

Central bank independence and accountability



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Discussions on central bank independence resurfaced earlier this year when the US President called on the Fed chair, who had been appointed by the President himself during the latter's first term, to cut interest rates

As the Fed held rates steady, based on its reading of incoming data and information on inflation and economic activity in the US, pressure was subsequently piled on the Fed's chair to resign. Unsurprisingly, such pressure generated an adverse reaction from financial markets and analysts, which seem to have led to a reconsideration in the call for such resignation.

However, more recently, the decision by the US President to seek to dismiss one of the Fed's board members, following allegations of fraud in a mortgage application prior to her appointment of Governor on the Fed's board, has reignited the debate on the importance of central bank independence.

Empirical evidence unequivocally shows that central bank independence has brought significant benefits to both investors and citizens in terms of lower long-term interest rates and inflation. Lower long-term interest rates benefit investors as it re-



duces the cost of borrowing, and hence encourages more investment, generating employment, while through innovation, investment creates better-paid jobs. At the same time, lower and stable inflation is beneficial to citizens in supporting their living standards by sustaining economic and financial stability.

Without independence, central banks would be neither credible nor transparent, and hence not trustworthy. The experience of politicians exerting strong influence in steering monetary policy have generally, even until very recently, resulted in very high inflation and significant currency depreciation.

The recent events in the US signal a renewed attempt by politicians to influence the steering of interest rates, which should be strongly resisted. However, central bank independence needs to be also accompanied by strong and effective accountability. After all, central bankers are unelected officials that have control over an important policy lever that significantly affects the lives of citizens and businesses.

In respect of monetary policy, central banks have come a long way in increasing transparency in their decision-making process, primarily through the publication of minutes of monetary policy meetings, projections, and other tools used in arriving at such decisions.

However, effective checks on central bankers to ensure not only their competence, but also high standards of integrity, both upon appointment and throughout their term, is also essential to earn the credibility and trust of the public.

Regulators of credit institutions, most of whom are central banks themselves, require ultimate beneficial owners (UBO), board members, and key officials of banks to undergo rigorous due diligence and a fit and proper test before granting an institution a banking licence. Adverse media about a UBO or board members of a credit institution are taken very seriously, and regulators could force UBOs involved in serious court cases to divest themselves from such credit institution or face the prospect of

withdrawal of their banking licence. Credit or financial institutions are a very different kind of business from other commercial enterprises. Banks, indeed, are subject to a high degree of regulation and intrusive supervision precisely because, unlike other businesses, such kind of institutions handle the life savings of citizens, where losses of such funds would have serious economic and social consequences.

Therefore, central bankers cannot be perceived to hold for themselves lower standards than those they advocate and impose on credit institutions, as their actions too could also result in serious consequences and repercussions, probably on an even wider scale. The proverbial "what is good for the goose...", applies also in this respect. In the Eurosystem, both the ECB and the national central banks, including the Central Bank of Malta, adopt an ethics framework which provides strict guidelines of conduct for central bankers.

While on the one hand, unbridled authority to politicians to dismiss central

bankers would seriously undermine credibility and trust in central banks, at the same time a low bar in accountability would be equally damaging. A delicate balance is therefore required.

Allegations made in respect of central bankers may be malicious, driven by ulterior motives, and sometimes could even arise from purely personal considerations. For example, some years ago a deputy governor of the Central Bank of Malta had directly experienced this, where despite no charges were ever brought to court by the authorities, an injustice had been perpetrated as the court had determined, in a defamation case, that serious allegations in his regard were unfounded.

In the current case involving a member of the Fed Board of Governors, no legal proceedings have been initiated so far, and therefore, calling for her resignation is premature, while going further, in taking steps to dismiss her at this stage, seriously rocks the independence of the Fed.

On the other hand, central bankers that remain in office while facing serious charges based on documented misconduct, or worse still, when independent judicial authorities find them guilty of such charges, would create a perception that central bankers are effectively unaccountable. This would equally undermine the reputation and credibility of the central bank and its trust, which ultimately could lead public opinion to sway politicians in eroding central bank independence, with all its negative implications.

While for the benefit of society, central bankers should treasure their independence, they need to also be mindful that this needs to be guarded by effective accountability based on both legal and moral grounds alike, as expected by the public.

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