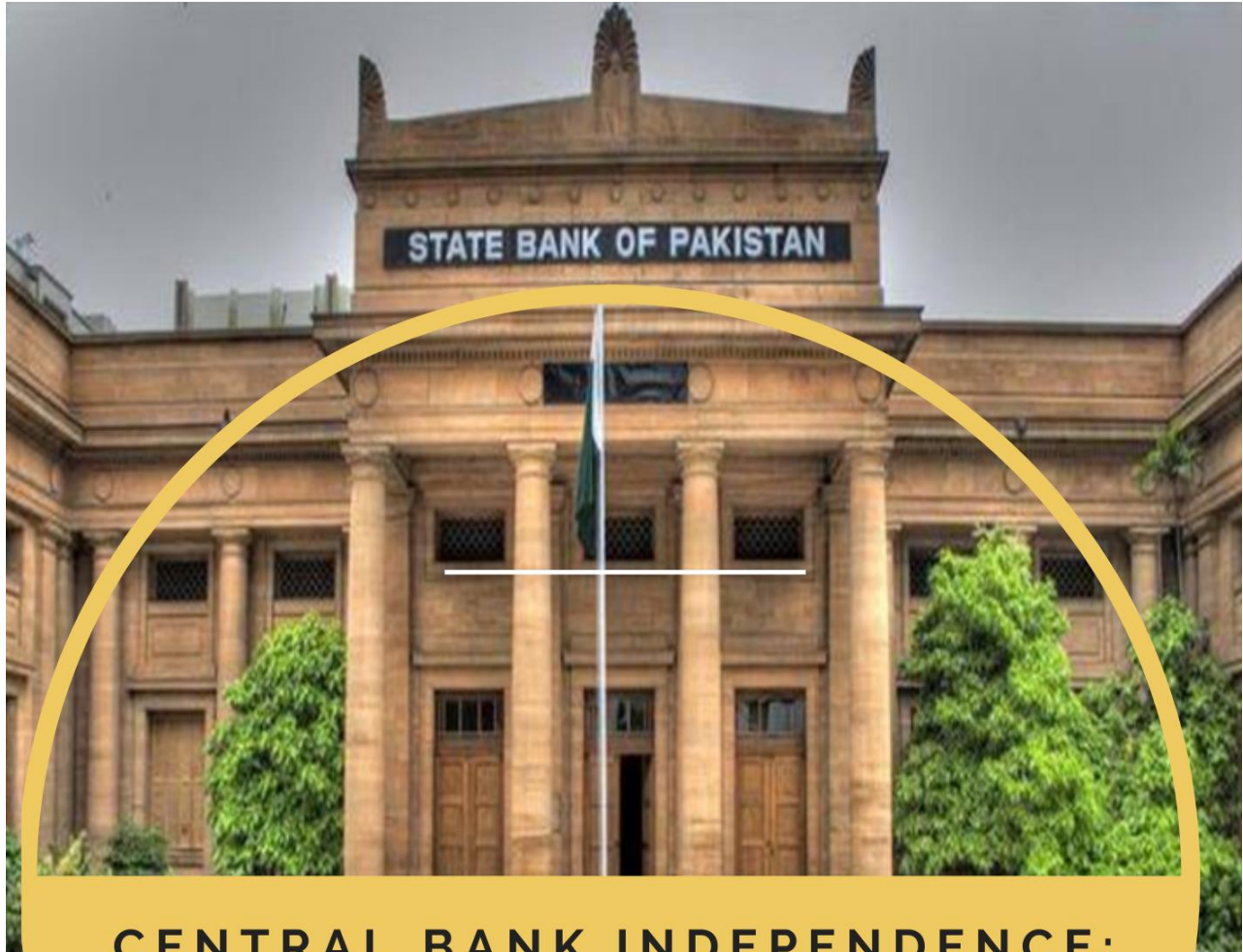




CENTRE for AEROSPACE & SECURITY STUDIES



**CENTRAL BANK INDEPENDENCE:  
REFORMATION OR DEFORMATION?**

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**WEBINAR REPORT**  
FEBRUARY 2022

**CENTRE for AEROSPACE & SECURITY STUDIES, ISLAMABAD**

**February 2022**

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## INTRODUCTION

Centre for Aerospace & Security Studies (CASS), Islamabad regularly conducts seminars, conferences, and webinars on key developments in national and world affairs. The aim of these events is to inform academia, policymakers, media, and other relevant stakeholders.

In recent months, debates on Central Bank Independence (CBI) have arisen in Pakistan following the Federal Cabinet's approval of amendments in the State Bank of Pakistan (SBP) Act and its subsequent passage in January 2022. While some have tended to highlight the merits of CBI, others have raised concerns regarding the law. However, in order to facilitate an informed discourse on the complex issue, it is imperative to acquire and disseminate insights from leading economists who possess a profound understanding of the subject. Moreover, it is important to propose a way forward that is able to address the concerns surrounding the legislation and ensure that the SBP creates value for the public and serves Pakistan's overarching long-term national interest.

In this context, CASS organised a webinar titled 'Central Bank Independence: Reformation or Deformation?' on 9 February 2022. The discussion focused on two key areas:

- Global evolution of the Central Bank Independence (CBI) debate, and,
- Merits and demerits of CBI in Pakistan's context.

CASS researcher Mubashir Ehsan moderated the webinar and provided a brief overview of the current debate surrounding CBI in Pakistan. The speakers were eminent economists, including Professor Dr Paul Wachtel, Dr Shamshad Akhtar, Professor Dr Shahida Wizarat, and Dr Usman W. Chohan who shared their understanding of CBI's nuances in both the global and national context. President CASS, Air Marshal Farhat Hussain Khan (Retd) chaired the webinar and delivered the concluding remarks. Participants included members of the think-tank community, local and international scholars, serving and retired civil and military personnel and members of the general public.

## EXECUTIVE SUMMARY

Central Bank Independence (CBI) has become an important issue in Pakistan's contemporary economic context. Globally, this subject has been debated at length, particularly after the 2008 Global Financial Crisis (GFC). Following a 40-year trend towards greater CBI, some countries are considering curtailing such autonomy, while in Pakistan it is an external stipulation by the International Monetary Fund (IMF) to increase CBI. Therefore, it is important to understand global evolution of the CBI debate and assess both its merits and demerits across a wider canvas, before contextualising it in Pakistan's context and rendering judgments on its appropriateness for the country's future economic trajectory.

Speaking from New York, **Prof. Dr Paul Wachtel** asserted that the debate on CBI continues to remain important in an increasingly complex world and stated that CBI (or even the perception of it) should not be taken for granted in emerging market countries. He stressed that CBI was developed with the monetary policy role first and foremost, but a changing global economic environment, marred by various global crises, calls for more nuanced understanding of central banks in the modern economy. As a consequence of crisis experiences (including the recent COVID-19 pandemic), discussion on the principles of central bank governance has moved away from CBI and now emphasises goal setting, transparency, and accountability. In his assessment, the global financial crisis added financial stability to a central bank's role in a significant way. This role has entailed close interaction between central banks and governments, as CBI cannot be cleanly separated from a country's political institutions.

**Dr Shamshad Akhtar** maintained that the 'SBP Amendment Act, 2021' was a welcome development considering that the SBP Act of 1956 had outlived its life. Moreover, she commended the Act for its streamlined objectives such as price stability, financial stability, and economic growth, and for the clear characterisation of the bank's functions. Nonetheless, she raised certain points of concern including the lack of accountability vis-a-vis its targets, the absence of a formal mechanism for coordination between monetary and fiscal policy under the new Act, and the lack of transparency provisions regarding the SBP. In light of this, she asserted that the State Bank's independence needs to be accompanied by institutionalised mechanisms for monetary and fiscal coordination and greater accountability backed by more robust transparency.

**Prof. Dr Shahida Wizarat** highlighted the impact of the SBP Amendment on the economic security and sovereignty of Pakistan. She alluded to the misconceptions regarding the amendment and stressed that the actual issue is not about the autonomy of the SBP, rather is about controlling and managing Pakistan's economy to stop it from pursuing its strategic goals and objectives. She explained that the formulation of Pakistan's economic policies benefits citizens in countries that control voting shares in

the IMF and the World Bank (WB). She explained how the nature of inflation in Pakistan (cost-push) does not require central bank monetary tightening policies. She then emphasised how this Act increased the power of the office of Governor SBP, and also laid out important concerns about the structure of the executive and the Board, including their decision-making powers, accountability, executive compensation, performance targets, alignment with national interests, protection of confidential information, and cooperation in crisis conditions.

**Dr Usman W. Chohan** analysed the changing 'conventional wisdom' around CBI and stressed that no single country has definitively answered the question of how a modern central bank should be structured. In Pakistan's context, he elaborated on the historical significance of the institution through the Quaid's vision of the SBP as a symbol of Pakistan's sovereignty in the financial sphere. Furthermore, Dr Chohan articulated CBI through the lens of Public Value Theory. He argued that 'independence' itself can mean several things and highlighted three different forms of CBI, each of which has merits. He then posed questions categorised into three areas: independence, coordination, and conviction. In his concluding remarks he drew upon lessons from other countries to highlight why Pakistan's current predicament is not new, and why other countries have generally not gone down the path that the former is going, with good reason.

While delivering the concluding address, **Air Marshal Farhat Hussain Khan (Retd)** weighed the pros and cons regarding CBI, especially in terms of the impacts of the recent SBP Amendment Act as discussed by the panel. According to him, Pakistan handled the COVID-19 pandemic very well and the SBP had an important role to play in supporting the Government of Pakistan's decisions. However, given the changes in the new Act, he hoped that the government would not lose its power over financial management, especially if a crisis like the pandemic occurs again. He reiterated the panel's consensus that transparency, accountability, and communication were more important for good central banking than independence.

## KEY TAKEAWAYS

- No country has settled the question of how to structure their central bank.
- Central Bank Independence (CBI) has evolved differently around the world, based on local requirements and local contexts. Therefore, each country, including Pakistan, should design its monetary authority according to the specifications of its local needs.
- The Global Financial Crisis of 2008 changed the expectations and roles of central banks worldwide, and the COVID-19 crisis has changed them further still.
  - Globally, nation states are passing through an extraordinary time (the pandemic) which requires extraordinary measures, including proactive central banks which are aligned with governments to preserve public value.
- In a well-functioning governance architecture, many institutions are granted 'independence' - functional independence, goal independence, or institutional independence. The central bank does not need to have privileged treatment in that sense.
- The question of why the State Bank of Pakistan (SBP) has been granted independence at this particular time and under such circumstances, when fiscal-monetary coordination is necessary, deserves keener attention.
- CBI, and institutional independence in the larger sense, should be seen in the context of national interests and national sovereignty, including economic sovereignty.
- The previous SBP Act of 1956 had outlived its life, and so an amended version was needed, but whether the 'SBP Amendment Act, 2021' is the correct law is still a matter of debate.
- Price stability will improve through an independent central bank, but there are multiple goals that central banks can and must pursue, including growth, employment, currency stability, macroprudential oversight, and financial supervision.
  - Pakistan's inflation dynamics are cost-push rather than demand-pull, so central bank interventions (monetary tightening) are not the best tool for curbing inflation given current economic conditions.
  - The definition of 'price stability' itself requires greater elaboration.
- Accountability and transparency are more important to central bank functions than independence per se.
- There is an imbalance in the relationship between the Federal Government and SBP, since the government is obliged to cover the SBP's finances, but the SBP is no longer obliged to cover the government's funds.
- The SBP Amendment Act, 2021 has provided sweeping powers to the Governor SBP, including the power to set his salary and evaluate his performance but there

are no performance measurement indicators and accountability measures in place.

- Section 52A exempts the Governor and the Deputy Governors SBP and the SBP from the laws of the country.
- There are also concerns about accountability and transparency under the new Act since the SBP's audit is to be conducted under an auditor who will not only be appointed by the SBP Governor but would also report to him.



## PROPOSED WAY FORWARD

- The society-wide impact of central banks must be considered, both in normal and extraordinary circumstances, first by understanding the international context, and then by looking at local requirements.
- Accountability and transparency should be more clearly established in any State Bank of Pakistan (SBP)-related laws, and law-making on such a sensitive matter should be a matter of careful democratic deliberation that is not passed through in a rushed manner.
- Narratives around Central Bank Independence (CBI) should be framed that highlight its ever-evolving nature, which shun absolutism about their structure.
- Pakistan's inflation dynamics are cost-push rather than demand-pull. Therefore, the central bank's focus on price stability should be reconsidered. Other priorities including growth, employment, currency, and financial stability are equally, if not more, important. Price stability itself requires greater elaboration in the SBP's context.
- Fiscal-monetary coordination should not only be seen as political manipulation, but as a mechanism of alignment among different arms of government, particularly as other economies around the world become more tolerant of such dynamics in the wake of COVID-19.
  - The nature of 'close liaison' between monetary and fiscal authorities, as envisaged in the SBP Amendment Act, 2021 needs much better clarification
  - The nature of reporting that the SBP will provide to Parliament, especially in terms of clarity and comprehensiveness, must be emphasised.
- The proposed compensation of SBP governors, deputy governors, boards, and directors, appears extraordinary; and should instead reflect the value that they provide, while also respecting the financial constraints of the country, including its other liabilities (such as salaries and pensions).
- Given the many suspicions that enshroud the SBP Amendment Act's intent, the SBP must engage in participatory confidence-building measures to reassure the public that this institution is not being turned into an agent of foreign interests.
- Pakistan's new 'groeconomics'-oriented policy should be revisited in light of the transformations envisaged in the SBP Amendment Act, 2021 which may not align (and may even subvert) the country's geoeconomic development.
- Further discussions, seminars, webinars, op-eds, essays, and other research endeavors must be undertaken to apprise the public of the importance of this subject and its many nuances.

## SUMMARY OF PROCEEDINGS

DR PAUL WACHTEL, PROFESSOR OF ECONOMICS, LEONARD N. STERN SCHOOL OF BUSINESS, NEW YORK UNIVERSITY, USA

### ORIGINS AND EVOLUTION OF CENTRAL BANKS

Detailing the origins and evolution of central banks, Professor Wachtel highlighted the earliest understanding of central banks as institutions that operated specifically for the government. Such institutions, for instance, included the Bank of Sweden, the Bank of England, or the private banks in the 17<sup>th</sup> Century, among others, which would facilitate the government with financing expenditures in return for the right to issue banknotes/currency. Professor Wachtel mentioned that it was only in the 19<sup>th</sup> Century that these government banks started to be seen as institutions that could help maintain financial stability by extending loans to the private banks in trouble. This shift, he said, was a consequence of British economist Bagehot's introduction of the idea of 'the lender of last resort.' Explaining the further evolution of the role of the central bank, he added that the central bank's present day role, in maintaining price stability by using monetary policy, was a 20<sup>th</sup> Century development, after Keynesian macroeconomics came into prominence. He shared that while price stability remains the primary role of central banks today, the contemporary central bank is a complex institution with multiple responsibilities that may overlap with the government's responsibilities.

### ORIGINS AND POPULARISATION OF THE NOTION OF CENTRAL BANK INDEPENDENCE (CBI)

Professor Wachtel highlighted that he first encountered the notion of CBI in the work of Milton Friedman from the 1960s when he explores how the objective of the monetary structure was to be free from irresponsible government tinkering. However, he said that the popularity of the term CBI came together in the 1990s and was attributable to certain forces. These forces, he highlighted, made CBI the most important idea in central banking and monetary policy in the late 20<sup>th</sup> Century. The **first** of these forces was the transition of many banks from private to public institutions, such as in the former colonial and former Soviet states. This required these public institutions to have a charter that defined their role. The **second** force was the emergence of the time-inconsistency problem, i.e., the political business cycle as an essential idea in macroeconomic modeling. The problem implies that opportunist politicians have the incentive to use monetary policies to expand the economy and increase employment and economic activity to achieve their short-term goals. In doing so, they ignore the longer-run inflationary consequences of their actions. This time-inconsistency problem warranted a greater emphasis on the independence of central banks. The **third** force, in his view, was the rising inflation problem in both the developed and developing nations in the late 20<sup>th</sup> Century. Increasing inflation led policymakers and the public to lose confidence in the ability of the government to address the aforesaid challenge and consider an independent structure of central banks as part of the solution. The **fourth** force, hence, was the emergence of empirical evidence around the 1990s that measured the characteristics of CBI. Such empirical evidence also suggested a correlation between the degree of CBI and low inflation rates.

## CENTRAL BANKS IN THE 21<sup>ST</sup> CENTURY

Professor Wachtel highlighted the idealised notion of a central bank as an independent institution with price stability as its sole objective. However, he maintained that global challenges in the 21<sup>st</sup> Century had transformed central banks into complex institutions with multiple responsibilities that often overlap with the government's responsibilities. To assert this, he cited the example of the expanded role of central banks during the Global Financial Crisis (2008-10) and the COVID-19 crisis (2020-21). During the GFC, central banks worldwide stepped in to provide support to the financial institutions in order to help maintain both national and international financial stability. A decade later, during the COVID crisis, central banks once again emerged as important players when they cooperated with governments to support businesses and households. Not only this, but central banks also took on the government's fiscal functions to provide the necessary support to businesses and households. In his assessment, central banks today could not be separated from a country's political institutions. Moreover, Dr Wachtel referred to Milton Friedman's excerpt from the 1960s, where he noted that even when central banks had existed as fully independent entities, they exercised independence only as long as there was no real conflict with the rest of the government. Further, he noted that central banks, a part of the public sector, need to adopt a broader role during periods of crisis in a complex world. He also restated the assertion of most central bank leaders that the central banks today ought to play some role in addressing global challenges such as climate change. Nevertheless, he stressed that price stability remains the primary role of central banks.

### IDEAL OUTLOOK OF A CENTRAL BANK

According to Dr Wachtel the term 'independence' is oversold. He asserted that governments need to instead focus on whether central banks possess the structures that can enable them to perform their required roles and meet public objectives. In this context, he postulated an ideal outlook of a central bank today. **First**, central banks need to have clearly stated policy targets and goals. **Second**, policy actions of central banks should be transparent and disclosed to the public. **Third**, central banks should be accountable to public institutions such as Parliament or Congress. Lastly, they should have the appropriate system that prevents the government from misusing the bank for purposes such as money creation and directing credit to chosen individuals, businesses, or activities for resource allocation. In order to ensure these preventions, central bank laws are clear and it is important to have central bank leadership that secures its role, is confident of the protections, and able to concentrate on appropriate activities.

## DR SHAMSHAD AKHTAR, FORMER GOVERNOR STATE BANK OF PAKISTAN (SBP)

### GLOBAL CRISES AND THE ROLE OF CENTRAL BANKS

Dr Akhtar emphasised that the traditional role of central banks, as conservative outfits that managed monetary policy, had been transformed into a much more expanded role today. In this context, she highlighted the important role of central banks in economic crisis management during the Global Financial Crisis (GFC) of 2008, and, more recently, the COVID-induced economic

crisis. The GFC necessitated a coordinated and unconventional monetary policy, which was marked by quantitative easing through asset purchase programmes. This, she said, brought to fore the significance of central banks in maintaining financial stability. She further stated that the more recent COVID-19 crisis required central banks in both advanced and developing countries to step in with unprecedented speed, scale, and size of reactive policies. These included, but were not limited to policy rate cuts, liquidity provisions, credit support to businesses, and employment. According to Dr Akhtar, the crisis necessitated unprecedented monetary expansion to be coordinated with fiscal expansion and vice versa, which contributed to economic recovery. Taking this into consideration, she quoted an excerpt from Mario Blejer's recent article, which says that 'central banks, for the past few decades, have been at the vanguard of a successful campaign to ward off recessions.' However, in Blejer's words, 'the huge role of central banks in propping up the markets has had dangerous unintended consequences.'

The speaker explained that while expansion of the monetary and fiscal side was necessary during the COVID-19 crisis, inflation risks have grown as recovery gained ground. Moreover, there is a recognition that it is not transitory inflation; instead, it was the range of multidimensional tools deployed by the central banks that have had complicated trade-offs. This, she stated, has generated controversial debates, including in Pakistan. In her view as recovery emerged, developing countries' macroeconomic vulnerabilities caused inflationary pressures. Most central banks opted to tighten monetary policies with the emerging markets stepping in earlier. However, she stated that some central banks lost their credibility in the process due to their failure to anticipate inflation and the inability to lift interest rates on a timely basis. Nonetheless, she stressed that no matter how complex, maintenance of expansionary policy would require monetary tightening and lowering and scaling back inflation expectations. Dr Akhtar also stated that people do not understand that central banks have to act when needed as there is no other platform that can do what they can do.

#### CASE FOR SBP AMENDMENT ACT, 2021

Dr Shamshad Akhtar maintained that the SBP Amendment Act, 2021 was a welcome development considering that the Act of 1956 had outlived its life. Moreover, she held the view that the re-capitalisation of the central bank (as highlighted in Section 4A) would go a long way to strengthen the bank's financial position. Profit sharing and reinvestment of central bank's profits back into its own balance sheet would help finance several of its schemes. Dr Akhtar also referred to Section 9C of the Act, which prohibits the Bank from extending any direct credit to the government. This, she surmised, was a powerful provision as it would encourage the government to adopt fiscal sustainability backed by domestic resource mobilisation, which needs to focus on raising tax-to-GDP ratios. Moreover, she commended the Act for its streamlined objectives of price stability, financial stability, and economic growth. She also praised the Act for a clear articulation of the Bank's functions ranging from its monetary policy functions to the banking sector functions.

## POINTS OF CONCERN VIS-A-VIS THE ‘SBP AMENDMENT ACT, 2021’

While the 2021 Act was a need of the hour, nonetheless, she simultaneously raised certain concerns.

The **first** concern being the absence of a formal mechanism for coordination between the monetary and fiscal policies in the new scheme of things. She highlighted that the institutional architecture for coordination between the central bank and the Ministry of Finance remains weak. She shared that although the Monetary and Fiscal Coordination Board (MFCB) existed and was headed by the Minister of Finance and then the Prime Minister, it eventually got politicised and remained dysfunctional. Moreover, she held the view that the ‘liaison arrangement’ between the fiscal and monetary authorities which the Act envisages was not a satisfactory proposition to ensure the required coordination. According to her, a weak coordination mechanism would stand in the way of accountability.

The **second** major concern that she highlighted was the lack of accountability vis-a-vis the targets. The SBP’s position on price stability remained unclear, despite the latter being its core objective. Although the Act defines price stability as low and stable inflation, she argued that this was insufficient and not backed by a disclosure of the approach and methodology for inflation management and the predefined inflation targets. She suggested that the latter factors are the prerequisites to ensure accountability.

**Thirdly**, mere submission of annual reports to the legislature would not lead to accountability as these reports were abstruse for parliamentarians. Moreover, she also raised concerns about the diffused and inadequate provisions regarding transparency. She stated that forming an executive committee of the chief executives and other high-level professionals would not introduce transparency rather only improve internal corporate governance. **Lastly**, Dr Akhtar expressed displeasure at the fact that the legislation was not made public before being approved by the Parliament. According to her, it is important for any legislation to be uploaded on government websites to allow citizens to comment on them.

### WAY FORWARD

According to the former Governor of SBP, the Bank’s autonomy needs to be increased in line with global practices on central banking. She offered the following recommendations:

- The SBP needs to disclose its approach and methodology for inflation management and specify predefined inflation targets.
- There must be an institutionalised mechanism for coordination between monetary and fiscal policies. This also requires fixing the dysfunctionality of the MFCB.
- Greater autonomy needs to be accompanied by robust transparency. Such transparency should not only involve internal governance through the formation of an Executive Committee, rather the Bank needs to integrate transparency in its codes.
- The mandates of the central bank relating to economic development need to be restructured and reformulated to be supportive of sustainable development and inclusive

growth. They also need to be supportive of low carbon and green transition and other environmental goals.

**PROF. DR SHAHIDA WIZARAT, DEAN & HOD, COLLEGE OF ECONOMICS & SOCIAL DEVELOPMENT (CESD), INSTITUTE OF BUSINESS MANAGEMENT (IOBM), KARACHI, PAKISTAN**

**SUBORDINATING THE ROLE OF GOVERNMENT OF PAKISTAN (GoP)**

Professor Shahida Wizarat shared her views on how the SBP Amendment Act, 2021 was not just about making the SBP autonomous, but rather about making the Government of Pakistan subservient, not only to the SBP but to the IMF as well. This was being ensured through Section 46-B (8) which states that the Government has to consult the SBP on any legislation related with the SBP and the latter would convey its decision after consulting the IMF. Since the US has 16.75% voting shares in the IMF, therefore, in her view, the SBP would now get subordinated not only to the IMF but the US government as well. She warned that the Government of Pakistan's powers were being eroded completely by removing the Federal Finance Secretary from the SBP Board, even if the provinces were going to have representation. She noted that the latter appeared to be a political move to have the provinces represented on the SBP Board, but not the Federal Government. Professor Wizarat then highlighted Section 4A (b) which states that the Bank shall request the Federal Government to remedy a deficit in the financial statement of the Bank and shall within a period not exceeding 30 days provide the said amount. Yet, the SBP would not be accommodating the Federal Government when it would need funds. This, she lamented, would make for a very asymmetric relationship.

**IMPACT OF THE ACT ON PAKISTAN'S DEBT BURDEN**

While highlighting the impact of the Amendment Act, she stated that the GoP cannot borrow from the SBP under the pretext of 'financial discipline,' and yet on the other hand, there would be considerable plundering of public money due to the heightened influence of the World Bank and International Monetary Fund (IMF) influence on the SBP. She highlighted facts regarding the increase in number of Executive Directors, and their high salaries and extraordinary perks and privileges. This was an area of considerable concern highlighted through her detailed research on the subject of executive compensation in the new dispensation of the bank under the Act. Professor Wizarat emphasised that if the Federal Board of Revenue (FBR) was unable to meet its revenue targets, the GoP would borrow money from commercial banks to pay its debts, which would increase the markup and the Debt/GDP ratio further. She also highlighted that the debt/GDP ratio was already at 110%, which was much higher than the 60% allowed under the Fiscal Responsibility Law (2005).

**CONTROLLING INFLATION OR ENSURING GOOD RETURNS TO INVESTORS IN RICH COUNTRIES?**

The Professor explained that the SBP had tried to control inflation in Pakistan over the last 30 years through monetary tightening, which was the wrong policy approach because it worsened the crisis and resulted in a decline in investments, output, and employment. She elaborated that, since increase in prices is on account of an increase in the price of oil, industrial raw materials, and capital goods due to devaluation, inflation was not due to demand-pull factors rather was a

cost-push phenomenon. Dr Wizarat stressed that the SBP had been trying to fight cost-push inflation through a demand-pull strategy since the 1990s. This was an important economic counterargument to the SBP Amendment Act's insistence on price stability as the singular goal of the central bank. On the other hand, increase in policy rates were only beneficial to citizens of countries who controlled voting shares in the International Financial Institutions (IFIs). These institutions force policy rates to be kept very low to revive economic activity in their own host economies. The high rates in Pakistan enable the shareholders in such IFIs to earn lucrative rates while pushing the country deeper into a recession.

#### **DEMOLISHING PAKISTANI INSTITUTIONS AND STRATEGIC OBJECTIVES**

Professor Wizarat shared her concerns regarding how the SBP Amendment Act, 2021 has an impact on the institutions and strategic objectives of Pakistan. She stated that the Act forbids the GoP from providing guarantees for short-term relief to commercial banks facing financial distress, thus paving the way for total collapse of Pakistan's financial sector and its replacement by foreign banks. She raised serious questions about how Pakistan would meet its industrial, strategic and defence needs, and expenditures related to the China-Pakistan Economic Corridor (CPEC); and how it would attain greater integration with regional countries, especially since there was so much antagonism in the US to CPEC and Pakistan's integration with the region? Professor Wizarat asserted that Governor SBP's recent decision that export earnings accruing through land routes would not be counted as export earnings was just the beginning of what will follow to rollback CPEC and discourage Pakistan's integration with regional countries. While explaining the priorities of the SBP Amendment Act, she pointed out that it clearly stated that the first priority would be debt servicing. If, after meeting debt servicing needs, money was available, it would be used for defence and development expenditures. Commenting on the issue of information confidentiality, she added that according to Section 46 B (6) of the Act, the SBP can share confidential information with any international public and nonpublic authority and organisation. She cautioned that this was a serious concern for Pakistan's security.

#### **EXCESSIVE POWERS TO THE OFFICE OF THE GOVERNOR SBP**

The SBP Amendment Act had also invested greater powers in the Office of the Governor SBP, and now the Governor would be appointed by the President of Pakistan for a period of five years, extendable for another five, instead of the present three-year tenure. She added the Governor and the Deputy Governors would have a considerable salary package based on 'the market rate'. She commented on the role of the Cabinet in approving a hefty package for these officials in less than five minutes and contrasted this with deprivation of civil servants of their pensions in Khyber Pakhtunkhwa.

Professor Wizarat declared that the Act was misleading people with the pretext that it was about the autonomy of the SBP. In actuality, it was about arrogating powers of the SBP Board in the office of the Governor. Section 9 (F) envisages the constitution of an Executive Committee consisting of the Governor and the Deputy Governors, making the SBP Board null and void. This Executive Committee would not be answerable to anyone. If the government wants to do any

legislation concerning the SBP, it will need to take permission from this Executive Committee. Another example of an attempt to concentrate power in the Governor SBP office is illustrated through Section 9 (G) which states that the Monetary and Fiscal Policy Coordinating Committee (MFPC) was to be abolished. In its place, the Governor and Finance Minister would maintain 'informal liaison.' She contended that this informal liaison cannot be a replacement for the Coordination Committee in view of its tasks and responsibilities.

#### PERFORMANCE EVALUATION AND ACCOUNTABILITY

Professor Wizarat explained that SBP Governor's power had been increased to the extent that he can fix his own salary and evaluate his own performance. She stated that Section 52A also exempts the Governor and the Deputy Governors SBP and the SBP from the laws of the country. Governor and Deputy Governors can no longer be challenged in any court if their actions are 'in good faith.' This, in her view, would encourage corruption, nepotism and illegal actions; and was very subjective in terms of how one would determine whether an action was in good faith or not. On the matter of accountability, there was none nor any penalty for nonperformance. The Governor and the Deputy Governors would not be responsible to the President, the Prime Minister, the Cabinet or the Parliament. According to Section 39, the SBP would be answerable to Parliament, but the Governor SBP would not be which was a strange clause, in her perspective, since he was the head of an institution that must be answerable.

#### SBP AUDIT

Professor Wizarat cautioned that the inclusion of Section 43 (2) had made a mockery out of the SBP audit process. The Act states that the SBP Board, which includes Governor SBP, will appoint an external auditor. Moreover, Section 4 of the Act states that the auditor shall report to the Audit Committee and the SBP Board (which includes the Governor) on matters arising from the audit and in particular on material weaknesses in internal controls relating to the financial reporting process. This makes the whole audit process dubious as the Governor SBP appoints the auditor to conduct the audit and report to him. The speaker reiterated that:

- The SBP Amendment Act, 2021 was not about autonomy of the SBP. Its main goals are to cut Pakistan to size and sabotage CPEC and regional integration, increase debts through borrowing from commercial banks at exorbitant rates, making it difficult to make resources available for defence and development, reduce Pak-China and South-South trade, increase prosperity to rich countries' investors, and put obstacles in Pakistan's nuclear and missile development programme.
- The Governor SBP had been made very powerful through arrogating the powers of the SBP Board and the Executive Committee into his office. Senior SBP officials are dependent on the same powers for extension of their contracts and award of new tenures.
- The Governor SBP and his team may easily report Pakistan's sensitive information to the IMF, the US government etc. without any domestic oversight and accountability mechanism.



- The biggest security threat to Pakistan is its colonial mode despite 75 years of 'independence' entailing the formulation of domestic government policies in the US, UK and their implementation by those selected from these countries.
- Most Cabinet members have US and UK citizenship (dual loyalties), plus there are a great many foreign and dual nationals in very high positions who are bureaucrats. From this one can imagine Pakistan's current conditions and the economic mess the country is in.

**DR USMAN W. CHOHAN, DIRECTOR ECONOMIC AFFAIRS AND NATIONAL DEVELOPMENT, CASS, ISLAMABAD**

#### CENTRAL BANK INDEPENDENCE: CHANGES IN CONVENTIONAL WISDOM

Dr Chohan began his remarks with the contention that there is no single country that has settled the question of how modern central banks should be structured, and so for anyone to speak authoritatively on a subject so complex requires nuance that is reflective of the local context and indigenous evolution. According to him, there has been a relationship between government ideology and monetary policy, which has varied greatly over time because of the structural changes in the global economic environment. Moreover, he added that it was very difficult, for instance, to set up a welfare function that allows the central bank to optimise the trade-off between economic dynamism and financial stability. He observed that the IMF has otherwise also been accused of having ulterior motives, and not just in the context of Pakistan but also other countries, thereby echoing a point made by Professor Wizarat. Pakistan was not the first country to face such a stipulation from the IMF. Other countries such as Thailand (during the Baht Crisis) and Latin American countries such as Argentina and Venezuela also faced similar situations. Each country has a unique economic context, and these contexts also evolve with time, he remarked. Furthermore, Dr Chohan cautioned that making institutions 'independent' comes with consequences in terms of their democratic accountability and oversight; and as part of a well-functioning democratic architecture, everyone must be held accountable.

#### HISTORICITY OF PAKISTAN'S INSTITUTIONS: QAID'S VISION

Explaining the historical significance of the State Bank, Dr Chohan referred to Quaid's speech on the inauguration of the State Bank of Pakistan, which demonstrates that the M.A. Jinnah, the father of the nation, saw the SBP as a symbol of Pakistan's sovereignty in the financial sphere. It is that sovereignty which is in question with an autonomous SBP. The Quaid also hoped to see the SBP develop into one of Pakistan's 'greatest national institutions,' thus emphasising its importance as a pillar of national life, and one that would also 'play its part fully throughout the world.'

#### PUBLIC VALUE PROPOSITION OF CENTRAL BANK INDEPENDENCE

Dr Chohan outlined several central bank functions and how they create value in two ambits: monetary policy and financial supervision. Citizens' values regarding employment, inflation, and other things can change, but the central bank is expected to address the values of citizens on these subjects as they have more independence in general compared to other agencies. Furthermore, in his view, a central bank's independence does have benefits such as monetary de-politicisation, in that it is not as easily hijacked by political considerations of each government,

but there are certain challenges like democratic accountability in terms of the 'politics-administration dichotomy.'

While commenting on the co-creation of value in this context, Dr Chohan opined that central banks co-create value but they may not necessarily respond directly to urgent political or citizen demands because there is a distance that is created through their independence. He explained that central banks create value through two things. First, financial supervision which encompasses microprudential policies, market integrity, macro-prudential (overall system) and special (risky) situations. Second, through monetary policy which encompasses elements such as interest rates, money supply exchange, and other tools, which all come into use over different periods and crises.

Given his work on the subject, he discussed how 'independence' itself could mean several different things and was something that could be granted in various degrees. He highlighted three forms in particular: goal independence, operational/functional independence, and institutional independence. 'Goal independence' involves negotiating goals with the government and then proceeding to attain them through the deployment of various means and tools. 'Operational/functional independence' is the most common form of independence, where the goal is given by the government, but the selection of the instruments to attain it is made by the central bank. Meanwhile, 'institutional independence', which is the question at hand in the SBP Amendment Act, 2021 involves enshrining independence into law, which grants the maximum independence and prevents maximum external intrusion into the bank's goal-setting and goal-attainment. In the speaker's view, it was questionable why SBP alone as an institution had been considered for increased independence since hundreds of institutions in Pakistan could be considered for at least, functional independence. Secondly he questioned the timing of the Act since this was a unique time in the life of countries, having undergone the collective stress of the COVID-19 pandemic, and responding with extraordinary fiscal and monetary measures. He appreciated that Pakistan had made exceptional efforts during the pandemic and demonstrated superior pandemic-related outcomes, as reflected in the Normalcy Index, where Pakistan had been ranked among the top three nations, alongside New Zealand and Hong Kong, which were wealthy island nations.

#### **ROLE OF SBP AND NATION-BUILDING**

As mentioned by other speakers, Dr Chohan also stressed that the central bank of a country is part of its bureaucratic ecosystem. It is a public body where coordination among the various arms of the bureaucracy is crucial to attain collective national goals. The SBP had, in the past, undertaken quasi-fiscal operations, especially in the pandemic (like other countries as well). In other words, central banks around the world have increasingly taken on a quasi-fiscal role, depending on the country and the context. He questioned why countries should not do more of this, especially in Pakistan where it succeeded during COVID-19 due to the extraordinary measures taken by the SBP.

Dr Chohan surmised that the SBP played a very positive role during the pandemic through counter-cyclical spending and assistance to industries such as construction, and this was because the Bank was aligned with the government. In the future, could the SBP be counted upon to behave in a similar manner if it were to be made independent and no longer aligned with government targets? This was a question he foresaw in the changes of law, through which the SBP might not necessarily be counted upon in the future. Highlighting a specific concern, he

questioned how one would define the nature of 'close liaison' in the context of the Amendment, and its medium of communication.

Dr Chohan then articulated his concern regarding the tenor of discourse in Pakistan regarding CBI, asking why the debate, which should be highly nuanced, proceeded in such an aggravated manner. While commenting on Dr Shamshad Akhtar's statement regarding the approval of the bill by a single vote in the Senate, Dr Chohan mentioned that this essentially is on party lines. He reiterated that no single country has settled the question of how a modern central bank should be structured. He stated that this is also at the crux of what Professor Wachtel said: that CBI was evolving and is being considered from different angles in different societies. To have a definite opinion regarding this can be problematic. In his view, think-tanks do not necessarily need to always provide concrete answers, but instead should raise the right questions, particularly regarding problems that contain a great deal of complexity and nuance. He concluded by highlighting the limitations of central bankers as human beings prone to errors, judgements and vulnerable to biases.

## QUESTION AND ANSWER SESSION

*There is a provision within the SBP Amendment Act, 2021 that grants immunity to the central bank from the jurisdiction of the National Accountability Bureau (NAB). To what extent can this be problematic?*

Dr Shahida Wizarat responded by saying that it is important that we evaluate the performance of those who are being paid. She argued that things had been purposefully left out within the Act because the Governor State Bank could only be held accountable to the IMF and the United States. So, even though the Governor was being paid a fantastic amount by the government, he will not be held accountable to the latter as the United States or the IMF will appoint him. She further added that it was evident that the present Governor had been attempting to do things far beyond his autonomy. In her view, the State Bank could take steps to ensure that the American line was toed, be it abandoning CPEC or keeping trade relations with the US and not increasing the South-South trade. Moreover, since all defence entities had been asked to open accounts with the State Bank, it was possible that the US and India could get engaged in the surveillance of Pakistan's defence-related companies.

*In the SBP Amendment Act, 2021, under 'Statement of objects and reasons' it is stated that the Act takes into account the ground realities in Pakistan, but does it really take into account the ground realities?*

Dr Usman W Chohan responded by saying that given the current conditions, the exceptional circumstances of a post-COVID environment, the way Pakistan's economy was structured, and the sort of deficits the country was facing, there was no pressing need to undertake this Amendment right now. However, he said that, in his considered view, the ground realities and societal conditions had not been taken into account.

*While there are examples of such autonomy in the world, is the problem with autonomy of the State Bank of Pakistan one of intent (suspicion of hidden agendas), incompetence, inability to read the full benefits through autonomy, or the method and the way it has been done?*

Dr Shahida Wizarat responded that there was a hidden agenda. If the State Bank of Pakistan's autonomy is compared to other banks in the developing countries, it is as autonomous as many other banks. According to her, it was not a question of autonomy but rather the timing. She further added that the economic turmoil and economic growth were being taken to the climax. Moreover, now Pakistan's assets and reserves would be controlled by someone who will either be directed by the United States or be a US citizen. This, she opined, could be a serious security risk.

**AIR MARSHAL FARHAT HUSSAIN KHAN (RETD), PRESIDENT, CASS, ISLAMABAD**

In his concluding remarks, Air Marshal Farhat Hussain Khan commended Pakistan's handling of the COVID-19 crisis and highlighted the vital role that the SBP played in supporting the government's efforts. However, given the changes in the new SBP Act, 2021, he hoped that the government would not lose its authority over financial management, especially if a crisis like COVID occurred again. Most importantly, he reiterated the panel's consensus that transparency, accountability, and communication should be the prime focus for good central banking rather than its independence per se.

He also weighed the pros and cons of CBI, especially in terms of the impacts of the SBP Amendment Act as discussed by the panelists. While highlighting the viewpoint of the proponents of CBI, President CASS observed that autonomous central banks prevent political interference and ensure disciplined regulatory functions. Moreover, an independent state bank should be better able to manage inflation, as highlighted by all the panelists. He also touched consented that while the amended Act was a welcome development, it might risk making the state bank subservient to the IMF and, as a matter of course, to the United States. He also cautioned as had the speakers that Act would increase the government's indebtedness as the latter would have to approach private banks for borrowing. In addition, he raised apprehensions about the appointment of the Governor of State Bank from abroad. This, he stated, could be a security risk as well.

## ANNEXURES

### ANNEXURE I: PROFILES OF SPEAKERS

**Air Marshal Farhat Hussain Khan, HI (M), SBt (Retd),  
President, Centre for Aerospace & Security Studies (CASS),  
Islamabad & Former Vice Chief of the Air Staff, Pakistan Air  
Force**

Air Marshal Farhat Hussain Khan (Retd) has rich experience in aviation and industrial management, diplomacy, and negotiations. During his service, he remained on various important command and staff appointments, including Vice Chief of the Air Staff and Chairman Pakistan Aeronautical Complex Board. He has also served as Pakistan's Air Attaché in New Delhi, India. He is the co-author of two books 'The Aviation City' and 'Milestones' about growth of the military aviation industry in Pakistan and its way forward.



**Prof. Dr Paul Wachtel, Professor of Economics, Leonard N.  
Stern School of Business, New York University, USA**

Professor Paul Wachtel serves as Professor of Economics at the New York University's Leonard N. Stern School of Business. Previously, Professor Wachtel has served as Chairperson of the Economics Department; Vice Dean for Program Development; Academic Director of BS in Business and Political Economy; the Chairperson of the University Faculty Council; and Research Associate at the National Bureau of Economic Research. His research has been published in numerous journals.



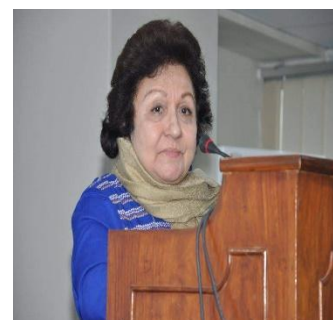
**Dr Shamshad Akhtar, Former Governor State Bank of Pakistan**

Dr Shamshad Akhtar is an economist with broad-based experience in a range of senior positions at national and multilateral organisations. Dr Shamshad has served as the Care-Taker Finance Minister of Pakistan holding multiple economic portfolios in the caretaker government and as Governor, State Bank of Pakistan. Moreover, she has served as Under-Secretary General of the Economic and Social Commission of the Asia and Pacific (UNESCAP); UN Secretary General's Senior Special Advisor on Economics and Finance; Vice President, Middle East and North Africa at the World Bank; Director General of Asian Development Bank (ADB); and Special Sr. Advisor to the President of ADB. Dr Shamshad currently serves as Chairperson of the Board of the Pakistan Stock Exchange; Pakistan Institute of Corporate Governance; Sui Southern Gas Company Ltd.; Karandaaz, and Engro Pakistan.



**Prof. Dr Shahida Wizarat, Dean and HOD, College of Economics and Social Development, Institute of Business Management (IoBM), Karachi, Pakistan**

Dr Shahida Wizarat is the Dean College of Economics and Social Development, and Head of the Department of Economics at the Institute of Business Management (IoBM). Earlier, she was Director Research and Chief Editor of Pakistan Business Review (PBR). She has authored three books, 'The Rise and Fall of Industrial Productivity in Pakistan' (OUP); 'Fighting Dependence: Proclaiming Sovereignty for an Enslaved Pakistan' (LAP); and 'Fighting Imperialism, and Liberating Pakistan' (CRS), besides numerous research papers published in international and national journals and newspapers.



**Dr Usman W. Chohan, Director Economic Affairs and National Development, CASS, Islamabad**

Dr Usman W. Chohan is an international economist and academic who serves as Director Economic Affairs and National Development at CASS. He is among the Top 10 Business Authors (out of 12,000 authors) on the Social Science Research Network, which is the largest open repository of knowledge in the world. He has published three books in the past three years: 'Public Value & Budgeting: International Perspectives'; 'Reimagining Public Managers: Delivering Public Value'; and 'Public Value and the Digital Economy.' In the fifth chapter of his second book, Dr Chohan highlights central banks as public managers and how central banks create value for the public. In the academic realm, his research has been cited widely, for example by the World Trade Organization; European Parliament; National Bureau of Economic Research; IIEE; and the OECD, among many others. Dr Chohan has also testified before various authorities based on his technical expertise. His forthcoming book is titled 'Pandemics and Public Value Management.'



## ANNEXURE II: PRESS RELEASE

### Transparency, accountability, and communication are hallmarks of good central banking, more so than independence.

This was the key message of leading economists at the Webinar on ‘**Central Bank Independence: Reformation or Deformation?**’ organised by the Centre for Aerospace & Security Studies (CASS) in Islamabad. The discussion focused on the global evolution of the Central Bank Independence (CBI) debate and merits and demerits of CBI in Pakistan’s context.

Eminent speakers included Prof. Dr Paul Wachtel from the Leonard N. Stern School of Business at New York University, USA; Dr Shamshad Akhtar, former Governor State Bank of Pakistan; Prof. Dr Shahida Wizarat, Dean, College of Economics & Social Development, Institute of Business Management (IOBM); and Dr Usman W. Chohan, Director, Economic Affairs & National Development, CASS. The webinar was chaired by President CASS Air Marshal Farhat Hussain Khan (Retd), while Mubashir Ehsan, Researcher at the Centre moderated the proceedings.

Speaking from New York, **Prof. Dr Paul Wachtel** provided a comparative assessment of Central Bank Independence (CBI) in advanced and emerging economies and stated that CBI (or even the perception of it) should not be taken for granted in emerging market countries. He stressed that CBI was developed with the monetary policy role first and foremost, but reflection on post-global economic crises calls for more nuanced understanding. As a consequence of crisis experiences (including the recent COVID-19 pandemic), discussion on the principles of central bank governance had moved away from CBI and now emphasize goal setting, transparency, and accountability. In his assessment, the global financial crisis added financial stability to a central bank’s role which involved close interaction between an independent central bank and the government as CBI cannot be cleanly separated from a country’s political institutions, he stressed.

**Dr Shamshad Akhtar** maintained that the ‘SBP Amendment Act, 2021’ was a welcome development considering that the Act of 1956 had outlived its life. Moreover, she commended the Act for its streamlined objectives of price stability, financial stability and economic growth, and for the clear characterisation of the Bank’s functions. Nonetheless, she stressed that no matter how complex, maintenance of expansionary policy would require monetary tightening as well as lowering and scaling back inflation expectations. In her view, the State Bank’s independence needs to be accompanied by institutionalised mechanisms for monetary and fiscal coordination and greater accountability backed by more robust transparency.

Sharing her concerns about the ‘SBP Amendment Act, 2021’ **Dr Shahida Wizarat** argued that the Act was not about the State Bank of Pakistan’s autonomy, rather its main goal was to control and manage Pakistan’s economy and to stop it from pursuing its strategic goals and objectives. In her analysis this included sabotaging CPEC and regional integration; increasing debt-to-GDP ratio through borrowing from commercial banks at exorbitant rates and over the long-term making it difficult to provide resources for defense and development; reducing Pak-China and South-South trade; while increasing the financial portfolios of IMF shareholders.

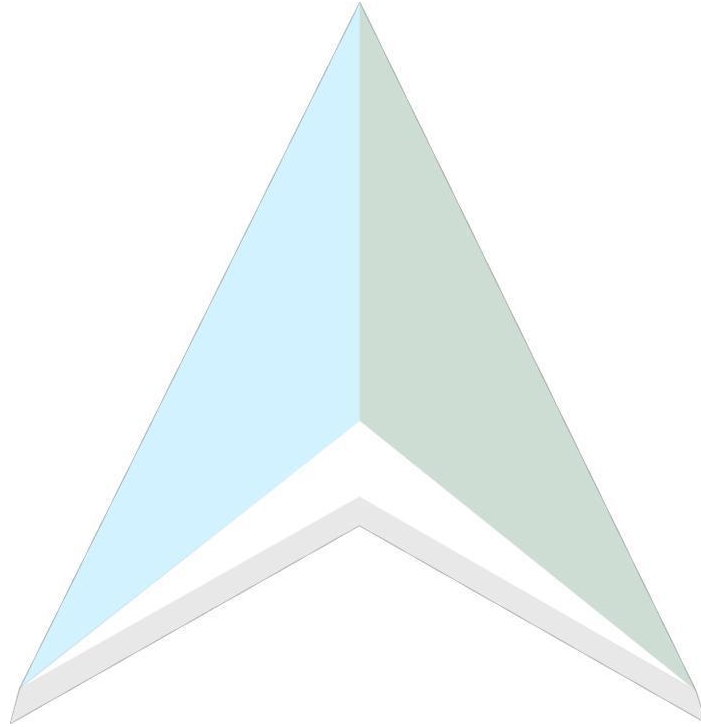
Discussing the public value of CBI, **Dr Usman W. Chohan** outlined how CBI had evolved differently around the world, based on local requirements and local contexts. In his view, each country, including Pakistan, should design its monetary authority according to the specifications of its local needs. Questioning the timing of the SBP Amendment Act, Dr Chohan advocated that in a well-functioning governance architecture, many institutions are allowed functional, goal or purely institutional independence, but the privileged treatment of the SBP, particularly when the economy requires stronger fiscal-monetary coordination during difficult conditions; and especially when imposed from outside, was suspect. He advised that the elements of Pakistan’s national

power, including its economy, should be in alignment with the country's core national interests. By making the central bank an independent and separate pillar of power over sensitive domains like monetary, price, and currency stability, Pakistan may not be aligning this instrument towards national interests, and risks compromising its economic sovereignty, he warned.

While delivering the *Concluding Address*, **Air Marshal Farhat Hussain Khan (Retd)** weighed the pros and cons regarding CBI, especially in terms of the impacts of the recent SBP Amendment Act as discussed by the panel. According to him, Pakistan handled the COVID-19 pandemic very well and the State Bank of Pakistan had an important role to play in supporting the Government of Pakistan's decisions. However, given the changes in the new Act, he hoped that the government would not lose its authority over financial management, especially if a crisis like the pandemic, occurs again. He reiterated the panel's consensus that transparency, accountability, and communication were more important for good central banking than independence.

The webinar was attended by bankers, scholars, journalists and students of IR and economics, who actively participated in the interactive question and answer session.





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