and other officials present their report in person and are available for questioning.

Article 42 also obliges the governor to furnish information on the Bank's operations to the Planning and Budget Commission of Parliament on a biannual basis. This commission is the largest of the Assembly's standing committees, with representatives from all parliamentary parties. Reporting before the Commission is therefore equivalent to parliamentary reporting. The governor and other officials appear before the Commission in person.

Financial statement

Audited financial statement

The Central Bank Law obliges the CBT to submit its balance sheet and income statement to the Prime Ministry along with its *Annual Report*, and to have its balance sheet published in the *Official Gazette*.[27] In addition, the balance sheet is also released through Weekly Press Bulletin. It also obliges the Bank to publish brief statements of account on a weekly basis, and specifies what these should contain.[28] In practice, the weekly balance sheet/statement is published on the CBT website as part of the Bank's *Weekly Press Bulletin*. *The Annual Report*, also published on the website, contains a detailed balance sheet.

External and internal audit

Since 2001, the Central Bank Law has required an external audit of the balance sheet and income statements.[29] Independent audits of the Bank's balance sheets and profit and loss statements for 2000, 2001 and 2002 were carried out by Deloitte Touche Tohmatsu and are published on the website. The 2001 and 2002 results were presented and audited according to both Turkish Accounting Standards and International Accounting Standards. [30] The terms of external audits now include assessing the conformity of the figures which the CBT reports for base money, net international reserves and net domestic assets with the audited accounts. These data are used as benchmarks for assessing Turkish conformity with the terms of its IMF accords.

In addition, the CBT has an Audit Committee appointed by shareholders.[31] Members have the right to see all information and documents they request. The committee reports to the prime minister and the CBT board.

It has become standard IMF procedure to carry out a 'safeguards assessment' of the CBTs of countries receiving IMF lending. To this end, a plan was drawn up in early 2002 to "further improve the transparency and effectiveness

of the CBT's control, accounting, reporting and auditing systems."[32] Measures included (a) expanding the role of the Audit Committee and (b) reorganising the internal audit function by (i) adopting a new charter detailing the mission, scope, accountability, independence, responsibility and authority of the audit function, and (ii) formulating an implementation plan identifying staffing levels, reporting lines, risk assessment methodologies and developing an internal audit manual and training programmes.

It was subsequently decided that the Audit Committee would meet twice a year with the external audit firm and also with a new internal audit department. The committee would also review the CBT's overall risk management practices and systems of internal control..[33] In line with the programme commitments to the IMF, on October 22, 2002 a new Internal Audit Department was established and a General Manager and Deputy General Manager were appointed. An internal audit charter which identifies the mission, scope, accountability, independence, responsibility and the authority of the internal audit function in line with the Standards for the Professional Practices of Internal Auditing of the Institute of Internal Auditors was adopted the same day. The Internal Audit Regulation which details internal audit activities such as the scope and tasks of internal audit, recruiting and training principles of its staff, reporting lines, and the methodology of risk-based internal audit, came into force on December 24, 2002. The Internal Audit Department is now fully functional, though is clearly in its early stages. On May 15, 2003 the newly established Internal Audit Department completed the audit of foreign exchange management and program data as of end-2002, meeting a structural benchmark. The preparation of an internal audit manual and the process of auction for the risk assessment of the activities of the Bank continue. With the recruitment of seven assistant auditors the personnel of the department has reached sixteen. The CBT considers it has sufficient resources to deal with the expanded range of audit -- and also publishing -- activities.

Conduct of officials

Standards of conduct for the board, the Monetary Policy Committee, the Audit Committee and the governor are set out in the Central Bank Law.[34] The Law also contains provisions for other bank personnel, including responsibilities for secrecy in carrying out their duties and penalties for offences such as embezzlement, and disclosure of information for personal gain.[35] The members of the board, the governor and vice-governors and the other member of the Monetary Policy Committee are prohibited by law from engaging in trade or becoming shareholders of banks or companies.[36] Governors and vice-governors may be discharged if they have been engaged in these activities.[37] Board members are barred from discussing or voting on credit issues concerning themselves or persons with whom they have relationships of interest or kinship.[38]

The CBT has an internal code of conduct for bank employees. This has not been made public, but details have been provided to the Bank of International Settlements.[39] Prosecutors in Turkey are allowed to prosecute civil servants in connection with their conduct in office only with the consent of the senior officials whom they report to. In the case of CBT staff, this means the governor or, for top officials, the prime minister.

The BRSA's (Banking Regulation and Supervision Agency) financial and operational independence is being strengthened. The BRSA is to have a separate budget submitted directly to parliament.[40]

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Turkey between 20 and 24 October 2003:

Central Bank of Turkey

23 October 2003

Fatih Ozatay	Vice Governor	
Yuksel Gormez	Specialist (Monetary Mechanisms)	Research Department
Erhan Yazgan	Assistant General Manager	Internal Audit Department

Ministry of Finance

21 October 2003

Hasan Gul	General Director	General Directorate of Budget and Fiscal Control (BUMKO)
Ahmet Kesik	Deputy Director General	BUMKO
Abdulkadir Goktas	Head of Department	BUMKO

Treasury

24 October 2003

Ibrahim Canakci	Undersecretary	
Ercan Sendil	Assistant to Undersecretary	
Nilgun Pehlivan	Head of Department	General Directorate of Public Finance

Turkish Court of Accounts (Sayistay)

22 October 2003

Erol Akbulut	Deputy Secretary General
Gulsun Canova	Principal Auditor
Feyzullah Okumus	Senior Auditor
Mehmet Bademli	Principal Auditor and Deputy Head of International Relations Department

ADDITIONAL INTERVIEWS

20 October 2003

Tugrul Belli	Secretary General	Turkish Bank
Emre Tezmen	Director Research and Institutional Sales	Turkish Bank
Belma Firat	Research Department Economist	Yapi Kredi Bankasi
Cenk Tarhan	Research Department Economist	Yapi Kredi Bankasi

24 October 2003

James Parks	Lead Economist	World Bank

NOTES

[1] Interviews with officials, 20-24 October, 2003
[2] Central Bank Law, Article 4, Paragraph 1
[3] The SDIF is the institution that takes over banks deemed unsound by the banking sector watchdog, the Banking Regulation and Supervision Agency (BRSA). The SDIF may, under the terms of the Banks Act, reduce or suspend reserve requirements for such banks. However, it must first seek the opinion of the CBT. The SDIF's power to take decisions on reserve requirements "only and purely" is limited to taken-over banks and can not be used for any other purpose than rehabilitating the bank or banks that are not sound. CBT officials and Turkish private bankers say that this power of the SDIF does not compromise the CBT's sole authority over the use of monetary policy instruments.
[4] Central Bank Law, Articles 19, 20, 22, 22A, 25, 28, 29
[5] Central Bank Law, Article 56
[6] Central Bank Law, Article 52
[7] Central Bank Law, Article 60
[8] Central Bank Law, Article 41
[9] Bank for International Settlements Turkey Red Book, January 2000, www.bis.org/publ/cpss36.pdf
[10] Interviews with officials, 20-24 October 2003
[11]Letter of Intent to the IMF, July 25, 2003
[12] Central Bank Law, Articles 45-55
[13] Central Bank Law, Article 22A
[14] Under the law, the board has the responsibility to "take decisions concerning monetary policy which may be implemented and monetary policy instruments which may be utilised" as well as to take decisions in areas such as acting as a lender of last resort or extending advances to the SDIF. Central Bank Law, Article 22, paragraph 1, (a) and (d)
[15] Interviews with officials, 20-24 October, 2003
[16] Interviews with officials, 20-24 October, 2003
[17] Central Bank Law, Article 22A
[18] Interviews with officials, 3-7 November, 2002
[19] Interviews with officials,3-7 November, 2002
[20] Interviews with officials, 3-7 November, 2002
[21] Interviews with officials, 20-24 October, 2003
[22] Information supplied by Turkey as a subscriber to the SDSS. http://dsbb.imf.org/country/tur/aabbase.htm
[23] Interviews with officials, 3-7 November 2002
[24] Interviews with officials, 20-24 October, 2003
[25] Interviews with officials 3-7 November, 2002
[26] Interviews, 20-24 October, 2003
[27] Central Bank Law, Article 58
[28] Central Bank Law, Article 63
[29] Central Bank Law, Article 42
[30] Interviews, 20-24 October, 2003. A decision is currently being made on the audit firm to be used for the 2003 audit.
[31] Central Bank Law, Articles 23, 24
[32] Turkish Letter of Intent to the IMF of April 3, 2002, Paragraph 19
[33] Interviews in Istanbul, 3-7 November, 2002
[34] Central Bank Law, Articles 19, 24 and 27 and respectively
[35] Central Bank Law, Article 35
[36] Central Bank Law, Articles 19, 22, 27, 29
[37] Central Bank Law Articles 28, 29
[38] Central Bank Law, Article 21
[39] Interviews with officials, 3-7 November 2002
[40] Letter of Intent to the IMF, July 25, 2003

OXFORD ANALYTICA

VENEZUELA

MONETARY TRANSPARENCY

Country Report 2003

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VENEZUELA

COMPLIANCE RATINGS

Monetary transparency	*2003*	*2002*	*2001*
Clarity of roles	••	••	•••
Open decision process	••	••	••
Availability of information	•••	•••	••
Central bank accountability	•••	•••	•••
Score	**2.50**	**2.50**	**2.50**

OUTLOOK & COMMENTARY

The economic recession has created an environment where the government has put additional pressure on the Central Bank of Venezuela (BCV) to prioritise broader macroeconomic objectives over price stabilisation. However, more detrimental to monetary transparency is the fact that the Chavez administration has used monetary policy instruments to attain fiscal policy objectives that appear to be more in line with the government's political agenda rather than economic concerns. An important test for the BCV's *de facto* operational autonomy will be whether it provides President Chavez with disbursements from international reserves that he has requested to finance agricultural programmes.

Short-term improvements should be attained in overall data availability, quality improvements, and providing information on statistical techniques and data compilation methods.

EXECUTIVE SUMMARY

2.50 Intent declared

In 2003, the Central Bank of Venezuela (BCV) continued to generate substantial doubts about its operational autonomy. The introduction of controls on foreign exchange operations has substantially undermined the central bank's capacity to implement monetary policy. In this context, the government's influence over monetary policy instruments in order to attain fiscal objectives has been evident in the last twelve months.

Monetary transparency would be greatly enhanced if the BCV would provide concise information on its monetary policy framework, the instruments used to attain objectives, and how these are integrated with fiscal policy goals into the macroeconomic coordination directives mandated by the constitution.

The BCV publishes a number of periodic reports that include descriptions of monetary policy decisions and the financial operations undertaken, information on financial markets, monetary aggregates, central government public finances, and legislation. Nevertheless, efforts should be made to publish methodological notes on the central bank's statistical techniques and data compilation methods in order to allay concerns about technical interference. The BCV's audited financial statements should be made publicly available.

Venezuela's overall score is unchanged from last year.

1. Clarity of Roles, Responsibilities, and Objectives of Central Banks

●● Intent declared

The objectives and institutional framework of monetary policy

In 2003, the Central Bank of Venezuela (BCV)[1] continued to generate substantial doubts about its operational autonomy. The introduction of controls on foreign exchange operations has substantially undermined the central bank's capacity to implement monetary policy. In fact, commentators expressed concern about the *de facto* incompatibility between the foreign exchange and monetary policies: the controls have created a monetary liquidity pool that pressures interest rates downwards, while the BCV should be seeking higher interest rates to control inflation. In this context, the government's actions and sway have made monetary policy to become much less effective.[2]

Central bank objectives and responsibilities

The constitution[3] sets out the objectives and responsibilities of the BCV, which are also ratified by the BCV Law (LBVC).[4] The main objectives of the central bank are to achieve price stability and maintain the value of the Venezuelan currency domestically and internationally. The BCV is also responsible for regulating financial markets, implementing monetary policy, administering Venezuela's international reserves, and managing foreign exchange policies.

The BCV shares responsibilities for foreign exchange policy with the executive. This situation has seriously hampered the central bank's ability to attain its objectives, since the government has had strong incentives to implement fiscal policy goals via changes in the foreign exchange framework. Commentators argued that this has been the case since the executive imposed a fixed foreign exchange rate and controls on foreign currency operations in February.[5]

Operational autonomy

The BCV's formal autonomy is enshrined in Article 318 of the constitution, which states that the BCV is autonomous from other branches of government. Furthermore, Article 320 of the constitution seemingly reinforces this autonomy by stipulating that the BCV should not -- under any circumstance -- be subordinate to the executive. However, the central bank is entitled to 'participate' in the design of foreign exchange policy, and required to coordinate its monetary policy with the Ministry of Finance's fiscal policy to pursue the agreed macroeconomic objectives. Therefore, the BCV's formal autonomy becomes ambiguous when considering all these shared responsibilities.[6]

In addition, the LBCV authorises the National Assembly to resolve differences that emerge between the BCV and the government over the coordination of macroeconomic policies. However, the law does not explain a precise method by which these differences can be sorted out.[7] The BCV's independence is further undermined by the National Assembly's capacity to approve the central bank's operational budget and to remove its board members by a two-thirds majority vote, should the board fail to meet its policy objectives without reasonable justification.[8] In this context, the incumbent government's majority in the National Assembly has continued to exacerbate these concerns.[9]

Institutional relationship between monetary and fiscal operations

The constitution and Articles 44-47 of the LBCV define the relationship between the central bank and the government. The BCV may not lend to the central government or issue any guarantees. Although the BCV may not finance fiscal deficits, commentators argued that this has been indirectly done by recording profits from foreign exchange operations (*utilidades cambiarias*) as budget revenues.[10]

Lending to government

Article 36 of the LBCV effectively prevents the central bank from financing the government and from guaranteeing government and sub-national government obligations. However, there are no specific provisions about lending to state-owned financial institutions, although long-term lending is prohibited. This became a controversial issue when the head of the Superintendence of Banks and Financial Institutions (SUDEBAN) resigned after protesting against the lack of any independent oversight over several public financial institutions.[11]

Central bank involvement in the rest of the economy

The BCV is responsible for regulating financial markets. As mentioned above, the central bank cannot provide any long-term lending or lending without any type of financial guarantee to institutions other than to multilateral organisations and other foreign central banks. The BCV is also responsible for managing the government's Macroeconomic Stabilisation Fund (FEM), previously the Investment Fund for Macroeconomic Stabilisation (FIEM).

Commentators have stressed that the monetary framework introduced in February -- under a fixed exchange rate alongside foreign currency controls -- has been implemented with numerous *ad hoc* amendments that are more in line with the government's political agenda than economic rationale.[12] Particular concern was raised about the use of monetary policy instruments (foreign currency controls) to implement fiscal policy: the controls have boosted the country's domestic monetary liquidity that -- in addition to depleted credit operations and increased non-performing loans -- have left private banks with the option of buying government debt to guarantee future profits. In turn, the government has used these resources to finance current public spending.

Many firms have been unable to meet the requirements established by the Ministry of Finance's Commission for Foreign Currency Management (CADIVI)[13] to purchase dollars, which has had a substantial negative impact in those sectors that base their production on imported goods.

Central bank profit allocation

The reform to Article 65 of the LBCV -- which permits BCV profit allocation every six months instead of at the end of the fiscal year -- has enhanced the government's ability to indirectly finance fiscal deficits. Article 71 of the LBCV establishes that at least 10% of any profits are allocated to the General Reserve Fund. The law also limits the amount allocated to the Reserve Fund to 15% of all the profits. The remaining resources are allocated to the National Treasury within a six-month period.

Any losses accrued by the BCV are covered with resources from the Reserve Fund. However, if these were to result in insufficient reserves, the Treasury must cover the losses. If the Treasury does not have sufficient funds, the government should issue debt.

Agency roles performed by the central bank on behalf of the government

The constitution and the LBCV define the central bank's agency roles.[14] These include acting as financial agent to the executive in its internal and external debt operations, the administration of international monetary reserves, and acting as a depository for National Treasury funds. The BCV also advises the government on public credit operations, and comments on the effects of the budget. These services are provided without obligation to the executive, which must reimburse the central bank for any expenses incurred.

2. Open Process for Formulating and Reporting Monetary Policy Decisions

●● Intent declared

The framework, instruments, and targets of monetary policy

The constitution, together with the LBCV and the Organic Law on the Financial Administration of the Public Sector (LOAF), establish the institutional framework for macroeconomic coordination. The BCV sets monetary policy but its targets and instruments must be consistent with the overall macroeconomic plan. Concerns remain over the ability of the BCV to prioritise its price stability objectives over the government's fiscal policy objectives. In the past, the central bank has announced that its interventions in the foreign exchange market were done in order to attain external balance, while hitherto there is uncertainty about the central bank's freedom to raise interests rates so as to damp down inflationary pressures.[15]

Framework and monetary targets

The BCV's webpage does not make available a concise document that explains its monetary policy framework and the instruments used to attain its objectives. The LBCV requires the central bank to use a medium-term framework and publish its monetary targets and the instruments used, as agreed in the annual policy discussions with the government. The *Macroeconomic Coordination Agreement* for each fiscal year has to be published by the time the National Assembly approves the annual budget bill, but this document has hitherto not made publicly available. The *2003 Macroeconomic Coordination Agreement*, which was approved in December 2002, was subsequently revoked in March.[16]

Overall, the monetary policy framework has been shaped by the government's decision to fix the foreign exchange rate and introduce controls on foreign currency transactions. Monetary policy is set to achieve an implicit inflation target, which traditionally has been measured by changes in the consumer price index (IPC), but no targets are made public. The CPI is produced through a limited survey that only covers Caracas, and it is highly distorted because of the government's frequent introduction of price controls.[17] Nevertheless, the BCV sets a series of intermediate targets for the monetary base growth rate and the overnight reference interest rate that are consistent with the implicit inflation target.

Monetary instruments

The BCV intervenes in monetary markets through two types of operations: repurchase operations to manage liquidity in the financial system, and interventions in secondary bond markets. The latter follow clear rules and are made electronically through an auction system, with details of the central bank's activities published on the same day. Any changes to the liquidity target are published in the BCV's *Monthly Report* and *Weekly Brief*.[18]

The monetary policy-making body

Monetary board

As set out in Article 15 of the LBCV, the principal monetary policy-making body within the central bank is the Board of Directors. The executive appoints five of the seven-member board, with the other two appointed by the

National Assembly. One member (from the president's appointees) must be a minister from the economic cabinet, but not the finance minister. The president also appoints the President of BCV, who also presides over the Board of Directors. The appointment of the BCV president is subject to legislative ratification, and the LBCV contains procedures for replacing the current BCV board members on completion of their tenures.

The responsibilities of the Board of Directors are clearly established in the LBCV, which is in charge of the management of monetary policy and the central bank's administrative decision-making. The terms of office for the board are also set out in the LBCV, but they do not ensure the independence of the directors. Non-compliance with the price stability objective as agreed in the annual plan can result in members' removal from the board.[19]

Advance meeting schedule

Advance schedules for board meetings are unavailable, since ordinary board meetings take place every Tuesday and Thursday. Tuesday meetings review previous events and set out an agenda for decisions to be adopted at the subsequent Thursday session.

Public statements on monetary policy

The constitution mandates the publication of BCV board minutes. Decisions are published on the BCV website, although this typically happens with a lag of three month.[20] Details of board decisions and BCV operations are also disclosed through press releases available on the website. Other monetary policy statements are published in the *Annual Report* (Informe de la Gestion Institucional) and the Year-end Address of President of the BCV.[21]

Periodic publications

The BCV publishes a number of periodic reports. In addition to the *Annual Report*, the central bank publishes the *Monthly Report*, which includes a short description of monetary policy decisions and the financial operations undertaken, and information on financial markets, monetary aggregates, central government public finances and economic legislation adopted during the month. The *Monthly Report* also discloses all adopted and issued regulations. The BCV also releases weekly and daily statements containing financial and foreign exchange market data.

Public hearings

The BCV does not hold public hearings or provide commentary on regulations and decisions adopted by the BCV. A framework for incorporating broad public consultation over technical changes in the operation of monetary policy does not exist.

Regulations on data reporting by financial institutions to the central bank

Articles 48-55 of the LBCV establish rules governing the relationship between the central bank and other banks. It contains provisions on the requirement for private sector financial intermediaries to provide the information that the BCV may request on their operations, the data necessary to evaluate their financial situation, and all information required by the central bank to adequately perform its functions.

3. Public Availability of Information on Monetary Policy

●●● Enacted

Release of central bank data

Venezuela does not subscribe to the IMF's Special Data Dissemination Standard (SDDS), but meets the requirements of the General Data Dissemination System (GDDS). The coverage of analytical accounts and time series has been improved; most of these data are available through the *Statistics Information* hyperlink.[22] Although the BCV authorities had previously mentioned their intent to publish an advance release calendars, it is still not available.[23] In addition, some commentators stated that the BCV's reputation for providing high quality data and technical assistance was now under threat from government interference. For example, the fact that the statistics office was transferred into the first vice-presidency office (*primera vicepresidencia gerencia*) was interpreted as either a step to avoid conflicts of interests (since the BCV both targets and measures inflation) or to increase the technical influence of the Ministry of Finance.[24]

The BCV's *Weekly Brief* provides detailed information on the central bank's financial and foreign exchange operations, monetary policy aggregates, and foreign reserves. The *Monthly Report* provides a detailed analysis of the economy, focusing on changes in domestic price indices, monetary aggregates, interest rates, and foreign reserves. The report also contains a summary of the monetary and foreign exchange operations of the BCV for the past month and provides a summary of the board decisions.

The central bank balance sheet

Articles 66-67 of the LBCV require the periodic disclosure of the central bank's balance sheet. Monthly statements have continued to be released within 15 days of the reference period. The six-month balance statement is also released within 15 days of the end of the reference period, while the annual statement is published with a lag of 30 days after the end of the fiscal year.

Lender of last resort

Article 48 of the LBCV authorises the central bank to carry out lender of last resort operations. The BCV may only perform these operations after reviewing the financial statements and the balance sheets of the beneficiary institutions. Loans have a 30-day duration and may be extended only once up to a 90-day period. All loans must be guaranteed with credit instruments or securities. The BCV does not publicly disclose the methodology followed to account and report on emergency lending operations to distressed institutions.

Public information services

The BCV produces a variety of regular and *ad hoc* reports, and data can be accessed through the *Statistics Information* hyperlink. It maintains a comprehensive website that sets out details of its operations. BCV officials are available to address any specific query raised by interested parties.

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

●●● Enacted

Accountability before a designated public authority

As set out in the constitution and Article 77 of the LBCV, the central bank is accountable to the National Assembly in terms of compliance with policy objectives. To this end, the BCV must submit a report every year to the National Assembly explaining its monetary policy and performance. In addition, the constitution and the LBCV (Articles 81-86) give the General Comptroller and SUDEBAN the authority to monitor all central bank operations.

Financial statement

Audited financial statement

The BCV is required to produce a financial statement that must be audited externally.[25] The statement must be published within three months of the end of the financial exercise. The monthly and quarterly BCV balance sheet, and the annual financial statements are available in the *Statistics Information* section.[26] An annual financial statement is also published as part of the *Annual Report*. However, the audited statements are not readily available to the public.

External and internal audit

The central bank's *Internal Regulations* (Title IV, Articles 88-89) provide the framework for internal auditing.[27] The constitution and the LBCV both contain provisions for an independently audited financial statement. The statement is produced by the BCV and audited externally by a private firm, which may be national or foreign. The same firm may not be hired more than three consecutive times, and is selected by the executive after consultations with the BCV.

Conduct of officials

Articles 28-30 of the LBCV contain general directives on rights and responsibilities for all BCV employees. Article 18 sets out standards of conduct for board members, while Article 19 details those for the BCV president. In addition, as established by Article 28, the Board of Directors is in charge of issuing complementary statutes that set out standards of conduct for employees. Details of these statutes are not publicly available.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Venezuela between 27 and 30 October 2003:

Central Bank of Venezuela (BCV)

30 October 2003

Jose Guerra	Manager	Economic Research Office

Ministry of Finance

29 October 2003

Elke Wecke	Director General	Office of Public Finance Statistics
Nora Guarata	Adviser	Vice Minister Office

ADDITIONAL INTERVIEWS

27 October 2003

Luis Ernesto Andueza	Partner	Macleod Dixon Solicitors
Antonio Casas	Board Adviser	Tecnoconsult

28 October 2003

Domingo Fontiveros	Chair	FEDECAMARAS
Haydee Cisneros de Salas		Economy and Finance Committee
Carlos Hernandez Delfino		
Tamara Herrera		
Amparo Parejo de Hibirma		
Ignacio Enrique Oberto		
Carlos Mollinedo	Economist	World Bank
Maria Magdalena Colmenares	Senior Social Specialist	
Angel Cardenas	Consultant	

29 October 2003

Richard Obuchi	Public Policy Centre	IESA

30 October 2003

Mercedes De Freitas	Head	Mirador Democratico
Robert Bottome	Director	Veneconomia

NOTES

[1] Banco Central de Venezuela Website: www.bcv.gov.ve
[2] Interviews in Venezuela, 27-30 October 2003.
[3] Constitution of the Bolivarian Republic of Venezuela: Constitucion de la Republica Bolivariana de Venezuela (as amended, in Spanish only): www.gobiernoenlinea.ve/documentos/PG_CAREA_GENERAL/PG_FOLDER_NORMATIVA_LEGAL/CONSTITUCIONES/CONSTITUCIONBOLIVARIANA.PDF
[4] LBCV, *Ley del Banco Central de Venezuela* (as amended in 2002, in Spanish only): www.bcv.org.ve/c3/refleybcv.asp
[5] BCV: *Normativa del Regimen de Administracion de Divisas; Convenio Cambiario No. 1-2* (in Spanish only): www.bcv.org.ve/c5/admondivisas.asp
[6] Interviews in Venezuela, 27-30 October 2003.
[7] Article 91, LBCV.
[8] Article 319, Constitution of the Bolivarian Republic of Venezuela
[9] Interviews in Venezuela, 27-30 October 2003.
[10] Interviews in Venezuela, 27-30 October 2003.
[11] Interviews in Venezuela, 18-20 November 2002.
[12] Interviews in Venezuela, 27-30 October 2003.
[13] Comision de Administracion de Divisas (CADIVI): www.cadivi.gov.ve
[14] Chapter III, Articles 44-47, LBCV.
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[16] *Acuerdo Anual de Politicas 2003* and *Acto de Anulacion del Acuerdo Anual de Politicas 2003* (in Spanish only): www.bcv.org.ve/c6/acuerdo.asp
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[18] *Boletin Mensual* (in Spanish only): www.bcv.org.ve/c1/Publicaciones.asp?Codigo=98&Operacion=2&Sec=True
Sintesis Semanal (in Spanish only): www.bcv.org.ve/c1/Publicaciones.asp?Codigo=1671&Operacion=2&Sec=True
[19] Article 27, LBCV.
[20] *Decisiones del Directorio en Materia de Politica Monetaria* (in Spanish only): www.bcv.org.ve/actpm/sintesisapm.asp
[21] These documents are available at: www.bcv.org.ve/c1/Publicaciones.asp?Codigo=91&Operacion=2&Sec=True
[22] *Informacion Estadistica* (in Spanish only): www.bcv.org.ve/c2/indicadores.asp
[23] Interviews in Venezuela, 18-20 November 2002.
[24] Interviews in Venezuela, 27-30 October 2003.
[25] Articles 87-88, LBCV.
[26] *Estados Financieros del BCV* (in Spanish only): www.bcv.org.ve/c2/indicadores.asp
[27] *Reglamento Interno del Banco Central de Venezuela* (in Spanish only): www.bcv.org.ve/c3/reglabcv.asp