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## **A Brief History of the Central Bank of Seychelles**

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### **1.0 Introduction**

The Central Bank of Seychelles was inaugurated a little over 25 years ago but has its roots going as far back as seventy years, with the establishment of the Seychelles Currency Board in the mid-1930s. Since its inception the organisation has evolved greatly, undergoing extensive changes in not only the way it operates but also in its policy objectives.

This short paper traces the evolution of the Central Bank from the days of the currency board, when the Seychelles was a British colony, to the present time, where the Central Bank has operational and institutional independence.

### **2.0 The Seychelles Currency Board**

As with other British colonies of the time, the financial system of the Seychelles during the 20<sup>th</sup> century was overseen by a currency board. The Seychelles Notes Ordinance and the Coinage Ordinance of 1936 bestowed the responsibility for the issue and redemption of Seychelles currency on the Colonial Secretary and later, with the

Financial Secretary, acting as Currency Commissioner.

This set-up was later updated in 1974 with the enactment of the Seychelles Currency Ordinance, under which, the issue, re-issue and redemption of currency became the responsibility of a Board comprised of the Financial Secretary and the Accountant General. One important change relative to the previous set-up was that the colonial government granted the Board the authority to hold and manage all the domestic and foreign assets of the country. The Board however did not have the power to undertake monetary policy; the issuance of domestic currency was constrained by the requirement that each issue be backed by foreign currency. A fiduciary issue of not more than 30 per cent of total issued currency was however possible, with the caveat being that the issue had to be backed either by government securities or guarantee. As with other colonies, the domestic currency, the Seychelles Rupee, was pegged at a fixed rate of R13.33 to the Pound Sterling.

As noted earlier, the Seychelles Currency Board had no policy responsibility and operated along strict procedures laid out by the government and as such had limited scope in influencing the domestic economy. The Financial Secretary would undertake an interest rate policy which would shadow that of the UK. The Board did not act as banker to the government or commercial banks. It did not provide the “lender of last resort” guarantee nor did it supervise the banking sector or impose any prudential requirements on the latter.

### **3.0 The Seychelles Monetary Authority**

The accelerated growth of tourism in the seventies brought about a rapid expansion in the domestic banking sector, which in turn exposed the weaknesses of the Currency Board. With the Board having no mandate to undertake monetary policy, adherence to a fixed exchange rate regime, implied that the domestic money supply would fluctuate according to the flows of external capital. This situation was understandably not conducive to stable and sustainable economic development. There was therefore a pressing need to establish an institution capable of managing the monetary aggregates with the ultimate end of influencing and stabilising economic activity. This was affirmed by an International Monetary Fund (IMF) mission team which, in 1976 was invited by the

Seychelles government to study the financial system and recommend any improvements.

On the recommendations of the IMF the decision was taken to create a central banking institution. However, given the rudimentary structure of the financial system and the lack of local expertise, it was decided that, as an interim step, a monetary authority be set up, with the establishment of a fully fledged Central Bank planned for a later date.

On December 1, 1978, the Seychelles Monetary Authority was established under the Seychelles Monetary Decree, 1978. All the responsibilities, as well as the assets and liabilities of the Currency Board were transferred to the Authority. The objectives of the Authority as specified in the Decree were:

- 1. to regulate the issue, supply and availability of money and its international exchange;*
- 2. to advise government on banking and monetary matters;*
- 3. to promote internal and external monetary stability and a sound financial structure;*
- 4. to fosters financial conditions conducive to the orderly and balanced economic development of Seychelles.*

Under the Decree, the Authority was empowered with the necessary tools so as to enable it to achieve the above objectives. These included (but were not limited to) the issue of currency, the management of external reserves, the provision of banking services to government and commercial banks, the provision of short-term advances to government and commercial banks, the inspection of banks and other financial institutions, the imposition and regulation of cash reserve requirements. The most significant difference with its predecessor was that the Authority was given the responsibility for monetary policy, thus enabling it to set monetary instruments such as interest rates and credit controls to achieve certain desired objectives. However, the 1978 Decree provided for a Board of Directors comprising of three members; one of whom was the Permanent Secretary of Finance; another being the Accountant-General; and the third being any person as may be appointed by the President. This provision ensured that the Authority worked in close association with the Department of Finance rather than operating independently.

Upon establishment, the Seychelles Monetary Authority quickly embarked on an ambitious work programme; setting up the necessary accounting systems and procedures; opening accounts for the government, certain statutory bodies and

banks; and creating banking relationships with banks abroad. The responsibility for the collection and compilation of monetary and banking statistics was transferred from the Government Statistics Office to the Research Department of the Authority. The Authority also began to compile Balance of Payments statistics. It also took over the handling of the IMF accounts and Reserve Tranche position from the Treasury.

In February 1979, the administration of the Banking Ordinance 1975 and the Banking (Special Provisions) Act 1976 was transferred from the Registrar General to the Monetary Authority. Barely three months later, the Authority had to deal with the liquidation of the Seychelles Commercial Bank, a locally incorporated bank. It acted quickly, protecting depositors and ensuring that the liquidation process was performed in strict accordance with the laws and regulations in force. Thus, less than six months after its inception, the establishment of a central monetary institution proved to be a wise undertaking.

#### **4.0 The Central Bank of Seychelles**

As mentioned previously, the Seychelles Monetary Authority was intended to only be a pro tempore institution, gathering experience and know-how of the domestic financial system, before being transformed into a fully-fledged Central Bank. Thus, with some minor adjustments, the SMA

Decree 1978 was turned into the Central Bank of Seychelles Act 1982, which was approved by the People's Assembly on December 29, 1982. On January 1, 1983, the Central Bank of Seychelles was officially inaugurated, with the simultaneous dissolution of its precursor, the Seychelles Monetary Authority.

As with its predecessor, the newly-formed Central Bank functioned in two buildings. The main office occupied a section of the second floor of Liberty House and currency verification and destruction was carried out in one room on the first floor of the same building. Banking transactions were conducted over the ground floor counters, which were shared with Treasury, while the currency stocks were held in one strong room on the ground floor and in two other rooms in the basement of Liberty House. As for the Research and Statistics Department, it occupied the top floor of the three-storey Pirates Arms building. This set-up was not appropriate for the efficient operation of an institution of high importance such as the Central Bank. Furthermore, the pressing need for a more secure and spacious currency vault led to the erection of the Central Bank building, which was inaugurated in June 1984.

During the twenty odd years of its existence, with growing experience and an increased number of qualified manpower, the Bank

has greatly evolved whilst maintaining its critical role in the economy.

In the early years of its existence, the Bank successfully managed to wield the necessary influence in order to curtail the damages to the country's productive base as the domestic economy expanded. As economic growth gathered momentum in the second half of the 1980s, the chief macroeconomic objective of the Bank was to secure a measure of external balance and uphold the liberal payment system. Monetary policy was given the leading role in supporting the external accounts and preserving confidence in the Rupee. Despite the government's commitment towards maintaining fiscal discipline, the attainment of a balanced fiscal position was not easily or consistently achieved. Given this fact, government often made use of the overdraft facility from the Bank to finance its budget deficits. The increasing indebtedness of the government to the Central Bank continued through into the 1990s, leading to major economic distortions, most visible in the monetary and external sectors in the form of chronic shortages in foreign exchange. The credibility of the Central Bank started to be eroded as the institution was seen merely as an extension of the Ministry of Finance, with monetary policy having been relegated towards accommodating the fiscal stance of government.

In 2002, conscious of the need to restore confidence in the institution, the Bank, in consultation with the IMF, commenced work on updating the Central Bank Act and in December 2004, the National Assembly enacted the Central Bank of Seychelles Act 2004 thereby repealing the previous legislation. Under the previous legislation, the Governor of the Bank also held the position of Principal Secretary in the Ministry of Finance. This may have led to a certain degree of ambiguity in economic policy decision-making as the Bank and government have different agendas. Under the new Act, the Governor of the Bank is no longer allowed to hold the post of Principal Secretary of Finance. Furthermore, a new board of directors of the Bank was appointed, constituting of directors from both the private and public sector. The new Act also explicitly sets out the objectives of the Bank, which are:

1. *to regulate the issue, supply and availability of money and its international exchange;*
2. *to promote price stability and the maintenance of both domestic and external value of the Seychelles currency;*
3. *to advise the Government on banking, monetary and financial matters, and in particular on the monetary implications of proposed fiscal or credit policies or operations of the Government;*

4. *to promote internal and external monetary stability;*
5. *to promote a sound financial structure;*
6. *to foster financial conditions conducive to the orderly and balanced economic development of Seychelles; and*
7. *to perform such other functions as may be assigned to the Bank by any law.*

The Central Bank of Seychelles Act 2004, formally provides the Bank with institutional and operational autonomy, which will undoubtedly serve to enhance the credibility of the Central Bank both domestically and internationally, placing the Bank in a better position to tackle some of the major economic imbalances plaguing the Seychelles economy and last but certainly not least, strengthen its role as financial watchdog of the economy. However, experience in other jurisdictions has amply demonstrated that bestowing legal autonomy on the Central Bank does not automatically enhance the institution's credibility in the community. Like every noble value, credibility has to be painstakingly earned and in the context of central banking, this is achieved through the quality, consistency and objectivity of the Central Bank's work, notably in the realm of economic policy, research undertakings, banking services and financial supervision.