**The Politics of Finance: How Capital Sways African Central Banks**

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(forthcoming in Journal of Development Studies)

While there is a large literature on the politics of central banking its insights are difficult to translate to Sub-Saharan Africa. This article addresses gaps in this literature by considering how the interests of those who control financial resources sway African central banks. Case studies of Kenya, Nigeria and Uganda demonstrate that variation in the sources of capital on which countries rely to finance investment helps to account for the pattern of variation in central bank policy stances. The analysis further develops and probes arguments about power derived from the control of capital in the context of developing countries.

# Introduction

In Sub-Saharan Africa, where governments face high pressure to increase growth and reduce poverty, central banks can play a crucial role in promoting economic development.[[1]](#endnote-1) They have the tools to promote both stability, in prices and in the financial system, and financial expansion, which refers to an increase in the volume of financial transactions in an economy and is often termed ‘financial deepening’ in the literature on finance and growth.[[2]](#endnote-2) Where central banks enjoy monetary autonomy, they can respond to short-term economic challenges by orienting policy towards stability or expansion, depending on which of the two objectives is perceived to be the bigger concern. In normal times, central banks may simultaneously promote stability and financial expansion, both of which are important for economic growth. Indeed, the literature on finance and growth suggests that it is beneficial for economic development when central banks strike a balance between both objectives in the long-run and avoid emphasising one over the other ([Epstein, 2006a](#_ENREF_23), [Barajas, Beck, Dabla-Norris, & Yousefi, 2013](#_ENREF_5), [Sahay et al., 2015](#_ENREF_72)).

A look at long-run central bank policy patterns in Africa suggests, however, that national continuities exist where some central banks consistently emphasise stability, in terms of both prices and the financial system; some emphasise financial expansion; and some place equal emphasis on both goals. What explains this long-run pattern of variation in policy stances and why do some central banks consistently emphasise one goal over the other despite the benefits of a balanced stance? Answering this question lies at the heart of understanding diverse development paths.

The predominant explanation in the literature on central banking is that the pattern of variation in central bank policy results from variation in central bank independence. Where governments grant central banks autonomy, the argument goes, the central bank is more insulated from political pressures for expansionary policies and thus better able to promote stability. It is however important to look beyond formal central bank independence as an explanation because it raises the question of why governments grant their central banks independence in the first place and because there is little variation in formal central bank independence across African countries.

This article provides an explanation for the pattern of variation in central bank policy in Africa that focuses on capital. Specifically, it is argued that states face strong incentives to implement policies which are in the interest of those who are major providers of investible resources. Insofar as different providers of financing have distinct policy preferences, cross-national differences in the types of capital upon which countries rely generate differences in long-run central bank policy stances. Where countries are more dependent on aid, central bank policy is more likely to reflect the preferences of donors for stability. Where countries are more dependent on natural resources, central bank policy is more likely to reflect government preferences for financial expansion.[[3]](#endnote-3) Whether the central bank policy stance in countries reliant on private business is oriented towards stability, financial expansion, or both, is likely to depend on the particular policy preferences of major business groups.

These arguments fit with an important stream of studies which finds that the preferences of foreign investors shape economic policy in countries that depend on foreign capital inflows.[[4]](#endnote-4) However, it is difficult to fully extend these insights, which are mainly based on studies of richer countries, to Africa, where economic structures differ and reliance on private foreign capital is limited.

This article departs from earlier literature by extending explanations for economic policy focused on capital to the African context. In doing so, this article contributes to the literature on the structural power of capital, which explores how those who control investment resources influence policy. However, research on structural power has largely focused on countries where private business dominates the economy. This article seeks to move the debate on the power of capital forward by probing the plausibility of hypotheses linking policy outcomes and the control of capital in contexts of dependence for investible resources on aid and natural resource rents. The variation across African countries regarding the sources of finance on which they rely for investment and in the contribution of business to investment creates the kind of variation needed to further develop and probe claims about the power of capital.

Case studies of Kenya, Nigeria and Uganda support the argument that variation in the sources of finance on which countries rely helps to account for the pattern of variation in central bank policy stances. In Uganda, which relies on foreign aid, the stance of central bank policy is oriented towards stability. In Nigeria, which relies on oil revenues that are largely controlled by the government, central bank policy is oriented towards financial expansion. In Kenya, where domestic business is a key source of finance and has a preference for a central bank policy stance that emphasises both stability and financial expansion, central bank policy places emphasis on both goals. Thus, while it is widely believed that African governments have been mostly powerless to shape liberal economic reform, which prioritises stability, this study underscores that economic structures mediated pressures for liberalisation and influenced policy autonomy.

The next section delineates the relationship between the sources of finance countries rely upon and the stance of central bank policy. The following sections present evidence from Uganda, Nigeria and Kenya to convey how reliance on a particular type of capital sways central banks. An avenue for further research is suggested in the conclusion.

# Money and Power

While a great deal of scholarship has focused on formal central bank independence to explain variation in central bank policy patterns ([Grilli, Masciandaro, Tabellini, Malinvaud, & Pagano, 1991](#_ENREF_35), [Cukierman, Web, & Neyapti, 1992](#_ENREF_19), [Bodea & Hicks, 2014](#_ENREF_9)), there are important reasons to explore additional explanations in the African context. One reason is that the evidence that formal central bank independence has a positive effect on the interests and capacities of central banks to fight inflation and constrain financial expansion in developing countries is at best mixed ([Cukierman et al., 1992](#_ENREF_19)). In addition, across Africa, levels of formal central bank independence have been relatively low and stable ([Garriga, 2016](#_ENREF_29)) and have thus difficulties to account for cross-national variation in policy. While an explanation focused on de facto independence may be more relevant in the context of developing countries it begs, just like formal independence, the question of why governments grant central banks independence in the first place.

The other three main types of explanations for central bank policy in the academic literature have also difficulties to account for policy patterns in Africa. One important explanation is that in countries that are more reliant on foreign investors, economic policy is more likely to reflect the preferences of those investors for policies to support price stability ([Maxfield, 1990](#_ENREF_60), [Maxfield, 1997](#_ENREF_62), [Mosley, 2005](#_ENREF_65)) and financial stability ([Gottschalk & Griffith-Jones, 2006](#_ENREF_30), [Jones & Zeitz, 2017](#_ENREF_52)). However, until recently many African countries received little foreign private investment because their investment climate was perceived to be weak.

The second explanation considers government partisanship. The argument is that when right parties are in power, central bank policy reflects their preference for stability; when left parties are in power, policy reflects their preference for economic expansion ([Hibbs, 1977](#_ENREF_41), [Alesina & Sachs, 1988](#_ENREF_2)). The insights from this literature are also difficult to translate to the African context, where both voting and parties are less often based on economic ideology than in developed countries.

According to the third type of explanations central bank policy is the outcome of struggles among different sectoral groups with different policy preferences. Policy is conceived as an exchange where politicians provide favourable policies to those sectoral groups with the greatest political influence ([Haggard & Maxfield, 1993, pp. 298-305](#_ENREF_38)). This article builds on this literature by following its approach to identify the preferences of policy relevant actors and assess their political strength. However, the explanation advanced here is focused on the control of capital because it allows illuminating why some actors gain more political influence than others and allows explaining policy patterns in contexts where the private sector has little influence because it is weakly developed as is the case in many African countries.

## The Structural Power of Capital

The argument that cross-national differences in the types of financing upon which countries rely account for long-run patterns of variation in central bank policy builds on propositions from the theory of the structural power of capital. The proponents of this theory take as a starting point that states have an ‘investment imperative’ ([Lindblom, 1977](#_ENREF_59), [Block, 1987](#_ENREF_8)). States need to maintain a reasonable level of investment in order to achieve the level of economic activity needed to finance the state apparatus and to maintain the popular support required for staying in power. As a result, states face imperatives to induce those who control capital to provide it for investment by creating a policy environment that reflects their preferences.[[5]](#endnote-5) Where governments fail to be responsive to those who control financial resources the ‘ultimate political sanction is non-investment or the threat of it’ ([Offe, 1984, p. 244](#_ENREF_67)). Thus, the central claim of theorists of structural power is that the mere *anticipation* of a downturn in investment following policies which are not in the interests of those controlling capital may be sufficient to elicit responsive policies.

Early research focused on the structural power of domestic private investors. Yet there is a much wider range of providers of financing which may exercise power rooted in the control of capital, such as aid donors and international banks ([Winters, 1994](#_ENREF_79)). While these actors may not always exercise power in a structural manner – that is, without the need to resort to open coercion or active leverage – their influence may nonetheless be daunting. The International Monetary Fund (IMF) and the World Bank, for instance, use conditionality to influence policy in heavily indebted developing countries and rescheduling debt and accessing new loans is difficult for these countries without IMF and World Bank approval.

Given that in many countries there are several providers of financing for investment, what determines the power of the providers of a particular category of finance? A framework developed by Jeffrey Winters ([1994](#_ENREF_79)) suggests that the power derived from the control over a particular category of financing tends to be higher when the category contributes a large fraction of investment finance or gross domestic product (GDP) and when capital is mobile because then its providers are able to relocate quickly when they deem the policy environment unfavourable. Accordingly, scholars began to examine how reliance on various types of external private finance shapes economic liberalisation. This research finds that variation in the sources of foreign private finance on which developing countries rely to finance investment helps to account for variation in economic policy ([Maxfield, 1997](#_ENREF_62), [Shambaugh, 2004](#_ENREF_73)).

## Extending Capital-Specific Explanations to the African Context

The insights from extant research on structural power cannot easily be extended to explain central bank policy in Africa because African countries rarely rely on global markets. As a result, capital-specific arguments have, despite their potential, remained underexplored and underdeveloped in the African context. Drawing inspiration from the argument that variations in countries’ sources of investment finance explain variations in economic policy, this article extends capital-specific arguments to the area of central banking and to the African context where aid, resource revenues, and domestic business tend to be dominant sources of financing. Specifically, the article contributes to theory-building by probing the plausibility of two propositions that can be derived through the combination of insights from three distinct sets of literature, namely literature on structural power, the political economy of aid and the political economy of resource dependence.

The first proposition is that in African countries which are more dependent on aid, the central bank policy stance is more likely to be stability-oriented. With respect to the providers of aid, the focus of this article is on Western governments and the multilateral institutions they dominate, notably the World Bank and the IMF, because they tend to have, compared to non-traditional donors such as China, a significant interest in influencing economic policy in the countries they assist. A stability-oriented central bank policy stance seeks to promote price stability, that is a low and stable level of inflation, and financial stability. To promote stability, central banks may use monetary and financial policy. Monetary policy controls the supply of money in an economy. Financial policy notably includes financial sector regulation and supervision and development financing. The latter refers to the subsidisation of credit by the central bank, for instance through credit guarantees.

What central bank policies does a stance oriented towards stability entail? The economic literature highlights three main types of policies, each of which tends to reduce the volume of financial transactions in an economy. First, the tightening of monetary policy, which refers to a reduction of the money supply, and the setting of low, clearly defined inflation targets. In order to reduce the money supply, central banks in developing countries tend to increase interest rates or to tighten regulation that affects the money supply, raising for example reserve requirements. Second, employing more stringent prudential regulation, whereby ‘prudential’ is defined as geared towards reducing the likelihood or costs of financial crisis. Prudential regulation may enhance financial stability by reducing the incentives to engage in financial transactions and activities or restricting them ([Brownbridge & Kirkpatrick, 2000](#_ENREF_12), [Turner, 2010](#_ENREF_78)). Third, reducing the emphasis placed on financial policies to reduce the costs of lending because credit growth raises risks for price and financial stability ([International Monetary Fund, 2013a, pp. 21-27](#_ENREF_50), [Sahay et al., 2015](#_ENREF_72)). Examples for policies to support credit growth are the design of development financing schemes, of regulations that support the provision of credit at below-market interest rates and of institutions that reduce the costs of credit provision.[[6]](#endnote-6) In sum, the tightening of monetary policy, the employment of more stringent prudential regulation and lower emphasis on policies that reduce the costs of lending are indications that a central bank orients its stance towards stability.

Building on structuralist theory this article contends that as aid dependence and thus the share of investible resources provided by donors increases, donors’ power to influence policy is likely to increase. The underlying assumption here is that insofar as governments want support from donors they will have to be responsive to donors’ concerns.

If central bank policy is responsive to the interests of donors, which policy stance can be expected? Although donors are a diverse group of actors and different donors have interests in different economic policies, several policies, notably policies to enhance price and financial stability, are of concern to most Western donors. In particular, two sets of literature on the IMF and the World Bank, the key donors in the area of central banking, suggest that these institutions have long considered price and financial stability as the primary goals of central banks.[[7]](#endnote-7) The first set of literature consists of publications by the World Bank and the IMF to explain the objectives of their interventions.[[8]](#endnote-8) The second set of literature consists of work in economics and political science on the objectives of the World Bank and the IMF in economic reform in developing countries.[[9]](#endnote-9) The preference of the IMF and the World Bank for an orientation of central bank policy towards stability stems to some extent from the recruitment of staff trained in economics departments teaching neoliberal approaches ([Chwieroth, 2007](#_ENREF_16)) and from the interests of powerful member states as their major shareholders ([Woods, 2006](#_ENREF_81)). Powerful states in turn have an interest in stable macroeconomic environments in developing countries, both to ensure the repayment of sovereign debt and to protect international investments in recipient countries.

The second proposition examined in this article is that in African countries which are more dependent on point-source non-renewable natural resources, the central bank policy stance is more likely to be oriented towards financial expansion. A central bank policy stance oriented towards financial expansion seeks to increase the volume of financial transactions in an economy. In the economic literature on finance, financial expansion is usually referred to as financial deepening and measured by indicators of credit growth ([King & Levine, 1993](#_ENREF_56)). The concept of financial expansion leaves open the purposes on which additional financing may be spent, reflecting the finding of the literature that financial deepening does not necessarily raise productive investment ([Tobin, 1984](#_ENREF_76), [Arcand, Berkes, & Panizza, 2012](#_ENREF_3)). In fact, there exist many examples of central banks permitting an increase in financial transactions that fuelled speculation or served to dispense patronage.

The literature on finance suggests that there are three main indications that a central bank orients its policy towards financial expansion. First, a reduction of interest rates or the loosening of regulation that affects the money supply because loosening monetary policy may raise the volume of financial transactions ([Mishra, Montiel, & Spilimbergo, 2012](#_ENREF_63)). Second, the loosening of prudential regulation and supervision because prudential frameworks aim to reduce financial transactions and activities ([Turner, 2010](#_ENREF_78), [Barajas et al., 2013](#_ENREF_5)). Third, an increase in the emphasis placed on financial policies that reduce the costs of lending such as credit guarantees because these policies contribute to credit growth ([Beck, Maimbo, Faye, & Triki, 2011, pp. 77-140](#_ENREF_6), [International Monetary Fund, 2013a, pp. 6-9](#_ENREF_50)).

In resource dependent countries, governments gain control of a large portion of resource revenues through various ways such as revenues from a state-owned extractive sector or, if the extractive sector is in part or entirely private-owned, through royalties, taxation or concession fees. Thus, as the access to and control of resource revenues by the state increases, the government’s control over investible resources and hence its policy space widens.

Work on the politics of resource dependence suggests that governments in resource dependent developing countries use the policy space to employ policies oriented towards economic expansion, often at the expense of stability ([Auty, 1994](#_ENREF_4), [Karl, 1997](#_ENREF_53)). Extending these insights to the realm of central banking suggests that the central bank policy stance in countries which are more reliant on natural resources is likely to be oriented towards financial expansion. There are two major strands of explanations for the tendency of economic policy in resource dependent developing countries to be expansionary: The first suggests that access to resource revenues allows for an increase in public spending, which is a sensible strategy to dispense patronage to political rivals and constituencies to consolidate power ([Ross, 2001](#_ENREF_71), [Morrison, 2009](#_ENREF_64)). The second strand of explanations suggests that the weakness of the private sector – a corollary of resource dependence – provides incentives to support private sector development by pursuing policies oriented towards growth rather than stability ([Karl, 1997](#_ENREF_53)).

The literature on resource dependence suggests that resource wealth does not affect all countries equally ([Ross, 2012](#_ENREF_70), [Papyrakis, 2017](#_ENREF_68)). For at least two reasons it is likely that incentives for expansionary policy are stronger in resource-exporting developing countries than in resource-exporting developed countries like Norway. First, poor resource-exporting countries have stronger incentives to invest oil revenues in the domestic economy, including in the domestic private sector, than capital-rich countries because the marginal rate of return is higher in capital-scarce countries. Second, compared to developed countries, developing countries tend to have weaker checks and balances so that citizens and politicians have fewer or less effective channels to demand stability-oriented policies if their concern for a reasonable level of economic stability is violated.

No prediction is made for the stance of central bank policy in countries which have only modest access to aid and resources rents and are reliant on private business for investment. Whether central bank policy in countries reliant on private business is oriented towards stability, financial expansion, or both, is likely to depend on the particular policy preferences of those businesses that are important providers of investment funds. These policy preferences in turn are likely to depend on the characteristics of the business group in question.

Notably, the financial situation of businesses matters ([Maxfield, 1994](#_ENREF_61)). The better the financial situation of businesses, the more they are concerned about stability in the financial system, since they have access to finance, and about the stability of prices, since inflation erodes their savings. Yet when businesses perceive access to cheaper financing as a major concern, they are likely to favour financial expansion. Thus, while all groups of businesses are likely to favour a modicum of stability and affordable financing, domestic and small and medium-sized enterprises (SMEs) in African countries, which often lack access to affordable financing, are more likely to prefer a policy stance oriented towards financial expansion than foreign-owned businesses, which often enjoy access to cheaper financing from abroad, and large enterprises. On a more general level, the argument is, however, that in African countries which are more dependent on the private sector, the central bank policy stance is more likely to reflect the preferences of business.

Before leaving the discussion of the policy patterns, the trade-offs between a policy stance oriented towards stability and a policy stance oriented towards financial expansion should be spelled out. Trade-offs are particularly likely to emerge when central banks attach different weights to different objectives. For instance, where a central bank places more emphasis on financial expansion than on price and financial stability, stability is likely to suffer. Allowing a major and rapid expansion of credit to support financial expansion may raise inflation by creating excessive demand and pose risks for financial stability by increasing exposures to risk, other things being equal ([Kindleberger & Aliber, 2005](#_ENREF_55), [Sahay et al., 2015](#_ENREF_72)). Similarly, where a central bank places more emphasis on price and financial stability than on financial expansion, negative effects on the latter are likely. Everything else being equal, credit grows more costly as monetary policy is tightened ([Mishra et al., 2012](#_ENREF_63)) and as more stringent prudential regulation is employed ([Turner, 2010](#_ENREF_78)). More costly credit, in turn, limits financial expansion.

That said central banks may place similar emphasis on both goals and the literature on finance suggests that synergies between price and financial stability on the one hand and financial expansion on the other exist up to a point. A reasonable degree of price and financial stability is an important – though insufficient – precondition for financial expansion ([Beck et al., 2011, p. 61](#_ENREF_6), [Barajas et al., 2013, p. 9](#_ENREF_5)). A moderate level of financial expansion in turn may benefit price stability by improving the functioning of the monetary transmission mechanism ([Mishra et al., 2012](#_ENREF_63)). Moderate depth of the financial system may also benefit financial stability by providing alternative sources of funding during times of financial fragility ([Sahay et al., 2015](#_ENREF_72)). A helpful image is thus that of a continuum with a policy stance oriented towards stability on one pole, a policy stance oriented towards financial expansion on the other, and a policy stance that places moderate emphasis on both goals in the middle. As one moves along the continuum from stability towards financial expansion, stability declines, and vice versa.

# Empirical Illustrations

Kenya, Nigeria and Uganda offer fertile ground for probing capital-specific explanations for economic policy because these countries do not have regional central banks and are therefore able to determine central bank policies at the national level. Moreover, the sources of finance on which these countries rely vary. As Table 1 shows, the relative importance of official development assistance (ODA) allows for Uganda to be characterised as aid dependent while the relative importance of resource revenues allows for Nigeria to be characterised as resource dependent.[[10]](#endnote-10) Moderate access to aid and resource revenues and the relative importance of tax revenues, which in Africa are mainly raised from enterprises, allow for Kenya to be characterised as dependent on the private sector.

Table 1. Sources of capital, averages 2000-2010

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Kenya | | Nigeria | Uganda |
| Net ODA received (% of central government expense) | | 21.6 | 12.7 | 77.6 |
| Net ODA received (% of GNI) | | 4.3 | 1.9 | 14.3 |
| Natural resource exports (% of merchandise exports) | | 12 | 94.9 | 5.1 |
| Natural resource rents (% of GDP) | | 0.03 | 34.5 | 1.4 |
| Tax revenue (% of GDP), average 2006-2010 | 17.8 | | 4.1 | 11.6 |

Source: World Bank (2013)

Unfortunately, the stance of central bank policy cannot be captured by a readily available quantitative indicator. However, there is some agreement on quantifiable measures of the orientation of central bank policy towards price stability, financial stability and financial expansion. For instance, the existence of low, clearly defined inflation targets or an inflation-targeting (IT) framework, which prioritises price stability over other central bank policy goals, are important indications that central bank policy is oriented towards price stability. A key indicator of the orientation of central bank policy towards financial stability in the African context is a high level of minimum capital requirements ([Fuchs, Losse-Mueller, & Witte, 2012](#_ENREF_28)). Finally, an important indicator that central bank policy is oriented towards financial expansion is that central banks have a team working on the promotion of savings, SME finance or rural finance because it captures whether the central bank has devoted resources to promoting an increase in financial transactions ([Consultative Group to Assist the Poor, 2012](#_ENREF_18)).

A quick comparison of central bank policy in Kenya, Nigeria and Uganda in the 2000s on the basis of these indicators is suggestive that variation in the sources of finance on which countries rely for investment helps to account for the pattern of variation in central bank policy stances. Specifically, the data is consistent with the proposition that greater reliance on aid is associated with a stability-oriented policy stance. As Table 1 shows, in the 2000s reliance on ODA was higher in Uganda than in Nigeria and Kenya. Meanwhile, central bank policy in Uganda in the 2000s is more oriented towards stability than in Kenya and Nigeria.

For instance, among the three country cases, Uganda is the only one which introduced an IT framework. In addition, regulation, measured by the level of minimum capital requirements, is more stringent in Uganda than in Kenya and Nigeria, as Table 2 shows. Moreover, Uganda’s central bank, the Bank of Uganda (BoU), places less emphasis on financial expansion than the central banks of Nigeria (CBN) and Kenya (CBK), as the lack of a designated team to promote financial access reforms suggests.

Table 2. Central bank policy stances in Kenya, Nigeria and Uganda, 2000-2009

|  |  |  |  |
| --- | --- | --- | --- |
| **Indicator** | **Kenya** | **Nigeria** | **Uganda** |
| Minimum capital requirements (%)a | 8 | 10 | 12 |
| Existence of a team focused on financial deepeningb | Yes | Yes | No |

Sources: a Data drawn from Barth et al. (2007) and Čihák et al. (2012). b Data drawn from CGAP (2012).

The data is also consistent with the proposition that the central bank policy stance in African countries which are more dependent on natural resources is more likely to be oriented towards financial expansion. As Table 1 shows, Nigeria was reliant on resource revenues in the 2000s, whereas such revenues were negligible in Kenya and Uganda. Meanwhile, central bank policy in Nigeria is more oriented towards financial expansion than in Kenya and Uganda in the 2000s.

For instance, the inflation objective of the CBN was merely to aim for ‘single-digit inflation’ in the late 2000s, while the BoU and the CBK had inflation targets of 5 per cent. While minimum capital requirements in Nigeria are higher than in Kenya, they are lower than in Uganda as Table 2 shows. These figures are consistent with a positive relationship between resource dependence and the orientation of policy towards financial expansion. Moreover, the existence of a team devoted to promoting financial access in the CBN and the CBK and the lack thereof in the BoU suggests that central bank policy in Nigeria is at least as much oriented towards expanding finance as in Kenya and more so than in Uganda. Besides, while Uganda’s and Kenya’s central banks refrained from financing the private sector in the 2000s, Nigeria’s central bank continues to do so through a development financing department.

The next sections offer case studies, which examine central bank policy stances in Kenya, Nigeria and Uganda in the era of economic liberalisation and illustrate the links between policy stances and the sources of finance on which the countries rely for investment. The analysis of central bank policy in Kenya also allows probing the argument that in African countries which are more dependent on the private sector, the policy stance is more likely to reflect the preferences of business. Each country study delineates two points: First, how capital mediated the response of central bank policy to the economic decline experienced by the mid-1980s and to the rise of economic liberalisation; and second, how the financial structures established by the late 1990s were reinforced in the 2000s and shaped central bank policy.

Each case study will not only highlight the structural position of the relevant providers of capital as indicated by their economic importance and measured by the amount of capital provided relative to the size of the economy; an important part of the exercise will also be to ascertain the perceptions of policymakers given the importance of anticipated reactions in arguments about structural power. According to the theory, structural power is partly a matter of policymakers’ perceptions because it is difficult to objectively identify how major providers of capital will react to a change in the policy environment ([Winters, 1996](#_ENREF_80), [Fairfield, 2015, pp. 415-418](#_ENREF_25)). The article will thus follow other studies of structural power which draw attention to policymakers’ perceptions and relate those perceptions back to the structural position of the major providers of capital.

## Uganda

Central bank policy in Uganda went through a major transformation: As in other African countries, central bankers promoted financial expansion until the 1980s. Yet over time, the stance of central bank policy became increasingly oriented towards stability, especially when compared to Nigeria and Kenya. This case study delineates that policymakers reformed central bank policy in an understanding that it is important to secure the support from donors to finance investment in Uganda.

### Desperate Adjustment

When President Yoweri Museveni seized power in 1986, following a civil war, pressures to orient economic policy, including central bank policy, towards stability rapidly increased. One source of pressure was Uganda’s economic collapse. Growth fell at an annual rate of 2 per cent between 1980 and 1987 ([Lateef, 1991](#_ENREF_57)); export revenues declined due to a fall in world coffee prices and the balance of payment deficit increased. Museveni’s government sought to meet expenditures by borrowing from the BoU, but this contributed to skyrocketing levels of inflation, reaching 160 per cent in 1986.

Another source of pressure was a change in the global ideological climate. While it had been part of the predominant economic thinking that governments in developing countries, including their central banks, may promote access to finance, neoliberal ideas increasingly replaced statist ideas from the mid-1980s onwards. Donors’ preferences changed accordingly and the IMF and the World Bank used Structural Adjustment Programs (SAPs) to promote economic liberalisation, which involved confining the role of the state to the promotion of stability. While Museveni disapproved of SAPs, claiming that they were ineffective and increasing indebtedness, his government adopted a SAP in 1987 in response to overwhelming pressures to raise funds from donors.

Initially Museveni’s government was able to maintain a policy stance that prioritised economic expansion despite inflation averaging 80 per cent between 1988 and 1991 because donors did not impose major sanctions on Uganda for failures to reform ([Dijkstra & Kees van Donge, 2001](#_ENREF_22), [Holmgren, Kasekende, Atingi-Ego, & Ddamulira, 2001](#_ENREF_42)). Yet in 1992 donors suspended aid dissatisfied with the limited progress in economic reform. The resulting fiscal crisis and made the Ugandan government painfully aware of its dependence on aid and the constraints donors imposed on policymaking.

To secure donor support, Museveni responded to the preferences of donors and oriented economic policy from economic expansion towards stability from 1992 onwards ([Holmgren et al., 2001](#_ENREF_42)). In particular, Museveni’s economic team employed tight fiscal and monetary policies. Museveni announced for instance in 1992: ‘There will be no inflation. Inflation is indiscipline’ ([Tumusiime-Mutebile, 2010, p. 42](#_ENREF_77)). Accordingly, the government set a point target for inflation at 5 per cent, delegated authority for monetary policy to the BoU and set the achievement of economic stability as the ultimate objective of monetary policy.

Moreover, in 1993 the Ugandan government agreed to a Financial Sector Adjustment Program (FSAP) with the IMF and the World Bank to orient financial policy from financial expansion towards stability. As agreed in the FSAP, the BoU liberalised interest rates and tightened prudential regulation. Satisfied with the progress of reforms, donors provided high levels of aid to Uganda in the late 1990s and early 2000s and used technical assistance rather than conditionality to influence policy. By the early 2000s Uganda had earned a reputation as ‘a pioneer of macroeconomic stabilisation and structural adjustment in sub-Saharan Africa’ among donors ([Collier & Reinikka, 2001, p. xiii](#_ENREF_17)).

### Continuity: Alignment with Donors

In the late 2000s, Uganda was highly reliant on aid, as indicated by an average ratio of ODA to GNI of 14 per cent between 2005 and 2010 ([World Bank, 2013](#_ENREF_83)). Donors had rewarded the Ugandan government for its economic reforms with high levels of ODA while financing from private sources had remained limited. Foreign direct investment (FDI), domestic private investment and government revenues, which are largely tax revenues, began to increase in the mid-2000s, indicating the increasingly important role of the private sector as a source of finance. Yet by African standards, Uganda’s private sector remained weakly developed and, from the perspective of the government, levels of tax revenues were not sufficient to finance the desired level of public investment ([Government of Uganda, 2010](#_ENREF_34)). Moreover, as Table 3 shows, donors provided a major share of investible funds. Therefore, the government believed that winning the support of donors remained critical ([Government of Uganda, 2010, pp. 62-66](#_ENREF_34)).

Table 3. Major sources of investible funds (% of total), 2006-2009

|  |  |  |  |
| --- | --- | --- | --- |
|  | Uganda | Nigeria | Kenya |
| Net ODA received | 25 | 6 | 11 |
| Revenue, excluding grants | 24 | 24 | 45 |
| Foreign direct investment, net inflows | 11 | 9 | 2 |
| Domestic private investment | 32 | 38 | 36 |
| Personal remittances, received | 8 | 23 | 5 |
| Total (%) | 100 | 100 | 100 |

Sources: Data drawn from the World Bank (2013) except for data on domestic private investment, which is drawn from various IMF country reports.

The continued reliance on aid in Uganda had two major consequences. First, the associated interaction of Ugandan policymakers and donors, notably the IMF, both facilitated and continuously strengthened an alignment of interests, especially in the areas of monetary and financial policy ([Harrison, 2001](#_ENREF_39), [Holmgren et al., 2001](#_ENREF_42)). Second, Uganda’s policymakers were keen on positive assessments of their monetary and financial policy by the IMF. Since 2005, Uganda has had a Policy Support Instrument (PSI) in place with the IMF. Under the PSI, the IMF closely surveys Uganda’s monetary, fiscal and financial policy and Ugandan policymakers agree with the IMF on policy targets. Uganda no longer receives IMF financing but, as a senior government official explained in an interview to justify responsiveness to the concerns of the IMF, ‘we still need the IMF to give a signal that everything is alright – to donors and to markets’ (Ministry of Finance, Kampala, December 15, 2012). This statement underscores two points. First, that the anticipated consequences of not being responsive to the IMF shaped policy. Second, that Ugandan public officials believe that donors make the provision of aid conditional on Uganda’s successful participation in an IMF program and that foreign investors base their investment decisions on IMF assessments of Uganda’s policy. The influence of the IMF in Uganda thus no longer rests on the provision of financing but the provision signals to potential providers of financing.

Monetary and financial policies were highly responsive to donors’ concerns for stability. The prime example is the BoU’s move in 2011 from monetary targeting towards an IT regime, which was advocated by the IMF as best practice ([Epstein, 2006b](#_ENREF_24)). While there was strong support for IT within the BoU, adopting it without IMF support would have been difficult because the BOU lacked both the technical capacities and the independence to implement an IT regime ([International Monetary Fund, 2013b](#_ENREF_51)). The IMF provided technical assistance for moving towards IT and lent credence to the BoU’s demands vis-à-vis the government for more independence by including reforms to enhance central bank independence as goals in the PSI.

## Nigeria

Expanding finance has been an important goal of the CBN since its establishment in 1959. Many African central banks, including the BoU and the CBK, pursued a policy stance oriented towards financial expansion in the 1970s to 1980s. Yet the Nigerian state’s access to oil revenues widened its fiscal and political space to pursue a wider range of options to deepen financial sectors, including: the acquisition of stakes in public development banks; the provision of credit guarantees; and a system of credit allocation that was more pervasive than in Kenya and Uganda ([Brownbridge, Harvey, & Fritz Gockel, 1998](#_ENREF_11)). This section delineates how the Nigerian state’s control of oil revenues mediated the pressures to orient central bank policy towards stability that began to heighten in the 1980s.

### Failed Adjustment

When Nigeria’s government embarked on structural adjustment reforms in 1986 it did so in response to overwhelming economic pressures, similar to Uganda, and in the face of public opposition to a SAP. In particular, oil revenues had declined from 22 to 11 per cent of GDP as oil prices halved in 1986. Moreover, Nigeria’s non-concessional external debt as a share of exports amounted to 790 per cent in 1986 due to Nigeria’s almost complete dependence on oil for export earnings ([World Bank, 2013](#_ENREF_83)). Nigeria had not been able to reschedule debt because it was unwilling to agree to a SAP with the IMF and the World Bank, which international creditors considered a precondition for debt negotiations ([Forrest, 1986, p. 24](#_ENREF_27)). While the Nigerian government was afraid of losing its policy autonomy through a SAP, it was by 1986 also convinced that a SAP was necessary to display responsiveness to the concerns of the IMF and the World Bank for a policy stance that prioritised stability ([Herbst & Soludo, 2001](#_ENREF_40)). Only then would it be possible to get the IMF’s and World Bank’s seal of approval and to reschedule debt, access new debt and overcome Nigeria’s recession

The objectives of Nigeria’s SAP resembled those in other African countries like Uganda and included notably: reducing inflationary growth and public investments; supporting private investment; and financial reform, including the removal of credit allocation guidelines ([Federal Republic of Nigeria, 1986](#_ENREF_26)). In contrast to Uganda, however, the government over time gained access to and control over resources that could replace those of donors through rising oil exports. Specifically, Nigerian oil revenues increased steadily from 1986 and, following the Iraqi invasion of Kuwait in 1990, Nigeria experienced an oil windfall which lasted until 1991. The access to oil revenues reduced the power the IMF and the World Bank had gained over policymakers through their influence on debt rescheduling ([Herbst & Soludo, 2001](#_ENREF_40)).

Nigeria’s central bank policy illustrates that the waning influence of donors and creditors allowed the Nigerian government to abandon the unpopular SAP from the late 1980s onwards ([Herbst & Soludo, 2001](#_ENREF_40)). In 1986 and 1987 the CBN sought to orient monetary policy from financial expansion towards stability, for instance by tightening monetary policy and removing interest rate controls. However, from the late 1980s onwards the CBN returned to statist and expansionary policies, loosening for instance monetary policy, introducing a maximum interest rate spread between saving and lending rates in 1989 and re-imposing ceilings on lending rates in 1991 ([Lewis & Stein, 1997](#_ENREF_58), [Herbst & Soludo, 2001](#_ENREF_40)). In addition, the CBN also failed to enforce prudential rules which had been tightened in 1991. Moreover, the CBN maintained its development financing schemes and ownership stakes in development banks. Many reforms were not even attempted. Thus, the increase in oil revenues opened up the political and fiscal space for expansionary central bank policy that allowed dispensing patronage to political rivals and key constituencies ([Herbst & Soludo, 2001](#_ENREF_40)). In 1992, the program with the IMF expired. It was not renewed due to Nigeria’s opposition to IMF support and limited commitment to reform.

### Continuity: Internal Financial and Political Control

In contrast to Uganda’s government, Nigeria’s government had substantial political space to pursue its own agenda in the 2000s. Not only were policymakers and the public opposed to IMF assistance because of the pressure the IMF had exerted on Nigeria during its SAP, but there was also limited need for financing from donors and thus for being responsive to them. As Table 1 and Table 3 show, reliance on donors, including the IMF, remained very limited in the 2000s because oil prices were at a very high level in the 2000s and, as a result, the oil revenues of Nigeria’s government were high as well, amounting to 26 per cent of GDP and 80 per cent of government revenue ([Central Bank of Nigeria, 2009](#_ENREF_14), [Central Bank of Nigeria, 2012](#_ENREF_15), [World Bank, 2013](#_ENREF_83)).

The government’s control of a high amount of oil revenues and limited aid dependence permitted the orientation of central bank policy towards financial expansion in the 2000s. Before elections in 2003, for instance, the CBN pursued expansionary monetary policies to facilitate domestic private investment and stimulate the economy despite disapproval from the IMF ([2001, p. 21](#_ENREF_45), [2004, p. 22](#_ENREF_46)).

Another example of the government’s ability to pursue its interest to orient central bank policy towards financial expansion refers to the policies the government employed in the aftermath of the systemic banking crisis Nigeria experienced in 2009/2010. While the CBN strengthened prudential regulation to enhance financial stability, monetary policy pursued the twin goals of promoting price stability and ensuring low interest rates to deepen financial sectors ([International Monetary Fund, 2011](#_ENREF_49)). In addition, the CBN massively expanded its development financing activities. Buoyant oil revenues provided the material basis for the CBN’s development financing and reduced the vulnerability to the IMF’s criticism of the CBN’s efforts to stimulate lending to businesses through expansionary monetary policy and development financing schemes because Nigeria was not reliant on IMF financing.[[11]](#endnote-11)

## Kenya

Kenya’s financial structure differs markedly from those of Uganda and Nigeria. Access to aid and resource revenues in Kenya was, except for the short phase from the late 1980s to the mid-1990s when reliance on donors was high, limited. Instead, Kenya largely relied on the private sector as a source of financing. Meanwhile, the CBK promoted to a greater extent than in Uganda and Nigeria simultaneously stability and financial expansion. The final case study suggests that Kenya’s policymakers employed that policy stance in an understanding that they needed to create a policy environment that responded to the concerns of business.

### Stop-Go Adjustment

By the mid-1980s Kenya’s policymakers were convinced that wide-ranging reforms were essential to raise growth, which had fallen from an average of 6 per cent between 1979 and 1981 to 2 per cent between 1982 and 1984. The government believed that the cause for the economic decline was a fall of private investment, stemming from policies that placed too little emphasis on stability and failed to intervene effectively in markets ([Government of Kenya, 1986](#_ENREF_31)). Thus, in contrast to Uganda and Nigeria, Kenya’s policymakers began reforms to stabilise and liberalise the economy not only to woo donors but also because they considered these reforms important to raise private investment ([O'Brien & Ryan, 2001](#_ENREF_66)).

Major reforms of central bank policy began in the mid-1980s. In particular, the CBK tightened bank regulation following some bank failures because it considered financial instability an impediment for investment ([Central Bank of Kenya, 1986](#_ENREF_13), [World Bank, 1989](#_ENREF_82)). The CBK also supported government efforts to develop a private capital market and raised deposit rates to stimulate savings, displaying sensitivity to donors’ concerns for financial liberalisation and market-based allocation of resources. Donors responded to the progress in reform by raising ODA, which amounted to 14 per cent of GNI at the peak in 1990. In addition, the IMF offered significant financing for structural adjustment between 1985 and 1989.

From the late 1980s onwards, however, the government, led by President Daniel Arap Moi, began to pursue a parallel strategy: While the regime continued to pursue reforms, it also increased efforts to dispense patronage to its political supporters to consolidate its power ([Throup & Hornsby, 1998](#_ENREF_75)). The CBK, for instance, both continued to fulfil some of the conditions imposed by the IMF and the World Bank in exchange for aid, such as the liberalisation of interest rates, and fuelled Moi’s system of patronage and corruption by expanding finance. For instance, the CBK became involved in several large-scale corruption scandals, the most notorious of which was the Goldenberg affair. In addition, the CBK protected so-called political banks, which were banks owned by politicians or individuals with political connections, at the expense of stability. Specifically, the CBK lent large sums to political banks which, in turn, lent them on to politicians for purposes such as election campaign financing ([Brownbridge, 1998](#_ENREF_10), [Throup & Hornsby, 1998, pp. 562-563](#_ENREF_75)). Moreover, when in the early 1990s many political banks became insolvent due to mismanagement, the CBK delayed their restructuring by allowing them to circumvent regulation and providing financial assistance ([Brownbridge, 1998](#_ENREF_10), [O'Brien & Ryan, 2001, pp. 497](#_ENREF_66)).

Monetary policy also supported the government’s efforts to consolidate power at the expense of stability. Instead of addressing inflationary pressures stemming from increasingly expansionary fiscal policy, lending to political banks and the Goldenberg payouts, the CBK allowed the money supply to increase beyond the ceilings agreed with the IMF ([Grosh & Orvis, 1996, p. 56](#_ENREF_36)). As a result, inflation increased considerably after 1989, reaching 20% in 1991.

Donors and business were quick to respond to the deterioration of the policy environment by withholding funds. Many foreign investors responded by relocating to other jurisdictions between 1989 and 1992. Overall, private investment declined from 12 per cent of GDP in 1987 to 9 per cent of GDP in 1992. Donors coordinated to suspend aid in 1991 and demanded reforms. Given the decline in investment, loud calls of the domestic and foreign private sector to resume the IMF program, the dependence on IMF support to service foreign debt and reliance on ODA, which averaged 13 per cent of GNI between 1988 and 1991, the government responded to donor conditionality from 1992 onwards with gradual reform and worked towards an agreement with the IMF and the World Bank. When Moi reached the agreement in 1993, among the first steps taken by the Kenyan government in exchange for aid was to orient CBK policy towards stability, by replacing the CBK governor, closing several political banks, and tightening monetary policy. This episode highlights the ability of those who control capital to punish unresponsive policy, the economic instability that follows from such punishment and thus the power that derives from the control of capital.

Throughout the 1990s, the relationship between the Kenyan government and donors remained thorny. Although the IMF deemed Kenya’s macroeconomic policies sound it followed other donors in reducing aid from the mid-1990s onwards due to concerns about corruption. As a result, Kenya became increasingly reliant on the domestic private sector as a source of financing. CBK policy in the late 1990s became oriented towards both stability and financial expansion because the Kenyan government believed that both policy goals were important to raise domestic private investment ([Government of Kenya, 2000](#_ENREF_32), [International Monetary Fund, 2008](#_ENREF_47)).

### Continuity: Wooing Business

It was not before elections in December 2002 put an end to twenty-four years of government under Moi that more concerted efforts were made to broaden Kenya’s financial base. The incoming government of President Mwai Kibaki considered raising domestic private investment and aid crucial to reverse the economic stagnation Kenya had experienced since the 1980s ([Government of Kenya, 2004](#_ENREF_33)). In order to ascertain the policy preferences of donors and businesses and elicit their funds, Kibaki’s government organised consultations, for instance the National Investment Conference in 2003. Businesses used the consultations to highlight their policy priorities. In the area of central bank policy the priorities of domestic capital, particularly of SMEs as the backbone of Kenya’s economy, concerned enhancing price stability and access to finance ([Kenya Private Sector Alliance, 2003](#_ENREF_54)). The IMF, which had a coordinating role among donors with respect to economic policy, emphasised during exchanges with the government that its support would be conditional on the improvement of the investment climate, notably by enhancing monetary and financial stability ([IMF, 2003](#_ENREF_43)).

In 2004, the government began to implement its economic reform program, which broadly reflected the preferences of donors and Kenya’s private sector. Central bank policy reforms focused on deepening financial sectors by increasing access to affordable financing and on improving financial stability ([International Monetary Fund, 2008](#_ENREF_47), [International Monetary Fund, 2009](#_ENREF_48)). To improve financial stability, the government notably increased the CBK’s powers to discipline banks. To deepen financial sectors, the CBK, for instance, permitted regulated deposit taking microfinance institutions to mobilise savings from the public. Moreover, the CBK oriented monetary policy towards price stability and maintained low and stable interest rates to support financial expansion.

Despite progress in economic reform, donors continued to withhold aid due to concerns about corruption in the late 2000s. As a result, displaying responsiveness to the concerns of the domestic private sector, rather than donors, remained a primary concern of the CBK. To respond to concerns about access to finance the CBK for instance permitted as one of the first African regulators mobile payment services in 2007 and agent banking in 2010. Within Kenya’s private sector, the CBK became considered a pioneer in promoting access to finance in the late 2000s.

# Conclusion

This article provides an explanation for central bank policy patterns in Africa that focuses on the interests of those who control financial resources. The analysis has three main findings. First, those who control the sources of finance on which countries rely for investment sway African central banks. Second, differences in the types of financing upon which countries rely for investment help to account for differences in the long-run orientation of their central bank policies. Third, the types of financing on which poor, presumably powerless countries rely may enhance or weaken pressures to orient central bank policy towards stability, which emerged in the mid-1980s with the rise of economic liberalisation.

The results of this research contribute to extending the theory of the structural power of capital to finance in African countries. Recent literature on structural power has focused more on the power of certain firms or sectors, moving away from the class-theoretic focus of an earlier generation of literature that argued structural power was a set of advantages of the entire class of capitalists. However, the focus of recent studies is still very much on countries where private firms dominate the economy ([Culpepper & Reinke, 2014](#_ENREF_21), [Young, 2015](#_ENREF_84)). This article extends arguments about structural power to contexts of dependence for investible resources on aid and on resource rents. As such, the article also responds to calls for research on structural power that shows how variation in this power leads to variation in policy outcomes ([Bell, 2012](#_ENREF_7), [Culpepper, 2015](#_ENREF_20)).

In addition, the case studies highlight the need to consider not only the structural position of major providers of capital but also the perceptions of policymakers. There are situations when a particular source of financing is important for investment but policymakers are not fully responsive to the interests of its provider because they fail to fully anticipate the responses of major providers of capital as happened in Kenya under Moi. That said, in each case study the structural position determined whether a provider of capital belonged to the set of actors that were relevant when policymakers evaluated the economic consequences of a given policy. The results of the article thus provide support for those studies that argue that researching structural power requires an empirical approach that integrates the concept’s structural foundations with policymakers beliefs ([Winters, 1996, p. xv](#_ENREF_80), [Fairfield, 2015, pp. 415-418](#_ENREF_25)).

Do the three country studies presented in this article prove the case? Certainly not, because there remain concerns about the generalisability of the findings from three country cases. That said, the evidence presented in this article does support some interesting hypotheses about the relationship between reliance on aid, natural resources and the private sector on the one hand and the orientation of central bank policy on the other that could be tested in a cross-country statistical study. One reason why this article centres on case studies is that no satisfying solution was found to address two main challenges of a statistical study: First, there are no readily available quantitative measures of the stance of central bank policy in relation to price stability, financial stability and financial expansion that are adequate for the context of developing countries. Second, there are significant limitations with respect to the years and developing countries for which data on the orientation of central bank policy is available. However, there is almost certainly scope for creative statistical approaches, especially as the availability of data on developing countries improves. For students of the power of capital this may be a fascinating research terrain.

**Notes**

1. The term ‘Africa’ refers to Sub-Saharan Africa in this article. [↑](#endnote-ref-1)
2. This article uses the term ‘financial expansion’ rather than ‘financial deepening’ because the earlier literature on finance often used financial deepening and financial development synonymously, even though the latter comprises more dimensions than an increase in the volume of financial transactions such as efficiency ([Sahay et al., 2015](#_ENREF_72), [Svirydzenka, 2016](#_ENREF_74)). [↑](#endnote-ref-2)
3. In this article the term ‘natural resources’ refers to point-source non-renewable resources. [↑](#endnote-ref-3)
4. See for instance Maxfield ([1997](#_ENREF_62)). [↑](#endnote-ref-4)
5. For an excellent introduction to the theory of the structural power of capital and a rich case study of Indonesia see Winters ([1996](#_ENREF_80)) [↑](#endnote-ref-5)
6. Regulations that support the provision of credit at below-market interest rates are, for instance, interest rate controls. Examples of institutions that reduce the costs of credit provision are credit registries. [↑](#endnote-ref-6)
7. While the IMF does not give grants, it is included in the category of donors here because it provides financial and technical assistance. [↑](#endnote-ref-7)
8. See for instance Guitian ([1995](#_ENREF_37)) and Independent Evaluation Office ([2007](#_ENREF_44)). [↑](#endnote-ref-8)
9. See for instance Epstein ([2006b](#_ENREF_24)), Rodrik ([2006](#_ENREF_69)) and Abbott et al. ([2010](#_ENREF_1)). [↑](#endnote-ref-9)
10. Countries are often categorised as aid dependent if net ODA exceeds 10 per cent of gross national income (GNI) and as resource dependent if resource exports as a share of exports exceed 30%. [↑](#endnote-ref-10)
11. See for instance IMF ([2011](#_ENREF_49)) for the expression of such criticism.

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