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Introduction

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During the last 20 years, most central banks have been given much more policy autonomy and independence. Along with this have come pressures for more accountability and transparency. This is entirely appropriate as independence and accountability should be an inseparable pair.

Most central banks have accepted this trade-off and have moved to improve their internal management structures and practices, the efficiency of their use of resources, and the transparency of their policy processes and actions, and of their financial statements.

External pressures from governments and others have played a role in motivating the reforms carried out by central banks. So has the general trend towards greater accountability and transparency and improved corporate governance in all enterprises and institutions. Central banks have not been alone in going down this path.

But many central banks have been proactive in reforming themselves rather than waiting until external pressures forced change upon them. This strategy has meant that these central banks have had a greater degree of control over the process of their reform and modernisation than would otherwise have been the case. They have been able to introduce the essential characteristics that lead to improved accountability and transparency while at the same time maintaining those characteristics that central banks believe make them 'special' or different. The policy performance of most central banks has been very good over the last 15-20 years and central bankers have been concerned that the drive towards more accountability for resource use and transparency did not inadvertently undermine the independence that they believe has been the major reason for the improved policy performance.

Taking the initiative in internal reform also strengthens the position of central bankers in their role as advisers to governments on the need for structural reforms that will improve the performance of an economy – and thus reduce pressure on monetary policy. Such advice is more likely to be listened to, or is at least harder to dismiss, if the advice-giver can say “you should do what we have done; it works”, rather than saying “you should do what we recommend; we think it will work.”

As the reform drive in central banks gained momentum in the 1990s, peer pressure and support amongst central bankers became an important element in spreading and deepening the reforms. The respect that most central banks and central bankers want and value the most is that of their central banking colleagues. Central banking is a “club” and most central bankers want to be well-respected members.

The modern culture of central banking

A few central banks started the process of reforming themselves in order to provide greater accountability, transparency and efficiency in the 1980s. But during the 1990s, many central banks began to adopt these principles as part of the modern culture of central banking. This didn't occur in any formal manner. Central bankers have many forums at which they meet each other and discuss formally and informally the key issues affecting their work and their institutions. While every country, and therefore every central bank, faces a specific set of economic issues and works within a specific economic and political environment, there are also many important similarities in the roles of all central banks and similar constraints on their behaviour. Through these interchanges amongst central bankers, certain principles and ideas become widely agreed and accepted.

In the 2000s, the need for central banks to be efficient in their governance, accounting and use of resources and transparent in informing stakeholders is seldom challenged. Most central banks have taken some steps to modernise themselves. What is still the subject of discussion is how comprehensive and wide-ranging these reforms in central banks should be and can be. Some central banks have taken a dramatic approach to reform and made substantial changes to their operating frameworks and structures. Others have taken a more deliberate step-by-step approach. But few central banks have ignored or remained immune to the need to reform and modernise.

New members of the club

A few new central banks are still being created, the Central Bank of Bosnia and Herzegovina being an example. Usually, with the assistance of the international

financial institutions and other established central banks, they try and incorporate the principles of good governance, accountability and transparency within their structures and processes from the beginning of their operations. This is an indication that these principles have become part of the agreed building blocks in setting up a new central bank.

The focus of discussions now is on how best to achieve the objectives of greater accountability and transparency whilst maintaining independence and policy autonomy.

This is where this book comes in. The opening section of the book, “The challenge of reform”, describes the environment that has led to reform and modernisation becoming issues that central banks had to address.

The chapter by Leszek Balcerowicz, “The challenge of reform”, was chosen to open the book for three reasons. First, it is an example where reform has impacted on almost all aspects of the central bank’s operations. Second, it shows how the political and social environment in which a central bank operates will have a major impact on its reform process. Thirdly, it shows that even in a very complex and difficult environment, substantial progress can be made on reform by a determined central bank. It is an example of the central bank becoming a beacon institution by demonstrating to politicians and the managers of other public sector enterprises that improved efficiency and accountability are both possible and beneficial.

John Mendzela asks the question “Why change?” – and answers it in his chapter. In part he is saying change is inevitable and therefore needs to be accepted. But he is also saying that change is beneficial and should not be seen as something central banks have to do but something they should willingly do. Kenneth Sullivan in his chapter discusses how central banks are increasingly adopting International Financial Reporting Standards (IFRS) as the accounting framework for their reporting. This is appropriate as it provides a framework that is accepted and understood by financial markets. But the adoption of IFRS does present central banks with some implementation issues. In the past, central bankers used to argue that not only were they different from all other institutions, they were unique and therefore should not be subject to accounting and governance rules designed for other institutions. I don’t think any central banker would try and make that case today. But I think the statement that central banks are ‘different’ remains a fair one. The question that is still under discussion therefore is how relevant these differences are for the issues of accounting and governance in central banks.

The book has a number of case studies of reforms in particular areas of central banks’ operations and functions which show that the reforms have impacted on most central bank functions: strategic management, financial supervision, IT, economic

research, payments systems, currency management, and financial accounting and reporting. The other stakeholders who have a legitimate interest in the operations of the central bank, such as governments and citizens, benefit from improved central bank accountability, transparency and efficiency. But the case studies in the book show that all central banks that have reformed believe their institutions have benefited from the process also.

The case studies have been divided into three sections:

II – Rethinking the scope of the central bank

III – Improving processes

IV – Central bank reform in action

Section II illustrates a principle that central bankers need to accept: the trend towards ‘modernisation’ can mean that central banks lose some of the functions they have been carrying out. One of the principles of modernisation is that institutions should focus primarily on their core competencies. This may in some cases imply that certain non-core functions should be handed over to other institutions. This is certainly the case if there is an inherent inconsistency or conflict of interest between the central bank’s core monetary policy function and the other function. But it may also be the case where there is not a direct conflict as multiple functions always add to the pressures on the time and focus of senior management.

In this book, banking supervision is the function that is the subject of two such case studies: the UK written by Michael Foot and Kazakhstan written by Bryan Stirewalt. It is interesting that in both cases, while the primary responsibility for banking supervision has been transferred to a new specialist institution, the central bank is still involved in the function in a variety of ways.

The other two chapters in this section, “Alternative models for outsourcing banknote services”, written by Adrian Baxter *et al*, and “Central bank operational efficiency: meaning and measurement”, written by Vern McKinley and King Banaian, both address the issue of improving the efficiency of core central bank functions. While central banks are not profit-maximising institutions, they have still come under pressures to focus on efficient use of resources. Many of the principles of efficient resource use developed for private sector corporations can also be applied to central banks. The first task is to measure how much each function costs. The second task is to do some sort comparison of costs of functions, using the performance of central banks that are considered to embody best-practice efficiency for this function. The third task is to take action where costs are found to be excessive, either through internal reforms or outsourcing. This last option illustrates that even where the central bank is clearly responsible for a function, the most efficient way to carry it out could be to delegate the operational role to a third party.

Pressure to do more

In many transition and developing countries, the trend at present is still in the opposite direction. Central banks are often asked to carry out non-core functions, in part because other institutions that should carry them out either do not exist or are ineffective. It is often difficult for central banks to refuse such requests. The requests are usually in the interests of the country as the central bank is often the most effective institution in the country. But the central bank has to be careful that it does not take on so many of these non-core functions that it diminishes its capability to carry out its core functions. The scarce resource will become management time and ability. However, at some time in the development of the country, institutional capacity elsewhere should improve and the central bank will find that its core policy functions become more important and complex as the economy develops. As these trends develop, the central bank should begin to divest itself of these non-core functions.

The third section of the book is titled “Improving processes”. There are two different but complementary approaches illustrated by the four case studies. The first two, “Managing central bank IT”, written by Bruce Summers, and “Do all central banks need a well-developed brain?”, written by Marko Skreb, show that efficiency, in the dual sense of better outputs and better resource use, can be substantially improved in the service operations of a central bank by a professional and focused approach. Reform should not be restricted to the policy functions of the central bank such as monetary policy and banking supervision. Improved performance and resource efficiencies are possible in all operations and achieving them will benefit the policy functions also.

The other two chapters focus on governance, and especially the role of strategic management. Francois van Zyl writes about South Africa’s experience and Mark Jewett and Colleen Leighton write about Canada’s experience. Both central banks have recently adopted a formal approach to strategic management. Central banks have always had a forward-looking approach to thinking about their core functions: monetary policy and banking supervision by their nature force you to look ahead. In a sense this could be described as strategic management. But it was often impossible, sometimes even for people working in the central bank, to know exactly where and how these strategic decisions were taken. The trend now is to make these processes clear. In some central banks, such as South Africa and Canada, this has led to the establishment of strategic management sections and processes that try to include as many staff as possible in the discussion process. I think more central banks will adopt this approach and these two case studies will be very helpful in that respect.

But the increased focus on strategic management also forces central banks to focus on their governance structures. Strategic management sections can come up with future scenarios and recommended actions. But a decision has to be taken on the most likely scenarios and their implications for the bank's operations. Resource decisions have to be taken, responsibilities assigned, expected outputs and deadlines agreed – and the whole process has to be monitored to make sure the plan is actually implemented. Where these various decisions will be taken is at the heart of good corporate governance.

As a first step, it should be made clear to all participants and stakeholders where the responsibility for taking strategic and operational decisions lies. It could be parliament, the government, the central bank's governing board or the governor. All will probably have a role and the roles will vary from country to country and even in a single country over time. There is no single governance structure that can be applied to all central banks in all circumstances. But the respective responsibilities of the politicians, the board and the governor should be explicit and unambiguous. If they are not, you will either get arguments where two or more of the groups claim it is their right to take the decision or vacuums where no group wants to take the responsibility.

The trend towards increased policy autonomy and independence for central banks over the last 20 years has passed more of the important operational decisions to the central bank. But the central bank also needs to make clear both for its own efficiency and for external accountability where within the organisation each decision will be taken, who will be responsible for carrying out each task and how performance will be monitored.

One issue that often arises in discussions on central bank governance is this: should the board be chaired by the governor or by an independent chairman? The answer largely depends on the role of the board. If the main role of the board is to appoint and monitor the performance of the governor and the bank I think it is inappropriate for the governor to be chairman. However, if it is a policymaking board and/or a board that has a major role in internal management issues, I think the governor should be chairman. But the board will also have some monitoring role and will need to establish specific bodies, such as sub-committees, to carry out this function.

Reform is a long-term process

The final section of the book looks at some examples of "Central bank reform in action". The first chapter written by John Singleton *et al* looks at the experiences of New Zealand, one of the early starters in central bank reform. An important lesson from the New Zealand experience is that reform isn't a one-stage process. New

Zealand has continued to analyse its structures and its operational performance and has made further reforms during the last ten years as a consequence. The chapter also shows that other stakeholders, especially the government, will play a major role in issues of corporate governance in a central bank. To make substantial change to the corporate governance structures of a central bank will usually require a change in the central bank's law as the key elements of its corporate governance should be set out in its law.

The final three chapters are case studies from Bosnia and Herzegovina, East Timor, and Pakistan. They all have two things in common. First, the environment for reform was very complex and difficult. Second, significant progress was achieved in all cases by having a clear strategy and by sheer determination. They are further examples of where central bankers can be reform leaders, not just for their own institutions but to demonstrate what is possible to other institutions.

While central bankers have always had to deal with a changing environment, the speed of the changes is constantly accelerating. Also, the trends towards improved corporate governance and accountability are still gaining ground in other areas. This will impact on central banks whether they like it or not. It is best for central bankers to accept this and be proactive. The case studies in this book show that this is possible, even in very difficult environments. Central banks can, if they accept the challenge, become leaders of the reform process in their countries.

Key reforms have been carried out by many central banks over the last ten years in the areas of central bank corporate governance, accounting and financial reporting. These reforms are at the heart of modernisation. They have been driven in large part by the aim of applying international standards of governance and accounting to central banks. These reforms have thus moved central banks to being more similar to other enterprises in these important features than they used to be. In my view, that is a good thing and should be welcomed by central bankers. It actually strengthens their case for maintaining the one thing they value most highly – policy autonomy and independence.