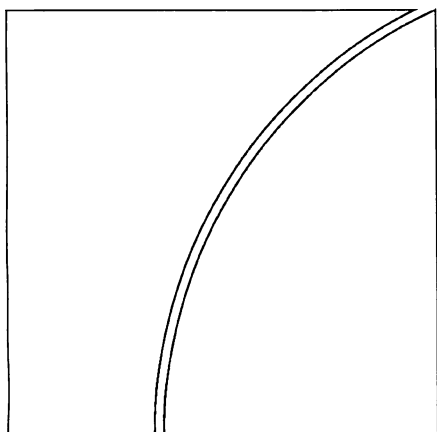




BANK FOR INTERNATIONAL SETTLEMENTS



Issues in the Governance of Central Banks

A report from the
Central Bank Governance Group

Chair: Guillermo Ortiz, Governor of the Bank of Mexico

May 2009

Electronic version; contains minor updates up to 12 May 2009.

Project Origins and Contributors

Origins

This project and report were initiated by the Central Bank Governance Group. The report draws heavily on an extensive body of survey data and other information contributed by central banks and monetary authorities belonging to the Central Bank Governance Network (currently 47 members – see the Annex for a list).

Under the guidance of the Governance Group and an advisory panel, the report was prepared by the Secretariat of the Central Bank Governance Forum (which comprises the Group and the Network) together with consultants engaged by the Bank for International Settlements.

Contributors

Chairs of the Central Bank Governance Group during the preparation of the report

Guillermo Ortiz, Bank of Mexico

Joseph Yam, Hong Kong Monetary Authority

Members of the Central Bank Governance Group during the preparation of the report

Stanley Fischer, Bank of Israel

Mervyn King, Bank of England

Donald Kohn, Board of Governors of the Federal Reserve System

Ian Macfarlane, Reserve Bank of Australia

Tito Mboweni, South African Reserve Bank

Lucas Papademos, European Central Bank

Y V Reddy, Reserve Bank of India

Tarisa Watanagase, Bank of Thailand

Zeti Akhtar Aziz, Central Bank of Malaysia

Zhou Xiaochuan, People's Bank of China

Advisory panel

Alan Blinder

Sir Andrew Crockett

Jacques de Larosière

Roger Ferguson

Lord George

Charles Goodhart

Roberto Zahler

Consultants

Petra Geraats

Ellen Meade

Bruce White

Secretariat of the Central Bank Governance Forum

Secretary General

Gavin Bingham

Central Banking Studies

David Archer

Serge Jeanneau

Anne Mackenzie

Paul Moser-Boehm

Contents

Project Origins and Contributors	iii
Preface	v
A road map of the report	1
Highlights	3
1. Objectives	3
2. Powers and resources	3
3. Objectives and incentives	4
Chapter 1: The main tendencies in modern central banking	5
1. Introduction	5
2. The role and objectives of the modern central bank	6
3. Political framework and legal status	11
4. Decision-making structures	13
5. Relations with the government and the legislature	14
6. Financial resources and their management	14
7. Accountability, transparency and oversight	15
Chapter 2: Roles and objectives of modern central banks	17
1. Introduction	17
2. Functions and objectives: chickens and eggs?	18
3. Objectives	18
4. The functions of a modern central bank	28
5. Good or bad bedfellows?	49
Chapter 3: Political framework and legal status	57
1. Introduction	57
2. Creating a legal framework for autonomy	57
3. Legal frameworks	59
4. Embedding and the management of legislative change	61
5. Legal status and ownership of the central bank	63
6. Specifying the type and breadth of powers	65
7. Provisions concerning the interaction between the central bank and the government	66
8. Appointments, terms of office, and dismissal	69
9. Provisions relating to legal action against the central bank and its officers	75
Chapter 4: Decision-making structures	77
1. Decision-making by an individual or a group?	77
2. Legal framework for decision-making	78

3.	Many roles ... how many boards?	80
4.	Supervisory boards	82
5.	Policy boards	85
6.	Individual or collective responsibility; voting or consensus	86
7.	External board members: when to include, what roles to assign	87
8.	Board size	88
9.	Committee dynamics	89
Chapter 5:	Relations with government	91
1.	Introduction	91
2.	Nature of contacts	92
3.	Managing the relationship	96
Chapter 6:	Financial resources and their management	103
1.	Introduction	103
2.	The central bank balance sheet	103
3.	Central bank income	112
4.	Balance sheet exposures: asset and liability revaluations	118
5.	Capitalising the central bank	123
6.	The operating budget	128
Chapter 7:	Accountability, transparency and oversight	135
1.	Introduction	135
2.	Central bank accountability	136
3.	Accountability arrangements and mechanisms	139
4.	Transparency	144
5.	Central bank accountability and independence	149
Chapter 8:	Management of non-financial risks	151
1.	A risk management framework	152
2.	Organisation of risk management: the centralisation/decentralisation choice	154
3.	Approaches and techniques for managing non-financial risks	156
4.	Links to other central bank management issues	160
Chapter 9:	Selected aspects of management and organisational structures	163
1.	Management and organisational structures	163
2.	Maintaining a corps of professional central bankers	171
Annex:	List of central banks and monetary authorities represented on the Central Bank Governance Network	183
References		185

26 countries in the sample that have a legal system rooted in civil law, about one half have provisions relating to the central bank in their constitutions. None of the countries with a common law tradition have constitutional provisions relating to the central bank.

Despite the importance of written codes in countries ruled by civil law, not all such countries have codified every attribute of the central bank into law. Brazil is a good example of this point: although the Central Bank of Brazil is given powers in the Brazilian constitution, it does not possess legal autonomy from the Government. However, the Presidential Decree that established inflation targeting in 1999 gave the central bank wide de facto autonomy.

In some cases, a constitution may limit the degree of legal autonomy that the central bank can possess, with respect to the discharge of certain functions. This possibility had to be considered when the Bank of Japan law was amended in 1997. The Constitution of Japan (Article 65) reserves sovereign executive power to the Cabinet, with the question being the extent to which decision-making on monetary policy was covered by that provision.⁵⁷

Several central banks have legal responsibility for policy in more than one country; national authority is ceded to them for this purpose. While the multistate ESCB/ECB system is the most recently created and perhaps best-known example, three other multistate central banks have been in existence for much longer. The Central Bank of West African States and the Bank of Central African States have existed since 1959 and are responsible for the two monetary unions in Africa that are known collectively as the CFA franc zone.⁵⁸ A monetary union among countries in the eastern Caribbean was founded in 1950 and is operated by the East Caribbean Central Bank.⁵⁹ Monetary unions are currently being considered by countries in southern Africa, western Africa and the Middle East.⁶⁰

A multistate central bank may possess some, but not necessarily all, of a central bank's powers. Some powers, such as the responsibility for banking supervision, may be retained domestically by the constituent national central banks – which is the case in the Eurosystem, where the authority for monetary policy is held by the Eurosystem as a whole, including the supranational ECB. (In contrast, the central bank of the East Caribbean Currency Union regulates banks on behalf of and in collaboration with the governments of member states.) Thus, the laws that govern the central bank may be

to the government, and laying out procedures for the appointment or dismissal of officials. See Table 4 and the associated discussion for further details.

⁵⁷ For further discussion, see Oritani (forthcoming).

⁵⁸ The CFA franc zone was established in 1945. The West African Economic and Monetary Union (WAEMU) currently unites eight countries in western Africa (Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo), while the Central African Economic and Monetary Community currently unites six countries in central Africa (Cameroon, Central African Republic, Chad, Republic of Congo, Gabon and Equatorial Guinea). Each union (and its respective central bank) operates separately but identically.

⁵⁹ The East Caribbean Currency Union currently consists of Antigua and Barbuda; Dominica; Grenada; St. Kitts and Nevis; St. Lucia; St. Vincent and The Grenadines; and two British territories (Anguilla and Montserrat).

⁶⁰ The Southern African Development Community (SADC) consists of Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe. The Economic Community of West African States (ECOWAS) combines the WAEMU countries with Cape Verde, The Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone; the Gulf Cooperation Council (GCC) comprises Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

La Porta, R, F Lopez-de-Silanes, A Schleifer and R Vishny (1998): "Law and Finance," *Journal of Political Economy*, vol. 106, no 6, December.

Lybek, T and J Morris (2004): "Central bank governance: a survey of boards and management", *IMF Working Paper*, no 04/226, December.

Maier, P (2007): "Monetary policy committees in action: is there room for improvement?", Bank of Canada, *Working Paper*, no 2007-6, February.

Marshall, J (2003): "Fiscal rule and central bank issues in Chile", in *BIS Papers*, no 20, October.

Masciandaro, D (2004a): *Financial intermediation in the new Europe: banks, markets and regulation in EU accession countries*, Edward Elgar.

——— (2004b): "Unification in financial sector supervision: the trade-off between central banks and single authority", *Journal of Financial Regulation and Compliance*, vol. 12, no 2.

Masciandaro, D, M Nieto and H Prast (2007): "Budgetary governance of banking supervision: a primer", in D Masciandaro and M Quintyn (eds), *Designing financial supervision institutions: independence, accountability and governance*, Edward Elgar.

McCauley, R (2006): "Consolidating the public debt markets of Asia", *BIS Papers*, no 30, November.

Mihaljek, D (2007): "Fiscal transparency from central banks' perspectives: off-budget activities and government asset funds", in *Temporary measures and off-budget activities*, Magyar Nemzeti Bank.

Moreno, R (2002): "Fiscal rule and central banking in emerging economies: an overview", in *BIS Papers*, no 20, October.

Morgan Stanley (2008): *Central Bank Directory*, Central Banking Publications.

Moser-Boehm, P (2006): "The relationship between the central bank and the government", in *Central banks and the challenge of development*, Bank for International Settlements, May.

Oritani, Y (forthcoming): "The public governance of the central bank: an approach from new institutional economics", mimeograph from Meiji University.

Padoa-Schioppa, T (2003): "Central banks and financial stability: exploring a land in between", in V Gaspar, P Hartmann and O Sleijpen (eds), *The transformation of the European financial system*, Second ECB Central Banking Conference, European Central Bank.

Peek, J, E Rosengren and G Tootell (1999): "Is bank supervision central to central banking?", *Quarterly Journal of Economics*, vol 114, May.

Pruski, J and D Zochowski (2006): "Changes in the financing structure of the real economy in Poland", *BIS Papers*, no 28, August.

Reserve Bank of Australia (2003): "The variability of Reserve Bank profits", *Annual Report*.

Reserve Bank of New Zealand (2007a): Memorandum to Minister of Finance, and Balance Sheet Review Qs and As, 19 June.

——— (2007b): "Reserve Bank announces changes to FX management", Reserve Bank of New Zealand, press release, 13 July.

Santomero, A, S Viotti and A Vredin (2001): *Challenges for central banking*, Kluwer.