

# Central Bank Independence, Accountability, and Transparency

*Also by Marco Arnone:*

PRIMARY DEALERS IN GOVERNMENT SECURITIES

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# Central Bank Independence, Accountability, and Transparency

A Global Perspective

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Marco Arnone  
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# Foreword

The International Monetary Fund (IMF) has always placed particular importance on the issue of central bank governance, since a robust central bank framework facilitates price and financial sector stability, which in turn is conducive to sustainable economic growth. Such a framework is important not only in conducting day-to-day central banking operations, but also for the evolving role of the central bank in the current global environment that is characterized by the extraordinary challenges facing policy-makers in the context of the global financial crisis.

The crisis, which started in August 2007 with the sub-prime market turmoil in the United States, has brought to the forefront important policy issues which are directly linked to the topics discussed in this book, in particular regarding the desirability and modalities of central banks' involvement in financial supervision. Furthermore, central banks around the world have responded to the financial crisis in ways which, at times, have departed from the conventional wisdom that prevailed before (i.e. widening the range of collateral and undertaking financial operations which used to be the prerogative of financial markets).

This book presents a comprehensive review of the literature on central bank independence, accountability, and transparency, as well as an analysis of the largest datasets ever published on these three pillars of central bank governance. The analysis reflects the importance given to the surveillance and technical cooperation work of the IMF's Monetary and Capital Markets Department in helping member countries to improve the structural, institutional, and operational aspects of central bank operations, and build strong monetary institutions.

I believe that this comprehensive review of the literature and careful consideration of central bank practice can provide useful guidance to policy-makers when they reflect on how to respond to the current challenges in ways which do not put at risk the advances achieved over the last 20 to 30 years. I also hope that this book, in particular the discussion on the sequencing of reforms to strengthen governance frameworks

and their linkages with the stages of development of financial markets, will help policy-makers apply the general guidelines discussed in the book to the particular circumstances prevailing in their respective countries.

Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund

# Preface

“It is my desire for the Banque de France to be in the hands of the government, but not unduly so” (Napoléon).<sup>\*</sup> We have certainly come a long way from the time of Napoleon, when the central bank (CB) was expected to be in the hands of the government, to the current consensus whereby CB independence has become a matter of pragmatic necessity, essential to ensure a firm commitment to price stability and financial stability. Indeed, the message that emerges clearly from the review of the literature presented in this book is that CB independence has increasingly been recognized as an essential aspect of their governance frameworks. With greater independence has come greater accountability, to both governments and the general public, requiring CBs to be increasingly transparent in conducting their operations. As a result, a sound CB governance framework is increasingly based upon three essential pillars: independence, accountability, and transparency.

This message is corroborated by a review of global trends in CB governance for a large group of CBs from advanced, emerging market, and developing countries. This book benefits from a wealth of information that is based in particular on the assessment of central bank independence for 163 CBs, representing 181 countries, and the assessment of CB accountability and transparency for 98 CBs representing 109 countries.

While it is valuable to review the literature and consider empirical evidence of CB practices in relation to governance, this book goes a step further by providing concrete guidance to policy-makers. A better understanding of the relationship between the three pillars of governance should assist policy-makers in determining the role of CBs in financial supervision and in sequencing reforms to strengthen the governance framework, taking into consideration the stage of development of the financial markets.

The book presents three main parts. In the first, it offers an overview of the literature on CB independence. It distinguishes base indicators of independence, which were first developed in the late 1970s, from the

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<sup>\*</sup>“Je veux que la Banque . . . soit dans la main du Gouvernement mais qu'elle n'y soit pas trop.” In Geneviève Iacono, *Le nouveau statut de la Banque de France, une étape vers l'union économique et monétaire*, Recueil Dalloz Sirey 89 (March 1994).

subsequent literature. Also, it summarizes the literature on CB accountability and CB transparency from the time it started to appear in the late 1990s. On the basis of the literature, new indicators of CB independence, accountability, and transparency are presented in the second part. These are then applied to large samples of CBs from countries at different stages of market development (i.e. advanced economies, emerging market economies, and developing countries) with a view to drawing conclusions on global trends for each pillar of CB governance and on their interrelationships. The second part also offers new empirical evidence on the relationship between CB independence and inflation performance. Finally, the last part draws lessons for policy-makers regarding the relationships between the pillars of CB governance, the role of CBs in financial supervision, and how to sequence reforms to strengthen CB governance frameworks.

Given the current global financial crisis and the evolving role of CBs in attempting to minimize the turmoil, this book takes on even greater significance. This is therefore an opportune moment for the publication of this book, and I am most grateful to all the authors and contributors for their hard work.

Jaime Caruana  
Counsellor and Director  
Monetary and Capital Markets Department  
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We are grateful for comments and suggestions on draft sections of this book provided by Laszlo Balogh, King Banaian, Martin Čihák, Christopher Crowe, Alex Cukierman, Jakob de Haan, Andreas Freitag, Alessandro Gambini, Charles Goodhard, Arman Khachaturyan, Luis Jácome, Tonny Lybek, Donato Masciandaro, Fausto Panunzi, Marc Quintyn, Pierre Siklos, Andrea Sironi, Guido Tabellini, Michael Taylor, and participants at the conference: "Central Bank Independence: Legal and Economic Issues," sponsored by the International Monetary Fund and the Central Bank of Peru, September 19, 2007 (Lima) and at the following Bocconi University (Milan) conferences: "Central Banking Conference – Does Central Bank Independence Still Matter?," September 14–15, 2007; and "European Conference on Financial Regulation and Supervision – Designing Financial Supervision Institutions: Independence, Accountability and Governance," May 29–30, 2006. We are especially indebted to Donato Masciandaro for providing such a welcoming and stimulating environment, for his thought-provoking suggestions, and collaborative spirit.

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We wish to dedicate this book to our families and friends.