



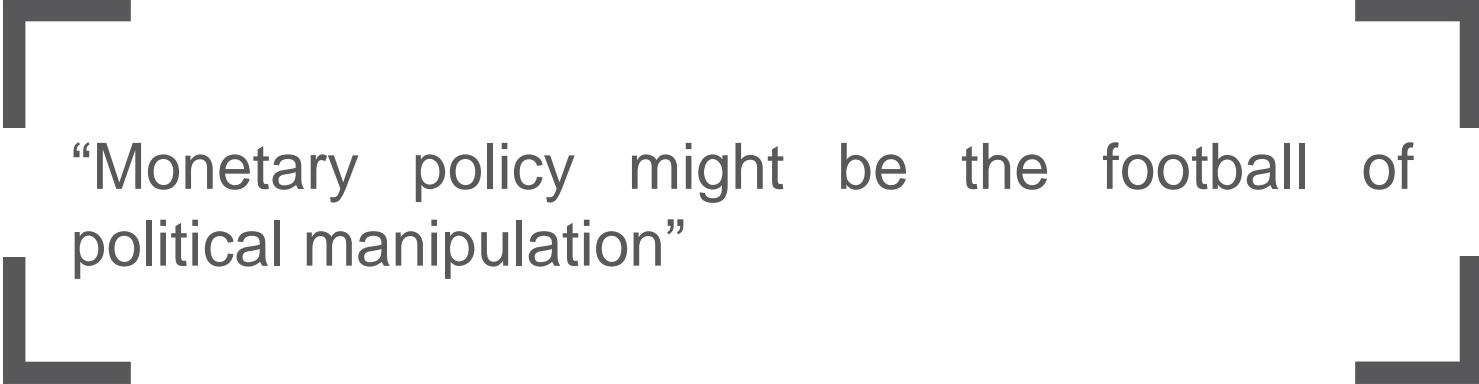
مصرف لبنان  
BANQUE DU LIBAN

# Merits and Challenges of Central Bank Independence: Case of Banque du Liban

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“Monetary policy might be the football of political manipulation”

*Milton Friedman -1962*



The trend towards a more independent, transparent, and accountable central bank is empirically observed and largely supported by modern monetary policy.



Reducing the inflation bias without having to implement inflexible rules.



Challenges have to be dealt with in order to actualize the merits for CBI.

## Outline:

- I. Introduction
- II. Purpose of Regulatory Independence
- III. Evolution and Assessment of Central Bank Independence
- IV. Central Bank Independence: Merits and Challenges
- V. Governance and Independence at Banque du Liban
- VI. Conclusion



# *Rationale*



Independence of regulatory agencies addresses the following downsides:

- Lack of commitment, time inconsistency and political uncertainty;
- Lack of competitive neutrality;
- Information and expertise asymmetries.

## *Long-term regulatory stability*



Regulators can help align the interests of users with the interests of investors.



Independence from the executive government can shield regulators from short-term party politics.

## *Role clarity and accountability*



Independence does not mean that regulators will work in a vacuum.



Independence is hard to realize if the roles and responsibilities are unclear and ill-defined.

# *Changes*



Independence is not a static given.



A deeper understanding of the practical implications of independence and how to realize it is paramount.



# *Determinants*



Academics have developed a number of indices:

- Budget independence;
- Conditions for dismissal;
- Appointment of members/head;
- Accountability and reporting;
- Power to set tariffs or price-setting;
- Power to review or approve contract terms

# *Outcomes*

-  Independence is a tool towards more effective outcomes – and not an end in itself.
-  At the micro-economic level, revenue stability and investor certainty are viewed as important elements of regulation.





To sum up:

- Regulatory independence serves to mitigate market failures;
- Independence ensures stability and consistency between the interests of citizens and investors;
- Independence should be implemented with diligent accountability and based on clear determinants.



# *Evolution*

-  Two global trends have emerged: the adoption of improved monetary policy practices and the elimination of high inflation rates.
-  The improved policy practices notably include a broad strengthening of central bank independence (CBI), increased transparency, and the affirmation of price stability.



Introduction of global endeavors aiming at enhancing corporate and central bank governance:

- IMF Code of Good Practices on Transparency in Monetary and Financial Policies (1999);
- BCBS Principles for Enhancing Corporate Governance for Banking Institutions (1999, 2006, 2010);
- Guidelines for insurance and deposit insurers IAIS (2003, 2011, 2012);
- IMF Safeguard Assessment for central banks (2000);
- Central Bank Governance Forum (BIS – 2005);
- OECD's Guidelines on Corporate Governance of State-Owned Enterprises (2005);
- International Association of Deposit Insurers in 2009



The financial crisis has altered the balance sheets of central banks and augmented the types of risks they need to mitigate.



The trinity of central bank governance enclosing transparency, independence, and accountability has emerged.



Central banking is the delegation of the monetary policy tasks to a bureaucracy that is independent and accountable.







The number of central banks with a relatively high degree of independence has steadily increased.



Developing and emerging market economies have shown the most comprehensive increase across all dimensions of independence.

# Assessment

-  Overall, there are 27 distinct metrics employed to produce the ratings for each central bank.
-  Cukierman (1992) and Cukierman et al. (1992) – LVAU and LVAW.
-  Cukierman (1992) and Cukierman & Webb (1995).
-  Kydland and Prescott (1977) and Barro and Gordon (1983).



Grilli et al. (1991).



Ueda and Valencia (2012).



Hielscher and Markwardt (2012).



Hayat and Farvaque (2012).



Dincer and Eichengreen (2014 - CBIW).



CBI is rarely a consequence of merely monetary logics, and it may involve other political domestic dynamics.



Bodea and Hicks (2015).

### Legal CBI before and after the Global Financial Crisis

IMF-Aggregate	1995-2007	2008-2010
Advanced economies	0.57	0.59
Commonwealth of Independent States	0.6	0.7
Emerging and Developing Asia	0.46	0.59
Emerging and Developing Europe	0.67	0.83
Latin America and the Caribbean	0.63	0.66
Sub-Saharan Africa	0.41	0.42

Source: Haan, J. and Eijffinger, S., 2017



The effect of legal CBI on price stability depends on the strength of the rule of law.



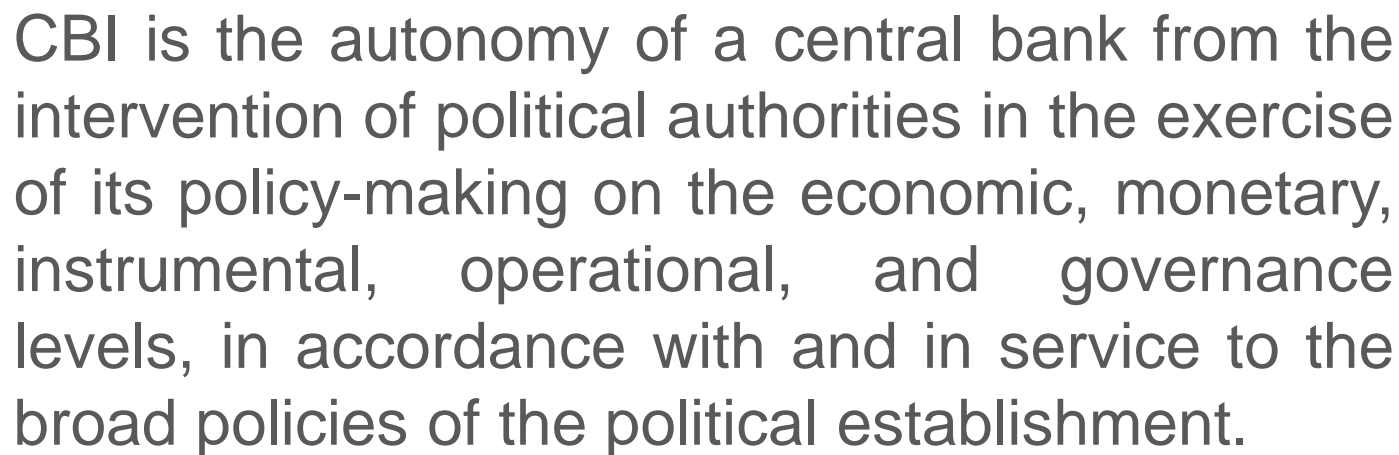
The correlation between CBI indicators is sometimes remarkably low.



To sum up, CBI assessment has been subject to evolution:

- distinguishing between legal-based and factual CBI;
- Political independence and economic independence of central banks should be considered distinctively;
- Political domestic dynamics and the rule of law are stressed as prerequisites.

















CBI is the autonomy of a central bank from the intervention of political authorities in the exercise of its policy-making on the economic, monetary, instrumental, operational, and governance levels, in accordance with and in service to the broad policies of the political establishment.

# *On the Global Level*

## *Merits*

-  First, CBI enables central banks to lead by example.
-  Second, CBI integrates central bank transparency and accountability.
-  Third, CBI contributes in enhancing social trust.
-  Fourth, CBI provides central banking with immunity against short-term political and industrial influence and distortion.
-  Fifth, CBI serves to realize optimum levels of inflation and price control.
-  Sixth, CBI contributes in achieving optimal growth and economic stability.

## Challenges

-  First, CBI should be founded on ethical and social basics.
-  Second, actualizing independent synergy between financial stability and monetary policy.
-  Third, CBI should be practiced while maintaining strategic integration with the fiscal authority.
-  Fourth, mitigating the drawbacks of unconventional monetary policy and rising populism.
-  Fifth, coping with the escalation of sovereign debt levels, inflationary central bank balance sheets, and expansion of central banks' operations.
-  Sixth, sustaining a delicate balance between regulatory and emergency roles.

# *On the Regional Level*

## *Merits*



Most of the merits on the global level are shared on the Arab regional level.



Aligning between the sustainability of economic growth and development, and the independence of development:

- A productive economy that curbs rentier trends;
- Knowledge and technology;
- Human capital;
- Accumulation of national provisions;
- Regional integration;
- Economic diversification;
- Industrialization;
- Good governance practices that curb corruption and induce participative democracy.



## *Challenges*



Existing vast deviation between central bank de jure and de facto independence due to weak democratization and standardization that causes political and instrumental vulnerability in central bank practices.



## *Governance at Banque du Liban*

-  Banque du Liban (BDL) had participated in a Fund assessment of its governance structure based on the ELRIC framework.
-  BDL focused on reserve management, financial reporting transparency, and audit and control procedures.



On the legal mandate and governance level (Code of Money and Credit):

- Safeguarding monetary and economic stability;
- Ensuring the soundness of the banking sector;
- Developing money and capital markets;
- Regulate and developing the payment, clearing, and settlement systems as well as electronic financial operations;
- Preserving monetary and economic stability.



On the role of the Board level:

- Clear understanding of their role in corporate governance;
- There is a clear distinction between policymaking and managerial boards.



On the strategic planning and budgeting level:  
BDL has clearly defined objectives for each function performed.



On the staff policies and remuneration level:

- Employee code incorporates the best conduct practices in the industry;
- a new structure, grading system, and performance management system are being developed.



On risk management level:

- Establishment of an Investment Committee;
- Following the IMF guidelines for the objectives of foreign exchange reserve management;
- The adoption of a “framework” for the investment decisions;
- Setting a formal system to identify, assess, and mitigate the risks at BDL branches.



On external audit level:

Adopting a formal policy for the selection, appointment, and rotation of BDL’s external auditors.



## On internal audit level:

- Audit is no more transaction-based but rather process-based;
- Audit is not focused on policies and procedures but on risk management;
- Reviews are conducted according to the Standards for the Professional Practices of Internal Auditing and best practices;
- The adoption of a “Framework of Good Conduct for Internal Auditors at Central Banks of Francophone Countries”.



On the financial reporting level:

- Financial statements are prepared in accordance with International Financial Reporting Standards;
- BDL's accounting software was updated twice in 1997 and in 2008;
- BDL's summary Balance Sheet is published every two weeks;
- BDL is part of the IMF General Data Dissemination System (GDDS).

# *Banque du Liban's Independence*

## *BDL's de jure independence*



BDL's independence is clearly highlighted in the Code of Money and Credit:

- The bank is a juridical person of public law;
- It shall not be submitted to the regulations of the public sector;
- The Governor has the widest powers and is entrusted with the enforcement of the law;
- The duty of the bank shall be the safeguard of currency as a fundamental guarantee for permanent economic and social development.

## *BDL's de facto independence*



BDL's de facto independence has been vigorously based on institutionalization:

- Strategic direction;
- Effective communication;
- Strong leadership.



On the conventional level:

BDL has been committed to ensure the basis for sustainable economic growth and comprehensive, sustainable, and independent social development.



On the unconventional level:

- Stimulus packages;
- Knowledge economy;
- Multipurpose and multidimensional financial engineering mechanisms.



On the regulatory level:

- BDL's regulatory role in preserving financial stability;
- Lessons inferred from the Lebanese model;
- Implementing compliance procedures.



To sum up, both perspectives, de jure and de facto, constitute a synergetic momentum for BDL's independence:

- BDL's de jure independence has been rooted in the Code of Money and Credit;
- BDL's de facto independence and enduring meritocracy lies within the specificities of the Lebanon's political economy.



CBI has been proved to be a valuable national asset. However, preserving this asset pauses the question of how to maximize the benefits of initiating new powers inside the central bank while minimizing potential frictions with monetary policy, limiting political threats to the legitimacy of central banks' operational independence, and sustaining political accountability and public transparency.

**Thank You**