

## **THE CREDIBILITY OF THE SOMALI CENTRAL BANK: INDEPENDENCE, TRANSPARENCY, AND ACCOUNTABILITY**

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### **Abstract**

The very purpose of this study is to review the credibility of the Somali central bank: its independence, transparency, and accountability. The reason why, this study was conducted is that there was no previous study in its kind regarding the credibility of the central bank of Somalia by looking at its independence, transparency and accountability. The first objective of this study is to find out if central bank of Somalia is credible in terms of political, financial, and monetary policy independence. The second objective is to examine the types and degree of transparency and to settle ways to measure the transparency of the Somali central bank. The third objective is to find out if there are clear and well defined financial accountability structures in the central bank (CB) of Somalia. In this study, central bank independence (CBI), transparency, and accountability was measured to find out whether these elements can influence or possibly could have some positive effects on central bank credibility. The questionnaire used in this research is a self-administered dichotomous scale. Data was analyzed by using Statistical package for social sciences (SPSS) in descriptive statistics. The target population of this study was 32 respondents from the banking industry in Mogadishu. The result of this study became 55.78 mean averages with a Std. Dev. 5.235. The overall mean averages for a total of 30 questions became 1.859 and overall Std. Dev. 0.1745 which meant the result showed greater abnormality and data distribution positively skewed to the right. The central bank of Somalia has no independence.

**Keywords:** Independence, Monetary Policy, Credibility, Political Independence, Financial Independence, Central Bank, Transparency, Accountability

## Introduction

In recent years, central banks have substantially changed their specific characteristics and attributes and number of countries that has developed such banks has increased. At the end of the 19<sup>th</sup> century, there were only 18 such banks that changed their operating structures, while by the beginning of the 21<sup>st</sup> century the number has increased to 173. Apparently, the first central banks were owned by the governments but fortunately some governments continuously incorporated and lastly developed functions that gave those banks the possibility made them the bank of the banks of the 20<sup>th</sup> century. These central banks have made their historic role for they were assigned changes during the 1990s as they were gradually become independent from their governments' control. Due to transformations 34 central banks adopted new statutes (Dumiter F. C., 2014). The structural changes of central banks happened because of two main reasons: in the first place, over the past decade 34 industrial and developing countries enacted legislations that allowed the increase of their central banks' operational independence. Also, independence in making decisions on monetary policy has been increased. This trend has been caused by three main factors: (1) the institutionalization of the European Central Bank (ECB) in 1999. (2) The stabilization programs of some emerging market countries. (3) The economic shift of former communist countries attempted to build market economies. In the second place, reforms have been made to increase transparency of monetary policy and accountabilities of central banks. As a formal principle, these reforms reflected an attempt to incorporate price stability into monetary policy. These two main reasons: enactment legislations allowing central banks' independence and reforms increasing transparency of monetary policy and accountabilities of central banks are supposed to make it easier for the public and elected representatives to monitor their central banks (Schwödiauer, Komarov, & Akimova, 2006)

Over the past 20 years, separation between central bank independence and political process has been a great objective. All over the world, there are many countries that have implemented some institutional reforms which gave their CBs more independence from the political process (Kydland & Prescott, 1977), and (Barro & Gordon, 1983). Some work has been done on time inconsistency on monetary policy, together with (Rogoff, 1985) who suggested that the theoretical rationale for these central banks reforms is under the idea that credibility of the inflation policy depends on central bank with more inflation adverse preferences. Around the world policy makers, academics and observers has reached a consensus that the goals of monetary policy should be established by the political authorities but the implementation of the monetary policy with its goals should be free from political control and interventions from politicians. The achievability of both stable prices and maximum sustainable employment depend the consistency of the economic growth rate and the expansion of its productive capacity. Achieving monetary policy working with substantial time lags requires monetary policy makers taking a longer term perspective when making their decisions-only an independent CB with a mandate to achieve the best possible economic outcomes in the longer term is best able to take

such perspective. When CB policy makers are subject to short term political influence to achieve short term economic output and employment gains only favoring and helpful in political election campaigns-such political interference in monetary policy generates and leaves behind an inflationary pressure that deteriorates economy's longer term prospects (Bernanke, 2010).

The institutional device associated with lower inflation is the central bank independence; independence also brings time consistent monetary policy. Central bank transparency (CBT) is absolutely crucial for it makes central bankers accountable and more credible in the eyes of the public. Transparency brings greater advantages such as reputability and flexibility on the credibility of the central banks. Transparency also attracts the private sector to infer central bank's monetary policy decisions (SPYROMITROS & TUYSUZ, 2012).

According to (Siklos, 2008), (Spinesi, 2009) and (Williams, 2009) the independence of the Central Bank from the government is an autonomy arrangement which is beneficial to the society but the CB cannot be completely independent from the government. Other authors such as, (Gabillon & Martimort, 2004), (Yang, 2008) and (Mixon & Upadhyaya, 2004) believe that the proponents and opponents of central bank autonomy cannot agree on why such arrangement is so beneficial to society. (Forder, 2005) Suggests convenience policy on the central bank's autonomy when some governments are convenient to the CBI policy; while (Cukierman A. , 1992) and (Eijffinger & de Haan, 1996) view that the CBI can reduce inflation. (Siklos, Bohl, & Wohar, 2010) Implied the financial stability system, its measurement and its implications with a monetary policy strategy aiming low and stable inflation and to look for prospects of price level targeting must be given special focus. Croitoru (2012) debates that there is a possibility for the central bank to act against the increase of effusive asset prices, since they can result severe financial crises and possibly throwing the economy into liquidity trap. So the central bank must prefer moderate and stable inflation to lower and stable inflation.

In the case of Somalia, the central bank independence (CBI) is under question – without independence there can be no transparency and accountability either. Somalia hasn't had access to international financial markets since late 1980s. Only the CB can enable Somalia to take the necessary measures to access international financial markets by settling arrears with creditors and to build track record of public financial management in the long term to warrant debt relief. CB is responsible to help Somalia by ensuring the following major tasks: (1) developing monetary and exchange rate policies and money supply regulations, (2) advising macroeconomic issues to government and to monitor economic indicators regularly, (3) to be the financial agent in the issuance of debt, (4) giving licenses to commercial banking services and other banks and to give legal protection for their operations, (5) drafting new central bank Act, (6) drafting new Commercial Banking Law, (7) setting sound payment systems. The absence of the above mentioned seven major tasks proves the functionality of the Somali central bank (SCB) is below the bottom line of the graph. Without a fully functional CB of Somalia, the Somali business

context faced a huge risk and the private sector of the Somali business could not continue to generate positive multiplier effects. So there is a need to rebuild a credible CB of Somalia under the following three directions: independence, transparency, and accountability.

Credibility is defined by Oxford Advanced Learner's Dictionary (Hornby, 2000) as "the quality that somebody or something has that makes people believe or trust them." central bank credibility (CBC) is the legitimacy of the CB, central bank independence (CBI) supported by the public, Competence Monetary Policy, Keeping the Unemployment Rate to a Minimum Level, Promising the Expectations of the Private Sector in Price Stability, the Appreciation of the Private Sector to the Objectives of the Policy Makers, the Effectiveness of the CB itself, and Keeping the Inflation Low (FORDER, 2004). "The central bank is credible if people believe it will do what it says" (Blinder, 1999). The researcher believes (FORDER) is measuring credibility while (Blinder) is defining it.

The definition of this study was derived from (Blinder, 1999) that defines central bank credibility (CBC) as people believe the central bank will do what it says. So the gab is the Somali Central Bank (SCB) needs credibility through independence, transparency, and accountability.

Generally, central bank independence must be beyond the political agenda, accountability should be upon society; transparency is to be fulfilled its task in a more efficient and complex communication mechanism (Dumiter F. C., 2014).

Independence is the most important element because transparency, accountability, and the communication channels become crucial only after granting independence to the central banks (Oritani, 2010). "Independent central banks, as a result, find it easier to keep inflation under control because their societies more willingly accept the sacrifices that come along with a tight monetary policy" (Tognato, 2012). The first attempt to evaluate central bank independence, the index was based on two pillars: political independence and financial independence measured only in 12 industrial countries which covered nine variables: final authority, the presence of the government representative in the central bank board, the degree in which the government appoints the board members, board members' number, board members' tenure, central bank governor's tenure, financial and fiscal independence, the authority which stipulates the check and balances of the board members, and the authority which determines the profit distribution (Bade & Parkin, 1988). In the second attempt (Grilli, Masciandaro, & Tabellini, 1991) developed an evaluation of central bank independence based on two pillars: economical independence and political independence measured in 18 developed countries that covered five variables: budgetary deficit monetary financing; monetary policy instruments; governor's and board members' appointments; the relationship between central bank and the government; and the fundamental law.

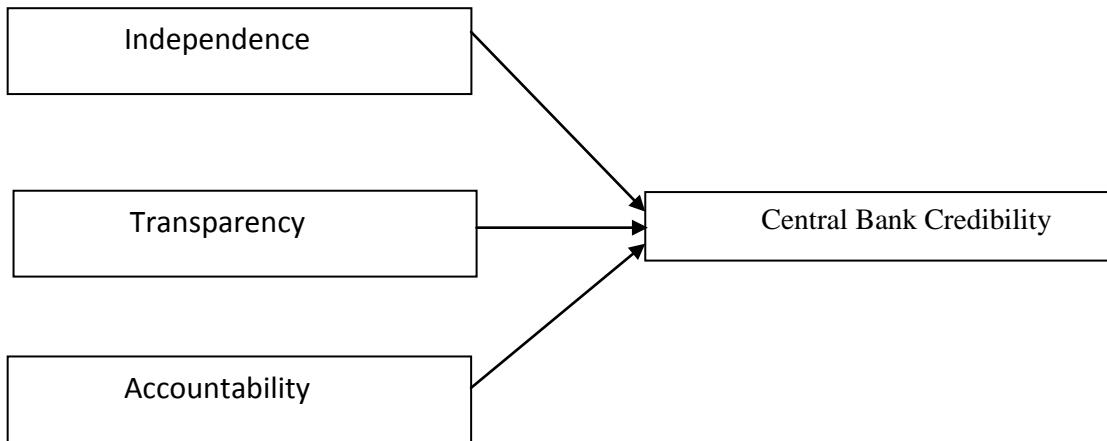
The first attempt in measuring central bank transparency an index which offered 11 variables regarding the supply of information, the understanding of the monetary policy process, procedural transparency and central bank autonomy and responsibility was established (Siklos, 2002). (Eijffinger & Geraats, 2002)[2004]) has distinguished five types of transparency: political, economical, procedural, policy and operational. Eijffinger and Geraats used a normalization technique the minimum score being 0 and the maximum score 1.

The first attempt to evaluate the degree of central bank accountability an index upon 21 developed countries which had a simple four variables was made concerning: the external monitoring of the central bank, publishing the meetings of the monetary policy council, publishing central Bank information in regular publications and the existence of an overridden mechanism in case of certain shocks (Briault, Haldane, & King, 1996).

When the central bank of Somalia was reopened in 2006 until the present time in 2015, its functionality is limited. The CB is operating under an old, in the mid of the 20<sup>th</sup> century decree Law N0 6 of 18 October 1968. Vision of the CB of Somalia is to: foster monetary stability, maintain the value of the Somali shilling, promote the economic growth of the republic, and contribute to the financial and economic policies. The reality is that the CB of Somalia cannot reach global financial markets because the bank has no functional regulator to attract private sector investors. The CB of Somalia lacks the following: legal and regulatory framework, strong property rights culture, enforceability of collateral contracts, and accessible credit information and sound financial structure. There are two other central banks (the CBs of Somali land and Punt land) though they are not in a position to perform key central functions of typical instruments necessary to conduct monetary policy yet they are challenge to the CB of Somalia. Because of the limited functionality of CB of Somalia, the Somali remittances companies are the main actors of the Somalia's financial sector. These remittances companies have large network of agents that give service all towns in the country.

Without a fully functional CB of Somalia, the Somali business context faced a huge risk and the private sector of the Somali business could not continue to generate positive multiplier effects. So there is a need to rebuild a credible CB of Somalia under the following three directions: independence, transparency, and accountability.

1. How Somali central bank can be credible in terms of political, financial, and monetary policy independence?
2. How can be examined the types and the degree of transparency and can be settled ways to measure the transparency of the Somali central bank?
3. Does central bank of Somalia have clear and well defined financial accountability structures?



Recently, the desirability of CBI became a popular feature in monetary making institutions like CBs to attain their objectives such as price stability. Basically CBI depends on two pillars: theoretical and empirical. Before anything else, it is better to understand the roles and primary responsibilities of CBs. Central banks have four traditional roles: conducting monetary policy; preserving financial stability; supervising and regulating banks; and safeguarding payment and settlement systems. Keeping and making sure the price stability and financial stability is the first primary responsibility a CB has to do. The CB should have both instrument independence and full financial independence to achieve its main objectives. In order to avoid any conflicts of interest, the high ranking officials in the CB must have to stay long term in office; also they should not have other positions in government or in the private sector. Developed countries showed better proxies in actual independence relative to CB legal independence than developing countries. In developing countries, their behavioral independence showed two indices which are extremely and relatively more important: (1) actual VS legally mandated CB governors' turnover, (2) the CBs of developing countries are extremely vulnerable to a very high frequency of political change meaning there are high occurrences of political transitions within a short period of time leading to replacement of the CB governor (Cukierman, 2006). Primarily, CBI can solve three inter-related problems: (1) CBI configures rationale balance between fiscal authority relatively to monetary authority not to satisfy the government's long-run budget constraints meaning both authorities; fiscal and monetary are separately independent. This separation of powers removes the possibility of inflation correspondence to the wishes of the monetary authority. (2) CBI protects citizens from transitional problems like tax distortions caused by bad political business. (3) CBI solves inconsistency problem of the monetary policy (Sousa, 2001). In developing countries, the TOR of Cukierman et al. (1992) is significantly related to inflation (Berger, Haan, & Eijffinger, 2000). There is a theoretical standard case for CBI intentionally keeping inflation bias because this bias is the consequence of the interactions between policy makers and rational public; this happens when the monetary policy makers care about both price stability and employment but their level of employment preference is higher than the natural level (Kydland &

Prescott, 1977), and (Barro & Gordon, 1983). According to (Barro & Gordon, 1983), and (Cukierman A. , 1992) the reason why this CBI inflationary bias is allowed to happen is the existence of two things: (1) tax distortions (2) employee unions, trying to keep the real wage above its market clearing level. Apparently, discrete policy makers create inflationary surprises trying to push employment above its natural level. The public understands and neutralizes any effect of inflation on employment because individuals acquainted the tricky temptations of the policy makers and correctly forecasts inflation. Undoubtedly, employment remains at its natural level but monetary policy is subject to a suboptimal inflationary bias. Then, the consequence becomes a severe dynamic inconsistency monetary policy under discretion. Rogoff (1985) suggested that conservative CBs can reduce bias by delegating the conduct of the monetary policy but consequently there appeared some smaller inflationary bias could be remained. Ironically, both CBs and governments need a contract approach to design a monetary institution that mediates them. Apparently, this institution is made of a body – tri-partite officials from government, CB and the parliament. The responsibility of the monetary institution is to structure a contract (optimal contract) between both parties: the government and CB.

Walsh (1995) proposed that an optimal contract can entirely eliminate bias if the CB is advised to make the correct output amount stabilization. Svensson (1997a) explained the optimal contract can be used as a means of inflation targeting. If a CB has long run price stability path and its aim is to make the output target equal to potential or the employment target equal to its natural level with the help of authority delegation to CB instrumental independence can bring the ideal institutional arrangement (Cukierman, 2006). The CBI rationalization outlined above is mainly based within the context of an inflation bias because of the primary motive of monetary expansion in both developed and developing economies. In the case of the developed countries, wide capital markets allow their governments to borrow and finance deficits without raising the cost of borrowing too much. But in developing countries, during deficit periods, governments put powerful pressures to monetize on their CBs because of limited access to capital markets. This revenue motive for monetary expansion leaves behind a social inefficient bias (Cukierman A. , 1992).

To credibility, CBs anxiously seek to build their credibility especially during periods of disinflation thinking over the prioritization of two matters: (1) upward sensitivity, (2) inflation deviations to downward from its targets. For this, a CB needs to make sure not to miss the inflation target either from below or above. When a CB for example tries to connect some level of its credibility to a precautionary demand aiming to price stability, then the CB is waging to extremely restrictive average policies because theoretically there is a precautionary demand for expansion in one way and precautionary demand for price stability on the other way. These two policies; demand for expansion and demand for price stability easily tend to offset each other because the precautionary demand for expansion creates inflation bias while the other causes

deflation bias. After the CB stabilizes inflation, the precautionary demand for expansion might remain to restart the risk of average inflation bias (Cukierman & Muscatelli, 2003).

Economic policy and policies themselves fall into separate directions – economic policies can gain credibility from private agents to be effective but policies can become credible if they are effective. It is the responsibility of the central bank to develop a successful economic policy in which its viability and reliability depends on the perceptions of private agents. Credibility cannot be sustained unless economic growth and price stability is achieved. With the respect of new classical theory economic fundamentals, an independent CB can prove its capability to promoting development and economic growth (Grabel, 1999).

Surprisingly, the emerging economies are increasingly developing the design and operation of monetary institutions (Central Banks and Currency Boards) involving monetary policy and exchange rates. The primary aim of these institutions is to influence the policy credibility. To gain financial credibility, political intervention by the government must be strictly prohibited otherwise the rational public would know the central bank financial policies are incredible and such political interventions may end up economically inconsistent liquidity trap (Schmieding, 1992).

Currency board is a monetary institution and its primary responsibility is the issuance of local currency which is fully backed by large stocks of a hard foreign reserve currency. The convertibility of the local currency must be upon demand and unlimited into the foreign reserve currency at a fixed exchange rate. Also there must be an inviolable strict line between the local and foreign currency reserve. As recommended by the IMF, the exchange rate must be written in the currency board's constitution (IMF, 1996)& Hanke et al. (1993) Assets payable in the foreign reserve currency and low risk interest earning securities are among the reserves held by the Currency Board. As the law may set, foreign reserve currency equals to 100 to 110 percent relative to the value of the local money stock (Grabel, 1999).

According to Ghosh et al. (1998), and Hanke et al. (1993) historically, currency boards have successfully operated seventy countries. During 1990s, currency boards were operating in Argentina, Bulgaria, Bosnia, Cayman Islands, Estonia, Falkland Islands, Faroe Islands, Djibouti, and Gibraltar. The Estonian currency board was credited to having successfully stabilized the economy; the currency board of Argentine ended inflation and maintained stability during Mexican financial crises in 1994 – 1995; during Asian financial crises and from British to Chinese rule, the Hong Kong currency board settled and maintained stability. In the emerging economies, their currency boards proved highly credible way to manage the exchange rates (Caramazza & Aziz, 1998). Empirical evidence is showing that countries with currency boards inflation is 4% lower than in countries with other types of exchange rates (Ghosh et al. 1998). When the currency board is maintaining fixed exchange rates by having sufficient holdings of the

foreign reserve currency, this means the board is giving confidence to investors and the public in general (Bhattacharya, 1997).

Finally, one must not confuse the responsibility of currency board with independent CB responsibilities. The currency board assists the operations of an independent CB in a complementary way which is proving to the public the monetary policy management would continue undisturbed by political intervention or any pressures from the government. Currency boards cure credibility deficit in countries where CB institutions are new or their performance is not good due to poor track record. The members in the currency boards are usually selected from the ranks of technocrats, economists, and bankers – they are appointed to stay long term in office to make sure the exchange rate policy is in the hands of independent authority free from strategic incentives to change direction toward improper deviations or wrong expansionary course (Grabel, 1999).

To transparency and accountability, there are two views; one view says transparency is a precondition for accountability, and the other view says transparency is the result of the accountability process. Although these two views are related to each other, transparency represents the whole society including media and financial markets to ensure whether central bank has done its objectives through clarity, truthfulness, and efficiency while accountability represents a responsible behavior imposed by legislation to make the CB feel accountable as it is undertaking monetary policy actions because accountability is directly happening to the conduct of monetary policy (Dumiter F. C., 2014).

### **Central Bank Independence**

Central Bank Independence (CBI) can be defined full independence from the government in issuing paper money – the authorities of the central bank should be commission members chosen by the votes of the parliament and there should be no any kind of relationship or communication between the cabinet of the ministers and members of the central bank commission. The state must be obliged to collect money in a legitimate way such as taxes. There is no way the government should be allowed to lend money from those who are responsible for the issuance of it (Ćorić & Cvrlje, 2009).

CBI represents the institutional capacity of the central bank which is typically an institutional mandate responsible to conduct monetary policy free from all kinds of political interferences from any sides including government, industry and other interest groups (Schwödiauer, Komarov, & Akimova, 2006).

Central bank independence (CBI) can be only found when monetary policy officials are not involved in any kind of political or government influence to implement the monetary policy (Ćorić & Cvrlje, 2009). In a much different way (Blinder) has pointed out the inevitability and

desirability of a close cooperation between the CB and the finance ministry in times of crises and he proposed three different settings: (1) at times of serious financial crises; (2) during the aftermath of financial crises, when the economy may be astounding and monetary policy may be unconventional; (3) in normal times when monetary policy is conventional, but he strictly recommends there must be inviolable, clear, and bright line on monetary policy between the CB and the finance ministry. (Blinder) sheds light CBs lack the independence of non-monetary policy activities such as bank supervision and relevance of authorities, for example; bank supervision and deposit insurance must be in the same hands. He concludes the rationality of the CB independence is to be against politicians creating too much inflation when they are facing elections because their aim is to produce incentives reducing inflation or keeping it low only in a short time horizon instead the monetary policy must be controlled by technocrats with long time horizons (Blinder A. S., 2012).

Some scholars argued for the success and better monetary policy, there must be a crafted cooperation between monetary and fiscal policies. There is a severe uncertainty that an independent central bank controls inflation unless some preconditions of fiscal policy are met. Central bank needs to examine any fiscal conditions that can support its independence. It may be the consideration of two separate equilibrium conditions: first, the real demand for money must be equal to the real supply of money; second, the real value of government liabilities must be equal to the real value of the consolidated government's surplus expected at present time. The government fiscal policy always ensures if the second condition is met (Walsh, 2011).

The relationship between central bank independence and economic performance produced the idea of CBI empirical support with three main conclusions: Firstly, there is a negative relationship between central bank independence and long term-inflation. There is a low inflation rate in countries with independent central banks compared in countries with their central banks are subject to government control. Secondly, there is a negative relationship between central bank independence and GNP when the long term budget deficit is expressed as percentage. Countries with independent central banks have much lesser deficit than those countries with their central banks are under government control. Thirdly, the central bank independence is not affecting negatively to the production or employment during over the long term (Schwödiauer, Komarov, & Akimova, 2006).

According to several studies with empirical results supporting central bank independence provided by Grilli et al. (1991), Cukierman et al. (1992), Alesina and Summers (1993), all these studies reached the same conclusions showing that there is a negative relationship between central bank independence and average inflation. Consequently, the central bank independence improves the possibility of reaching low inflation goals without real economic costs. On the other hand, if policy makers employ incentives of expansionary fiscal policy giving the possibility of creating surprise inflations make the monetary policy implementing low inflation policy

incredible in the eyes of the public (Daunfeldt & Luna, 2003). The ability to halting inflation expectations at a level that can be suited with monetary policy objectives brings reward of credibility to CBs (Łyziak, 2013).

In general, CBI falls into two categories: independence of goals and independence of instruments. Goal independence refers how it is possible for the central bank to determine the goals of its activities without being involved by the government. When it comes to the instrumental independence, the central bank needs absolute freedom to select the instruments that can make possible for the bank to achieve its goals. (Ćorić & Cvrlje) believe this division was accepted by most of the authors in papers written in 1990s (Ćorić & Cvrlje, 2009).

According to (Lybek, 2004) to CBI is identified as formal and effective (actual) independence. The formal (statutory) is a type of CBI stipulated and guaranteed by legislation that could possibly be divided into three stages: when independence is established by international treaties like the European Central Bank (ECB); the practice of constitutional independence like the CB of Switzerland; and establishment of independence under national legislation acts. (Lybek) advocated the safeguarding of goal and instrument independence can only be achieved when issues of personnel and financial autonomy of central bank are secured under the national legislation acts. The qualification requirements of the CB governor and board members; the nomination and appointment of the CB governor and board members; the term of office, and the dismissal of the CB governor can only happen by the approval of the legislative body.

According to (Ćorić & Cvrlje, 2009) the CBI criteria is divided into four categories: Nomination and dismissal of the central bank governor and other members was the most important category. The independence of the central bank to define the goals of the monetary policy and the final authority in decision making was the second most important category. The third category searches up to what level the central bank defines price stability and its main goal. The fourth category measures the imposition of the central bank lending restrictions.

Apparently, there are distinctions between goal (political) and instrumental (economical) independence. CBI basically appropriated with instrumental independence comes in the first place while goal independence comes in the second place. The more the government implements monetary policy independently the more the chance the central bank would have opportunities to solve the problem of time inconsistency, Debelle & Fischer (1995).

According to Eijffinger and Haan (1996) two more types of independence appeared: individual and financial independence. There is a positive solution by the presence of the government officials in the boards which employ people but the implications of financial independence shows negative impact if the government tries to be involved in any kind of credit relations between the

central bank and the government itself. The most important factor in the role of CBI is “time” to implement consistent monetary policy.

In the history of the European Central Bank (ECB), the experts outlined five types of independence as preconditions for optimum implementation of the monetary policy: institutional independence, legal independence, personnel independence, functional and operational independence, and lastly, organizational and financial independence. (Ćorić & Cvrlje, 2009).

### **Increasing Role of CBI**

For many years, there was a problem of independence, how independence is to be measured and how CBI influences macro-economic variables. In 1970s and 1980s most of the developed countries experienced high and continuous inflation rates. Two authors, Barro and Gordon (1983) explained the reason why? They proved that central banks set variables above their natural values which makes possible the balance of external and internal to happen and the result became high inflation rates. The public wanted to know the truth – they asked why such high inflation was happening, they needed explanations about the motives of the central banks, the subject of the price stability to economic growth and the reason why the economic objectives were became unrealistic? The answer was clear, there was an inconsistency of monetary policy and the behavior of central banks was motivated by political influence. The ruling parties have always been oriented to short term economic gains. It is a common knowledge to everyone the expansionary monetary policy is a unique solution but it always ignores the short term inflation effects. The solution of the problem seemed the CBI is to be increased.

Although the increase of CBI was a way tremendously intended to reduce inflation rate, after a time new reasons emerged. Cukierman (2006) suggested the increased independence was due to by two factors: (a) global and (b) regional. The idea of liberalization strongly advanced to all segments of economy, and especially influenced capital flow and the expansion of capital markets, and the need for stable macro-economic conditions was highly increased. Both domestic and foreign investors put their trust to a higher level of CBI with greater efforts focusing to prolonged price stability.

Regional contribution motives that increased independence were as follows: (1) after the institutions formerly designed safeguarding nominal stability, like the European Monetary and the Bretton Woods systems have been breakdown, a new search for alternative institutions has emerged; (2) the highly independent German Bundesbank showed a good track record in assurance of nominal stability; (3) Maastricht treaty by EEC prerequisites central bank independence upgrading for the membership in the European Monetary Union, taking Bundesbank as an example; (4) after inflation has been successfully stabilized, policy makers commenced thinking over institutional arrangements which have the capabilities of reducing

future inflations. Increasing central bank independence appeared a live natural way and could have a high possibility to achieve this objective; (5) the former socialist countries tried to create institutional frameworks in order to have better and orderly functioning market economies. The realization of industrial economies that legal independence is negatively related to inflation motivated the grant of substantial de jureindependence to many central banks (Cukierman, 2006).

### **Measurement of CBI**

To measure central bank independence, the following four categories can make a CB more independent: (a) the appointment of the central bank governor not by the prime minister or minister of finance but by the board of the central bank. This brings the central bank governor not to be subject dismissal and has to stay a long term in office. In the appointment process, these features are important preventing the governor of central bank pressures from politicians; (b) policy decisions of the CB must be made without direct involvement of the government; (c) the charter of the CB must give its first priority making price stability the primary goal of the monetary policy; and finally CB independence is in a higher position when the ability of the government to borrowing from CB is limited (Dincer & Eichengreen, 2014).

According to the pioneering work of Bade and Parking, (1988), the measurement of formal independence can be based on legal criteria of political (goal) and economic (instrument) independence. Later Cukierman, Webb, and Neyabti (1992) developed a comprehensive index an LVAW of CBI. It is a measurement which gives a numerical weights to each question.

Bade and Parking (1987) and Banaian, Laney, and Willet (1983) started the first attempts at measuring central bank independence. BP divided central banks into four classes by using three dimensions of central bank structures: (1) final authority over monetary policy making; (2) no government officials in the boards of central banks; (3) board members independent of government appointment. Alesina (1989) supported the work of BP introduced marginal coverage criterion inspecting the ability of monetary policy to resist the pressures of fiscal policy possibly monetize debt. Grilli, Masciandaro, and Tabellini (1991) proposed an index of eight features equally weighted summation approaching interpretations of central bank laws and disagreements. Cukierman, Webb, and Neyapti (1992) produced the most popular measurement of central bank independence. They considered 17 different legal attributes by using a variety of scales measurement like two or three point scales and as higher as seven point scales sometimes in an unweighted average (LVAU) and weighted average (LVAW) (Burdakin, Banaian, Hallerberg, & Siklos, 2011).

Which one is beneficial for the society; a democratically elected government creating a socially high cost inflationary bias by trying to achieve objectives like high employment and easy financing of government expenditures or a conservative central banker which has primary

concerns about price stability than government does? The answer is clear. The only main objective of monetary policy that a CB should focus is the monetary policy on price stability. To be realized this focus of the bank effectively the bank must get sufficient backup of legal independence in the choice of monetary policy. Receiving explicit or implicit instructions from the government officials is strictly forbidden by laws of the central bank mandate. Sufficient personnel and financial independence is a gauge showing central bank legal independence which is giving the central bank the capability to resist political pressures and enough capacity to prepare constraints against the government's ability resorting inflationary financing (Cukierman, 2004).

According to (Haan & Sturm, 2001) CBI measurement usually encounters disputes and problems like unexplicit laws that cannot make clear specifications about the line of duties between two authorites: the central bank authorities and political authorities under all possibilities. This always brings unclear indicators of actual independence compared to legal independence. Cukierman (1992) believes industrial countries may show better proxies measurement for actual independence than developing countries. Therefore, Cukierman (1992) and Cukierman et al. (1992) developed central bank autonomy which was based on the central bank governor's term office instead on central bank laws. It is clear, this literature is turning the understanding to a higher turnover of central bank governors indicates a lower level of independence. Until now, a few studies have used the TOR of central bank governors as an idicator for CBI and the matter was concluded the existence of inflation performance between developing countries and the TOR of central bank governors. This literature has a drawback – the studies available until recently are all based on the data of Cukierman (1992) and Cukierman et al. (1992). De jure and de facto indexes necessary to measure central bank independence are as follows: Political independence (final authority; the presence of the government representative in the central bank board; the degree in which the government appoints the board members; board members' number; board members' tenure; and central bank governor's tenure), Financial independence(financial and fiscal independence; the authority which stipulates the check and balances of the board members; and the authority which determines the profit distribution), this is the first attempt measured in 12 developed countries (Bade & Parkin, 1988). Economical independence (budgetary deficit monetary financing; and monetary policy instrumrnts), Political independence(governor's and board members' appointments; the relationship between central bank and government; and fundamental law), the second attempt measured in 18 developed countries (Grilli, Masciandaro & Tabellini, 1991). LVAU & LVAW unweighted and weighted measures respectively (governor; monetary policy making process; monetary policy objectives; limits upon the unguaranteed borrowings; limits upon guaranteed borrowings; terms of lending; potential beneficiaries of the central bank borrowings; imposed limits upon the central banks borowings; maturity of loans; restriction on interest rates; and prohibition on lending on primary market), measured in 68 developed and developing countries Cukierman et al. (1992). TOR

(Turn over rate of central bank governor), measured in 19 developed and 39 developing countries (Cukierman & Webb, 1995).

The possible measurement limits of CBI is usually outlined into four categories: personnel; policy objectives; policy instruments; and financial independence. In personnel independence, there must be legal procedures capable to limiting the government's role in appointment and dismissal of central bank governor. CBI is measured by looking at the primary monetary policy objectives of CBs to maintaining price stability. CBI is also measured by checking the policy instrument of the CB because, central banks achieve their monetary policy objective through policy instrument independence. Finally CBI is measured by the financial independence of a CB. There mustn't be interdependence between government and central bank in budgetary matters. This assures the determination of fiscal policy and budget of the central bank not allowed to be a subject to executive or legislative decisions (MOMANI & AMAND, 2014).

## **Transparency**

Central bank transparency (CBT) refers as an atmosphere which is favorable to the side of the public in terms of the accessibility, understandability, and timely basis of the information about the objectives of the monetary policy, its legality, institutionality, and policy framework, monetary policy decisions, the information related to monetary policy, the terms of central bank accountability, and the rationality of monetary policy and its data (IMF, 2000).

According to (Geraats, 2002) transparency is defined as, when, the information between monetary policy makers and other economic agents is symmetrical. (Geraats) is advocating that transparency is new and largely responsive to the best practices of central banking. Transparency is one of the most important key features of monetary policy. In 1998, there was a survey of 94 central banks conducted by Fry, Julius, Mahadeva, Roger, and Sterne which became the most understandable survey on the conduct of monetary policy. The survey showed a greater consideration of transparency by 74% of the central banks marked transparency as a vital component of their monetary policy framework. Lack of transparency generates opacity, which leads to asymmetric information, then, the result becomes uncertainty. If both central bank and private sector have the same information about the structure of the economy, then, it appears that transparency prevails. However, transparency doesn't mean perfect information or full certainty.

The beginning of central bank transparency characterises in a number of intertwined mechanisms. First, transparency includes bulky means to pressuring the government to be more responsive to the public. Second, transparency is a primary key of accountability which is getting support from central bank independence. Third transparency enhances the communication between markets and policy decisions. In a transparent atmosphere investors are aware of policy action. In good transparency, there is less chance of financial distress caused by sharp movements of asset prices

after policy changes happen. Fourth, transparency enhances policy credibility, policy flexibility, and credibility of central bank's commitment (Dincer & Eichengreen, 2014).

The internal decision making process of the central bank depends on transparency. Central bank achieves its mandate through transparency that explains the uses of different instruments of monetary policy. Transparency needs well defined monetary policy strategy and a timely statistical data in the form of publications and forecasts on which the central bank bases its decisions. These days, there are academic communities and political audiences who base their arguments and ideas on the favorability of transparency in monetary policy. There are four categories on which an IMF code called "good practice on transparency in monetary and financial policies" is structured. Categories are as follows: (1) clarity of roles, responsibilities and objectives; (2) formulating open process and reporting policy decisions; (3) public availability of information policies; and (4) integrity of accountability and assurances. Inflation rate targeting has especial importance in the operational transparency of central banks because there could be a monetary policy action that could change, for example, the central bank financing rate – the prevailing of this matter necessitates the existence of time lag (which empirical research shows it could take 6 up to 8 quarters) between monetary policy action and the response of the inflation rate. This time lag changes the transparency into opacity and the public feels difficulty to monitor and evaluate how the central bank is doing its actual commitment to inflation rate targeting. A central bank always has a course of policy actions and the public has expectations of inflation. When the influence of public expectations and the credibility of central bank and maintenance of its independence act accordingly the target becomes credible and the inflation expectations are reduced to minimum level. In terms of employment and ex-post real interest burden creates costly unsuccessful operations trying to bring down high inflation rates to lower target rates. If disinflation social costs get higher the implementation of disinflationary policy politically becomes very difficult and central banks lose their instrument independence (Schwödauer, Komarov, & Akimova, 2006).

Eijffinger and Geraats (2002 [2004]) has distinguished five types of transparency: political, economical, procedural, policy and operational. Eijffinger and Geraats used a normalization technique the minimum score being 0 and the maximum score 1. At this moment the researcher likes to describe these five types of transparency one by one: (1) Political transparency indicates openness about policy objectives and institutional arrangements like central bank independence, contracts, and override mechanisms that clarify the motives of monetary policy makers; (2) Economic transparency focuses on economic data, policy models, and central bank forecasts. This economic information is used for monetary policy; (3) Procedural transparency gives details about the monetary policy strategy and policy deliberations account through minutes and voting records. This typical provision describes the way monetary policy decisions are taken; (4) Policy transparency is a form of policy inclination that embraces explanation of policy decisions and prompt announcements and indications of likely future policy actions; (5) Operational

transparencysupports operating instrument to control errors. It also prevents macroeconomic transmission disturbances. This whole process concerns the implementation of monetary policy actions.

### **Measurement of Transparency**

According to Fry et al. (2000) measurement of transparency covers a wide range of aspects on monetary policy frameworks ranging from institutional characteristics to policy focus and monetary analysis. (Fry) constructed indices in which he included a measure of policy explanations primarily based on (1) if central bank prepares explanations of policy decisions; (2) the publication preparations of forward-looking analysis; (3) assessment explanation and analysis (bulletins, speeches, and research papers). But, here, the researcher inclines to present other types of central bank transparency measures: Siklos (2002) measured central bank transparency in 20 developed countries and European Central Bank. He constructed indices composed of the following 11 main variables: publication of minutes of central bank meetings; key assumptions in generating outlook; publication of committee voting record; regular information published about how monetary policy decisions are made and their justification; operational instrument of monetary policy; instrument independence; are monetary policy and operational objectives the same?; special recognition of the role of financial system stability; economic modeling procedures; forms of communication; and publication of a monetary policy strategy and limits of monetary policy. Eijffinger & Geraats (2002 [2004]) measured central bank transparency according to their five types division. Each has three variables. (1) Political transparency measure: is there a formal statement of the objectives of monetary policy with an explicit prioritization in case of multiple objectives? Is there a quantification of the primary objectives? Are there explicit institutional arrangements or contracts between the monetary authorities and the government? (2) Economical transparencymeasure: does the central bank disclose the formal macroeconomic models that uses for policy analysis? Are the basic economic data relevant for the conduct of monetary policy publicly available? Does the central bank regularly publish its own macroeconomic forecast? (3)Procedural transparencymeasure: does the central bank provide an explicit policy rule or strategy that describes its monetary policy framework? Does the central bank give a comprehensive account of policy deliberations within a reasonable amount of time? Does the central bank disclose how decisions on the level of its main operating instrument/target were reached? (4) Policy transparency measure: are decisions about adjustments to the main operating instrument or target promptly announced? Does the central bank provide an explanation when it announces policy decisions? Does the central bank disclose an explicit policy inclination after every policy meeting or an explicit indication of likely future policy actions? (5) Operational transparency measure: does the central bank evaluate to what extent its main operating targets has been achieved? Does the central bank regularly provide information on macroeconomic disturbances that affect the policy transmission process? Does the central bank regularly provide an evaluation of the policy outcome in light of its macroeconomic objectives?

(de Haan & Amtenbrink, 2003) developed an index based on three main pillars of central bank transparency measurement: (1) Objective measure which has five variables (clear objectives, clear priorities, clear definition, clear time horizon, and quantification); (2) Strategy measure that has three variables (announcement of the strategy, interest rate decision immediately announced and always explained, and inflation forecast); (3) Communication strategy measure which has six variables (parliamentary hearings, frequency of reports, meeting schedule, press conference/press releases, publication of minutes, and publication of individual votes).

## **Accountability**

According to the definition of Demertzis et al. (1998) accountability is defined in a combination of meaning and responsibility in which the targets of economic performance is under the care of policy makers who are bearing, can and would have been held the responsibility to make the indicators of economic performance closer to the target values set (Haan, Amtenbrink, & Eijffinger, 1998). Central bank transparency has two different rationales: economic benefits and democratic accountability (Blinder et al. 2001).

## **Measurement of Accountability**

Fry et al. (2000) reported two types of accountability measures: public accountability and accountability with respect to a specific target which have common characteristics of combining both transparency and responsibility. The central bank accountability measurement indices first constructed by BHK (1996) is based the following four variables: the central bank must be subject to external monitoring by the parliament; the minutes of meetings necessary to the decisions of monetary policy must be published; the central bank must publish an inflation or monetary policy report, in addition to standard central bank bulletins; and there must be a clause that allows the central bank to be overridden if certain shocks appear. Bini-Smaghi & Gros (2000) measured accountability in 20 developed countries and ECB using the following measures: Ex ante accountability; Ex post accountability; and accountability procedures. Here, the researcher considers the measurement of accountability procedures and there are four variables: participation of government representative at meeting of the decision-making bodies as observers; publication of summary minutes; publication of detailed minutes; publication of the votes of the members of the decision-making bodies. Ex ante accountability has five variables: clear definition of the objective of price stability; announcement of the operational target; announcement of the intermediate target; announcement of indicators for assessing monetary policy; and explanation of how monetary policy targets affect other policies and objectives. Ex post accountability has six variables: publication of data on intermediate target or explanation of possible deviation; publication of inflation forecast and deviation from inflation target; explanation of main policy measures and underlying reasons; explanation of how these measures affect other policies; regular public reports; and hearings in parliament.

## **Design**

This study adopted a descriptive research design to achieve the study objectives. Descriptive study attempts to describe or define a subject, often by creating a profile of a group of problems, people, or events, through the collection of data and tabulation of the frequencies on research variables or their interaction (Cooper & Schindler, 2000). This study uses quantitative approach which determines the relationship between an independent variable and dependent variables (Hopkins, 2000). Survey is a research design that is used to present oriented methodology used to investigate population by selected samples to analyse and discover occupancy. Its main purposes to find out descriptions of some part of the population and explain as they are, as they were, or as they will be (Oso & Onen, 2008). The justification of choosing the survey design is the rapid collection of data, and the suitability of the nature of this study. It also has been utilised to collecting primary data process of this study.

## **Sample**

The sample size of this study is composed of 32 respondents from the banking industry in Somalia, especially in Mogadishu.

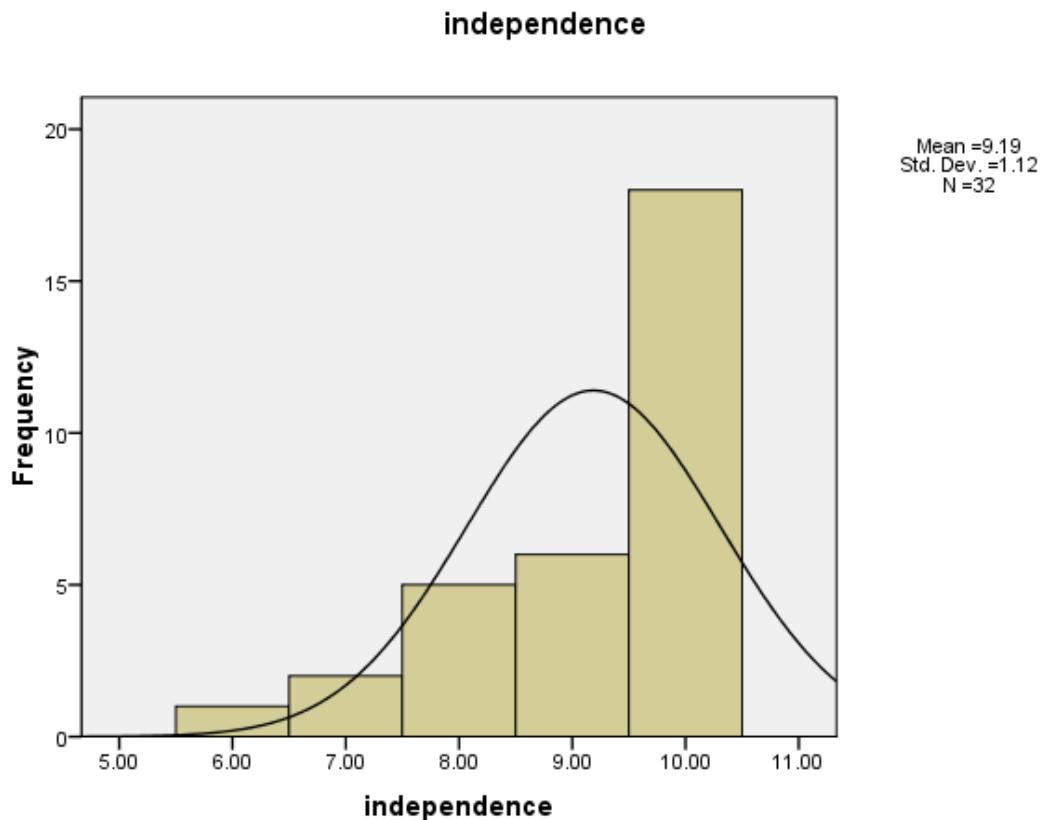
## **Instrument**

The study made use of primary data. Primary data was collected using a semi-structured questionnaire which was administered to the management of the banking industry in Mogadishu. The questionnaire sought to obtain information pertaining to general information of the respondents, effect on central bank credibility: independence, transparency, and accountability.

## **Result**

### **Figure 4.1.1 Independence**

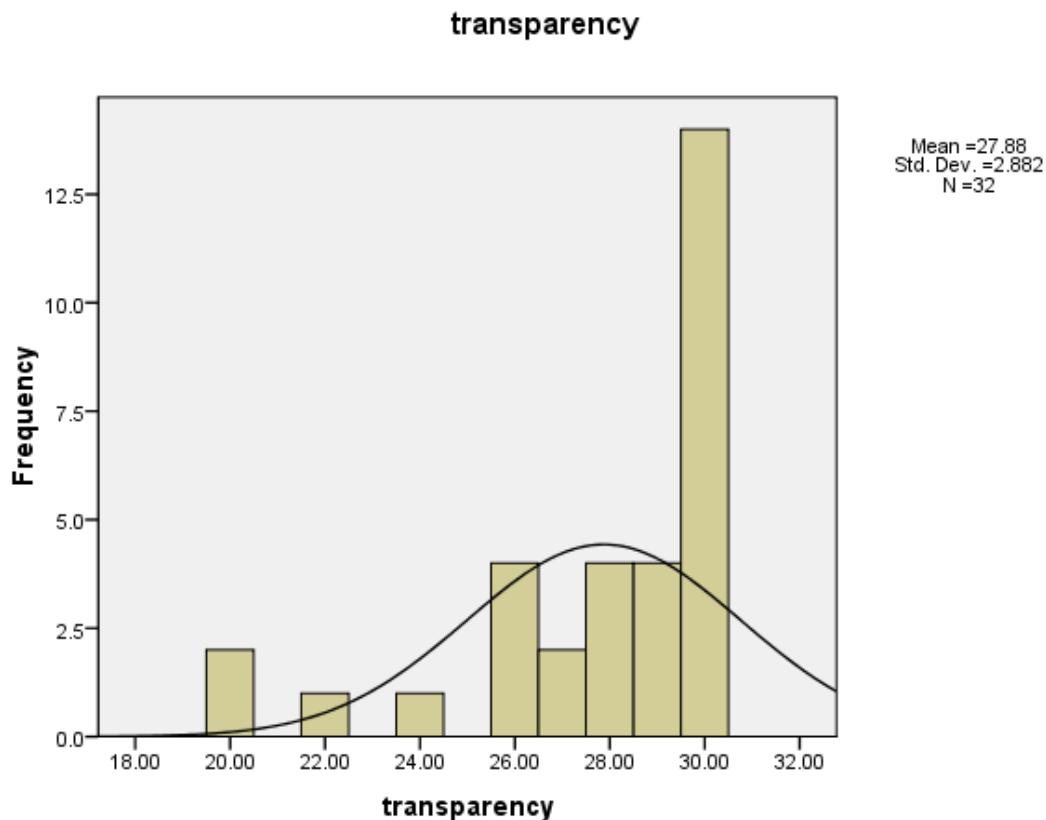
Independence has shown an abnormality of data distribution about five questions of central bank independence. The result is quite positively skewed to the right. The frequency of the lowest average mean question is below one. The second lowest average mean question, its frequency is below five. The third lowest average mean question has a level five frequency. The frequency level of question four which ranks the fourth position in high mean average is above five. The frequency level of the last question which has the highest high average mean is above (15) fifteen. The overall of high mean average of five questions of central bank independence questions is 9.19 and the Std. Dev. is 1.12



Source: Primary data

**Figure 4.1.2 Transparency**

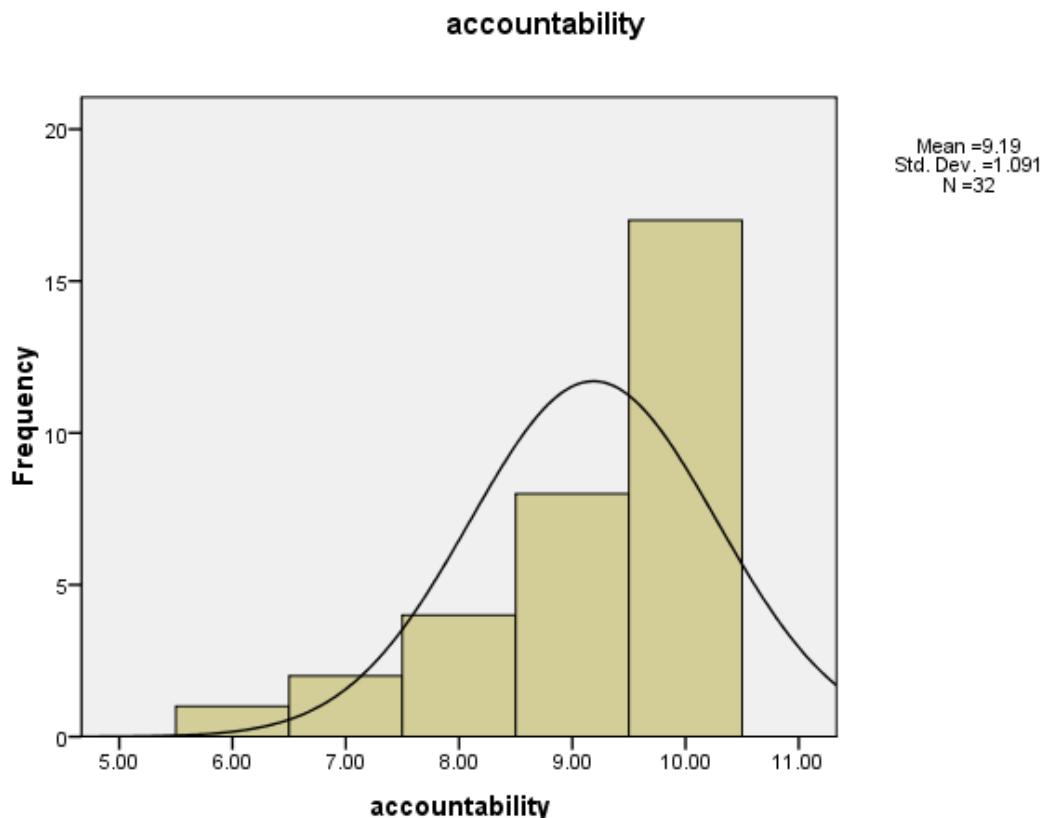
Transparency has indicated an abnormality of data distribution which is somewhat different from the abnormality of central bank independence. The central bank transparency questions were (15) fifteen in total but this graph has shown only eight histogram bars on central bank transparency, obviously some of the questions had same high mean average. But the interesting thing is that eight transparency questions are below level five frequencies. The rest seven central bank transparency questions which originally had high mean average of 1.94 and 1.91 have now got the highest frequency level which is above 12.5. The overall computation of high average mean of (15) fifteen central bank transparency questions is now 27.88 and the Std. Dev. is 2.882. Three questions of central bank transparency which originally had high average mean of 1.84 have just fallen the central tendency of the mean bell shaped line. Five transparency questions have gone left side of the central tendency mean line while seven questions have gone to the right side, so the result is positively skewed to the right.



Source: Primary data

#### **Figure 4.1.3 Accountability**

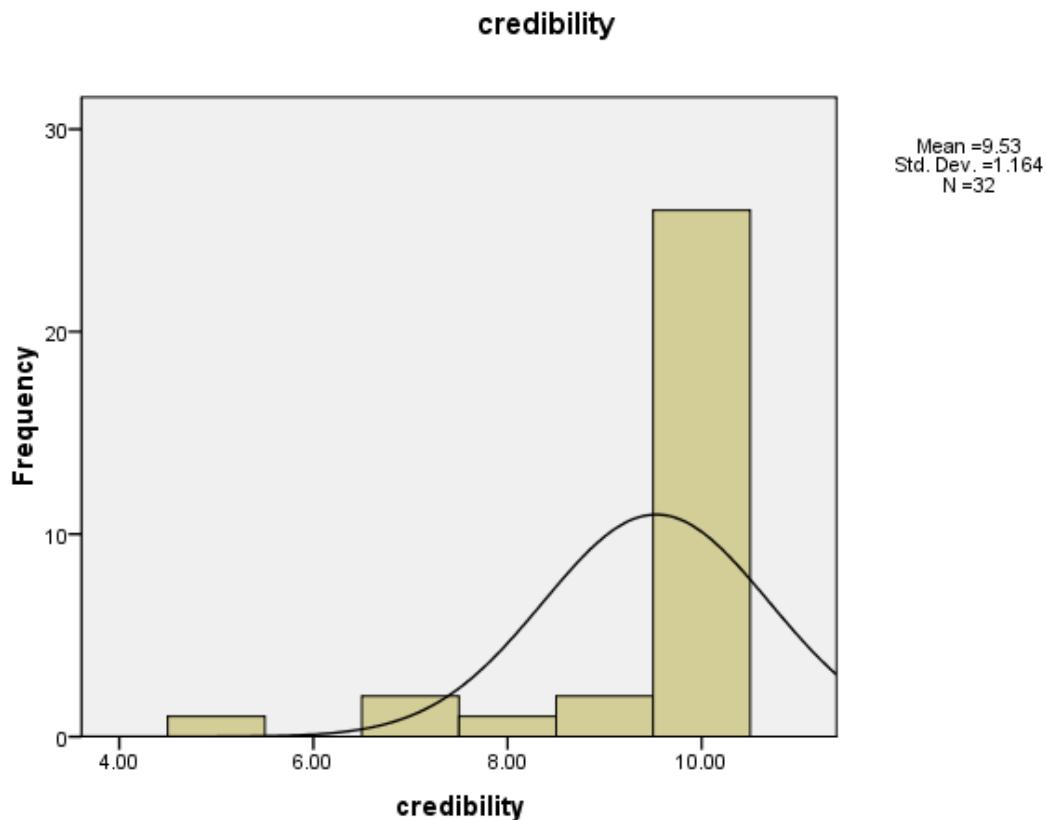
Accountability has proven an abnormality of data distribution about five questions of central bank accountability which is very similar to the data distribution of central bank independence. The result of data distribution is quite positively skewed to the right. Three central bank accountability questions have dramatically fallen to below frequency level of five while one question is below level (10) ten frequencies. The last central bank accountability question is somewhere between of the level of frequencies 15 – 20. The overall of originally high mean average central bank accountability questions is now 9.19 and the Std. Dev. is 1.091



Source: Primary data

**Figure 4.1.4 Credibility**

Credibility has given an abnormality of data distribution about five questions of central bank credibility which is basically similar to others but typically, it is quite different because four central bank credibility questions are far below the frequency level of five. The last credibility question is surprisingly skyrocketing to the highest frequency level of (30) thirty which it is seen in the first time. This data distribution is positively skewed to the right side of central tendency line. The overall mean average equals 9.53 and its Std. Dev. is 1.164

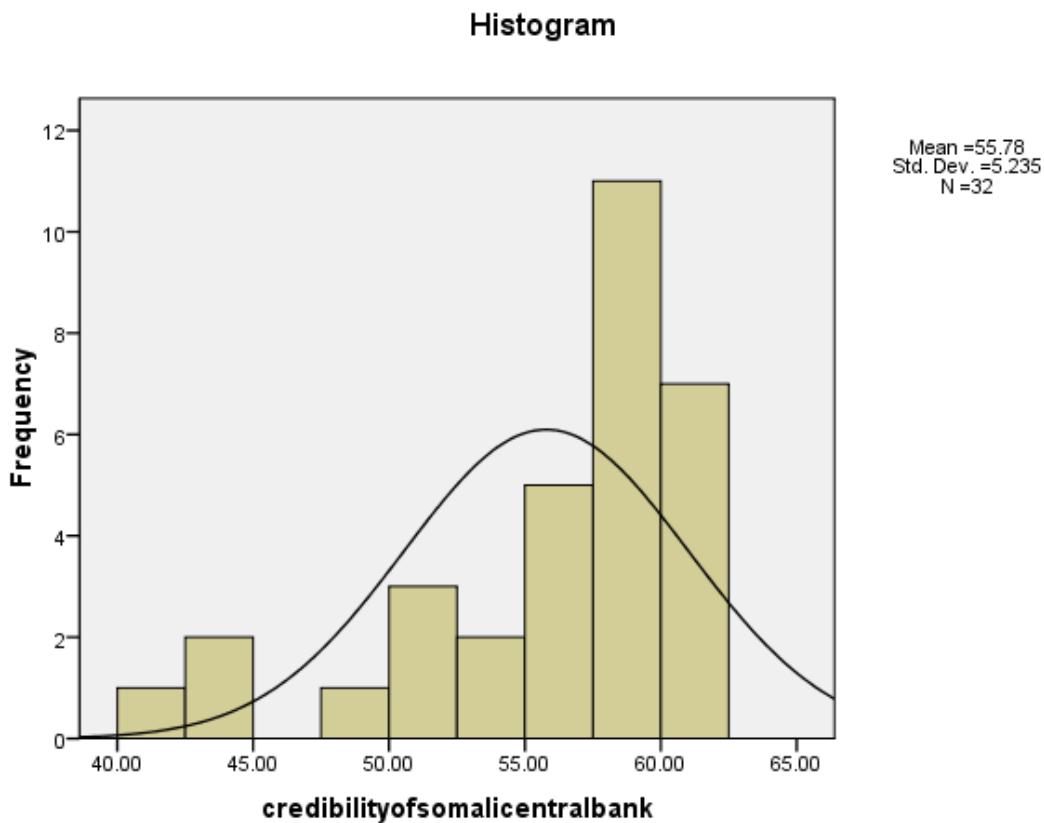


Source: Primary data

**Figure 4.1.5 Credibility of Somali Central Bank**

The credibility of Somali Central Bank has merely shown the greatest or overall abnormality of data distribution about (30) thirty questions answering whether central bank of Somalia is credible in which the first five questions have described central bank independence while the next (15) fifteen questions have described of central bank transparency and the next five questions are about central bank accountability. The last five questions are about central bank credibility. It is not surprise whether this graph has shown only nine histogram bars instead of (30) thirty. Let the researcher show you how this is happened. The highest original high mean average 1.97 has appeared only one time in credibility questions while the second highest average 1.94 has appeared four times: one in independence, two in transparency, and only one time in credibility. The third highest mean average 1.91 has shown seven times; five in transparency and two in credibility while the fourth highest mean average 1.88 has appeared in only and only one time in accountability questions. The fifth highest mean average is 1.87 and it has appeared only one time in central bank accountability questions while 1.84 which is the sixth highest mean average

has shown itself four times, only one time in central bank independence questions and three times in transparency. 1.81, which is the third lowest mean average has happened five chances: four times in independence and transparency in equal chances, and only one time in credibility while second lowest mean average 1.78 has also had five chances to happen; four times in transparency and accountability questions by equal chances and only one chance in independence questions. The lowest mean average 1.75 has only had one chance to happen in central bank transparency questions. So everyone can see now that these nine histogram bars have accounted for nine mean averages: (1.97, 1.94, 1.91, 1.88, 1.87, 1.84, 1.81, 1.78 and 1.75). It appears almost (21) twenty-one questions have already gone to the right of the central tendency line in which (12) twelve of them have fallen below level twelve frequencies and nine of the twenty-one questions happened below level eight frequencies while the rest nine questions are below level five frequencies, so this abnormal data distribution is positively skewed to the right. The overall mean computation of (30) thirty questions is 55.78 and the Std. Dev. is 5.235



Source: Primary data

## **Discussion**

The countries their central banks dominated the literature review of this research were among developed and emerging economies. The monetary policy of their central banks always supported independence, transparency and accountability and it is the independent monetary policy that necessarily established a clear tight border between central bank authority and government officials to safeguard the independence of the monetary policy because those governments themselves already implemented the CBI to represent the institutional capacity of their central banks. In Somalia, the government authority has never allowed an independent monetary policy and the idea of CBI has never been advocated in the public institutions for the interest of the public. This is the mainstream which is behind the reason why this larger discrepancy between literature review in this research and the result of the Somali central bank appeared.

## **Conclusion**

The primary responsibility of an independent CB is to make sure and keep the price stability. To do this, the desirability of CBI became a popular feature in monetary making institutions like CBs to obtain their objectives. Only CBs that have long price stability path can make the output target equal to potential or the employment target equal to its natural level with the help of authority delegation to the instrumental independence of the CB that could bring an ideal institutional arrangement. During disinflation, CBs think over two matters in order to safeguard their credibility: upward sensitivity and inflation deviation to downward from its targets. Similarly CBI rationalization is based within the context of an inflation bias.

## **Recommendations**

The findings of this study is indicating and suggesting the areas, where the ailing Somali central bank can look for its institutional recovery arrangements. The central bank of Somalia needs full independence which will make the bank to be transparent and accountable.

- The final authority of the CB of Somalia must be stipulated by the board members
- The board members' number, the board members' tenure, and central bank governor's tenure must be clearly stated in a central bank's statutory enacted by the parliament
- The authority of the central bank of Somalia that stipulates the check and balances of the board members must be independent
- The CB of Somalia must enjoy an economical independence which the bank determines the budgetary deficit monetary financing, monetary policy instruments, and the final authority which determines the profit distribution
- The governor's and board members appointments must be happened by the vote of the parliament
- As political transparency, the CB of Somalia must describe the formal objectives of the monetary policy with an explicit prioritization in case of multiple objectives. The CB of

Somali has to quantify the primary objectives. the SCB must have an explicit institutional arrangements or contracts between the monetary authorities and the government

- As economical transparency, the SCB must prepare a basic economic data relevant for the conduct of monetary policy which is publicly available. The bank must use policy analyses to disclose the formal macroeconomic models. The SCB must regularly publish its own macroeconomic forecast
- As procedural transparency, the SCB must provide an explicit policy rule or strategy that describes its monetary policy framework. The bank must give a comprehensive account of policy deliberations within a reasonable amount of time. The SCB must disclose its decisions on the level of its main instrument
- As policy transparency, the central bank decisions must be about adjustment to the main operating instrument or the announcements of prompt targets. The bank must provide an explanation when it announces policy decisions. The central bank of Somalia must disclose explicit policy inclinations after every policy meeting or an explicit indication of likely future policy actions
- As operational transparency, central bank of Somalia must evaluate how its main policy operating targets have been achieved. The bank must regularly provide information on macroeconomic disturbances that affect the policy transmission process. The SCB must regularly provide an evaluation of the policy outcome in light of its macroeconomic objectives
- The central bank of Somalia must be subject to external monitoring by the parliament
- The government should have no rights to give instructions to the central bank of Somalia
- The government should participate at meeting of the decision making bodies as observers
- The central bank of Somalia must have rights to prepare publications of the votes of the members of the decision making bodies
- The central bank of Somalia should have rights to prepare publications of statement of accountability and ultimate responsibility for monetary policy
- The central bank of Somalia should publish an inflation or monetary policy report of some kind, in addition to standard central bank bulletins/reports
- The central bank of Somalia must explain publicly to what extent it has been able to reach its objectives
- The central bank of Somalia must clearly define the objectives of price stability
- The central bank of Somalia must always and immediately announce the interest rate decisions
- The central bank of Somalia must publish the risks to the forecast and it must be better able to forecast inflation

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