Chapter 7

Central Banking Reform Across the World: Only By Night Are All Cats Grey

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Central Banking Reform: 'They Are All the Same'[1]

At first glance, a map of the world's central banks reveals a considerable amount of isomorphism. During the last three decades, the 'art of central banking' (Hawtrey 1932) has been fundamentally transformed. First of all, central banking has 'moved upwards', in the sense that it has increasingly been lifted out of its national context, and international co-operation between central bankers has taken on a life of its own. As a result, problem formulation, policy analysis, decision-making and monitoring now take place in distinct transnational forums. Not only has the number of international forums for central banking co-operation increased and their activity intensified; today the purpose, functioning and effects of international co-operation between central banks increasingly involve authoritative soft governance (Marcussen, 2006a, 2007).

Second, central banking has 'moved sidewards'. Decision-making processes regarding monetary policy – the domain of central banking – is taking place on a track that runs parallel to and is separate from ordinary democratic decision-making. Through their formal autonomous status, central banks have become involved in political processes in which public accountability and transparency take on different meanings and forms to those normally associated with political decision-making. By de-politicizing central banking, elected politicians have accepted that large areas of macroeconomic decision-making are outside their sphere of influence and that the political arena of monetary policy has shifted away from electoral politics (Marcussen 2005). What is more, to the lay politician central banking has become increasingly esoteric, requiring specialist knowledge to understand it. The authority that this specialist status endows on central bankers has further enhanced the de-politicization, rationalization and objectification of central banking (Marcussen 2006b; see Gregory in this volume).

Third, central banking has 'moved forwards', meaning that ideas that were traditionally associated with central banking culture are now being widely shared

1 Many thanks to Tom Christensen and Per Lægreid, the editors of this volume, as well as to the other contributors who, at meetings in Norway, New Zealand and Australia, have helped to significantly improve first drafts of this chapter. Also thanks to Johannes Lindvall for help on the Swedish case, and to a long list of people interviewed in both Canberra and Wellington.

by the entire political class. The idea that a 'sound' macroeconomic policy is the most appropriate one is now taken for granted in most political contexts. A 'sound' policy is deemed to involve sound money (low inflation), sound finances (low public deficits) and sound institutions (independent central banks). The present uncontested status of classical, stability-oriented central banking makes it much easier for central bankers to navigate in the political landscape and to consolidate their positions of power (Marcussen 2000).

All in all, we seem to be witnessing veritable global processes of institutional transformation which, at a general level of analysis, involve a kind of institutional isomorphism.

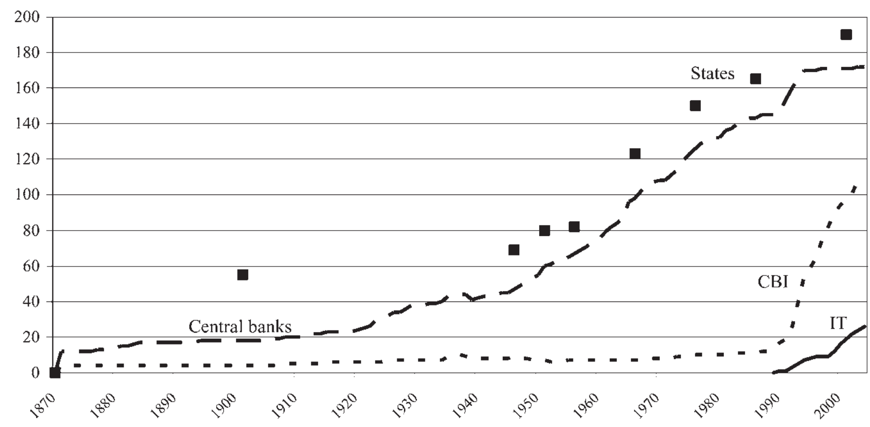

Figure 7.1 The diffusion of international standards, 1870–2003

For the period 1870-2003, the figure depicts (i) the number of sovereign states in the world (ii) the number of central banks in the world (iii) the number of central banks that has obtained greater legal independence (CBI) through formal reforms, and (iv) the number of central banks that have introduced inflation targeting (IT) as an instrument in their monetary policy making.
Sources: Cukierman et al. (1992), Freedom House (1999), Jácome (2001), Malisewski (2000), Maxfield (1997), McNamara (2002), McNeely (1995: 42), The Morgan Stanley Central Bank Directory 2004, www.centralbanknet.com; national central bank legislation.

Figure 7.1 illustrates how certain institutional forms have achieved, or are on their way to achieving, global dominance. One of these is the *state form*, which continues to excel as the most important sign of internal and external sovereignty. While it may be true to say that the global political scene is overcrowded with a wide variety of non- or quasi-state actors, the sheer number of sovereign states continues to grow, thereby underlining their continuing importance in world affairs.

Associated with the state are a number of different signs of statehood, among which a national currency and a *central bank* seem to be central. In the interwar years, a large number of existing states founded their own central banks, and an overwhelming majority of the new states created since then have, as one of their first acts, created their own central banking institutions.

Apart from a very few key common functions, national central banks continued to be very diverse in their organizational set-up. Not until the 1990s was the idea of agency autonomy fully consolidated in the world of central banking. Formal *central banking independence* was introduced worldwide in countries as different as South Africa, Sweden and India. Still, as we will see later, legal independence can be introduced in a large variety of ways and it does not necessarily mean that the central bank in question is free to behave as it chooses. Disregarding that fact, a global consensus now seems to have emerged that it is appropriate to leave large parts of monetary policy-making and financial supervision to autonomous agencies (Christensen and Lægreid 2006a).

Most recently, the idea that central banks, in their conduct of monetary policy, should strive to keep the level of price inflation close to an explicitly stated *inflation target* has been adopted by a large number of central banks worldwide, though the diffusion of this idea is not yet as pronounced as some other patterns of diffusion dealt with here. As a professor at Princeton University, as a member of the Federal Reserve Board, and now as Chairman of the Federal Reserve, Ben Bernanke has been and continues to be an ardent advocate of inflation-targeting in the world's largest economy. If he decides to make his actions match his words, it is quite possible that this specific instrument of monetary policy will become even more widely accepted internationally and that in the coming years the popularity curve in Figure 7.1 will incline steeply upwards.

An even more recent fashion in central banking concerns *transparency* (Libich 2006). Traditionally, the world of central banking has been shrouded in secrecy and hence has been prone to much myth-making. Monetary policy-making and financial supervision still do not live up to the standards of accountability and service-mindedness that we expect from the rest of the public administration, but central bankers are increasingly convinced that the efficiency of monetary policy will be significantly improved if they communicate on a regular basis with relevant actors on the financial markets and in the specialized media. In the world of central banking, transparency is chiefly seen in terms of efficiency gains, and not primarily as an institutional feature that enhances democracy and legitimacy (see Blomgren and Sahlin-Andersson in this volume). Figure 7.2 illustrates how, over the last couple of years, some central banks have introduced measures designed to improve communication with other relevant actors.

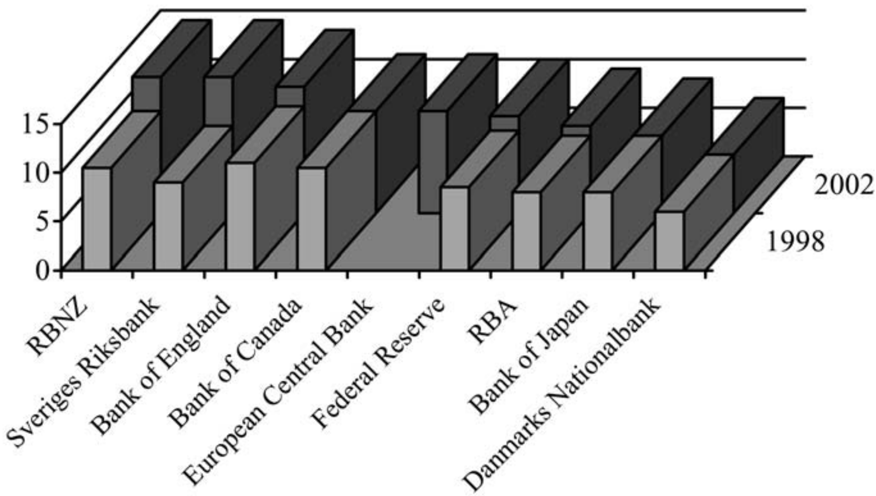

Figure 7.2 Central bankers are starting to 'Talk'

Note: Eijffinger and Geraats (2006) established 15 criteria for transparency and measured whether selected central banks have introduced practices which impact on their transparency score. According to this measure, '15' is the highest possible score of transparency and '0' the lowest. Data on the transparency of Danmarks Nationalbank has been added by the author.

Central Banking Reform: 'They Are All Different'

Thus, one important fact about modern central banking is that it has gone through tremendous change over the past decades (Siklos 2002). Some observers even talk about a 'quiet revolution' (Blinder 2004) and they hypothesize that central banking may be going through a paradigm shift into an entirely new age (Marcussen 2006c). The focus on these worldwide reform processes should not conceal, however, that important national differences still exist in how central banking is organized in practice.

	Danmarks Nationalbank	RBA	Sveriges Riksbank	RNBZ
Transparency		X	X	X
Inflation Targeting		X	X	X
Central Bank Independence			X	X
Governor Contract				X

Table 7.1 Formal reforms in national central banking during the 1980s and 1990s

Table 7.1 indicates that some central banks have gone all the way. Not only have they implemented all the new organizational fashions, they have also been central actors in the global diffusion of these standards. The Reserve Bank of New Zealand (RBNZ) is a case in point (Eichbaum 1999; Singleton et al. 2006). When a Labour government won the elections of 1984 it faced a currency crisis. Finance Minister Roger Douglas removed exchange controls, let the currency float freely and deregulated the financial sector. This strategy later came to be referred to as 'Rogernomics' (Boston 1987). In popular parlance, the Labour government was 'Muldoon-proofing' monetary policy (Sir Robert Muldoon was prime minister for the National government from 1975 to 1984). These measures paved the way for a profound reform of the RBNZ. Douglas initiated talks with the RBNZ in 1986 and the bank itself formulated the first drafts for reform. By 1988, Douglas had publicly presented the reform plans for the first time, and the reform bill was passed by Parliament without a single vote being registered against it (King 2001, 61). Section 8 of the 1964 Act for the RBNZ required that monetary policy should promote economic growth and social welfare in New Zealand, and it emphasized the desirability of also promoting the highest level of production, trade and full employment and, finally, of maintaining a stable price level (Evans et al. 1996, 1864). The new 1989 Act, which took effect from February 1990, clearly stated that price stability should be the sole objective of the bank's monetary policy.

The governor at the time, Don Brash, was to be held personally responsible for achieving an inflation target which should be publicly agreed upon between the governor and the minister of finance. Since the country had been used to double-digit inflation levels for more than two decades, the first targets agreed upon in March 1990, 0–2 per cent, seemed radical. However, after only two years the objective had been reached (von Furstenberg and Ulan 1998, 211; Bollard and Karagedikli 2006).

Apart from specifying that the RBNZ should pursue a single, publicly adopted, inflation target, the government also decided to grant the bank complete operational independence. Once the inflation objective had been defined in Policy Target Agreements (PTAs), nobody could interfere in the governor's efforts to achieve that objective (Gregory 1996).

With regard to transparency, the RBNZ has all it takes to make it the most transparent central bank on earth. The governor appears before Parliament to explain his policies, and a number of regular inflation reports and Monetary Policy Statements are made publicly available, outlining the background to and content of decisions made in the bank. Minutes and press releases are published and press conferences held, and the bank has adopted a so-called 'public communication programme'. Under this programme the governor himself gives an average of two to three speeches a week with a view to 'building a public constituency in support of price stability' (Governor Brash, cited in von Furstenberg and Ulan 1998, 212; interview with Alan Bollard November 2005).

At the other end of the scale we find Danmarks Nationalbank, whose statutes date back to 1936. While this indicates that the basic structures and status of the bank are pretty robust, it does not score very high on transparency. The information disclosed to the outside world is limited to a quarterly report containing ordinary macroeconomic analysis, thematic articles by central bank personnel and the governor's speeches. It does not release minutes from the meetings of the Bank Directorate, the bank's governor does not appear before Parliament, and press conferences are a rare event, taking place, for instance, in connection with the release of the annual report.

Danmarks Nationalbank is participating in the Exchange Rate Mechanism II of the European Union (Jensen 2005). This means that it is obliged to keep the Danish currency within a predefined margin in relation to the Euro – the currency of the twelve full members of the European Economic and Monetary Union. Consequently, it does not follow an explicit inflation target, although its statutory objective is to maintain a stable value of the national currency (Danmarks Nationalbank 2003, 109).

Because Danmarks Nationalbank has not gone through any statutory reforms since 1936, it is the statutes from then that form the basis for the present independent status of the bank (Christensen 1985). Thus, the bank has its own income and distinct budget, its management structure bears many resemblances to a private company and the governor is nominated for life. In preparation for the establishment of the Economic and Monetary Union in Europe, the central banks of all EU member states were evaluated with regard to their 'institutional compatibility' with EMU standards. Both the forerunner of the ECB, the European Monetary Institute (EMI), and the European Commission found no reason to undertake further reforms of the bank, since its 1936 statutes already granted it full independence (EMI 1998; European Commission 1998, 38–9). In fact, contrary to the three other inflation-targeting central banks reviewed in this context, Danmarks Nationalbank has, apart from its 'instrument[al] independence', also a large degree of 'goal independence'. In other words, the bank sets its own intermediate objectives as well as deciding on the instruments to be applied to achieve those objectives.

However, formal independence does not necessarily imply that the bank possesses real independence in its day-to-day work. Not until the beginning of the 1980s did a political consensus emerge that the central bank governor, and he or she alone, could make monetary policy. In concrete terms, this meant that when the Liberal–Conservative government came into office in 1982, one of its first acts was to publicly announce in a press release that it had no intention of devaluing the Danish currency inside the framework of the European Exchange Rate Mechanism and that it intended to pursue a so-called stability-oriented macroeconomic policy. During the 1970s, the various Social Democratic minority governments had pursued a so-called sheltering strategy in response to the oil crisis. They absorbed the unemployed primarily in the public sector, and the current account deficits, fiscal deficits, general government spending, net foreign debt, interest rates and inflation all grew incessantly (Mjøset 1987; Schwartz 1994, 2001). The press release issued by the incoming Liberal–Conservative government, headed by Prime Minister Poul Schlüter and Minister of Finance Henning Christophersen, can be regarded as an important step in an informal reform process whereby, as in the case of Australia, the government indicated that it had changed course and would leave monetary policy-making to the central bank governor, Erik Hoffmeyer. Since then, the bank has not had any serious conflicts with the various minority governments. Neither the Social Democratic government of 1993–2001, under Prime Minister Poul Nyrup Rasmussen and Minister of Finance Mogens Lykketoft, nor the present Conservative–Liberal government, under Prime Minister Anders Fogh Rasmussen and Minister of Finance Thor Pedersen, had or have any intention of deviating from the line laid down in September 1982.

Between these two extremes of complete acceptance of fashionable organizational standards (RBNZ) and complete rejection of formal organizational reform (Danmarks Nationalbank) we find Sveriges Riksbank and the Reserve Bank of Australia (RBA). As regards Sveriges Riksbank, at the very beginning of the 1990s both the Labour government and the incoming Conservative government declared war on inflation and formulated a so-called stabilization policy (Lindvall 2004, 108–16). After speculative attacks on the Swedish kroner in the autumn of 1992, the currency left the Exchange Rate Mechanism of the European Union and, in January 1993, the Riksbank declared an explicit inflation target.

In February 1993 a proposal was made to reform the statutes of the Riksbank in order to enhance its independence. This proposal was never formally subjected to a vote in Parliament since it was obvious that it would not gain enough political support. It took another four years (until November 1997) and a Social Democratic government to present a distinct reform programme, which was adopted in the Swedish Parliament in March 1998. From 1999 onwards, Sveriges Riksbank belonged to the group of formally independent central banks (Marcussen 2000, 263–270; Heikensten and Vredin 2002).

With regard to transparency, Sveriges Riksbank publishes inflation reports, financial stability reports, quarterly reviews and annual reports. It also releases minutes from board meetings where monetary policy is discussed. Together with the RBNZ it is one of the most transparent central banks in existence.

In Australia central banking has gone through reforms too. But contrary to the sweeping reforms in New Zealand and Sweden, the reforms of the Reserve Bank of Australia (RBA) have primarily taken the form of informal and incremental institutional remodelling (Bell 2004, 105). Like Danmarks Nationalbank, the RBA has traditionally possessed a rather high degree of formal independence. Since 1911, legislation has granted Australia's central bank the kind of independence that 80 years later was to be implemented almost everywhere (Coleman 2001; Bell 2002, 477–478). Thus, the statutes that govern the RBA today have not been altered to any significant extent since the legislation was passed in 1959 (King 2001, 62).

When the Labour government (ALP) came to power in 1983, it faced speculative attacks against the Australian dollar. Like his counterparts in New Zealand the following year, the treasurer, Paul Keating, let the currency float freely, removed exchange controls and deregulated the financial sector. At the same time he formalized a so-called Price-and-Income Accord with the employees' organizations. An open debate about the status of the RBA began in 1989 when Keating appointed Bernie Fraser as the new governor of the RBA. The Liberal opposition leader, John Hewson, demanded that the RBA statutes be fundamentally reformed according to the New Zealand model. Talk about RBA reform fell silent, however, when the Labour government was re-elected in 1993. Since then, there have been no further serious calls for changes in the RBA statutes.

Inside the RBA, though, there was a growing feeling that changes had to take place; if not formally, then informally. In June 1990 the deputy governor of the RBA, John Phillips, publicly broke a taboo and argued that monetary policy should have the sole objective of fighting inflation (Bell 2004, 62). This indicated an ideational shift within the bank which was not reflected in the policy of the Labour government. The bank then started to announce and explain its interest-rate changes. This, too, was new. And finally, after a visit from the IMF and the first indications that Sweden, Great Britain and Canada, like New Zealand, had introduced well-functioning inflation-targeting, the RBA, in 1993, took the final step and announced an inflation target for its monetary policy. By 1993 the recession had already reduced inflation in Australia. The aim was to maintain low inflation in a band between 2 and 3 per cent, while keeping an eye on growth and employment. In recognition of these gradual changes, Ian Macfarlane was nominated Central Banker of the Year in 2002 by *Euromoney Magazine*.

It was not until the mid-1990s that the RBA achieved real substantial control over monetary policy-making. The Liberal government of John Howard, which had come to power in 1996, nominated Ian Macfarlane as the new RBA governor when the term of Governor Fraser was set to expire. With the so-called '1996 Statement on the Conduct of Monetary Policy' the Howard government formally recognized the operational independence of the RBA and endorsed the RBA's inflation target of 2–3 per cent (Bell 2004, 88). In the eyes of the government and the RBA governor, the 1996 statement made reforms of the RBA Act of 1959 irrelevant. In July 2003, when Ian Macfarlane was re-appointed as governor, the Howard government re-endorsed the 1996 Statement. On 17 September 2006, Macfarlane was replaced by Glenn Stevens as governor of the RBA.

As regards transparency, the RBA publishes monthly bulletins, a quarterly Statement on Monetary Policy and an annual report. The top managers, including the governor, give a number of speeches to national and international audiences. In addition, the governor regularly attends three- to four-hour-long hearings in the Economics Committee and the Standing Committee on Banking, Finance and Public Administration of the House of Representatives. However, the RBA does not publish its minutes, and the governor does not give many interviews to the media or hold press conferences to explain the RBA's policy decisions, although it does publish a press release. Overall, the RBA is clearly more transparent than Danmarks Nationalbank, but it is not among the world's most transparent central banks.

How can we best understand the diversified local translation of global reform ideas in Sweden, Denmark, New Zealand and Australia? The transformative (Christensen and Lægreid in this volume), the experiential learning (Olsen and Peters 1996) and the translation (Czarniawska and Sevón 1996) perspectives on institutional reform are all useful in this regard. These three models encompass a large number of internal and external systemic as well as agency-related factors which seem to throw light on the ways in which global reform ideas are contextualized, thereby displaying a large degree of local institutional variation. Nevertheless, despite idiosyncratic and contextualized trends in the four countries studied, one should not shy away from drawing general conclusions about reform paths and dynamics (Pollitt and Bouckaert 2004, 24–38).

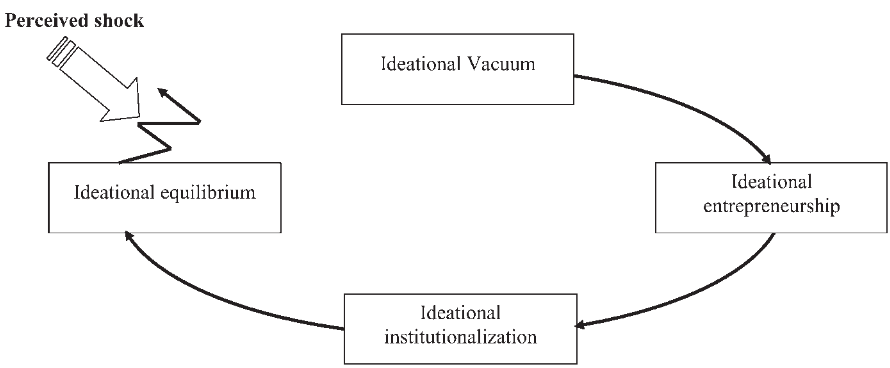

Figure 7.3 The ideational life-cycle
Source: Marcussen (1999, 389)

Figure 7.3 outlines, at a quite general level of analysis, a reform path – an ideational life-cycle – which seems to be indicative for the diffusion and translation of central banking reform ideas in the four countries discussed in this chapter. The point of departure is a situation in which macroeconomic policy-makers consider 'integrated central banking' to be the natural state of affairs. The broadly shared consensus that the central bank is a multi-purpose institution which is fully integrated into the rest of the state apparatus amounts to what can be characterized as an *ideational equilibrium*. This is a situation in which the basic functions, relations and structures of the central bank are essentially uncontested and taken for granted. Of course, as the Danish and Australian cases illustrate, such a consensus about institutional forms might de facto be in direct conflict with the formal statutes of the central banks in question. But for the actors concerned, there is typically no perceived misfit between the formal structures of the central banks and their shared beliefs. As long as central bank behaviour is in full accordance with shared norms, the formal structures are secondary. During the 1970s, a defining characteristic of central banking in these four countries was that politicians not only thought it was possible to directly intervene in monetary policy-making, but also that it was their duty as responsible politicians to make monetary policy support their general political objectives of full employment, international competitiveness, social security and so on.

Such broadly based consensus seems to be quite robust. The ideas underlying public management structures, functions and relations do not very often go through paradigmatic changes. Therefore, it normally takes a change in government in combination with a generally perceived crisis for actors to begin to look for new ideas. In New Zealand, Australia and Denmark these conditions were already present in the early 1980s. In Sweden it took a further decade before a serious currency crisis forced the Riksbank governor to withdraw the kroner from the European Exchange Rate Mechanism. As a result of the perceived crises in the four countries, the newly elected governments were suddenly thrown into what can be called an *ideational vacuum*. This is a situation in which old ideas have been given up and in which the government and other decision-makers are looking around for new ideas to help them make sense of what seems to be a complex and unruly reality. Since New Zealand was a first-mover, much of the inspiration for central bank reform in that country seems to have come from purely theoretical sources. The time-inconsistency literature (Kydland and Prescott 1977) appears to have played a role in its move towards central bank independence, while the principal-agent literature seems to account for the model according to which the governor signs a performance contract and consequently is held personally responsible for achieving the inflation target.[2] Thus, it may have been the case that an epistemic community of monetary experts inside and outside the country acted as *ideational entrepreneurs*.

Compared with New Zealand, the other three countries were late-comers. The currency crisis of 1983 did indeed lead to economic reforms in Australia, such as floating the currency. But it is primarily inside the RBA that we shall find the most important ideational entrepreneurs. Inflation-targeting was first introduced informally in 1993 and finally endorsed by the government in 1996. It was also inside the RBA that we find the most eager forces in favour of de facto instrumental independence. One of the first speeches given by Bernie Fraser, when elected governor in 1989, was on the topic of central bank independence (Bell 2004, 119). The idea was supported

2 For other management changes inside the RBNZ, see Mendzela (1994) and Singleton et al. (2006).

by the opposition party, but it was never a winning strategy, and the RBA was, as we have seen, never formally reformed. In concrete monetary policy, however, the role of the bank has developed from an advisory role to one of substantial operational independence (Bell 2004, 105–6).

In Sweden, the Conservative Party also promoted the idea of central bank independence after the 1992 currency crisis. Like in Australia, it did not gain much support in Parliament. In fact, central bank independence was considered to be positively 'un-Swedish' and serious concerns regarding the democratic accountability of an autonomous central bank were aired. A Social Democratic member of the Riksdag, Hans Gustafsson, argued:

> It is possible that one can apply efficiency arguments to exclude politicians from democratic politics. But I think it is wrong. It is undemocratic and it does not resonate with our way of doing things (19 March 1993, anf. 57).

In 1995, however, Sweden became a full member of the European Union and was thus prompted, like other EU members, to reconsider the status of its central bank. By 1997 the Social Democratic reform proposal was ready. Over just four years the attitude towards central bank independence had changed considerably. Member of the Riksdag for the Social Democratic Party, Pär-Axel Sahlberg, argued that the proposal for independence was a step into a new modern world:

> Many of us think that it is incredibly positive that we are in a new era, a new world. New resources and new instruments are needed in policy-making, and they particularly need to be transitional … It is the new history to which we can relate this proposal (Riksdagen, 4 March 1998, anf. 16 and 20).

Unlike Australia, then, reform was implemented in Sweden in response to external pressure for change, that is, EU membership (prop. 1997/98, 48). Australia did not experience pressures of this kind, which meant that it was sufficient for it to adapt informally.

Informal adaptation is also the story we hear from Denmark. The incoming Conservative–Liberal government in 1982 declared its willingness to pursue so-called stability-oriented macroeconomic policies, implying 'sound money' (no more competitive devaluations and persistent low inflation), 'sound finances' (preferably a surplus in the public budget), and 'sound institutions' (the de facto independence of the central bank). Like Australia, but contrary to Sweden, Denmark was not directly pressed to reconsider the status of the central bank, since the country had decided to opt out of Economic and Monetary Union in 1993. In addition, unlike Sweden, Norway and Great Britain, the Danish currency draws its credibility on the financial markets from its linkage to the Euro and not from an explicitly stated inflation target. In other words, since 1982 there have not been any obvious reasons to alter the established monetary policy strategies or institutions.

Thus, *ideational institutionalization* has taken different forms in the four countries in question, thereby emphasizing the relevance of the transformative perspective to public management reform. The question that will be addressed in the next section concerns whether the new ideational equilibrium resulting from the first generation of reforms is being challenged. What have the reactions to the original reforms been? Are we seeing a path-dependent continuation of the reforms already undertaken (reinforcement); or are we witnessing a gradual overturning of the initial reforms and a challenge to central bank independence (retrenchment); or, as a third alternative, has there been further country-specific fine-tuning of the various central bank models (refinement)?

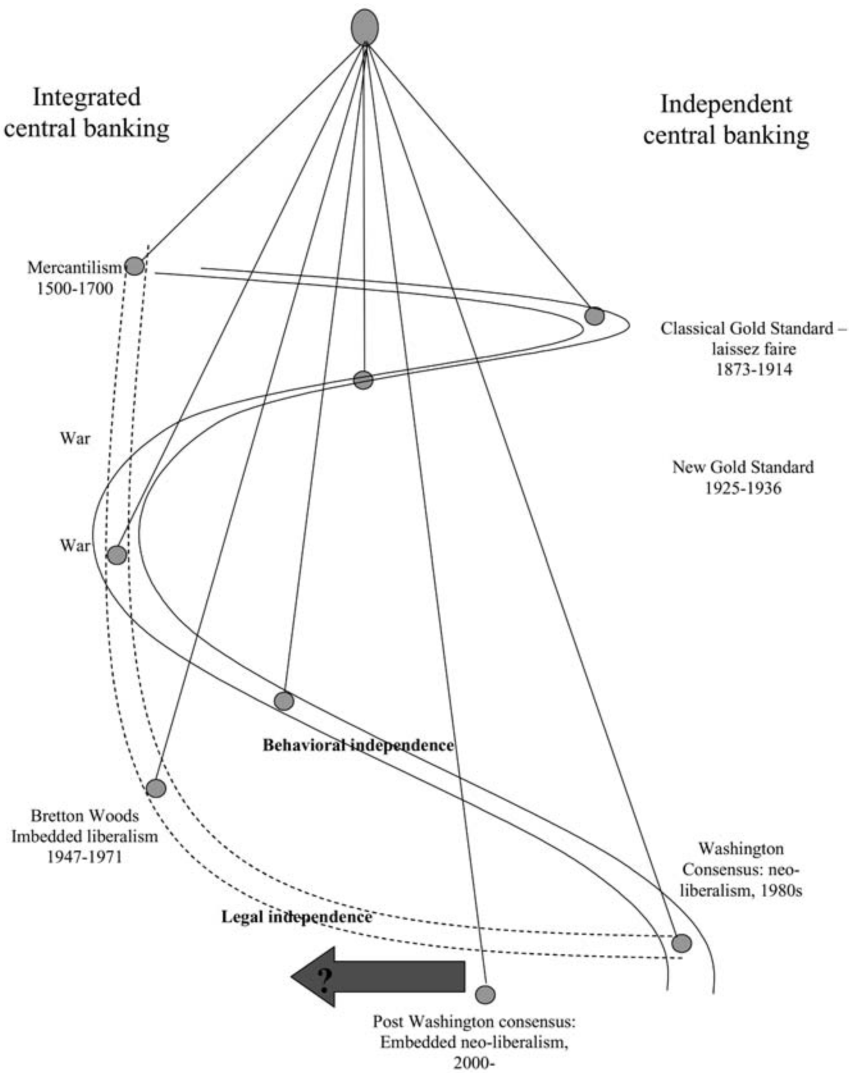

Figure 7.4 Pendulum swings of fashions and practices

Which Way is the Pendulum Swinging?

It is always dangerous to talk about institutional reform in terms of pendulum swings between two poles. It gives the impression that there exists only a limited set of reform options and that ongoing reforms are only replications of past practice. However, if we bear in mind that a pendulum never swings back to exactly the same position from where it came, the history of public management reform can indeed be understood as one of pendulum swings from one fashion to the next (Aucoin 1990; Gregory and Norman 2003). Globalization has not created a worldwide diffusion of institutional standards, but it may have speeded up the pendulum swings from one extreme to the other. This is why it becomes relevant, only two decades after the emergence of the ideas of central bank independence, to ask whether the policy-makers in government and Parliament are showing signs of 'striking back'. Is the centre being reasserted? Is the ideational equilibrium that existed throughout the 1990s being challenged by second-generation reforms?

Figure 7.4 illustrates that the institutional standing of central banks has oscillated between an ideal-typical situation of 'formal integration' in the state apparatus, and an ideal-typical situation of formal de-coupling and 'independence' from the rest of the state apparatus. If one looks at central banking practice, however, it becomes clear that independence enshrined in the provisions of the central bank's formal statutes (legal independence) and its real independence as experienced in day-to-day policy-making (behavioural independence) may be two quite different things. Over the last three to four centuries, behavioural and legal independence only seem to have coincided three times. Nevertheless, irrespective of their formal status, central banks generally have an interest in working actively with, rather than against, the rest of the state apparatus. No organization can afford to run the risk of being completely without allies, whether in Parliament, in government or in society at large (Kettl, 1986). In other words, 'central banks, whatever their statutory relationship with government, are unlikely to deviate far from the domestic political consensus about appropriate action' (Goodhart et al. 1994, 20).

The first two central banks to be founded, the Swedish Riksbank (1668) and the Bank of England (1694), were created by the state, for the state. It was not until the era of the classical gold standard (1870–1914) that the stability culture, which has been at the core of central banking activity until the present day, involved a considerable degree of behavioural independence on the part of the central banks concerned. This was the golden era of central banking. Not only were the most important functions of the central banking metier invented, it was also a period in which typically Conservative and Liberal governments pursued a laissez-faire policy (Gallarotti 1995). The general idea was that economic equilibrium should not be disrupted by untimely political intervention; hence central bankers, on the whole, were left to themselves. Central banking was basically considered to be a technical endeavour. Elected politicians did not have strong opinions about or plans for how monetary policy should be conducted on an everyday level. Thus, although the central banks, as a general rule, were not legally independent, they behaved in distinctly independent ways. With the approval of national politicians, the central banks pursued an external stability objective, that is, a relatively stable currency defined in relation to a certain amount of gold. Internal stability, that is, employment and growth, was a secondary concern.

World War I definitively ended the golden era of central banking. Everywhere in Europe the working classes started to organize themselves much more effectively than they had done hitherto. Through trade unions and Social Democratic parties they acquired political influence and changed their view of political priorities – an important point in this regard. In fact, the previous consensus that external stability should come first, and internal stability second, was reversed (Eichengreen 1992; Simmons 1994). During the war, a large number of barriers to the free movement of capital and goods had been introduced, and in many places these were retained after the war. The so-called 'first globalization' had come to an end (James 2001). The stability culture so dear to central bankers faded away into the background even though the most prominent central bankers of the time, Montagu Norman at the Bank of England and Benjamin Strong at the Federal Reserve Bank of New York, travelled around the world to act as 'monetary missionaries' (Chandler 1958; Sayers 1976). Norman went all over the British Empire and Strong travelled around Central and South America, disseminating the doctrine of central bank independence and stability. Although their success was limited, they managed to prepare the ground for a new organization for central bankers, the Bank for International Settlement (BIS), whose primary objective was to enhance central bank co-operation, independence and stability (Toniolo 2005).

During the 1930s, the worldwide recession put a definitive end to central bank independence. The central banks and their stability culture were often accused of being the main sources of unemployment, social unrest and extreme political ideologies. Amid the climate of depression, World War II broke out, and as the war drew to an end the consensus began to tip in favour of 'embedded liberalism' (Ruggie 1982) – a doctrine that held that the focus on external stability should not prevent states from promoting employment and growth on their own territories. This represented a compromise between the focus on internal stability espoused particularly by John Maynard Keynes and Harry Dexter White's focus on external stability and openness. After the war, many central banks were nationalized, and policy-makers, with the help of the most recent scientific advances, became keen to steer the societal machinery in a more active and much more detailed way than hitherto (Dezalay and Garth 2002). It was Keynesianism that was taught at universities, while neo-classical economics was removed from the curriculum for a time. One of the founding principles of the Keynesian doctrine was that monetary policy was too important to be left only to the central bankers.

In the world of central banking, however – in the BIS, for instance – the governors remained faithful to the classical stability culture. They were not disturbed by the fact that the political majority spoke against their interests. They would simply wait for the pendulum to swing back in their favour. They knew that, at some point, the world would realize that price stability was too important to be left to politicians.

And indeed, their moment eventually came. Towards the end of the 1970s a series of complicated factors – the adoption of the flawed sheltering strategy in the face of the oil crisis; a change in monetary doctrine by Fed Governor Paul Volcker; the accession to power of Ronald Reagan and Margaret Thatcher; Milton Friedman's intellectual diplomacy; and idea diffusion by the OECD, neo-liberal think tanks and the financial media – provided national policy-makers with a new paradigmatic framework for their economic policies (Hall 1992). Governments that came to power in the first half of the 1980s – whether Liberal, Conservative or Social Democratic – were offered a complete ideational set-up to replace old and discredited thinking. Some governments initially resisted this trend – François Mitterrand in France and Robert Hawke in Australia may be cases in point – but liberalized capital markets made such strategies increasingly difficult to uphold for longer periods of time. Everywhere national politicians became preoccupied with signalling credibility and stability to the financial markets. The 'second globalization' became a reality and in the 1990s a new golden era emerged for central bankers in which their legal independence now matched their behavioural independence.

Now, some ten years later, the question is whether the pendulum is swinging back in favour of national politicians? Is a Post-Washington consensus emerging according to which social relations ought to be embedded in democratic political institutions? The evidence seems to point in different directions.

The first conspicuous tendency, as noted in the introduction to this chapter, is that all the institutional standards discussed so far – the state, the central bank as an institution, central bank independence, and inflation targeting – are on the rise. New states are being created that more likely than not have a central banking institution that is formally independent of political intervention and supervision. This indicates that the first generations of management reforms are still going strong. The IMF is travelling the world, like Montagu Norman and Benjamin Strong in the interwar years, providing technical assistance to developing countries. This assistance most typically consists of advice about how to establish autonomous government agencies, such as independent central banks. There is no indication that this will change in the near future. Likewise, when new central banks are created, they are established as independent agencies right from the beginning. The European Central Bank is a good example. It would take a change in the Treaty of the European Union to modify the statutes and mandate of the ECB – the most independent central bank in the world. As regards inflation-targeting, it could be argued that it still remains to be seen whether we are talking about a truly global fashion. However, fashions tend to radiate from the most powerful actors in social networks and since Ben Bernanke, a passionate pro-inflation-targeter, has been appointed as the new Fed Chairman, it is plausible that the global diffusion of that specific standard will receive a new impetus. In addition, the IMF is a keen advocate of inflation-targeting and is trying to sell it to some of the most unstable countries in the world. In short, this may point to a linear continuation of the present reform practices.

Critics of this trend, though prominent, are in a minority. Nobel Prize winner Joseph Stiglitz and Princeton professor Paul Krugman have been long-time critics of the economic dogmatism which they think is personified by the former Fed Chairman, Alan Greenspan. One of their arguments is that Greenspan did not pay enough attention to either employment or inflation. In addition, in various countries some central bank governors may be starting to look at multiple objectives when planning their monetary policies. One example may be Australia, where the RBA has apparently been moving away from the strict stability-oriented orthodoxy. Former

RBA governor Ian Macfarlane is reported to have stated, in 2001, that the single inflation objective 'is being questioned' (Bell 2004, 95). However, when Australian policy-makers cross the invisible line that keeps the territory of the RBA apart from normal policy-making, they seem to receive warnings from the financial press.[3] This indicates that it is still not generally considered legitimate for policy-makers in Australia to openly intervene in the business of the RBA governor. The stability culture is not seriously at stake, so it is not possible to talk about a return to old practices of integrated central banking.

Having said that, there are nonetheless clear signs that the original institutional standards are being refined. Two recent developments – scientization and transparency – indicate that independence is being implemented in more nuanced ways than was originally conceived. Through scientization, monetary policy-making can achieve a status that sets it apart from ordinary political disputes (Marcussen 2006b; see Gregory in this volume). Whereas the granting of a formally autonomous status is a way of *de*-politicizing monetary policy-making, the process of scientization helps to *a*politicize the world of central banking. The 'art' of central banking is becoming a 'science' subject to the rules of scientific communities, for central banking is now so esoteric that it is only understood by a small number of people with specialized knowledge. Fundamentally politically contentious issues are being reified, rationalized, objectified and intellectualized. Only peer-review is considered to be a legitimate and relevant correcting factor in scientized policy-making. Political intrusion is considered to be not only highly inappropriate but downright irrelevant. There are a number of indicators pointing towards the increased scientization of monetary policy-making. As an observer from CentralBankNet observed: 'Anybody who is not a top-flight academic economist will soon start to feel distinctly out of things in the exclusive club of central bank governors' (<www.centralbanknet.com>, accessed 7 November 2005). Increasingly, central bank governors not only have degrees in economics from the most prestigious Anglo-American universities, they also have PhDs and in some cases they have even served as high-flying economics professors. Ben Bernanke at the Fed, Mervyn King at the Bank of England, Stanley Fischer at the Bank of Israel, Axel Weber at the Bundesbank, David Dodge at the Bank of Canada, Seung Park at the Bank of Korea, Leszek Balcerowicz at the National Bank of Poland, not to mention Charles Soludo at the Central Bank of Nigeria and many more, have all been prominent economics researchers. The central bank observer continues: 'After all, it was not so long ago that the conventional wisdom held that market knowledge, judgment and administrative competence were what really mattered and "long-haired intellectuals" – who were thought to know little about how markets actually worked – couldn't get a finance job for love or money' (op.cit.). Thus, scientization in the new millennium may be considered as a refinement of the independence that was diffused worldwide during the 1990s.

Another refinement concerns 'transparency' (see Blomgren and Sahlin in this volume). Back in the interwar years, transparency was flatly rejected. The Bank of

3 See, for instance, Adele Ferguson, 'RBA's fragile independence', BRW, 5 May 2005, and John Garnaut, 'Deputy Dogfight in the RBA corral', *The Sydney Morning Herald*, 26 August 2006.

England representatives who appeared before the Macmillan Committee in 1931, for instance, could not see any value in publishing an annual report about the bank's activities. On the contrary, they thought that such a public display of information might distort 'public debate.' Committee member John Maynard Keynes asked Deputy Governor Sir Ernest Harvey whether 'it is a practice of the Bank of England never to explain what its policy is?' Harvey responded that, 'I think it has been our practice to leave our actions to explain our policy.' Keynes continued: 'Or the reasons for its policy?' Harvey: 'It is a dangerous thing to start to give reasons.' Keynes: 'Or to defend itself against criticism?' Harvey: 'As regards criticism, I am afraid, though the Committee may not all agree, we do not admit there is need for defence; to defend ourselves is somewhat akin to a lady starting to defend her virtue' (Issing 2005, 66). Central banks thought it natural that their operations should be considered exempt from the kind of legislation that was valid for the rest of the public administration. Thus, in March 1975, a student at Georgetown University Law Center filed an action against the Federal Reserve's Open Market Committee (FOMC). Citing the 1966 Freedom of Information Act, he wanted immediate access to the minutes from the FOMC meetings (Goodfriend 1986). The case went all the way to the Supreme Court, which finally held that the FOMC, like any other public institution, was bound by the Freedom of Information Act, *unless* it could prove that the publication of information would significantly harm the government's monetary functions or commercial interests. In other words, the Fed should explain why it communicated the way it did. This gave rise to some theoretical debate about whether central bankers were correct in rejecting complete public access to the affairs of the central bank. Information theorists concluded that under certain circumstances information could be detrimental to stated goals. No wonder, then, that 'central banking traditionally [has been] surrounded by a peculiar and protective political mystique' (Brunner, cited in Goodfriend 1986, 64). Speaking about central bankers, Milton Friedman once observed that they had two principal objectives: 'avoiding accountability on the one hand and achieving public prestige on the other' (Friedman, cited by Fischer, S. 1990, 1181, fn. 5).

All this may be about 'to change.' Today, there is a 'general consensus among central bankers that transparency is not only an obligation for a public entity, but also a real benefit to the institution and its policies' (Issing 2005, 66). On the one hand, central bankers duly recognize that their institution cannot exist in a vacuum, cut off from public scrutiny. On the other hand, much time is being spent making a scientific case for how transparency can enhance the effectiveness of monetary policies. In other words, when central bankers talk, they talk to the financial markets and not to the larger public (Blinder et al. 2001). The argument is simple: when the central bank starts to pursue explicit inflation targets, it needs markets to be effective and 'rational'. If markets are irrational, it will become difficult for the central bank to lay down a monetary policy strategy that will help it to reach its inflation target. One way in which the central bank can improve the rationality and effectiveness of the financial markets is to reveal not only its policy decisions but also the arguments and data that have led it to make these decisions. The clearer the central bank is about what it is doing and why, the easier it becomes for the financial markets to form an opinion about how the situation will develop in the short term. If actors in financial markets feel well informed about the short term, then, it is argued, the central banker can more easily achieve its objectives in the medium- to long-term. 'So inflation targeting now is conducted – almost by necessity,' argues former Riksbank governor Lars Heikensten, ' – with a high degree of openness and clarity' (Heikensten 2005, 6). Central banks that have a long history of policy effectiveness and credibility do not necessarily need to talk as much as central banks with a low level of perceived credibility. That is 'why "nouveau riche" institutions with poor credibility "talk", and why institutions that have a "wealth" of credibility can afford to whisper' (Eijffinger et al. 2000, 119). This may explain why, in Norway, a hitherto unheard of degree of transparency has been adopted. The governor of the central bank, Svein Gjedrem, has decided that his quarterly inflation reports should contain projections of interest-rate levels three years into the future.[4]

Overall, scientization and transparency seem to be all about fine-tuning elements from the first generation of central banking reforms. There are no coherent data to indicate that the first generation of reforms is being rolled back towards integrated, multi-purpose central banking.

Central Banking Reform in Four Small Economies: Only By Night Are All Cats Grey

According to central bankers themselves, 'central banking has gone modern' (Blinder 2004). Indeed, central banking across the world has gone through tremendous processes of change over the last couple of decades. More and more central banks are being created and, increasingly, central bankers are receiving a formally independent status. It could be argued that central banking, after almost a century on the political sidelines, is experiencing its second golden era. The sweeping reform processes have made central banks more alike. Their policies, personnel, strategies, external relations, and functions mirror each other to a large extent. Never before has central banking been such a global phenomenon.

Nevertheless, this chapter demonstrates how four small economies have in fact reformed in quite different ways. The central banks of all four are now formally, and to a large extent behaviourally, independent of government supervision and control. Yet only the Riksbank and the RBNZ have actually been reformed. The statutes of Danmarks Nationalbank and the RBA have remained largely unchanged, and they have essentially only gone through informal reforms. With regard to monetary strategies, three central banks have adopted an inflation target which matches their floating currencies. Danmarks Nationalbank has an explicit target too, which is to protect the value of the currency in the European Exchange Rate Mechanism while keeping inflation down. Again, we see differences in perspective. With regard to the last measure, transparency, the RBNZ, the RBA and the Riksbank have already gone some way ahead, whereas Danmarks Nationalbank seems to be a late-comer. The closed nature of the Danish central bank is remarkable in a country traditionally

4 Ralf Atkins, 'Central Bankers Eye Norway's Clarity on Rates', *Financial Times*, 26 May 2006.

characterized by accountability mechanisms. On the other hand, the central banks of Sweden, New Zealand and Australia are not accountable in the same ways as other public institutions. Central bankers still have a special and protected status in the public administration.

The chapter also highlights the direction of present reforms. There are no convincing data to indicate that the initiated reforms are being rolled back. Central bankers are indeed experiencing a second golden era, and they are striving to maintain the reform momentum. This is why I consider scientization and transparency measures essentially as means to enhance the authority and effectiveness of central banking. What we are seeing is a fine-tuning process to consolidate the first generation of reforms.