IMPLICATIONS AND IMPORTANCE OF CENTRAL BANK INDEPENDENCE IN THE AFTERMATH OF THE EXCEPTIONAL MEASURES

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"Sovereign is he who decides the exception" Carl Schmitt Political Theory as quoted by Philip Mirowski

"The role of a central banker is to protect their people from the bankers…" words pronounced during a meeting of the G20 by the governor of one of the most important central banks.

Crafting reforms for banks – and even those labelled as structural ones – has been an active sphere of activity in the last few years even if many of us would be less than satisfied about the character and depth of what has been decided. Most attempts at actual restructuring, however, have barely left the documents where the proposals were drafted (Vickers, Liikanen…) and the Too-Big-Fail problem or the shadow banking system have not been tackled.[2] As to the sheer "reforms" like Basel III or Dodd-Frank, moving targets both of them as regulators keep modifying aspects of it all under pressure from particularly the largest institutions, let alone the significant changes introduced when adopting the rules in each country or region, amount to little more than increases in -risk-weighted - capital ratios and inconclusive liquidity requirements.

Curiously enough, however, and even if a matter of debates and pronouncements from various sides plus the actual behaviour of the major most influential institutions in these last few years, no consensus has been struck about a different permanent role for central banks – beyond the present day crisis - not even about their role in preserving financial stability. Thus, the expression "exceptional measures" has been concocted, a fragile fig leaf to justify policies that are unacceptable for the last quarter of a century orthodoxy about what should central banks be all about and that are supposed to be immediately – even prematurely - abandoned as soon as "green shoots" of a recovery sprout.

But in fact, in the words of Axel Leijonhufvud: "There are two aspects of the wreckage from the current crisis that have not attracted much attention so far. One is the wreck of what was until a year ago – the piece I am quoting was published in May 2008 – the

[1] The usual proviso applies that I am speaking on strictly personal terms and not in the name of the Central Bank of the Argentine Republic I continue to be an official of, in the last few years as an advisor to the Chair of its Board of Governors.
[2] For a sceptical view of the "structural reforms" see, for instance, "Creating a Safer Financial System: Will the Volcker, Vickers and Liikanen Structural Measures Help?" by Viñals, J. et al., IMF SDN13/14, !4 May 2013.

widely accepted central bank doctrine. The other is the damage to the macroeconomic theory that underpinned that doctrine". [3]This two assertions being still true to-day.

In spite of some clear words from Axel and a whole lot of valuable members of the profession, the subject is bulging with misunderstandings and in many cases with supposed "truths", in many cases with less than solid empirical justifications. As we will have a chance to explore later, the subject and the lack of movement away from widespread ideas in the last quarter of a century might belong to the amazing survival of neoliberalism in spite of the present-day crisis.

Let me take up some of those misunderstandings.

The first one, about the notion of "crisis" as referring only to the present-day one erupting in the North Atlantic – with its consequences around the world - as the justifying circumstance for the "exceptional measures" undertaken.
Sometimes it sounds that there has not been anything like it in the last 50-70 years when not only a few very well advanced countries – like some Nordic ones in the late 1980's and early 1990's – but many developing ones have experienced severe banking crises in the era of financial globalisation.

Maybe, the first ones to be hit were the Southern Cone countries in Latin America at the beginning of the 1980's involving costs – both fiscal and in terms of output - amounting to a substantial proportion of their GDP well above, in relative terms to estimates of the present-day crisis. [4] In this last case, no doubt, hurried adoption of the last developments in macroeconomic theory to these fragile economies played a significant role; these countries, in fact, having been guinea-pigs of the most audacious but precisely also most appealing constructs of mainstream academia at that time.

So if for central banks there are lessons to be learned from banking crises, we should not restrain ourselves to the "extraordinary measures" reluctantly introduced by the major central banks but to a much wider experience particularly if we are concerned about developing countries and the design of central banks for these countries.[5] It is sometime surprising to see truly talented and normally critical colleagues in advanced countries "discovering powder" as we say in the Spanish language. For instance as taken up by the Financial Times economics correspondent Martin Wolf only a couple of weeks ago commenting an excellent paper presented at a conference organized by the San Francisco FED, currency mismatches in the balance sheet of non-financial firms would be a source of financial fragility to be avoided.

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[3] "Keynes and the Crisis", CEPR, Policy Insight No.23, May 2008.

[4] For Argentina – 1980 – Chile and Uruguay – 1981, fiscal costs and output losses relative to trend – in terms of GDP – where, respectively, (55.1&10.8%), (42.9&92.4%) and (31.2&87.5%).

[5] It was surprising for us to witness the debate about "resolution" authority for banks that had to be unwound, something we have been doing for decades and fully introduced in our banking legislation AND Criminal Law the various ways one can proceed in these matters; of course, with the added inconvenience that central bank authorities and officials also have had to attend court (in spite of the strenuous efforts by the IMF to have our countries change their laws and institute an almost impunity for central banks). For the U.S. case, see Rakoff,Jed S. "The Financial Crisis: Why Have no High-Level Executives been Prosecuted"?, NY Review of Books, January 9th. 2014. Rakoff mentions that one of the possible reasons for the dearth of prosecutions is the "too big to jail" one.

What about the Indonesian crisis of 1997? It was precisely a case of currency mismatches in the non-financial sector spilling over to the financial sector when devaluation of the rupee made it burdensome for firms to service their foreign exchange denominated borrowing and as a consequence defaulting on their domestic denominated debt towards the banks. Precisely because of such experience as well as the closer to us experience of Argentina in 2001-2002 that our central bank persistently argued at G20 meetings to take up the matter of currency mismatches.[6]
Another subject, of course, is that of controls on capital flows opposed by the staff of the IMF strongly advising countries to get rid of them, in spite of the right to impose such controls consecrated in Art. VI, sec. 3 of the Articles of Agreement just to come half-way round and accept that they might be of some use – after all other habitual measures having been taken – to stop the various problems associated with them.

In fact it seems to be the other way round as exposed only a few years ago by Malcolm D. Knight the then General Manager of the BIS. when opening a conference later transcribed in a volume about "Central Banks and the Challenge of Development" (2006) when stating "…it is of course almost a platitude to say that what constitutes an effective policy framework depends on the country's specific situation – its history, its stage of development, and so on. Yet discussions among Governors at this meeting underlined *a surprising degree of common ground among central banks*" (my emphasis). [7] And of course, the unmentioned "common ground" was the view of the central bank officials from the major advanced countries.

Additionally, it might quite interesting to look back at the secular and not only the last few decades experience of central banking in those countries that are now taken as advanced, for instance, to examine how they used to live under capital controls and pegged exchange rates.

In brief, diversity of circumstances and of development levels has to be taken up in the design of regulations for the financial sector and most specifically for the structure and policies of the central banks.

So what is this business of the "independence" of central banks? This leads not to a misunderstanding but to true Rubik cube of misunderstandings The idea is not new, for instance, the Reichsbank in Germany at the time of the early 1920s hyperinflation was "independent" and as it is well known some of the major central banks – those of England and France - were privately owned banks up to the end of World War II. [8]

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[6] See Martin Wolf "The Emerging Risks of ticking time bonds", FT, December 10, 2013 and Hyun Song Shin "The Second Phase of Global Liquidity and Its Impact on Emerging Economies", November 7, 2013 presented to the San Francisco FED conference "2013 Asia Economic Policy Conference: Prospects for Asia and the Global Economy", November 3-5, 2013.
[7] See, for instance, "The Liberalization and Management of Capital Flows: An Institutional View", November 14, 2012. The IMF is however playing a rather strong card insisting that under Art. IV it still retains the right to decide when the introduction of such controls is right for the health of the international monetary system.
[8] See Bibow, Jörg "A Post Keynesian Perspective on the Rise of Central Bank Independence: A Dubious Success Story in Monetary Economics", Levy Economics Institute, WP No.625 about a more realistic history than the habitual one about the jealous "independence" of the Bundesbank, "independence" that was imposed not only on the ECB – to little avail for those worried about CBs financing their governments

As it is well known central banks in the last couple of decades were pushed into single-minded institutions but for some honourable exceptions. Their only aim was to keep inflation low, extremely low, by the way, with little justification in historical experience about the advantages *per se* of such low inflation levels. [9]

And to pursue such an objective, first by control of monetary aggregates and later through the "indirect" means of intervening in the short-run interest rates market to "target" a certain inflation rate, their "independence" from government indications – sometimes labelled as "political interference" had to be jealously preserved.

One of the less discussed matters is what are the proclivities of central bankers, additionally, if there is something common to all of them particularly once they become independent. The literature takes it for granted that independent central banks will always be conservative-oriented. Inflation always will be their top priority and will matter well above full employment or growth even if in the words of a former governor of the Bank of England to be an inflation targeter does not imply to be an "inflation-nutter". Is it that as labelled by Jaime Caruana, the present-day general manager of the BIS, central banks might have liberated themselves from "fiscal dominance" to become under the rule of "financial dominance"? [10]

An abundant literature accumulated "proofs" that central bank independence was causally associated with lower inflation. [11]The theory underlying this view is the time

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– but also to all and every one of the CBs of the Eurozone at the very moment when actually they ceased to be monetary policy makers. On the subject see also the same author "The Euro and its Guardian of Stability: The Fiction and Reality of the 10th. Anniversary Blast", Levy Economics Institute, WP No.583, November 2009. As mentioned by Bibow the Bundesbank, central bankers and mainstream academia have endlessly used to the case of, after all, brief hyperinflation in Germany and its supposed role in bringing in Hitler to power as a justification for their "austeritarian" policies while passing over the following 10 years of deflationary policies as a more decisive factor. See such a counterargument see Pedersen "The German Hyperinfation…".

[9] For some debate of the importance of low inflation levels see, for instance, Khan, M.S. and A.S. Senhadji "Threshold Effects in the Relationship between Inflation and Growth", IMF WP00/110, June 2000 or Stiglitz, J. "Central Banking in a Democratic Society", De Economist, 146, No.2, 1998. Khan et al. show that for developing countries no negative effect may be detected up to 11% inflation per year; Stiglitz quotes Bruno and Easterly (1986) finding that below 40% per year there is no evidence that inflation is costly plus other authors of impeccable orthodoxy failing to show that inflation at low levels has a negative impact on growth.

[10] See his speech at the Banco de Mexico "The changing nature of central bank independence", Mexico, 14-15 October 2013.

[11] Maybe the first contribution was that of Parkin, M. and R. Bade in "Central Bank Laws and Monetary Policies: A Preliminary Investigation" in The Australian Monetary System in the 1970s" edited by M.Porter, Monash University Press, 1978 followed by a string of unpublished University of Western Ontario manuscripts in 1980,1982,1985 and 1988. Later it was A. Alesina to take up the argument in "Macroeconomics and Politics", NBER Macroeconomic Annual No.3, 1988, again in "Politics and Business Cycles in Industrial Democracies", Economic Policy, 1989 and jointly with L. Summers "Central Bank Independence and Macroeconomic Performances: Some Comparative Evidence", Journal of Money, Credit and Banking, 1993. Other major contributions, all of them supportive of a causal connection between central bank independence and lower inflation where Grilli,V., D.Masciandaro and G.Tabellini "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries", Economic Policy, 1991 and Cukierman, A. ,S. Webb and B. Neyapti "Measuring the Independence of Central Banks and its effect on policy outcomes", World Bank Economic Review, 6, 1992 and also Cukierman, A. "Central Bank Strategy, Credibility and Independence", MIT Press, 1992.

inconsistency models of Kydland and Prescott and, as applied to monetary policy, of Barro and Gordon. [12] Politicians would be prone to manipulate monetary policy to achieve short-run economic expansion independently of what could be the more long-run consequences, namely inflation in the minds of those authors.

The various "proofs", however, were severely criticized in several contributions. For instance, Charles Goodhart in a supposed memo to the governor of the Bank of England that in fact is a review of Cukierman's book – as it turns out heavily financed by various central banks and the BIS – after examining the statistical work on the role of central bank independence in achieving price stability states: "It is pretty feeble stuff on which to base a policy campaign" and in the next paragraph he follows: "Moreover, AC (Cukierman) has not appreciated the strength of the argument that correlation does not imply causation". [13]

The measurement of central bank independence was found to be based mainly on their legal framework, their statutes, although at some point – already in Parkin and Bade – a distinction had been drawn between political and financial independence only to concentrate on the first one. This led, for instance, to James Forder to show that, in fact, in most cases, the indices used to measure central bank independence were chosen because of their clear association with inflation. Forder follows to show that comparing three of the more ambitious studies – in terms of indices and number of countries involved – correlation between the rankings of the various central banks according to their independence was very low, particularly if the two widely accepted cases, those of Germany and Switzerland, are taken away from the exercise. What according to the indices used by one author was a very independent central bank did not rank as high for the other authors. Forder concludes that the indices used point to different characteristics of the notion of "independence" not clearly spelt out and the fact that they rank banks very differently mean that they hardly could be used to prove that independence is associated with low inflation. Additionally, the fact that some indices as "reasonable" as other ones of independence – for instance those showing financial independence-were discarded not showing any association with lower inflation lends ground to suppose that there is a high degree of subjectivity in the whole exercise. [14]

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[12] Kydland, F.W. and E.C. Prescott "Rules rather than Discretion: The Inconsistency of the Optimal Plans", Journal of Political Economy, vol.85, 1977 and Barro, R.J. and D. Gordon "Rules,Discretion and Reputation in a Positive Model of Monetary Policy", Journal of Monetary Economics, vol. 12, 1983.

[13] See Goodhart, C.A.E. "Game theory for central bankers: a report to the governor of the Bank of England", Journal of Economic Literature, vol.32, March 1994.

[14] See Forder, J. "Central Bank Independence: Reassessing the Measurements", Journal of Economic Issues, vol.33, No.1, March 1999. In Cukierman et al. Greece and Portugal were taken away from the group of developed countries as, for instance, Greece would have the fourth most independent central bank at the same time that it showed the highest inflation rate. For another piece in which the question of subjectivity is taken up, see Mangano, G. "Measuring Central Bank Independence: A Tale of Subjectivity and of its Consequences", Oxford Economic Papers, vol.50, No.3, 1998. Mangano showed that comparing Grilli at al. with Cukierman's, on average the authors diverged in the assessment of 30% of the legislation under consideration and in the case of some countries in up to 50% and they also disagreed on which criteria should be included in an index of legal independence with only nine out of 15-16 being common to both. Mangano also showed that even with some improvement in the independence indices relations with inflation and other macroeconomic variables were devoid of statistical significance coming

We are left, therefore, with the need to define a notion of central bank independence at more abstract level for which Milton Friedman might come to our rescue "…a central bank should be an independent branch of government coordinate with the legislative, executive and judicial branches, and with its actions subject to interpretation by the judiciary". [15]

But central bank independence of such a kind has been a matter of debate as to its consequences for democratic accountability. Precisely some of the characteristics of "political independence" the one that advocates of independence had identified as crucial for price stability, might question the democratic accountability of central banking. Only the wrong assumption that stabilising the price level – if that would be the result of "independence" – is politically neutral and achievable for a central bank would justify surrendering such a function of the state to a body run by non-elected officials. But choices about inflation vs. deflation are far from politically neutral as they have distributive effects at least between debtors and creditors even if, for the moment we leave aside consequences for the "real" economy. Even if, for the sake of the argument, one would leave aside the question about the distributive effects of choices about rates of inflation, it sounds somewhat contradictory for the advocates of central bank "independence" as the basis of ensuring low inflation to which such a high priority - we hope a public-spirited one – they grant, to insist that the task of the independent central bank is just technical.

Again, that monetary expansion or restriction has no short-run or long-run effects on economic activity or employment is a heroic hypothesis that has been intellectually repeatedly challenged and at the practical level not followed by central banks, even independent ones, facing the consequences of a recession. [16]
Consequently, on at least three grounds that of low vs. high inflation, the distributive effects at least between debtors and creditors plus the effect of monetary policy on the "real economy" it is hard to understand that even a "narrow" central bank only devoted to monetary policy is busy with sorting a problem that it is only "technical". Besides the fact that it is difficult to believe that a central bank by itself, either by controlling the monetary aggregates – something fallen out of fashion but not fully – can really control inflation independent of many other factors (exchange rates, fiscal policy, "liquidity preference" like in the present-day "deleveraging" experience, etc. something that was well known more than 50 years ago to none other than Milton Friedman. [17]

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to the conclusion that: "It thus appear that former tests purporting to link an ill-defined measure of independence with various macroeconomic variables were not reliable".

[15] See Friedman, M. "Should there be an Independent Monetary Authority?" in "In Search of a Monetary Constitution" edited by Leland B. Yeager, 1962.

[16] See, for instance, Siglitz, J. op.cit for arguments about how money matters and also A. Leijonhufvud, op.cit. and also "The Perils of Inflation Targeting", VoxEu, June 25, 2007.

[17] Friedman, M. "A Program for Monetary Stability" (1960).. By the way, M Friedman was not in favour of "independence" because it was thought as granting to much a concentration of powers "…in a body free from any kind of direct, effective political control". Besides contrary to the following generation of advocates of central bank independence as instituting "rules" against "discretion" – the mother of all sins - Friedman thought that an independent central bank would be too open for "discretion" in its policies thus advocating a fixed rule for monetary policy.

Besides the flawed attempt to assign “independence” scores and associate them with inflation for “narrow” central banks dealing only with monetary policy, what the literature has forgotten is that central banks have been dealing with various other things that have a lot to do with their independence. But for this last brief period of at least at the level of elaboration of ideas where there was that attempt to reduce central banks to only monetary policy, these institutions since their creation have been dealing with government finance and banking crises as well as, most important for present-day developing countries under financial globalisation, exchange rate policy.

Capie and Wood in a recent brief survey of the experience of central bank independence, mainly of the Bank of England and the Federal Reserve, as well as briefly for the ECB, looking in the mirror of the most audacious experiment in central bank reform, that of the New Zealand, in the late 1980s – that started the fad for “independence” and inflation targeting all over the world – come to the conclusion that there has never been anything like it. [18]

The Bank of England was born to finance the government in exchange of some privileges that were successively widened; a reciprocal dependency had been established right from the beginning between government and central bank, the government in need of finance mainly for wars and the central bank keen to preserve and increase its various privileges. During the period of the “Pax Britannica” then the emphasis shifted to preserve the exchange rate – under the gold standard – although at the moment when severe crises erupted, it was the government to instruct the Bank to save the banks, even if after 1844 reforms it was not supposed to do so. Other wars came and go and the Bank – remember in private hands - obliged by financing the government.[19] In the Second Postwar period of the XXth. Century the main concern again became the defence of the exchange rate, even if fixed but adjustable under Bretton Woods rules (although the Bank maintained the privilege of moving the interest rates it always consulted the Treasury). With the collapse of such system, the Bank could concentrate on monetary policy and even there was the brave joint attempt to make it independent – in “instruments” but not as to ”goals” as the government was supposed to fix the inflation rate to be aimed at – and take away supervision to a new agency – the FSA – bank as well as other sectors of financial activity. The crisis has ended up with all that, the Bank being returned a great deal of what had been transferred to the FSA plus following an expansionary monetary policy that has little to do with managing the inflation rate. Additionally, confronted with the beginning of the crisis it fast resorted to the government to support Northern Rock, another deviation – if justified - from “independence”.

The FED the creation of which was much more influenced by the attempt to stop financial crises, found itself almost immediately pressed to help the U.S. to finance its participation in WWI; again a direct role in government finance. After WWII, as an outcome of conflict between Treasury that wanted to keep interest rates low so as to

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[18] See Capie, F. and G. Wood “Central Bank Independence: Can it survive a crisis?”, March 2013 version.

[19] Capie and Wood, op.cit. quote the legendary Montagu Norman, Governor for two decades of the BoE still in private hands, when telling a meeting of Commonwealth central bankers: “I am an instrument of the Treasury”.

reduce the cost of debt service, eventually in 1951, the "Accord" was struck and the FED gained some independence vis à vis the Treasury. [20] And of course, under the present crisis, resorted to all kind of instruments to "bail-out" banks – or bankers – to then get involved in QE, an acknowledgement that monetary policy might, in their opinion as well as that of the BoE, have some effect on unemployment (of course, we all know that the Fed preserved its dual mandate under which it has to look after employment as well as inflation and the level of interest rates).

A brief mention to the case of the ECB. As is well known the ECB the most independent of all imaginable central banks cannot lend to government or purchase government bonds in the primary market (there is a complicated question of the ECB mandate if one goes backwards in the Treaty on the Functioning of the EU to art. 2 to discover that the legal mandate might be more elastic). But there is no prohibition, and use has been made of it, to buy government bonds from the EZ banks.

Capie and Wood extract an interesting conclusion from their examination of those cases and of that of New Zealand: "…the whole argument of our paper is that such a creature cannot exist".[21]

In fact even much more interesting their examination of the NZ case lead them to a conclusion well known to lawyers, i.e. the matter of incomplete contracts. Even in the detailed case of the provisions of the reform in NZ there were omissions, the main one the possibility of a financial crisis (something similar, in my opinion, did influence some extreme strictures governing the "European System of Central Banks"). Another one, is the matter, of great importance for EMEs of the management of the exchange rate and foreign exchange reserves (in the case of the Eurozone in the hands of the Financial Committee made up of the Ministers of Finance).

The matter of "incomplete contracts" is of the utmost importance to gauge the utility of a distinction that has become common among some authors, i.e. the "structure" of monetary policy vs. the policy conduct. For some of them, "independence" in the sense of a structure – established by the powers of the state - under which the central bank could be delegated the functions, mainly the monetary policy ones, that would create the right incentives for central bankers to pursue some common shared objectives without having to mingle in the day-to-day running of monetary policy could be the ideal solution, mixing democratic control and technical efficiency. But the structures are prone to break down as new unpredicted or unpredictable events will force the central bank and the government to come together; this is precisely what happened in NZ although without too much change (besides the high turnover of governors). And this is what has been happening each time that a major crisis hit a country, developing or advanced.[22]

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[20] Sproul, the head of the NYFED that started the conflict about interest rate levels worried as he was with the consequences of the Korean War, however, stated that the FED should be "independent within government not independent of the government".

[21] See Capie, F. and G. Wood, op.cit, p.27.

[22] Stiglitz, op.cit., argues against independence on the basis – among other things of the "fallibility" of human beings or boards of human beings. See Stiglitz, J. op.cit.

Why is it hen that central bank “independence” has been so eagerly received in academic circles and led to the actual establishment of such “independent” central banks.

Adam S. Posen commenting in the mid-1990s the various attempts to establish a causality leading from central bank independence to the absolutely unchallenged objective of attaining price stability brings up another actor to the scene, i.e. the financial sector. [23]In his view national differences in the degree of bank independence in the post-war period resulted…from differences in financial sector opposition to inflation” (p.253). Some evidence is provided that inflation – as well as sudden and strong disinflation - is not good for financial sector profits. And therefore a fight against inflation is part of the lobbying efforts of that sector. For Posen central bank independence is not an exogenous proposal but is endogenous to the political-economic system. In countries were the financial sector aversion to inflation and their lobbying capacities are stronger, one would see “independence’ being established. Moreover, Posen argues that if such lobbying and society’s preference for price stability were strong there would be no need for central bank independence. Political support above all and any other consideration is what ensures “contract completeness” (my words). Posen goes on to construct an index (FOI) of financial opposition to inflation and finds that regressions of independence and of low inflation on that index give satisfactory, in his view, results. Moreover, as the various indices of FOI could not possibly be a consequence of central bank independence, it is argued that correlation in this case results in causality. The conclusion is reached that for price stability there must be both central bank independence and a political coalition strong enough to keep up the fight in spite of its various consequences not all of them positive all around.

From a different side, Forder has produced a brave attempt to try to understand why was it that the idea of central bank independence had become so widely accepted in spite of the evidence of it causally determining price stability was less than conclusive. In his “Why is Central Bank independence so widely approved?” Forder explores the reasons for the sudden acceptance of a hypothesis that only had been tentatively advanced at the end of the 1980’s by Alesina and that was neither new nor generally accepted before and for which arguments were far from conclusive. [24] In search of an explanation – and most specifically for the academic support for its generalised adoption – Forder resorts to the notion of “Groupthink”. [25]

In some circumstances people sharing a common objective could fail to see the weakness of their arguments and resist taking account of valid counterarguments. Mechanisms are created to impose uniformity leading to self-censorship among doubters and pressure on dissenters.

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[23] See, in a second version, his viewpoint in “Declarations are not enough: Financial Sources of Central Bank Independence”, in NBER Macroeconomics Annual 1995, vol.10, eds. Bernanke, B.S. and J.J.Rotemberg. In some of the more orthodox literature monetary policy is a game of the central banks against the worker’s unions.

[24] For the Forder, J. paper see Journal of Economic Issues, vol.39, No. 4, December 2005. As to the Alesina, A. ,see op.cit.

[25] In fact the title of a book by Irving Janvis, Boston, 1972 in which the mechanics of governmental decision taking was analysed to understand why groups of highly qualified experts had taken flawed decisions.

In a way, such a type of explanation has been advanced by Philip Mirowski to explain the persistence of neoliberalism in spite of the present-day crisis. Mirowski bases his analysis of the notion of "thought collective" that was introduced back in the 1930's by Ludwik Fleck, a Polish microbiologist that, in the English speaking world, is mostly considered to be an unappreciated forerunner of Thomas Kuhn's theory of scientific revolutions.[26] "A *thought collective* is defined by Fleck as a community of persons mutually exchanging ideas or maintaining intellectual interaction. Members of that collective not only adopt certain ways of perceiving and thinking, but they also continually transform it—and this transformation does occur not so much "in their heads" as in their interpersonal space". "There arises a *thought style* characteristic for that group. There also arises a certain *collective mood* which straightens up the ties among the group members and inclines them to act in a certain way". "When a thought style, developed and employed by a collective, becomes sufficiently sophisticated, the collective breaks into a small *esoteric* circle—a group of specialists which "are in the know"—and a wide *exoteric* circle for all those members, who are under the influence of the style, but do not play an active role in its formation". And follows in a way that many of us would feel familiar with "The force which maintains the collective and unites its members is derived from the community of the *collective mood*. This mood produces the readiness for an identically directed perception, evaluation and use of what is perceived, i.e. a common *thought-style*". [27]

[26] For Mirowski see his recent book "Never Let a Serious Crisis Go to Waste: How Neoliberalism Survived the Financial Meltdown", 2013. Fleck's best known work in its English language translation is "Genesis and Development of a Scientific Fact" (1979). For an examination of Fleck's life and theories, from which the following quotations come, see Sady, Wojciech, "Ludwik Fleck", The Stanford Encyclopedia of Philosophy (Summer 2012 Edition), Edward N. Zalta (ed.), URL = http://plato.stanford.edu/archives/sum2012/entries/fleck/

[27] Some further notions expounded by Fleck would seem close to our experience: "It is peculiar that those who participate in social creation of a thought style do not sometimes realize it either. After years they do not remember that once they perceived and thought differently, and they recall their research not as a winding road, full of turns, blind steps, successes resulting from compensation of accidental errors, etc. And above all they do not record in their memory those moments when new ideas appeared as a result of misunderstandings between researchers" and "The next aspect of social nature of cognition is the phenomenon that members of a thought collective mutually reinforce themselves in the conviction that their thought style is true".Stanford Encyclopedia…, op..cit.

So what are we going to do with the Rubik cube of “independence”. Facts have destroyed much of the arguments in its favour. The most important central banks – as “narrow banks” dealing only with monetary policy - have thrown themselves into monetary expansion in a way trying partly to compensate for the pressures arising by opposition to a continuation of fiscal expansion. And that in spite of the whole debate about the paralysis of monetary policy once zero interest rates have been reached. But additionally, they have involved in a major way to preserve the stability of the financial sector – about which one could not question the objective but the methods used – and at least through open market operations, indirectly have been financing their governments.

The “chorus”, however, keeps claiming to an early end to so-called “extraordinary measures”, in fact they were already advocating such a retrenchment already in 2009. In fact, it looks like there is a “divorce” between, so to speak, theoretical discourse and the actual practice of the main central banks, something that came up quite clearly a couple of days ago in the debate between Bernanke and the assistants to his presentation. And the chorus is made up of financial sector institutions and academics. In this sense as it came clear over this present-day crisis academia is playing a very aggressive political role by trying to paralyze the only instrument that “austerianism” had left in the hands of public authorities.

In my own opinion close to those of Forder but even more to that of Mirowski what is at stake is a fight to take away from public intervention currency and financial matters leaving a wide ”policy space” for private forces in their running. The neo-liberal agenda is returning with a vengeance. They have seen the abyss and they want to control how they lead the system to a new one. Myopia that had being pasted on government institutions and “politicians” will become their prerogative if we do not stop them I n some way. Their institutions feel safer and academics bask on their tenures at high salaries in good institutions plus the “perks” they get from consulting at extraordinarily high emoluments.

So what next for the rest of us? A fight for recovering a role for a democratic based monetary policy. Mandates that have de facto been enlarged for central banks have to be politically explained and defended; we should take from Posen the notion that for a different policy a different consensus has to be built.

Central banks should of course, fully recover their role of preserving financial stability. Through their activity at international level a new voice has to be present. There are many holes to be covered and if unsuccessful in reaching decisions at that level, we have to learn from each other and introduce further regulations which anyway will not violate commitments at international level as either we are more demanding than their timid efforts or we choose to take up subjects too easily forgotten. Research, solid research, in which the present-day Governor of the Reserve Bank of India played a

significant role, has shown that capital inflows could be a nuisance and, in fact, not necessary for growth. I would like to mention again what I presented last year in the meeting at Cagliari. There is not only a demand boosting role for monetary policy – with its own positive impact on growth through ensuring "producers" – not "the markets" – that demand will be there if they create jobs and invest in new plant. But also there is developmental role that as surveyed in my last year presentation many of the major central banks got involved in at a different stage of their development and political circumstances (I guess as with the Marshal Plan, the French post-war experience had something to do with the fight against "communism", i.e., capitalism had to show that it could deliver higher standards of living as well as a welfare state). Even marginally, but conceptually valuable, the "Funding for Lending" scheme of the Bank of England shows a preoccupation to make credit available to SMEs.

I include below a description of what the Central Bank of Argentina is trying to do to promote credit for investment purposes.

THANK YOU!

APPENDIX

Central Bank of Argentina policies to promote credit to the productive sector [28]

The multiple mandate of the new - 2012 - Central Bank Charter incorporates the goals of employment and economic development with equity. Through this change, the central bank aims to be closer to productive activities and to the various regional economies.

Currently, in order to promote credit to the productive sector, the Bicentennial Program for Productive Financing (PFPB) and the “Credit Line for Productive Investment” (LCIP) have been implemented.

Bicentennial Program for Productive Financing [29]

The Bicentennial Program for Productive Financing is a credit line designed to increase productive capacity and competitiveness, to encourage import substitution, international trade by domestic companies and the generation of employment.

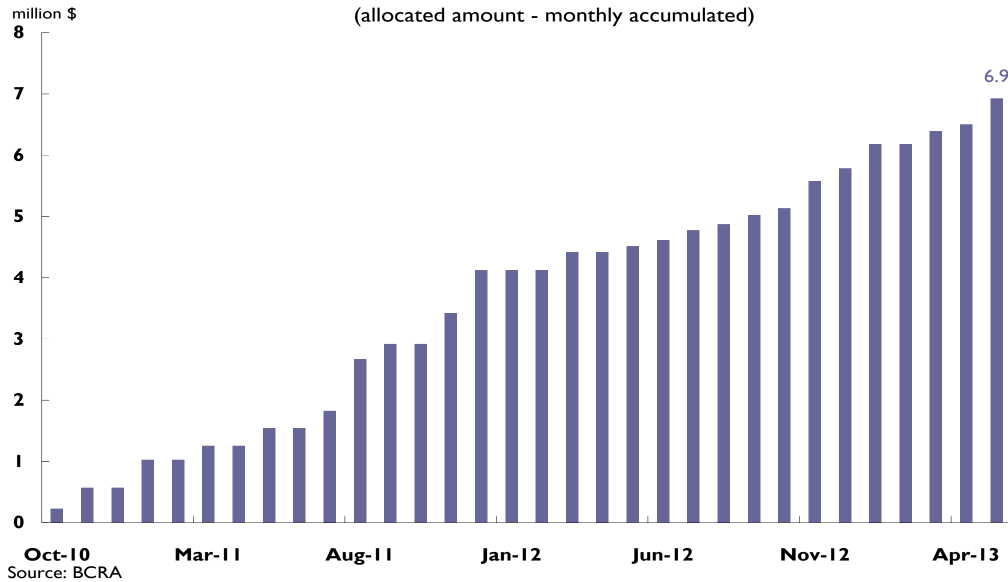
In this context the Central Bank Overdrafts regime for productive sector financing was launched in June 2010. Funds are made available to financial institutions through overdrafts for a maximum 5-year term collateralized with government bonds. With these funds, financial institutions may offer loans in pesos to finance productive sector’s investment projects with an average term equal to or exceeding two and a half years, charging a fixed interest rate (9.9%). Funds are intended to finance investment projects considered strategic by a Project Evaluation Unit[30].

Since the implementation of the Bicentenary Productive Financing Program, the Central Bank has conducted 23 auctions. As a result, the total amount allocated through the beginning of the PFPB has reached $6.9 billion. This amount stands for 1.7% of total loans (pesos and foreign money, average of May 2013) to the private sector and 0.3% with respect to the GDP.

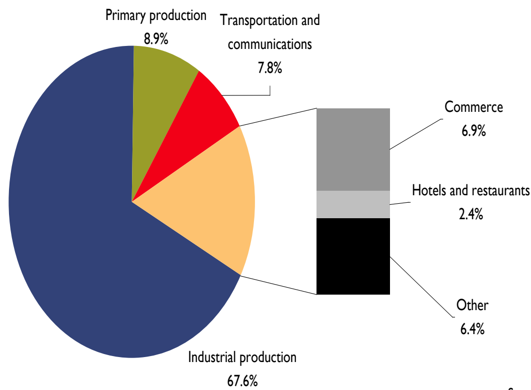
[28] This is a revised version of a report submitted to a Financial Stability Board workshop on Long-Term Financing at Basel on June 27-28th. 2013.

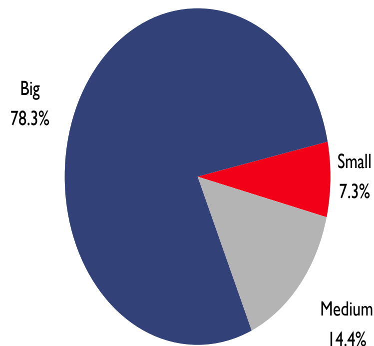
[29] Central Bank Communiqué A 5089.

[30] The Project Evaluation Unit is made up of representatives of the Ministry of Economy, Ministry of Industry and Ministry of Agriculture.



Thus, total funds actually disbursed since the beginning of the program had reached $4.8 billion, which accounts for about 70% of the total allocated amount. When considering economic sectors, manufacturing concentrated most funds disbursed (about 70% of the total). Additionally, if the size of the firms that received the funds is considered, it can be seen that most of them were granted to big enterprises (78.7%), and, to a lesser extent, to medium (13.9%) and small enterprises (7.3%).





Credit Line for Productive Investment [31]

In early July 2012, the “Credit Line for Productive Investment” was created. It mandated that the 20 largest financial institutions in the system, and those that are financial agents of the State at all its levels of government – Argentina being a federal republic - must allocate a sum equivalent to at least 5% of their peso deposits of the private sector to the financing of purchases of capital goods or the construction of productive facilities. This line set the maximum interest rate for such loans at 15.01% while their term could not be less that 36 months and it was required that half the total amount be granted to micro, small and medium size enterprises (MSME).

During the first half of 2013 and once more in the second one, the Central Bank took the decision to promote this credit line once again, this time considering an amount equivalent to 5% of private sector deposits in pesos outstanding, respectively, in November 2012 and May 2013. General credit conditions were maintained, except for the interest rate, which was raised to 15.25%.

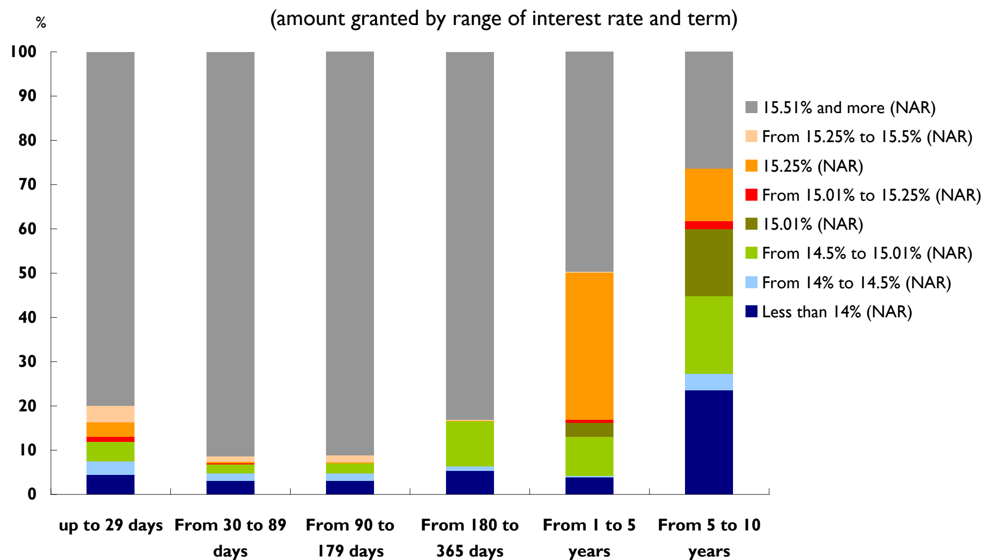
Additionally, in the second half of 2013, allowance was made to the possibility that MSME could use up to 20% of the funds involved in the corresponding project to finance working capital associated with the productive investment.

Total credit disbursed by the “credit line for productive investment” during the first stage (second half of 2012) largely exceeded the goal set by the Central Bank. Preliminary data shows that, as of May 2013, more than half of the target amount for the first half of 2013, set at $ 17.4 billion had been disbursed. Moreover, up to mid-2013, $3.1 billion had been disbursed about, corresponding to remaining loans granted in 2012 on a phased disbursement schedule. Thus, considering both the projects already funded corresponding to the first half of 2013 and those agreed in 2012 but disbursed on a phased basis, about $12 billion have been effectively granted from January to May 2013 under this credit line.

Additionally, it is estimated that total credit, granted and to be granted, including the third stage, would reach $54 billion, what stands for 2.4% of GDP and 13.4% of total loans to the private sector, approximately.

Available information regarding the impact of the “credit line for productive investment”, demonstrates its effectiveness to increase availability of financing for investment, to facilitate credit access to MSME and to improve financing conditions. In fact, since the implementation of the line, an extension in the term of the loans and a reduction of interest rates has been observed. The imposition of a minimum term of 36 months and a maximum interest rate of a bit more than 15%, led to an improvement in financing conditions to the productive sector in general and to MSME in particular.

[31] Central Bank Communiqués A 5319, A5380 and A 5449.

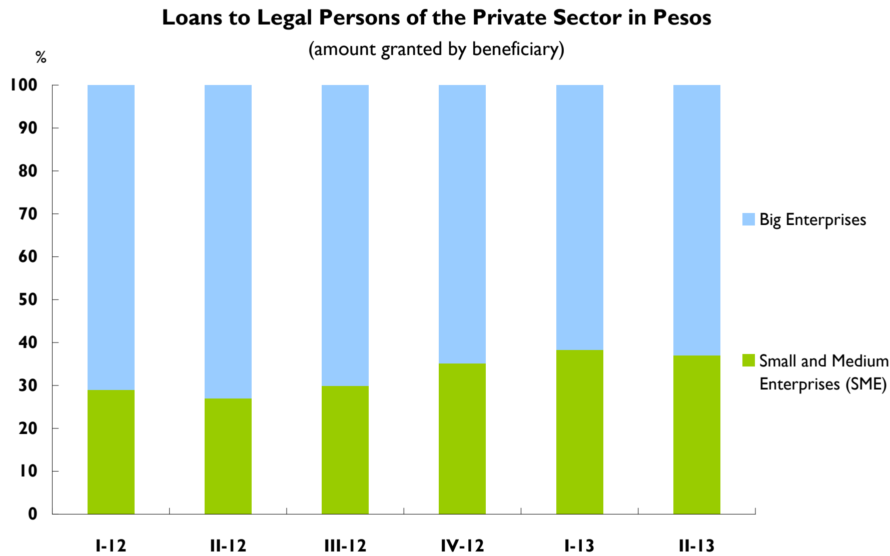


Note: amount grabted thruogh notes, pledge-backed loand, mortgages and other loans. The share was calculated over the acummulated amount in the first four months of the year.
Source: SISCEN

The “credit line for productive investment” consequences on the term extension can be confirmed when the evolution of y.o.y. change of loans granted to firms is considered. The importance of the availability of long-term credit is that it allows companies to make investments in scale and quality.

The requirement to apply no less than half of the loans to MSME, led to a significant increase in lending to these companies. As a result, since May of 2012 the amount of loans granted to MSME recorded a higher y.o.y. change than that of the rest of the beneficiaries, both persons and big enterprises.

The acceleration in the growth rate of loans granted to small companies implied a rise in its share in total loans to companies; MSME explained less than 30% of total financing to enterprises up to the second quarter of 2012, while since the third quarter this proportion started to increase, reaching 35% in the last quarter of 2012 and growing to 40% in the first and second quarter of 2013.



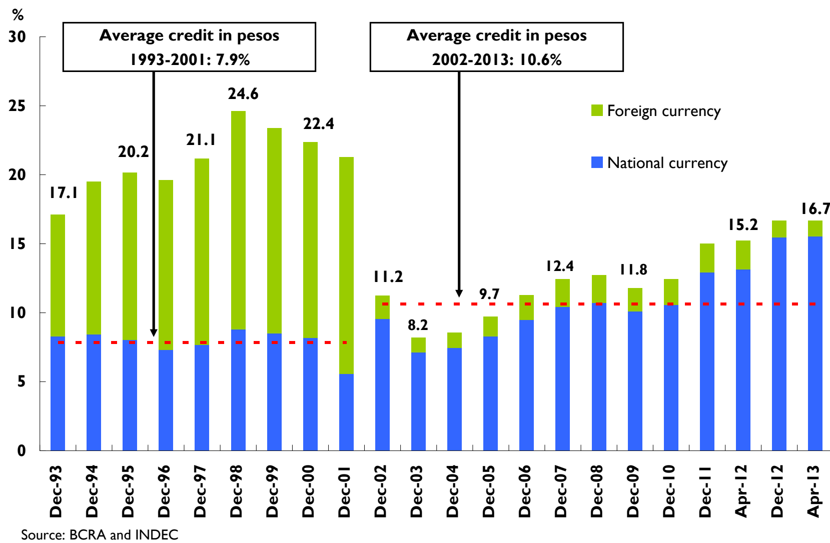
Note: amount grabted thrugoh notes, pledge-backed loans, mortgages and other loans. II-13 includes April and May.
Source: SISCEN

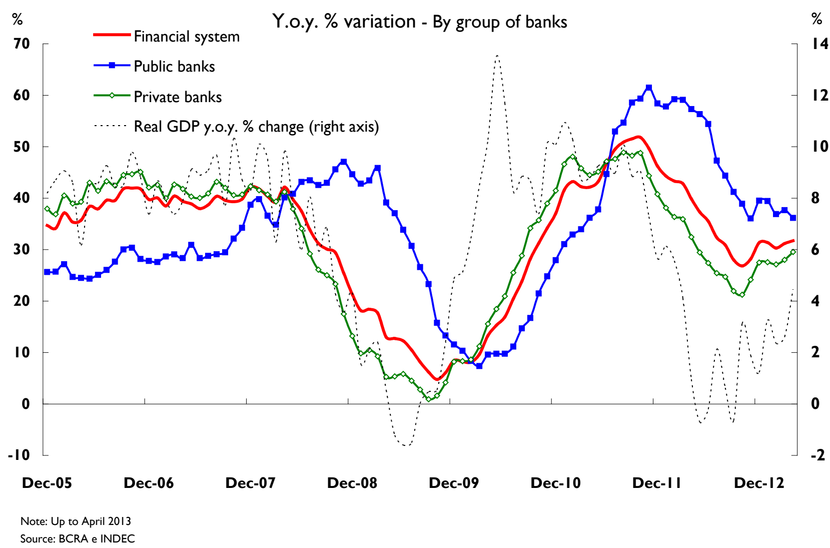
Dynamics of credit

A year after the reform of the Central Bank Charter, the positive results achieved in the area of private sector financing showed the importance of recovering monetary policy and financial tools that had been eliminated at the beginning of the 1990s.

Bank credit, specially the one directed to the productive sector, always a very low magnitude in the case of Argentina, increased in relation to the size of the economy. Thus, it was possible to revert in a large extent the pro-cyclical behavior distinctive of the financial system. During the second half of 2012 and in the first months of 2013, the growth of bank intermediation levels for production and consumption was maintained, contributing to moderate the impact of both, the economic slowdown of our commercial partners, mainly Brazil, and the lower agricultural crop due to unfavorable weather conditions.

Thus, total bank credit to the private sector continued gaining depth in the economy, reflecting a significant increase of its relation to output (GDP). In the last 12 months, financing of the financial system rose 1.5 percentage points (p.p.), reaching in April 2013 a level of 16.7% of GDP. Since late 2009, it accumulated an increase of 5 p.p., despite of the local impact of financial and economic global turbulences of the last years.





It is noteworthy that last year's credit expansion did not endangered the risk map naturally faced by the financial system. In this regard, the financial system maintained low delinquency levels and high loan loss provision coverage, as well as low net liquidity exposures, currency mismatches, market and operational risks.

Likewise, in order to strengthen the financial system, continue to promote loans aimed at supporting economic growth and adapt domestic regulations to international standards (Basel II, II.5 and III), in November 2012 the Central Bank amended minimum capital regulations applicable to financial institutions as from January 2013. Taking into account the regulatory changes mentioned above, capital compliance by the financial system reached, in April 2013, 14.3% of total risk-weighted assets, a level consistent with values recorded by other emerging and developed economies. Excess capital

compliance accounted for 66% of total regulatory requirement, a clear sign of banks' capital sound position.