

How independent is a Central Bank?

In an autocracy the Central Bank is the instrument of the state and takes instruction from the government or Leader. In some democracies like Turkey and India the politicians clearly change personnel in the Bank to get the answer they want.

In an advanced sophisticated democracy the relative powers of the government and the Bank are more subtle. It is still fashionable to claim that the Fed, the Bank of Japan and the Bank of England are independent . The answer is, only up to a point.

It is true it is now common for Central Banks to have Committees or Boards of actual or supposed experts to review the domestic economy regularly and to set interest rates at the short end. This process is said to be independent. In practise it is heavily influenced by the appointments made to the committee which are under government control, and or to the views of the Bank Governor who is also appointed by the government.

Mr Trump took a strong interest in the appointment of Chairman of the Fed when the vacancy occurred and made clear his wish to have a Chairman who backed his expansionary growth oriented policies. When he did not do so sufficiently the President and the markets complained until he changed policy.

In the UK it was commonly reported that the former Chancellor was keen to appoint Mr Carney as Governor and got his way during the appointment process. Mr Carney had a negative view of Leave, a crucial and contentious issue. His view coincided with the Chancellor's. The Bank did not rate the obvious upsides from ending the payments to the EU, having our own trade, fishing and farming policies and the other gains. The Bank joined the Treasury in making a series of short term forecasts about the immediate aftermath of a Leave vote which were predictably far too pessimistic.

The famous pioneer of so called independent Central banking was the German Central Bank set up after the War and continuing into the Euro era. It was true that for many years the German Central Bank made decisions on rates and money that were unchallenged by politicians. The truth was the politicians were happy with what the Bank was doing and there was no need to challenge. The first major disagreement between Bank and government came with the decision of the government to press on rapidly with amalgamating the Ostmark into the DM on the merger of the two Germanies. The Bank gave good advice on the rate of transfer and the timing which the government overrode, reminding the Bank of their supremacy. The Bank was right on the economics but overridden by the politics.

Further humiliation came for the once proud Central Bank when the German government decided to abolish the DM, the currency the Central Bank had to control and guide, and to go into the Euro. The Central Bank had to accept its sidelining with the abolition of the very currency it had proudly

championed for years.

In the UK Chancellor Darling rightly overrode the Bank of England on interest rate changes during the banking crisis. It was dressed up as Bank decision by the Bank agreeing to hold an out of diary special meeting to cut rates to co-ordinate with other countries following Ministerial agreement. Gordon Brown changed the inflation remit of the Bank when he wanted to influence policy more directly.

The USA gets it right. The Fed has twin objectives of inflation and growth, and has to work closely with the Administration's economic policy. The President was right to demand money loosening at the end of 2018 and the Fed came to accept his judgement for themselves.