

Chapter 5: Relations with government⁹³

The Main Issues

Most of the choices to be made in shaping the central bank's relations with the government and legislature are practical ones with important consequences. Good relations allow effective coordination of policies and operations. And for fundamental policy issues on which the central bank may be only an adviser – regime choice and framework design – the central bank is likely to lose access to the political decision-making process if it does not maintain good relations. Yet, relationships that do not respect the autonomy intentionally provided by the central bank's statute may undermine the effectiveness of policymaking, to the detriment of the public. In that context, here are the main issues:

- What arrangements can ensure effective dialogue and consultation between the central bank and the executive and legislative branches while avoiding inappropriate influence of those branches?
- What are the limits on central bank advice to the government, in private and in public, on issues outside of its mandate?
- Can governments and legislatures publicly comment on the conduct of monetary policy without undermining the central bank's autonomy?

1. Introduction

As public institutions, central banks need to interact with government. Chapter 3 discussed the interaction in terms of the legislation governing the central bank. Chapter 7 will consider interaction in the context of accountability. This chapter considers the interaction in practical terms. The discussion focuses mainly on the central bank's means of maintaining a relationship with the executive branch without undermining central bank autonomy. Depending on the system of government, some aspects will be relevant for the central bank's relationship with the legislature as well.

If the amount or intensity of contact between the central bank and government exceeds that envisaged in the central bank's statute, it can provide a conduit for active political influence that threatens central bank autonomy. In some important areas, policy coordination can be achieved without close contact if relations are governed by clear roles and responsibilities. Ideally (from the perspective of macroeconomic policy efficiency), the government knows the central bank's policy "reaction function". It can then anticipate the monetary policy response to a planned fiscal action and adjust accordingly. Coordination between monetary and fiscal policy can thus be achieved without close interaction.

However, both the central bank and the government are likely to make better decisions within their independent spheres of responsibility if they can exchange information with one another during the period of deliberation on those decisions. For example, much work may be needed to understand the policy implications of a major change in the tax system, and advance consultations with the central bank may contribute to better outcomes. On a technical level, information flows between the central bank and the government are typically also necessary for the day-to-day implementation of monetary policy. In some countries, particularly in emerging markets, the perception of close

⁹³ This chapter was prepared mainly by Paul Moser-Boehm.

coordination between the central bank and the ministry of finance is of crucial importance to investors, particularly in periods of financial stress. In addition, the regulatory functions or advisory responsibilities of the central bank may call for close coordination with the government. Liaison will be needed if the central bank performs banking or debt management services for the government. Participation in international forums also calls for coordination.

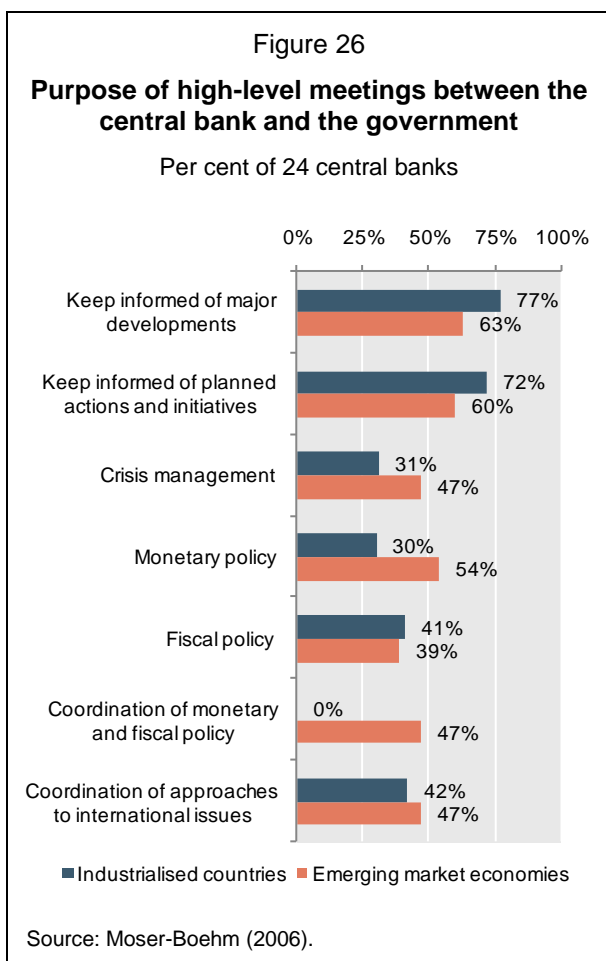
2. Nature of contacts

2.1 Meetings of senior central bank and government officials

This section draws on a 2005 BIS survey (BIS (2005d)) and related discussions by central bank governors.⁹⁴

2.1.1 Formal meetings

All central banks in the survey exchange information and cooperate with government, but the process for doing so differs considerably between industrialised countries and emerging market economies (Table 10). In industrialised countries, it is common for the governor and the minister of finance to meet one-on-one or in a small group, less so in emerging market economies.



In contrast, it is far more common in emerging market economies than in industrialised countries for a government representative to participate in meetings of the central bank's board or for the governor to participate in cabinet meetings. The average number of meetings of senior central bank officials with counterparts in government is twice as high in emerging market economies (47 per year, or about one per week) as in industrialised countries (23, or about two per month). However, the number of types of such meetings is higher in industrialised than in emerging market countries.

Strikingly, for about half of the central banks from emerging market economies, the coordination of monetary and fiscal policy is a key purpose of their high-level meetings with the government, while none of the central banks of industrialised countries say that this is why they meet with government (Figure 26). Similarly, discussing monetary policy is a purpose of the meetings considerably more often in emerging

⁹⁴ See Moser-Boehm (2006) for a more detailed analysis of this issue.

market than in industrialised economies. It is not clear why this is so. One possibility is that limitations to monetary policy autonomy are more of a factor in some emerging market economies than in industrialised countries, and as a result there is a greater need to meet and agree. In addition, having generally more meetings (to discuss a larger range of subjects) may make it more natural in emerging market economies to discuss monetary policy as well, especially in countries in which some members of government are not well versed in monetary policy matters.

Table 10
Frequency of meetings between the central bank and government
 24 central banks

Type of meeting	Per cent of central banks having this type of meeting		Average number of meetings per year	
	IC	EME	IC	EME
Governor and minister of finance	73	31	8	9
Governor and other high-level government officials	91	62	5	21
Deputy governors and high-level government officials	27	15	9	32
Senior officials and department heads	36	15	7	12
Government representative on central bank's board	18	62	17	17
Governor at (economic) cabinet meeting	9	54	10	29
Financial stability or supervisory committee	18	38	9	14
Other	36	23	4	3
Number of meeting types	Percentage of respondents using		Total average number of meetings per year	
One	–	–		
Two	9	31	23	47
Three	36	31		
Four	55	38		

IC Industrialised countries. EME Emerging market economies.

Source: Moser-Boehm (2006).

The degree of involvement of the governor also varies considerably across countries. Some governors have less than a handful of meetings with senior members of government each year, while others meet with the head of government or the minister of finance on a weekly basis. For example, the Governor of the Reserve Bank of Australia generally meets with the Minister of Finance *after* the meeting of the Reserve Bank Board, while the Governor of the Central Bank of Norway and the Minister of Finance meet on the day *before* interest rate meetings of the Bank's Executive Board. In the Czech Republic, the Minister of Finance has the right to participate in the weekly

meeting of the Board of the central bank, and the Governor (or Deputy Governor) has the right to participate in a weekly meeting of the Government. In Mexico, the Minister of Finance and the Deputy Minister of Finance may attend the meetings of the Board of Governors, with a voice but without voting rights. Although it rarely happens, the Governor may also be invited to attend cabinet meetings. In the United Kingdom, the Governor meets the Chancellor of the Exchequer about once a month; although they discuss a broad range of matters, including appointments, they only rarely discuss monetary policy. In the United States, a Federal Reserve/Treasury luncheon is hosted at the Federal Reserve Board by one of the Governors on a rotating basis once every three weeks or so. In part, that meeting reflects a commitment made by both sides in their 1951 Accord to maintain an ongoing exchange of information.

The purposes of meetings involving the governor tend to be more wide-ranging in emerging market economies than in industrialised countries, a difference probably reflecting the broader mandates of emerging market central banks. In emerging market economies these meetings also tend to be relatively more institutionalised than personal, in the sense that other senior officials may occasionally substitute for the governor. In industrialised countries, meetings would be less likely to occur in the absence of the governor.

2.1.2 *Informal contacts by governors*

The governor and other senior central bank officials also maintain contact with their counterparts in government over the phone and by email (Table 11). In most countries the governor and the minister of finance keep in touch by phone, with both sides initiating contact with similar frequency. Calls are typically made once or twice per month. The governor and the head of government also keep in contact over the telephone in the majority of countries, but less frequently than with the minister of finance. Informal contacts between the governor and the head of state are still less frequent, and generally not made in about half of the countries surveyed.

As discussed above, consultation between the central bank and the government tends to be a more continuous, frequent activity in emerging market economies than in industrialised countries. In line with that pattern, informal contacts between the governor and senior government officials are on the whole more frequent in the emerging market economies. Indeed, in about a third of the emerging market central banks in the survey, a general coordination group has been established at the staff level to deal with all central bank/government issues, and almost half of emerging market central banks have set up such a coordination group for monetary and fiscal policy coordination. By contrast, such groups are rarely used in the industrialised countries.⁹⁵

In emerging market economies, the level of the government counterpart who is contacted by the governor tends to be higher than in industrialised countries. This is consistent with the governor having a higher average rank in official protocol in the former (where the most frequent case is the governor having the same level as the minister of finance) than in the latter, where the governor most often is at the level of the highest ranking civil servant at the ministry of finance.

⁹⁵ The only exceptions are coordination groups for financial sector/financial stability issues and for crisis management, which are used in a number of industrialised countries and emerging market economies alike.

Table 11
**Informal contacts between the governor
and selected senior government officials**
Per cent of responses from 23 central banks

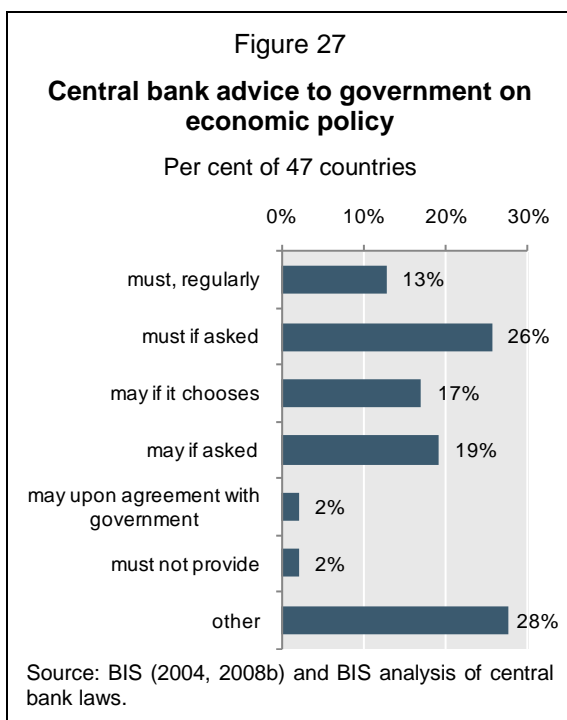
Characteristic of meeting	Head of state		Head of government		Minister of finance		Deputy minister of finance	
	IC	EME	IC	EME	IC	EME	IC ¹	EME
Generally not done	40	54	30	23	10	8	30	15
Frequency per year:								
Up to five	100	80	67	33	13	–		13
Six to ten	–	–	17	33	63	38		38
Eleven to 25	–	20	–	–	25	31		13
More than 25	–	–	–	22	–	23		13
Direction:								
Usually governor contacts government official	33	20	17	44	25	–		–
Usually government official contacts governor	–	40	50	22	–	15		13
Each side initiates contact with similar frequency	–	20	33	22	75	77		63

¹ Insufficient information was provided for this column.

Source: Moser-Boehm (2006).

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2.2 The role of the central bank in the economic policymaking process



The central bank is almost always a centre of economic expertise, and in some countries there is no counterpart with similar expertise in government. As a result, about half of the central banks in industrialised countries and two thirds in emerging market economies have a legal obligation to provide advice on economic policy to the government if the government asks or, in a few cases, as a matter of course. Other central banks have the right to provide such advice if they deem it appropriate, or they may provide it on request.

For the majority of central banks, contributing to the debate on government economic policies is thus not voluntary – they must do so if asked, and other survey evidence suggests that many are in fact asked to provide advice (Figure 27). However, central banks can

choose whether to provide the advice publicly or privately. Judging from what is in the public domain, most prefer giving their advice privately.

In at least two cases, it may be difficult or even undesirable to keep policy advice to government out of the public eye. One is if the central bank is the sole source of official macroeconomic analysis in the country. In that case, it can be in the interest of both the government and the public if the analysis is published, as it may serve as a baseline for the government's budget or as a voice of reason that helps to convince the public of the need for reform. However, publication may come at the cost of drawing the central bank into debates outside its own mandate, thus making it difficult for the central bank to retain its political neutrality.

The second and more difficult case is that in which the central bank judges that government policies pose a massive risk to the long-term health of the national economy, a threat of imminent fiscal dominance or a lack of progress away from it. Whether central bankers have a whistle-blowing responsibility when it perceives that government economic policies will be ruinous is a matter for each country's tradition to determine. It is not clear whether the independence to conduct monetary policy makes central bankers more like independent professionals (who may have a "civic duty" to speak out) or like civil servants (whose obligations may be more complex). This second case also concerns extreme circumstances in which the foundations of good government are at risk and the central bank must make a choice as to what role to play in an institutional, not primarily economic, crisis. As the following section will point out, such circumstances are rare but probably not rare enough to be ignored.

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3. Managing the relationship

Table 12 shows that serious conflicts in industrialised countries between the central bank and the government, while not frequent, do occur from time to time. In contrast, in emerging market economies the odds are considerable that a governor will find himself or herself in serious conflict with government at least once.

One reason for disparity in the frequency of conflict may be that, on average, the emerging market economies have the shorter histories. Even with a well conceived central bank law, institutions need the time to establish their territory and flesh out the extra-statutory protocols governing interactions between them over cycles encompassing both stress and calm. Well known disputes (and their resolution) in Canada (1961) and the United States (1965) show that the law does not cover every aspect of the relationship; a recent dispute in Iceland illustrates that sharp conflicts can arise even when the law is very clear.

Differences may also result from some governors' active guarding of the boundary lines. For example, in 1988, Federal Reserve Chairman Greenspan publicly rebuked an undersecretary of the Treasury who had written to him requesting an easing in monetary policy.⁹⁶ Similarly, in 2006, the EU Commissioner for Economic and Monetary Affairs and the chairman of the EuroGroup wrote to ECB President Trichet to request more meetings with him; Trichet replied bluntly that there was no need because the President of the ECB is the spokesperson for the euro, not a politician.⁹⁷ In some countries, the boundary lines are less well established and thus more difficult to guard.

⁹⁶ Havrilesky (1995).

⁹⁷ As reported by Reuters, 8 June 2006.

In Colombia, for example, the President has on occasion publicly demanded a cut in central bank interest rates.

Table 12
Incidents of tension between central bank and legislature, 1990–2007

Per cent of responses from 40 central banks

	Total	Industrial-ised countries	Emerging market economies
Legislature passed formal resolution or formal comment on the central bank and its policies, outside or in addition to the legislative review foreseen in the law	9	0	16
Central bank and its policies were subject of extraordinarily heated debate in the legislature that went substantially beyond the critical review of the central bank that is part of the ongoing process of accountability	15	9	20
At least one of above	19	9	28

Source: BIS (2002, 2008b).

Managing the relationship with government will be different for central banks that are themselves an integral part of the (narrowly defined) state apparatus. Such is the case for the People's Bank of China, which reports directly to the government and formulates and conducts its policies under the leadership of the State Council.

3.1 Formal approaches

Some approaches to relationship and dispute management can be institutionalised. Two types of the institutionalised procedures in use by central banks are discussed below, along with a number of aspects raised in Chapter 3.

3.1.1 Directives

A particularly clear type of convention is a statute giving government the power to override the central bank's autonomy on monetary policy decisions. Although this power is relatively rare, it exists in at least four countries belonging to the Central Bank Governance Network (see Box 3).

Observers sometimes argue that the government's power to issue a formal directive to the central bank (even if subject to conditions and in a transparent manner) constitutes a major reduction in what is deemed an essential level of central bank autonomy. However, some central banks operating under such a government power tend to believe that it can be a useful escape valve when its relationship with the government is extraordinarily tense. In such cases, the government can take control of policy, but it must do so in public and choose an explicit alternative path. If the governor deems the path unacceptable, he or she could resign, but that outcome could be a major blow to the government, especially if the governor's reputation is high. If the government fears that outcome, its policy choices become narrowed to those that still have a measure of support in financial markets. The provision for a government directive can thus make it feasible to achieve a resolution without resort to a change in the central bank law, which, if done at a time of conflict, may lead to a long-lasting and economically damaging degradation of the central bank's autonomy.

Box 3 Government directives to the central bank

The approaches taken by governments to issue directives to central banks vary substantially, as illustrated by the procedures instituted in Canada, Korea, Malaysia and New Zealand.

In Canada, the law requires regular consultations between the Minister of Finance and the Governor. If an issue cannot be resolved in these consultations, the Minister can issue a directive on monetary policy but only after further consultation with the Governor and the approval of the Prime Minister. The directive must spell out specific instructions and applies for only a specified period of time; Parliament must publish it within 15 days.

In Korea, the Minister of Finance may request the Monetary Policy Council of the Bank of Korea to reconsider a decision that the Minister believes is in conflict with the economic policy of the government. The request must be announced publicly. If, in response, the Monetary Policy Council reaffirms the decision with at least five members concurring, the President of Korea must make the final decision.

In Malaysia, current law (under review) provides that the Minister of Finance may issue a directive to the central bank at any time, and the central bank must comply. If the central bank objects, the Minister must present both the directive and the objection in the legislature.

In New Zealand, a more detailed approach is taken. The Prime Minister may issue the directive to the central bank on the advice of the Minister of Finance. The directive applies for a maximum of 12 months, after which it can be renewed. It must be published and presented in Parliament, and the Governor and the Minister of Finance must negotiate a new Policy Targets Agreement (PTA) that is consistent with the directive within 30 days.

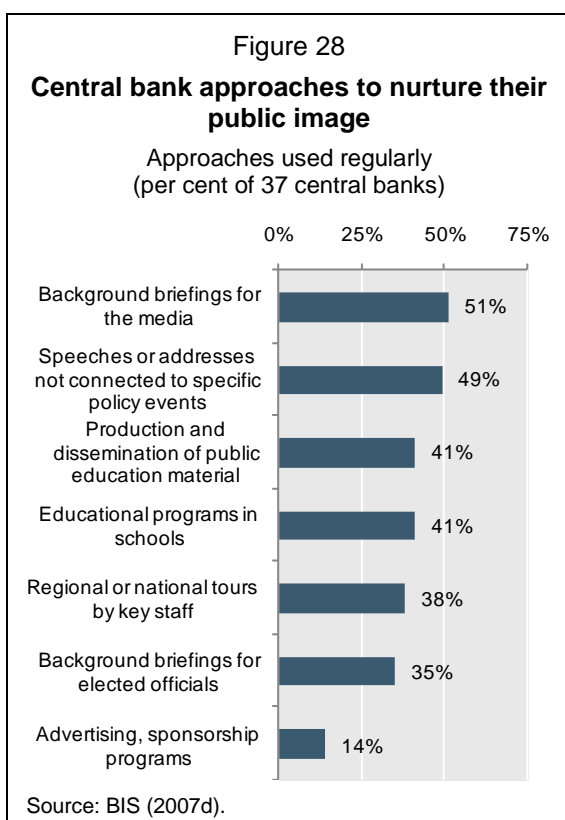
A somewhat different mechanism is used in Japan, where the Minister of Finance and the Minister for Economic and Fiscal Policy (or designated delegate) may submit proposals to the Board regarding monetary control matters; or they may request that the Board postpone a vote on monetary control matters until the next Board meeting.

3.1.2 Memoranda of understanding

Several central banks have drawn up an MoU with their government to facilitate their interaction with each other.⁹⁸ For example, early on in his tenure, the current Governor of the South African Reserve Bank had a number of contentious meetings with the Minister of Finance and his staff. The situation was ameliorated by a suggestion from the Governor for a new approach to their meetings; the approach was formalised in an MoU and substantially improved the relationship. In Hong Kong SAR, a 2003 Exchange of Letters between the Financial Secretary and the Chief Executive of the HKMA set their respective roles.

⁹⁸ These MoUs may overlap but are generally different from those covering the roles of various agencies in financial sector supervision or in dealing with institutions in financial distress.

3.2 Informal approaches



Informal arrangements for interacting with government vary widely, but some major approaches are evident. A number of these approaches would seem to be most relevant for maintaining a productive relationship with government if they are seen by the central bank as part of their “active management” of the relationship. Active management means trying to understand the perspective of the government and preparing facts and arguments proactively so that problems can be addressed while they are still manageable. It also means, when possible, avoiding having the government be publicly surprised by the central bank; such surprises can work to the detriment of the central bank’s public reputation. Background briefings for elected officials are one way to avoid such surprises, but, as Figure 28 shows, central banks seem to use such briefings notably less than background briefings for the media as a means of nurturing their public image.

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Table 13
Topics addressed regularly in background briefings for politicians
 Per cent of 37 central banks

Briefing topic	Total	ICs	EMEs
Monetary policy mandate and objectives	54	62	44
Central bank’s role in financial stability	51	57	44
Raison d’être, identity of central bank	46	57	31
Limits to what the central bank can achieve	46	48	44
Dedicated effort to directly enhance the reputation of the central bank	35	29	44
General financial literacy	22	24	19

Source: BIS (2007d).

Regarding the topics featured in the background briefings that central banks provide for politicians, the most frequent are the monetary policy mandate and objectives and the central bank’s role in financial stability (Table 13). Central banks in industrialised

countries more so than in emerging market economies tend to hold such briefings regularly⁹⁹

3.3 *Communication*

In some countries the central bank has an obligation to comment publicly on selected aspects of government policy (including at times on matters that are unrelated to central bank issues), and in a few cases the government has an obligation to comment on general aspects of monetary policy. However, in the majority of cases each side can choose how frequently it comments on the policies of the other side (Table 14). Central banks in industrialised countries have a higher propensity to comment on the fiscal and structural policies of the government than do their counterparts in emerging markets, and central banks as a whole comment more frequently on government policy than governments do on monetary policy – indeed, central banks rarely consider it a taboo for them to comment on government economic policies. Many of the central banks in emerging market economies say their comments on government policies are part of their duty, whereas, in industrialised countries, tradition and (to a lesser extent) the personal preferences of the governor play the most important role. The Deutsche Bundesbank, with its long tradition of commenting critically on fiscal policy, is a case in point. The Federal Reserve is another, whose Governors frequently make public comments and speeches on a wide range of economic and social issues.

More generally, wider public support for central bank autonomy may allow central banks to comment on fiscal policy more freely than in the past. However, national traditions differ, and a movement by the central bank to speak out more openly on fiscal and structural policies needs to be considered carefully. Two examples illustrate the range of outcomes that can result from such public disputes over policy.

First, during the 2004 federal election campaign in Australia, the Prime Minister claimed that interest rates would rise if the opposition were to come into power. This claim was accompanied in some political campaign material by the suggestion that the Reserve Bank of Australia had endorsed the current government's economic policies. In response, the Reserve Bank of Australia lodged an official complaint with the Electoral Commission. That response was understood to have reduced the chance of a reoccurrence of such an event.

Second, having objected unsuccessfully to the monetary policy conducted by Magyar Nemzeti Bank, the Government of Hungary in late 2004 passed an amendment to the central bank law to increase the number of members of the Monetary Council from nine to 13.¹⁰⁰ The move was interpreted by many as an attempt by the Government to stack the Council in its favour. However, with the central bank law stipulating price stability as the central bank's primary objective and with an inflation targeting framework in place, the increase in membership did not change the stance of monetary policy in the way the Government may have expected.

Overall, snares await the governor who either indulges in disputes with the government or, more broadly, chooses to speak publicly about matters unrelated to central banking. Comments from the central bank about government policies have their appeal to the

⁹⁹ The smaller propensity of emerging market central banks to provide such background briefings for politicians ties in well with their larger propensity to have regular meetings with government officials where monetary policy is discussed. These regular meetings may thus take the place of the background briefings that are used more often in the industrialised countries.

¹⁰⁰ The number of members on the Monetary Council, currently at nine, is predicted to decline to seven.

media because they come from a source that has an aura of professionalism and political neutrality. But, as stories of conflict help attract an audience, the media can tend to magnify them.

Table 14
**Public comments by central banks
 and governments on each other's policies**

Per cent of 22 central banks

Topic	Must comment		Chooses to comment							
			Often or always		At times		Rarely		Never	
	IC	EME	IC	EME	IC	EME	IC	EME	IC	EME
Comments by the central bank										
Government's budget	10	8	30	33	50	42	10	8	10	0
General aspects of fiscal policy	–	–	50	17	30	50	20	8	–	17
Financial sector policy	–	33	33	17	60	25	10	–	–	8
Structural policy	–	–	40	17	40	42	20	25	–	8
Comments by the government										
Monetary policy decisions	–	–	–	17	70	42	30	17	–	8
General aspects of monetary policy	–	17	–	17	50	33	20	17	20	–

Source: Moser-Boehm (2006).

Likewise, problems can emerge if the governor speaks out on a wide range of topics that are not related to his or her professional responsibilities. In such cases, the governor can be perceived as attempting to advance a personal or political agenda and thereby lose her or his reputation as an impartial expert. Even if a governor does not initiate speaking on such topics, the governor is often asked about them by the media precisely because of the weight and prestige of the governor's office. If the governor chooses to respond, a disclaimer such as "this is only my personal opinion" is of limited use. One way for the central bank to address the issue is to minimise such comments – for example, by the governor refusing to take open questions from the news media. However, in some countries such an approach is unthinkable for a senior public official and could be interpreted as a sign of disdain for democratic practices or of weakness in exercising the bank's policy autonomy.

An alternative approach is for the central bank to engage with the media on the economic policies of the government or broader issues only if the topic is critical for the central bank. And if it is, the comments can be usefully preceded with a statement that they are not political but based on impartial economic analysis. That stipulation is most effective if it is rarely needed. Just as it is important for political leaders to be in the news, it is important for the governor to keep his or her powder dry until needed.