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On Central Bank Independence

Dr. Usman W. Chohan

The notion of *central bank independence* (CBI) is both sensitive and complex, driven not just by a local economic context but by larger international "conventional wisdom" on what monetary authorities should do. In Pakistan, the ongoing efforts to make the State Bank a truly autonomous body have drawn considerable political heat. The language surrounding the debate, including accusations of a “viceroy” governor of the State Bank, have shown just how politically-charged the question of CBI can be in an emerging market. For this reason, it helps to examine the merits and demerits of CBI as it has played out internationally.

In *Reimagining Public Managers: Delivering Public Value*, I dedicated a chapter to the question of central bank independence in the context of creating value for the public. What I found, and built upon in my analysis, was that ultimately creating value for society in the monetary sphere could be attained by an autonomous central bank or just as much by a democratically-dependent central bank. In other words, CBI is not an automatic guarantor of public value creation in monetary affairs. Perhaps more importantly in its converse: both an autonomous central bank and a democratically-subservient one can equally bungle the inflation problem, both can put monetary stability at risk, and both can place the financial system as a whole in jeopardy. To see why, the arguments of both sides can be weighed in the abstract, as well as our local context.

Proponents of central bank independence will argue that governments (both democratic and autocrat) have a strong incentive to disburse a monetary stimulus during either an upcoming election (to gain votes) or during mass public discontent. Governments therefore continually risk the temptation of driving up inflation and running large deficits (violating financial discipline) in order to placate their publics. Such behaviour is short-termist in nature, generating lasting national deficits for the sake of winning immediate benefits from monetary actions. In the past, certain governments in Pakistan did demonstrate a tendency to pressure the SBP on monetary policy, and some governors of the SBP did resign in protest. Therefore, the foregoing argument does have some application in Pakistan, since some governments have in the past shown an inclination to resort to the monetary levers to curry favor with the public.

The opponents of central bank independence, who have been vocal in their dissatisfaction with the new SBP law, argue from several points that CBI is not in the country’s long-term interest. The first argument stems from the notion of democratic control of monetary resources. Since the governor of the State Bank is not elected by the people, it would be undemocratic to empower such a technocrat to make the sorts of calls over a nation of 210 million people at his seemingly personal discretion on sensitive monetary affairs that have such wide-ranging effects. The second argument flows from this point, and regards national sovereignty. The IMF has been the major advocate of granting autonomy to the SBP, yet many view the IMF as an instrument of neo-imperialism and hybrid warfare, and rightly so. The notion of a “viceroy” governor emanates from this point, since an IMF-imposed governor will likely work in the Fund’s interests rather than in the interest of the people of Pakistan. It isn’t just that such a governor would take orders from the IMF or enact policies that serve external agents; an IMF-appointed governor may simply do nothing during an economic crisis, and through his deliberate inaction sink a society or bring down a government.

There are two further important arguments against CBI which reflect the changing international attitudes and “conventional wisdom” around autonomy for central banks, which have emerged in the wake of the 2008 Global Financial Crisis (GFC). First, central bankers are not as astute a group of technocrats as they would like to have us believe. Before the GFC, it was fashionable to treat central bank czars as all-knowing demigods, in the way that the US Federal Reserve's Alan Greenspan projected himself as a benevolent philosopher-king who understood the "animal spirits" of the market. After the GFC, many financial observers realized that the emperor wore no clothes, and the arrogant Greenspan had been foolishly propping up asset bubbles in the United States ("the Greenspan put") for several decades, almost leading the world financial system to collapse in the process. Second, the obsession in the West that erupted in the wake of the 1970's oil price shocks centered around controlling inflation as the #1 priority for central banks. However, inflation doesn't really exist in the developed world anymore. No matter how much money is pumped into the system, countries such as Japan and the United States simply don't see any inflationary threat. They are aging societies that are gradually de-industrializing and importing goods at cheaper prices from the Third World. So the obsession with inflation, which is a prime motive for promoting CBI, is redundant in the West itself.

For the IMF to be pushing outdated ideas in the developing world is nothing new - whatever fails to work in the West is often promoted as an IMF solution in the Third World - austerity being a prime example. As a young and rapidly growing country, Pakistan does experience double-digit inflation, but this should not be the #1 priority for our economic security in any case. Instead, (1) increasing employment, (2) promoting economic growth, and (3) protecting the value of the Rupee are more important, in my judgement, than the risk of runaway inflation in peacetime conditions. So while Pakistan is seemingly adopting a "modern" policy change according to IMF stipulations, we must realize that CBI is now an antiquated notion which is being questioned in the developed world itself. Although CBI was one of IMF's pre-conditions for its $6 billion loan to Pakistan when it faced difficulties in 2019, $6 billion is too small a price to pay, the opponents would argue, for compromising national sovereignty and economic security.

A new paradigm for our central bank must weigh the pros and cons of CBI in the larger and longer-term context. Although politicians have certainly had, and will continue to have, an immense temptation to borrow from the SBP and bully the bank towards disbursements on an easy monetary stance, there are several counter-arguments to CBI that must also be carefully attended to. Having a "viceroy" governor who acts as a yes-man to the IMF is not in our longer-term interest, nor is it wise to think of wonky technocrats as all-knowing sages.To have an unaccountable technocrat run monetary affairs with impunity based on his own (or his external benefactor's) prejudices is as bad a formula as a short-termist elected government trying to gain free votes through binge-spending. Central bankers are, as Alan Greenspan finally admitted in his disrepute, vulnerable to poor judgement just as everybody else is.

In his apologia, *The Map and the Territory,* Greenspan argued that central bankers may have a map for the economy in their minds, but then they have to actually navigate a difficult, complex, and shifting economic territory with that imperfect map. In Pakistan, self-centered politicians and hubristic technocrats alike may have something akin to a map in their mind, but taking monetary policy decisions in a young, large, and undisciplined society, is a difficult "territory" for any authority to navigate. Central bank independence cannot, in and of itself, resolve that challenge of maps and territories.

The writer is Director for Economics & National Development at the Centre for Aerospace & Security Studies (CASS). The article was first published in THE NATION. He can be reached at cass.thinkers@gmail.com