CENTRAL BANK INDEPENDENCE, THE BUNDESBANK EXPERIENCE AND THE CENTRAL BANK OF THE REPUBLIC OF TURKEY

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Abstract

This paper primarily aims to investigate the concept of central bank independence as it is stated in the literature. Following the theoretical approach, the true meaning of central bank independence is evaluated with special reference to the Deutsche Bundesbank, considering its well-known reputation and success as to inflation. Additionally the position of the Central Bank of the Republic of Turkey is questioned in terms of independence.

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I. INTRODUCTION

The world-wide acceleration of inflation in the 1970s, has culminated in increasing international interest in the constitutional status of central banks. It was proposed by the monetarists to set a rule for a steady rate of growth of the money supply to provide a remedy for unsatisfactory monetary performance then. As a result of

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financial innovation, long-established relationship between money and prices have changed and this proposal has become inoperative to a greater extent. The behaviour of money relative to income and prices had always fluctuated but recent fluctuations seemed to be both greater and longer-lasting than those in the past which led to the search for some other way of anchoring policy. Today, the concern with monetary policy is to achieve monetary stability by designing an arrangement based upon credibility of monetary policy.

There has recently been an accelerated movement towards delegation of more legal authority to central banks basically due to two reasons: First, highly independent banks such as the Bundesbank and the Swiss National Bank have produced a very good record in achieving price stability. Second, the inflationary experiences of the 1970s increased the quest of the public and its elected officials in developed economies for price stability. However, legal independence alone may not be sufficient to deliver actual central bank independence. It can be a good indicator of actual independence provided that there is enough tradition and respect for the rule of law. Moreover, the differences in every country's priorities for economic policy have special importance in analysing the interrelationship between a country's economic performance and the statutes of its central bank.

The transfer of responsibility for monetary policy to the central bank is in fact a good basis for successful monetary policy. However, this is not a guarantee for stability and better economic performance. In order for the degree of independence to have a significant effect on the course of a country's monetary policy and economic outcomes, two conditions should be fulfilled: First, monetary policy should be an effective instrument; i.e, it must be capable of shaping economic outcomes. It is generally agreed among most economists now that in the long-run the Phillips curve is indeed vertical at the natural rate of unemployment. Therefore, monetary policy can do little to affect real output. Most economists also agree that market rigidities do exist in the short-run, meaning that there is in fact short-run trade-off between unemployment and inflation. Second, the country should enjoy national monetary autonomy. Although floating exchange rates increased the effectiveness of monetary policy, increasing financial integration has tended to reduce monetary autonomy.

The rest of the study is organized as follows: In section II, we analyse the definitions and measurements of central bank independence. Following the investigation of the relationships and possible conflicts between the government and the central bank, we draw attention to a political approach to central bank independence. The last issues of the second section are empirical and theoretical studies related to central bank independence and macroeconomic performance. Considering that the Bundesbank is one of the most independent central banks in the world and it has a strong reputation in this respect, section III aims at investigating the sources of its independence and related reputation. Analysing mainly the relations between the Turkish Treasury and the Central Bank of the Republic of Turkey (CBRT), section IV tries to reveal an explanation as to the statutes of CBRT in terms of independence. Final section is devoted to our conclusion.

II. CENTRAL BANK INDEPENDENCE

II.1 Definitions and Measurements of Central Bank Independence

A basic distinction as for the central bank independence has been made as "political" and "economic" independence by Grilli *et al.* (1991). Political independence is defined as the ability of the central bank to determine its policy objectives free from the government influence. Economic independence, on the other hand, consists of the ability of the central bank in determining and implementing its policies freely to achieve its objectives.

According to Issing (1993), there are also personal elements of independence. However, it is too problematic to grade personal independence. Criteria in measuring the personal independence are likely to incorporate the appointment of the members of the central bank's governing body, the duration of their respective contracts, the possibilities of dismissing the central bank governor and other members of the governing body. Issing (1993) points out that the importance of provisions barring reappointment is the most difficult criterion to be measured correctly. It would be evaluated whether the bank's executives should from the outset not be tempted to try to secure for themselves a second term of office by granting appropriate favors or they are "encouraged" to behave well by the incentive of a subsequent career. On the other hand, the value of the legal possibility of dismissal at any time as a sanction should be scrutinized in determining the personal independence. The courage, steadfastness and skill of the members of the decision making body are imponderables but must be seriously taken into account. Although it seems difficult to determine the personal independence, various investigations undertaken in this area show considerable agreement in assessing the degree of independence.

Baka (1994-95) states that central bank independence is analyzed by taking into account three aspects: a) institutional independence, which is primarily defined in terms of the bank's position within the system of governmental institutions and the procedures applied in appointing and recalling the bank's authorities; b) functional independence, expressed in the powers and capacity of the bank as regards determining and applying monetary policy and in its autonomy in taking decision on the performance of the other functions specified in its Articles; and c) financial independence; i.e., a permanent definition of the procedures for accumulating and distributing the bank's resources that excludes any possibility of financial pressure being exerted.

There is no single institutional characteristic, by means of which the central bank independence to be ranked. However, information on formal, structural relationships specified by statute and information on informal relations between central banks and government may prove useful in determining the central bank independence. However, all these indicators may be misleading and although a central bank that appears not to be constrained by law, may be heavily influenced by other branches of government. The relationship between the central bank and other entities of government can be strongly influenced by tradition because it is a result of gradual evolution. It is generally agreed that countries with a traditional sentiment toward controlling the financial power of the national government also have central banks that are most likely the candidates for being classified as independent.

A single, clearly defined price stability objective is very important and desirable for central bank's monetary policy to be independent. Multiple objectives, on the other hand, are likely to be conflicting objectives, which is a recipe for public distrust. Multiple or unclear statutory objectives are not likely to be consistent with the desire to promote monetary policy credibility because credibility problem arises from the fact that policymakers have a propensity to shift between different objectives. When the central banks are granted more independence to achieve their objectives, they must be subject to strong accountability and monitoring mechanisms. In order for the central banks to be monitored and judged, their objectives and policies must be clearly stated and their actions must be transparent to the public. Because monetary policy independence is usually accompanied by administrative and financial independence, it is also necessary for central banks' administrative and financial actions to be monitored.

All countries with an independent central bank provide its central bank with a statutory basis for its objective(s). The central bank has also to have control of the instruments of monetary policy in order to perform its obligation. Differences in statutory design as for the monetary and fiscal policy, influence bargaining power and therefore credibility by vesting power over targets exclusively in the central bank or not, and in establishing mechanism which do or do not improve transparency. A central bank's ultimate defence may lie more in public opinion than in statute because a determined government can always change the law. As a result, transparency is likely to increase the independence of the central bank.

The extent to which government chooses to impose constraints on their own monetary policy freedom by delegating certain authority to central banks, is likely to depend on country-specific factors. Those factors could be past inflation and monetary policy experience, the nature of existing checks and balances in the political system, the economic awareness of the public, etc. It is the government that ultimately determines the central bank's authority and its scope of action. Although price stability conflicts with other government objectives, governments often pass laws that grant their central banks authority and autonomy in order to pursue it. A government can choose the strength of its commitment to price stability by means of central bank independence. The attainment and sustainability of price stability can be beneficial in reducing the high costs of inflation. They are also necessary, although not sufficient, for developing a local capital market. Government and business can borrow more conveniently and cheaply from a well-developed local capital market in the long run.

II.2 The Relationships and Possible Conflicts between Monetary and Fiscal Policy Authorities

II.2.1 Public Debt Management and Central Bank Credit to Government[1]

Central bank's ability to create money is the primary source of tension between the monetary and fiscal authorities because the creation of fiat money is one source of government revenues through imposing an implicit tax on money balances. Government's fiscal operations could be viable in the long run only on condition

[1] See Leone (1990) for an analytical analysis of the central bank credit to the government.

that its current debt burden plus the present value of its expenditures equal the present value of revenues. Fiscal viability requires that the discrepancy between the debt plus expenditures and tax revenues should be financed by seigniorage.

The availability of central bank credit is one of the alternative for the government to finance its deficit. Government's fiscal decisions may limit the independence of central banks by affecting their monetary policy decisions and their financial positions. Therefore, appropriately defined limits would allow central banks to pursue monetary policies independent of government fiscal decisions and protect their financial positions, especially in conditions where access to central bank credit by governments is cheap relative to market conditions.

If the government deficit and the net acquisition of other assets are greater than the availability of credit from the central bank and the real rate of interest is greater then the economy's rate of growth, then the government debt to Gross Domestic Product ratio will grow without limit. However, the demand for government debt is finite; therefore, this process cannot be sustained forever by the government. At the end, government will have to reduce the deficit selling foreign or other assets or increasing its demand for central bank credit.

When legal limits on central bank credits to governments are established, this does not necessarily mean that the central banks will be independent from pressure from governments which is looking for borrowing alternatives. The legal limits may not be clearly defined or they do not include all possible forms of government debt with the central bank. In order to achieve macroeconomic stability through designation of appropriate limitations and in order for central banks to perform monetary policy independent of fiscal actions while protecting their financial positions, it is necessary to have some kind of limitations on the growth of net government debt in addition to the limitation of government borrowing from central banks.

The limit on total outstanding government debt should consist of all forms of outstanding government and government-guaranteed debt net of government financial assets. Likewise, foreign exchange losses which are among the assets of central banks actually reflect an additional form of government debt with central banks. Therefore, foreign exchange losses represent a fiscal problem which will require a fiscal solution. Otherwise, these losses will contribute to unsustainable debt growth or inflationary processes through increasing government debt or through increasing central bank debt or printing money. Therefore, government debt with central banks arising from foreign exchange losses should be included in the legal limitations to central banks lending to government.

Those limitations will contribute to long-run macroeconomic stability and central bank independence. In spite of those limitations, the financial position of central banks may still be threatened as a result of lending to governments which is made under inappropriate conditions. In order to minimize this possibility, central banks should preferably acquire government securities in the open market within the margins allowed by the limits. Any other form of government borrowing from the central bank on the other hand should be exceptional and subject to market-related interest rates and conditions. The determination of maintaining fiscal discipline at all times, keeping public sector financial needs within the margins allowed by the kind of structural constraints, has primary importance in facilitating a predictable and prudent central bank behaviour regarding the financing of governments.

It is difficult, on the other hand, to determine whether actual legal limitations on central banks' lending to government have contributed to encouraging fiscal discipline. In countries with chronic fiscal deficits, legal limits have become unsustainable in the long-run and the establishment of this kind of limitation has not been sufficient to guarantee fiscal discipline. In countries, where fiscal discipline has been a permanent feature of actual behaviour, legal limitations appear to be unnecessary. Legal provisions alone do not guarantee independence. Monetary stability can be achieved only with a central bank of established independence because of the short term nature of the government policies.

Central banks are incapable of incurring losses due to their monopoly power of issuing currency. Moreover, the true result of central banks' operations, which often have involved large losses, are hidden because their operations are not transparent to the public. Consequently, it is easy for the political authorities to be able to implement expansionary policies without being subject to budget restrictions. Therefore, a sound financial position of central banks is a prerequisite to formulate anti-inflationary policies because central bank losses are expansionary. It is better to implement a law that does not require budgetary appropriations to finance central bank losses because budgetary dependence increases the risks of government involvement in the formulation of central bank policies.

In fact, it is implausible to create a system which is separate from the fiscal authority and the value of the public debt. The value of the currency can be guaranteed by the central bank conditional on the sound operation of the fiscal authority. Although fiscal and monetary policy are controlled by two authorities which are at least partially independent, they are linked by the intertemporal government budget constraint.

II.2.2 Foreign Exchange Policy and Central Bank Independence

The central bank cannot be truly independent if the government control the exchange rate. This is due to the fact that the money supply and the exchange rate are not independent instruments in the long run and in most cases in the short run and this is reinforced when capital is mobile. Therefore, attributing their control to two independent policymakers may cause conflict between monetary and exchange rate targets. This would eventually force one of the two policymakers to give up its independence.

In practice, the outcome of a conflict between the central bank and the government will depend on the personalities of the head of the central bank and the minister of finance, the reputation of the central bank and its overall standing among other policymaking institutions, and the degree of public aversion to inflationary policies. If the government actually sets the exchange rate at a level inconsistent with the monetary target and sticks to that level, then, the central bank is likely to loose its control of the money supply because sterilized intervention will be ineffective.

According to a commonly held view, exchange rate policy is too serious a matter to be left to central bankers particularly in a democracy. The assignment of exchange rate policy to central banks may entail some costs because they prevent exploiting the short term trade-off between employment and inflation. Besides they are interested primarily in maintaining price stability. Therefore, they may be perceived as not paying enough attention to unemployment. Thus, according to the mentioned view, the choice between unemployment and price targets should be left to political forces in a democracy.

Cottarelli (1994) argues that, if political forces decide that the economy will benefit from central bank independence taking into account the fact that the long run benefits of lower inflation are higher than the short run costs arising from imperfect price flexibility, then the central bank must be endowed with the instruments that will allow it to exercise its independence. However, the argument as for the central bank's control of both monetary and exchange rate policies does not mean that central bank independence should be necessarily unbounded. The preference for an independent central bank involves some loss of governmental control in all aspects of policymaking and will require some extra effort in terms of coordination. Thus the degree of central bank independence is a political choice.

Cottarelli (1994) advocates that monetary and exchange rate policies should be assigned to the same decision maker, primarily because they represent two aspects of the same instrument. Otherwise, the central bank will not be truly independent in either the scope or timing of its actions. It is also argued that the division of responsibility for monetary and exchange rate policy between authorities should be avoided. Because, this division could create conflict and results in policy inaction.

II.2.3 Prudential Supervision and Monetary Policy

There are different views as for whether the central bank or a separate supervisory agency should be involved in the day-to-day supervision of financial institutions. The arguments in favour of the involvement bases on two things: First, by means of performing supervisory and regulatory function, the central bank can garner valuable insight into the overall state of the economy. Second, the ability to influence bank policy through regulatory pressure is likely to give additional force and impetus to monetary policy measures. However, the central bank exercising this additional power might easily cross the line from impartial macromanagement of the economy to credit allocation and micromanagement of individual institutions.

According to the conflict of interest argument, it is claimed that a central bank which is responsible for banking supervision, and therefore, both for bank failures and associated deposit losses, faces temptations to compromise price stability by providing monetary growth and low interest rates that may prevent prospective bank failures. Central bank's concern of systemic health also provides a degree of implicit insurance. Because this is very hard to price properly, it is usually unpriced, leading in turn to moral hazard.

One of the opposing argument states that although the cost of a rescue will eventually be born by the taxpayer, a bank rescue typically requires injection of immediate liquidity, which can come only from the central bank as lender of last resort. Cukierman (1994) advocates that large-scale bank failures are monetized more easily when deposit insurance and other prudential functions are performed by the central bank. Moreover, bad debts are likely to be automatically monetized without much budgetary legislation. If those functions are performed outside the central bank, it is more likely that the budgetary implications of rescue operations will be more visible to the public eye. There is a drawback in the implementation of those functions outside the central bank as such financial crises will not be handled as swiftly as when the central bank has direct responsibility. If the functions assigned to a central bank other than its primary objective are not subordinated to it, those functions would affect the management of its portfolio and the control of the money supply. Actions such as lender of last resort to stabilize the financial system during banking crises, and deposit payments on liquidation of insolvent banks, affect monetary policies as the central banks incur losses and created money.

Bank supervision and regulation are a function closely related to the exercise of the executive branch. Governmental agencies are directly and substantially involved in that function. Heller (1990) states that monetary policy is a macro-economic activity that touches individual economic agents only indirectly, while regulatory and supervision policies involve direct control by governmental agencies. The central bank will get involved in the day-to-day exercise of governmental authority if it assumes daily regulatory authority. This would involve the central bank in partisan politics which is in turn unavoidably endangering its independence (Heller, 1990). Heller (1990) judges from the evidence provided by a limited sample of countries that central banks without supervisory responsibilities are more successful in attaining a low inflation rate than those with shared or full supervisory responsibility.

Heller (1990) advocates that the central bank should not be the primary regulatory agency. However, he believes that there is still an important role for the central bank in the regulatory process that will enhance and supplement its monetary policy function, such as setting rules that establish appropriate liquidity levels for the financial institutions and in monitoring adherence thereto. He also believes that by giving the major supervisory and regulatory responsibilities to a banking agency while focusing the responsibilities of an independent central bank on monetary policy and supervision of liquidity, a possible conflict between supervisory and regulatory concerns and monetary policy objectives will be avoided.

As it is generally agreed that the greater the focus on the independence of monetary policy, the less is the need for the central bank to be engaged in other activities. The important point as to the separation of supervision from the central bank actually is that whatever the arrangements for supervision of financial institutions are, the central bank should remain sufficiently informed to be able to maintain a sound payments system in the interests of monetary control.

II.3 A Political Approach to Central Bank Independence[2]

The difference between the concepts of "autonomy" and "independence" is particularly important while evaluating central bank independence in terms of political economy approach. Even though "autonomy" of the bank is a scalar concept, "independence" could be defined as full autonomy. There is a qualitative difference between them. Autonomy is defined as a specific range of decision-making power within an institutional/policy-making context where

[2] This section heavily depends on Bowles and White (1994).

other political/economic actors also have some input. Independence, on the other hand, is defined as a legal attempt to insulate the central bank from all other forces in society.

The notion of central bank "independence" is indefensible according to political economy approach because it is based on the assumption that politics is restricted to the realm of government and politicians. This view regards an independent central bank as apolitical. However, such an analysis is fundamentally misleading in terms of political economy approach because it depoliticizes the economy and results in a view which takes economic policy as an area of technical debate. Political economy approach, locate the issue of the position of the central bank within a framework which explicitly recognizes that economic institutions do not exist "above" or "outside" politics but are embedded in a complex matrix of political forces which transcend the conventional division between policy and economy. Although, technical/economic analysis treats central bank autonomy as exogenous, political economy analysis investigates its determinants. The political economy approach stresses that the evolution of the status of the central bank is not ordained by natural factors, nor can it be explained in terms of simplistic imputations about the behaviour of governments, but is rather the outcome of more complex and dynamic political processes.

The political economy approach determines finance, industry and labor as domestic socio-economic forces which apply pressure on governments in certain direction and condition the range of feasible policy options available to governments. The attitudes of these three constituencies may reasonably be expected towards the issue of central bank independence and the supposed economic benefits it offers vary depending on their distinctive economic interests. Because both industry and labour benefit from macroeconomic policies which aim at employment and growth, they share common interests. They will therefore be more skeptical of moves to increase the autonomy of the central bank whose main function is to prevent inflation at the expense of other macroeconomic objectives. It is stated on the other hand that greater central bank autonomy is attractive to the financial sector not only because it helps to protect them against the potential ravages of "unsound" governments responding to the pressures of other socio-economic constituencies, but also because it brings about an institutionalized reallocation of state power in their favour.

Creating an independent central bank which is more difficult than maintaining it requires an act of political will. Governments add a new actor which surely seeks to preserve its own autonomy to the political system by making the central bank independent. This does not mean that the central bank independence could not be irreversible. However, the cost of irreversibility depends on the central banks ability to create a supporting external environment.

Once the central bank has become independent, its ability to sustain that independence reflects both the resources it possesses and the strategies it chooses to pursue. Goodman (1992) claims that expertise in monetary affairs confers power on all central banks, and those central banks enjoying monopoly on expertise posses a powerful tool in policy disputes. He states that in the short run such expertise enables independent central banks to set policies different from those desired by the government without risk of losing their independence. However, in the long run, realizing their vulnerability to political threats, central bankers accept the accommodation of political demands as a means of preventing more complete and durable political control.

The process of globalization and the growing pressures on governments resulting from increased international openness, the increased volatility and complexity of international financial markets impose mounting restrictions on the decisional autonomy of national governments. This has been a major factor in providing both the intellectual rationale for and political impetus behind the argument for central bank independence.

It is advocated that central banks are intrinsically political agencies in numerous ways: they are linked to specific social constituencies and interests; they are part of the state system and they operate as self-interested agencies like their institutional counterparts in other sectors; they act politically to build up their own image and resources and aggregate political support within government and society.

The issue of central bank autonomy is intrinsically political in that the feasibility of any move to strengthen banks and grant them greater autonomy depends on the particular constellation of politic-economic forces, in any given national context. The specific constellation of these forces and the balance of power among them are structured by the increasing globalization of financial markets and a concomitantly emerging crisis of national governance. It is also political in the sense that the move towards greater autonomy and full "independence" involves a redistribution of power over key areas of macroeconomic decision.

There is a crucial contradiction between the politics of insulation represented by the notion of central bank "independence" and the politics of accountability so central to democratic systems of government. According to the political economy approach, the current interest in central bank independence may not only be symptom of an emergent crisis of governance but also of an emergent crisis of democracy.

From the political economy approach, some practical implications are deduced over central bank independence. The greater central bank autonomy or virtual independence should not be viewed as an institutional panacea valid in all national contexts. Greater autonomy may be justifiable in certain contexts in terms of more effective macroeconomic decision-making. The political ingredients, the representation of different political interests in state and society within the institution and the mechanism for ensuring accountability to elected authorities should also be given systematic attention in constituting the bank's autonomy. However, the desire to ensure democratic accountability and widen representation of social constituencies runs up against the problem of credibility losses.

II.4 Theoretical Models

The theoretical studies of central bank independence and economic performance concentrate on the possible conflicts stemming from the delegation of monetary and fiscal policy to independent institutions. In theoretical literature, an independent central bank is identified as the one that does not cooperate with the fiscal authorities in determining its policies. A dependable one, on the other hand, cooperates with the fiscal authority. The cooperative solution is found to be pareto superior to the noncooperative solution in all theoretical models. It is not considered to be much realistic to assume that there is only one policy authority and that monetary policy is the only policy instrument. It is perfectly possible that if the government does not like the policy of the monetary authority, it will use fiscal policy to try to undo the impact of monetary policy on some variable such as aggregate demand in spite of having set up an independent central bank.

Doyle and Weale (1994)[3] analyse the result of the co-ordination of the central bank's and the government's policies by estimating their reaction functions. By means of those reaction functions, the forces to which they have responded are aimed to be identified and the magnitude of the responses is to be quantified. As a result of the game theoretical approach, they illustrated that the Nash equilibrium point representing the un-coordination between the monetary and fiscal authorities may be less attractive than the equilibrium which would be found if they set their policies jointly. If monetary and fiscal policies are separated, there is a risk that monetary and fiscal authorities will compete against each other in an undesirable manner. As a result, it is possible to have an equilibrium with high budget deficit and a high interest rate. They argue also that the competition between the two authorities may be a source of dynamic instability. However, it is not very clear whether the benefits of independence are greater than the costs which may arise from a failure of coordination between the two independent authorities.

Pollard (1993) argues that theoretical studies have also weaknesses. She points out that the models are too simplistic

[3] See Gökbudak (1995) for an analysis of the study made by Doyle and Weale (1994).

because the preference structures of the two authorities and the models of the economy are not completely specified. Considering that policy is made in a world of uncertainty, she criticizes the models in that they are designed as operating in a world of certainty. The policy conflict between an independent central bank and fiscal authority can increase after the addition of uncertainty. One of the most important deficiencies of the theoretical models according to Pollard (1993) is that they omit the public which is one of the most important player in these policy games. The credibility of a macroeconomic program is heavily influenced by public perception because the public can limit the ability of policymakers to take advantage of an inflation output trade-off. If an independent central bank can increase the public perception as to the credibility of its policy, economic results will be improved as a conclusion. Pollard (1993) also states that the theoretical models fail to address the feasibility of the policymakers' goals. In a country in which there is a stream of deficits, an independent central bank could be useful if its credible commitment to price stability forced the government to evaluate the sustainability of its policy goals.

II.5 Empirical Studies[4]

The examination of empirical studies made as to the central bank independence has primary importance in determining the relationship between central bank independence and the economic performance. It seems to be indicated by the empirical studies that the higher the degree of central bank independence, the lower the inflation rate. Moreover, this is achieved without hurting growth. It

[4] Due to its special importance, only the study made by Cukierman *et al.* is mentioned here. See Gökbudak (1995) for other empirical studies about the central bank independence and economic performance.

could also be dedicated that the central bank independence is beneficial in reducing fiscal deficit.

The empirical work undertaken by Cukierman *et al.* (1992) is the most comprehensive study and has a special importance among empirical studies made up to date. Cukierman *et al.* also take into account the informal factors that are important in determining the central bank independence in addition to the formal ones. They determine informal arrangements between the bank and other parts of government, the quality of the bank's research department, and the personality of key individuals in the bank and the government as informal factors. However, these factors are difficult to quantify in an impartial manner.

Although the legal status of a central bank is important in determining its actual independence, many central bank laws are highly incomplete and leave much room for interpretation. Tradition or the personalities of the governor and high officials of the bank at least partially shape the actual level of central bank independence. Reality may be very different from the law. When actual independence diverges from legal independence, it is hard to find systematic indicators of it. Cukierman *et al.* develop two additional indicators from the actual frequency of change of the governor and from responses to a questionnaire sent to experts on each country. They determine turnover of central bank governors as an indicator of the central bank independence assuming more rapid turnover of central bank governors reflects a lower level of independence. They claim that if the political authorities frequently take the opportunity to choose a new governor, they will at least have the opportunity to fire off those who challenge the government. Cukierman *et al.* state that it would be expected that turnovers at the central bank that occur simultaneously with or shortly after changes in the government would indicate lower independence than turnovers that occur at other times. Cukierman *et al.* accept that a low turnover, on the other hand, does not necessarily imply a high level of central bank independence because a relatively subservient governor may stay in office a long time. They find that turnover rates in developing countries extent into a range considerably above the highest rates in the industrial countries.

Cukierman *et al.* use questionnaire on central bank independence as another indicator of central bank independence. It is based on responses to a questionnaire that is sent to a nonrandom sample of specialists on the monetary policy in various central banks. Although some questions involve the same issues that underlie the legal variables, they focus on the practice rather than the law. Although the judgements of those responding to the questionnaire are subjective and not entirely uniform, the responses are helpful in identifying divergence between actual and legal independence, especially when the divergence is large.

Cukierman *et al.* deduce from their study[5], including four different rankings of independence of central bank independence, that legal independence is an important and statistically significant determinant of price stability in industrial countries but not in developing countries. The establishment of respect for the central bank charter and management is also another important step in creating an independent central bank. The rate of turnover of the

[5] See Gökbudak (1995) for a detailed analysis of the empirical study made by Cukierman *et al.*

governors contributes significantly to the explanation of inflation and even inflation variability across the overall sample of countries. However, it is not significant in explaining variations of inflation within the industrial group. An inflation based index of overall central bank independence which combines the legal and turnover information contributes significantly to the explanation of cross-country variations in the rate of inflation. They state that the discrepancies between the actual and legal independence are wider on average in developing countries than in industrial countries. They find two-way causality between inflation and turnover of central bank governor. As a result, Cukierman *et al.* claim that lower independence induces higher future inflation which in turn reduces the subsequent actual level of central bank independence, and so on.

However, Pollard (1993) states the results of the empirical studies have the following deficiencies: 1) the difficulty in measuring the degree of central bank independence; 2) the possibility of a spurious relationship between independence and economic performance; 3) the possible endogeneity of central bank independence; and 4) the inclusion of the fixed exchange rate period in the sample data of some of the studies. In theory, under a fixed exchange rate regime, the degree of central bank independence should not be a determinant of a country's inflation performance because monetary policy cannot be set exogenously.

Pollard (1993) criticizes the empirical studies except Cukierman *et al.* (1992) in that all of the central bank independence indexes apply equal weight to each factor that is thought to be relevant for independence. Because empirical studies use the objective of price stability in measuring the central bank independence, Pollard (1993) claims that the usage of it as one of the measure of central bank independence may result in a bias between the measure of independence and the inflation rate. Pollard (1993) points out that although the empirical studies provide evidence of a negative correlation between central bank independence and inflation and between central bank independence and fiscal deficit, they do not provide evidence of causality.

III. THE DEUTSCHE BUNDESBANK[6]

The Deutsche Bundesbank is one of the most independent central banks in the world. Foreign powers have twice compelled the German authorities to enhance its independence and in fact external factors have important influence on the formation of a domestic institution since the central bank's creation in 1875. After four years from the political unification of Germany in 1871, the Reichsbank was established.

The Deutsche Bundesbank was created in July 26, 1957. The act created a more unified structure. Although the Land Central Banks retained their names, they were merged with the Bundesbank becoming its main offices in each state. Article 3 of the Deutsche Bundesbank Act states that, the Bundesbank shall "regulate the amount of money in circulation and of credit supplied to the economy with the aim of safeguarding the currency." Article 12 requires the Bundesbank "to support the general economic policy of the federal government" but only insofar as this support does not undermine the task of preserving monetary stability.

[6] See Gökbudak (1995) for a detailed historical evolution of the central banking in Germany.

Goodman (1992) claims that the Bundesbank's sustained policy of price stability, a goal to which it is committed by statute, is the most important evidence of its independence. Conventional wisdom attributes German price stability to the appearance of a new social consensus, which was founded in reaction to the hyperinflation of the 1920s. However, Goodman (1992) advocates that simply historical memory cannot account for the numerous instances in which the Bundesbank's policy of price stability has been challenged. Goodman (1992) argues that despite the political or labor leaders' occasional attempts to move monetary policy in a more expansionary direction, the Bundesbank has proved independent enough to hold to its anti-inflationary goal.

No independent central bank can afford to take its own independence for granted, given the incentives of politicians to control monetary policy. An independent central bank must function as strategic actor who seeks not merely to shape the economy but also to protect their independence. Central bank is required to build and maintain the support of key societal actors especially the support of the financial community in order to protect its independence. The Bundesbank has been aware of that its independence ultimately rests on societal support, and it has long taken that support into account in fashioning monetary policy. For these precise reasons, the Bundesbank has sometimes given ground.

III.1 Institutional Framework and Organizational Structure

By comparing the long-run average inflation rates in industrial countries, it is seen that the Bundesbank is the most successful in preserving the domestic value of its currency. The Bundesbank experience shows that the constitutional central bank independence is an effective institutional mechanism for assuring lasting domestic price stability because it is otherwise impossible to be achieved if the government is given the power to use domestic monetary policy to pursue other short-term economic policy objectives such as temporary boost in employment or the collection of seigniorage. Central bank's independence renders the credibility necessary to convince the public of its commitment to price stability and to bring down expectations of long-run expectations.

The supreme policy making body of the Bundesbank is the Central Bank Council which determines the general course of monetary policy. The issue of the nomination of the Council members by the Federal Government may be interpreted as the council members are tempted to adopt policies to please their government and assure reappointment. However, Neumann and Hagen (1993) advocate that the incentive for such partisanship remains limited. Because, individual terms of office which is eight years are twice as long as a Federal Government's term and longer than the terms of any federal state government. Moreover, the incumbent is granted a second term of equal length almost automatically when retirement age has been reached. Council members have little reason to fear for their jobs when the Bundesbank's policies do not conform with the government's political interest because they have no specific mandate and cannot be released from office except for personal reasons or upon request by the Council. Furthermore, their personal independence is strengthened by high salaries in terms of international standards.

Therefore, they have no reason to lobby for lucrative positions in the financial industry.

Issing (1993) states that the appointment procedures of Members of the Directorate and Presidents of the Land Central Banks have certain differences in case of the Central Bank Council of the Deutsche Bundesbank. This makes it possible to spread political influence in time and space. Moreover, the constitution of the supreme decision-making entity in the form of a board in which all members have equal-voting rights puts the governing board's independence in a broad foundation.

The Council holds undivided power over the course of the domestic monetary policy under the mandate of the Bundesbank Act which makes the Bundesbank Central Bank Council independent of instructions from government or any other political authority with regard to monetary policy. The Bank could not be forced to lend directly to government except for short-term overdraft credit, which is in turn subject to explicit limits and quantitatively negligible. Thus, its authority over domestic monetary policy instruments is not restricted by a requirement to finance government deficits.

The Bundesbank's commitment to price stability is limited most seriously by the exchange rate policies. Given the authority by the External Economic Relations Act, the federal government determines exchange-rate regime of Germany such as joining or leaving international exchange-rate arrangements. Although the federal government generally consults with the Bundesbank on these matters, it could be deduced from the past experience that the general political considerations ultimately have the prerogative over the Bundesbank concern.

In order to have full control over monetary policy, the central bank also needs to be functionally independent in addition to its institutional independence. In using the traditional instruments of monetary policy[7], Issing (1994) states that the Bundesbank has the sole and unrestricted authority. The Bundesbank's functional independence is somewhat limited, because government members may attend and propose motions at meetings of the Central Bank Council. Moreover, they have the right to ask Council decisions to be delayed for up to two weeks. By considering that the "veto right" can only be used to delay action by the Central Bank Council, not to block it, and it has actually never been used up to date, this has never led to cry serious problem as far as the conduct of the monetary policy is concerned.

The geographical distance between the site of the Federal Government (Bonn) and the site of the Bundesbank (Frankfurt) is another factor of independence according to Tietmeyer (1994a). This may also have helped to prevent strong informal channels of influence. The Federal Parliament has just passed legislation providing for the Bundesbank's seat to remain in Frankfurt, even if the government should move to Berlin.

The legislature's decision as for the assignment of almost all responsibility for bank supervision to another institution, the Federal Supervisory Office, is important because the central bank is freed at the outset from the risk of getting into such conflicts as might otherwise arise from any difficulties which might beset individual banks. Issing (1993) states that the deployment of distinctly selective and problematic regulatory instruments, in particular credit ceilings,

[7] See Gökbudak (1995) for the monetary policy instruments of the Bundesbank.

would moreover almost inevitably draw the central bank into conflicts with policy-makers and pressure groups that would be bound to jeopardize the status of independence *de facto* and in the longer run also *de jure*.

II.2 The Accountability of the Bundesbank

There is no clear line of accountability from the Bundesbank to any one elected person or body as for its conduct of monetary policy. Although up to ten positions of the decisions making Central Bank Council incorporating president and vice president are held by individuals appointed by the President of the Federal Republic upon nomination by the Federal Government and after consultation with the Central Bank Council, the majority of positions are ex-officio held by the Presidents of the Land Central Banks. These Presidents on the other hand are not expected to pursue the interest of their Lander or to receive instructions from them. It is concluded in practice that the Bundesbank is not directly accountable either to the Upper (State) or to the Lower (Federal) House of the German Federal Republic. Beyond the re-appointment of senior officials and possibility of changing legislation, there appears to be no complementary mechanism for accountability. The budget process is wholly independent of Government control. The Bundesbank's salary structure however, must be tied to that of the public service and the Federal General Accounting Office examines, *ex-post* the Bundesbank's annual statement of accounts which is communicated to the Federal Minister of Finance. It could be deduced that the high degree of independence given to the Bundesbank is based upon a general consensus on the part of the German public with regard to the broad trust of economic and monetary policy. It is the pursuance of an active and open information policy which provides the Bundesbank with broad support for its policies. Moreover, active and open information policy might be regarded as part of public accountability in a wider sense.

III.3 Monetary Targeting

Because of the global inflationary trend at the beginning of the second half of the seventies, the central banks of the most major industrial countries had adopted monetary targeting strategies. In spite of its advantages of establishing credibility and ensuring discipline among the monetary policy makers, the implementation of monetary targets has encountered difficulties in numerous countries since the middle of the eighties due to the the process of deregulation and innovation. Therefore, a suitable strategy for achieving the final objective of price stability has been questioned.

The Bundesbank has been pursuing the goal of safeguarding the currency with the aid of monetary targeting strategy[8] for twenty years. In spite of the most recent difficulties, Tietmeyer (1994b) claims that the risks to the monetary targeting strategy have so far been relatively small in Germany because the German financial markets were liberalized and deregulated much earlier than those of many other countries. It is also true that there is no much reason to look for loopholes in the form of new financial instruments due to the lower level and the lesser volatility of inflation rates.

Tietmeyer (1994b), considering the internal and external studies' conclusion as for the validity of the monetary relationships even after the reunification, states that this strategy is no doubt an

[8] See Gökbudak (1995) for further information about the monetary targeting strategy of the Bundesbank.

aspect of German "stability culture", which should not be abandoned without need. He believes in that the abandonment of monetary targeting as pursued so far, would involve the risk of being misinterpreted as a rejection of a stability-oriented monetary stance. He cannot see any better alternative other than monetary targeting. He states that the definition of relevant money stock is continuously reviewed and adjusted in connection with the financial innovations.

IV. THE CENTRAL BANK OF THE REPUBLIC OF TURKEY

IV.1 On the Issue of Central Bank Independence in Turkey

Starting from the outset of 1980s, economic structure in Turkey has got into a great transformation process. It was aimed with the 1980 stabilization program that the share of the Central Bank of the Republic of Turkey (CBRT) in the financial system was to be lowered, which enabled the financial system to perform its functions soundly. This is also necessary to pass on the market economy. However, the regulations made after 1980 for the purpose of improving financial system were not much fruitful because of the monetization of the rapidly increasing government deficit. The increasing access of the government to the CBRT sources in order to finance its deficits leads to ever growing of the balance sheet of the CBRT; as a result, the share of the Bank is gradually increasing in the financial system. Moreover, the rapid growth policies pursued after1980 resulted in excessive borrowing of the government, which in turn prevented the CBRT from pursuing sound credit policies.

Especially after1984, there have been important changes in the organizational structure of the CBRT resulting from its employment policy. Employing qualified staffs, particularly in the

Research Department, the CBRT has been able to access to problems with greater expertise. By means of research and investigations made by those staff, the policy makers are provided with beneficial knowledge in taking decisions. In providing the central bank with institutional independence, its personnel should bear a great responsibility. Only executives with a high level of motivation of research, and a high level of technical quality could resist the pressure coming from the political decision makers.

Starting from the mid-1980s, some institutional changes were also introduced. In 1985, the auction system has been started with the sale of the Treasury papers by CBRT. In 1986, the interbank money market has come into practice, and in the following year, the CBRT has started to make open market operations. In 1988 and 1989, the gold market and the foreign exchange market were opened, respectively. These regulations aimed at conducting the monetary policies autonomously using the market oriented instruments. With the Decree no. 32 introduced in 1989, many limitations on Turkish Lira (TL) have been abolished and capital movements have been freed and the value of TL has been determined according to the international demand for and supply of TL.

The establishment of Eximbank is another success achieved in the field of institutionalization. Until then, the CBRT has taken important duties in encouraging foreign trade. Transferring its duties which are meant to be an investment bank and which are related to the promotion of the exports upon expert bank, the CBRT has taken an important step towards going back to its primary objectives.

In 1989, the rules governing the operation of short-term advances to the Treasury were laid down in an agreement between the CBRT and the Undersecretariat of the Treasury and Foreign Trade. Following the implementation of this agreement, which sets a ceiling on the Treasury's recourse to the advance extended by the CBRT at a preferential interest rate, the rate of increase in this advance was limited to 22 percent (CBRT, Annual Report, 1989). This agreement is important in terms of independence because in order for central banks to protect the value of their product; i.e., national currency, they are required to be separated from the Treasury which is a spending institution as opposed to the central banks.

The announcement of monetary program in 1990, is a step towards increasing the autonomy of the CBRT incorporating the following subjects: central bank should not be a part of policies aiming at creating employment; it should not be a means of incentive policies; its medium term objective must be to provide stability of the domestic and external value of TL; inflation expectations are removed at the end provided that the monetary program is credible and can be implemented successfully; inflation would be controlled provided that the balance sheet of the central bank was not increased in the medium term. The announcement of monetary program is important in increasing the credibility of the CBRT. However, it is not possible for the Central Bank to perform price stability by enforcing a monetary program, in an environment where public sector deficits are increasingly financed every year through monetization. For an economy which consumes without producing, and earns without working and heavily depends on short-term capital inflows, the central bank independence is not much meaningful.

It is not consistent with the practice to claim that central bank is completely independent from political decision makers in a country like Turkey. It is stated in the CBRT Law that "the Bank shall exercise independently and under its own responsibility the power conferred upon it by this Law." Because of the difficulties with the economic structure, however, the CBRT could not use the power given to it by the law most of the time. During the liberalization process of the 1980s, State Economic Enterprises had difficulty in adjusting to the changing economic and financial conditions. Although the public sector expenditures increased continuously, accompanying revenue increasing measures were absent. This accelerated the growth of the public sector deficit, which resulted in a financial bottleneck. Because of the persistent nature of the public sector deficits which have been financed through borrowing or monetary expansion, there has been a pressure on the interest and exchange rates and inflation.

It will be useful to give the ratios of the last five years' public sector borrowing requirements (PSBR) to the Gross National Product so as to reveal the fiscal imbalance which considerably prevented the CBRT from using its powers and policies in providing and maintaining price stability. The ratio of the PSBR to the GNP was 7.5, 10.2, 11.6, 11.3, and 8.2 respectively in 1990, 1991, 1992, 1993, and 1994[9]. Moreover, interest payments of the consolidated budget which were approximately 4 percent of the GNP before 1993,

[9] The first four data have been received from the CBRT Annual Report (1994), and the last one has been received from the Treasury.

increased to 5.8 percent in 1993 and to 7.6 percent of the GNP in 1994. (CBRT, Annual Report, 1994). Therefore in assessing the independence of the CBRT, the mentioned size of fiscal imbalance should also be taken into account.

In Article 4/I of the Law of the CBRT with the header of "Fundamental Duties and Powers" it is stated that "the fundamental duties of the Bank and in order to assist the economic development according to this Law are: to conduct money and credit policy in conformity with the Development Plans and Annual Programs and according to the economic necessities and in a manner to perform the price stability." Therefore, given the Development Plans and Annual Programs and the growth rate and the price rises which are both fixed by these Plans and Programs, the Bank will use its authority according to those given data.

IV.2 The Relationships Between the Treasury and the Central Bank in Turkey

The CBRT was founded on 11 June, 1930 by Law no.1715 as a joint stock company. The purpose of establishing it as a joint stock company was to isolate it from the political pressures upon its money and credit policies. According to the Law no. 1715 which was valid when the CBRT started to process in 1931, the capital of the Treasury and the foreign banks cannot exceed 15 percent of the total capital. Law no. 1211 has amended this law in 1970. It was explicitly stated in this law that the share of the Treasury cannot be less than 51 percent of the capital. This law made the Treasury the sovereign body in the elections of "the Board members" who are elected by the General Assembly.

With Law no. 1715, the CBRT is to give advances to the Treasury. The CBRT gave the first credit to the Treasury amounted to 250 million TL against which gold was taken as collateral in 1942. The Treasury has been enabled to take advances which cannot be more than 15 percent of the current year's general budget appropriations since 1947. After the 1960 military takeover this ratio decreased to 5 percent for a while. Thereafter, it again increased to 15 percent.

Law no. 3985 dated April 21, 1994 amended article 50 of the Law no. 1211 of the CBRT, which regulates the account of short term advances to the Treasury. According to this law which was forced into practice on January 1, 1995: "The Bank shall open a short term advance account to the Treasury amounted to the 12 percent of the excess of the current budgetary appropriations over those of the previous year. The percentage limit will be 10 percent for the year 1996, 6 percent for the year 1997, and 3 percent for 1998 and the following years. The Central Bank loans to the other public sector institutions were also limited by this law to not more than half of the limit placed on short-term advances to the Treasury.

The relationships between the CBRT and the government are determined by Law no. 41 carrying the header "Relations between the Bank and the Government and Duties Connected with Them." The CBRT states its independence by the end sentence of the law no. 4 as: "The Bank shall exercise independently and under its own responsibility the powers conferred upon it by this Law." However, there is a difficulty for the Bank to be "independent" of the government in taking decision because the members of the Board are elected by the General Assembly in which the Treasury has the majority of voting rights. Furthermore, the governor is appointed for a term of five years by the Council of Ministers.

The CBRT, in performing the lender of last resort function, could bring some liabilities to the banks or increase its liabilities in order to maintain its superiority to them. In addition to its authority to request information and documents from the banks since 1984, the CBRT, "... shall follow up and examine the financial standings of banks and shall submit to the Prime Ministry its views thereon together with its suggestions when necessary" stated in the Article 43 as amended by Law no. 3098. Tokgöz (1995) advocates that the banks tend to prefer profitability to liquidity, therefore it is necessary for the banks to be under the continuous supervision and control. According to Turkish regulations, the power for supervision and control is under the authority of the Treasury to a greater extent and of the CBRT to some extent.

Law no.3985, which amends article 40/II-d of the Law of the Central Bank provides the Central Bank with the opportunity to support the banking system directly in the case of uncertainty and distrust in the banking system on condition that those banks have no unlawful operations. The new regulation allows the Central Bank to extend monthly advances, up to four months, to those banks that face rapid withdrawals of funds provided that this amount is not more than twice the bank's net worth, to remedy liquidity problems of those banks and strengthen their financial situations. Implementations began on April 28, 1994 and advances accounts were opened for the banks facing liquidity problems in exchange for Government Bonds and Profit Sharing Certificates. These accounts were completely closed down by June 8, 1994 (CBRT, Annual Report, 1994).

The Finance Ministry was the only public authority to protect, to manage and to sell and purchase the government's whole assets until 1983 in Turkey. For the period of Turgut Özal's Prime Ministry, the Treasury was merged with the General Directorate of Trade and attached to the Prime Ministry as Undersecretariat. After a long time, the Treasury became an independent Undersecretariat on April 20, 1994, with the amendment of law no. 4059. The Treasury has been given the duty of arranging the process of the domestic and foreign financial relations of all public enterprises. Article 2 of this law has also determined the subjects and the way the Treasury will co-operate with the CBRT. The first part of Article 2 gives the Treasury the following duties: "The formation and the implementation of policies related to the circulation and the stability of the national currency in co-operation with the CBRT. Moreover the implementation of the exchange rate policies and the establishment of the co-ordination between the Treasury and the CBRT on subjects of financial sectors." As it can easily be seen that the implementation of money and credit policies are given as a duty both to the CBRT and to the Treasury in their foundation law, which will definitely result in a conflict of interests. In the Turkish Constitution, it is stated in Article 167, on the other hand, that "the state takes measures which performs and improves the sound functioning of the money, credit, capital, goods and services markets."

V. CONCLUSION

Many countries have recently approved legislation in order to grant their central banks autonomy from political power. These banks have been free to formulate and implement monetary policy and have also been freed from the burden of financing the public deficit, within a statutory mandate to pursue price stability. Central bank independence is considered to be efficient mostly as a safeguard against the onset of high inflation rather than as a remedial device. The experience indicates that in order to stabilize high inflation in addition to the delegation of authority to the central bank, the political establishment should actively and fully got involved.

It is evident from the experiences that central bank independence is a necessary but not sufficient condition to ensure the maintenance of the value of money. Even an independent central bank cannot lastingly defend monetary stability against a "society of excessive demands." That is to say, every society ultimately gets the rate of inflation it deserves and basically wants. Taking into account the temptations inherent in the political process, a society can signal its determination to safeguard the stability of its money only by choosing the appropriate institutional arrangement.

Sound central bank policies require strengthening central bank independence especially in a framework of more market-oriented policies. Independence of a central bank cannot be introduced in the abstract by just passing a law. It is important to state that no democracy can make its central bank fully and irreversibly independent. Within sovereign nation states, any status currently accorded to the central bank is always subject to change through legislative amendment. Central bank independence will depend not only on legislation but also on the political and economic context and the persons involved. As a matter of fact, the form of application of a central bank law may be more important than the letter of the law. However, the establishment of the institutional framework by law, which is necessary for conducting independent central bank policies, is also important.

Since the degree of formal independence necessarily will be imprecise, the effective independence and therefore credibility of a central bank will be inevitably linked to its own operational record. As a result of the recognition of the value of monetary policy "credibility" and "transparency" for achieving policy objectives efficiently, many countries have made changes in their monetary policy operations and presentations, during 1970's and 1980's. In making changes, the relationship between central banks and governments gains importance and should have been reconsidered in an appropriate manner. The role of modern central banks and the allocation of functions between central bank and the government should be determined appropriately.

It is principally accepted that the full autonomy of the central bank from the government is incredible. However, the desired degree of independence depends on country specific factors such as country's inflation history, the nature of existing checks and balances in the political system, the level of public awareness and debate of economic issues, and the state of development of financial markets. The concept of central bank independence has practical meaning in industrialized countries with deeper capital markets as it is stated by Banaian *et al.* (1983). In most less developed countries, in order to finance their deficit, governments must rely on their own central banks and foreign capital markets. Greater scope for central bank independence is possible for the more developed countries where private domestic capital markets provide an additional source of government finance.

The important question as to the central bank independence is that what degree of formal independence is desirable and realistic by politicians and society in general. Afterwards, given the intended degree of central bank independence, it is important to determine the arrangements needed to put that independence in place considering that ultimate responsibility rests with the political leadership. Therefore, it would not be wrong to suggest that the central bank independence could be referred as independence within government rather than independence from government.

It is theoretically and empirically supported that, if the credibility of monetary policy can be established through precommiting those responsible for the conduct of monetary policy not to pursuit short run temptations, price stability can be maintained without any systematic cost in terms of employment and economic growth. Reducing inflationary expectations and the rate of increase in wages and prices requires the precommitment of monetary policy to a pre-announced course. Another institutional device for committing monetary policy is the delegation of authority to a semi-independent institution like the central bank with a mandate to focus on price stability. The maintenance of a fixed parity with the currency of a low inflation country is another device. The choice of monetary anchor is not important in building up credibility. However, the determinant of credibility is the record of policy-makers in sticking to their commitments. It must be demonstrated to the public that the commitment is taken seriously.

Moreover, it is extremely important to back up the strong arguments of central bank independence by appropriate mechanisms. The degree of central bank independence can be expected to change with the personalities involved, although the legal and institutional setup is invariant. In order for the central banks' policies not to be dependent on personalities, it is particularly important to establish the accountability mechanism over the central bank. Moreover future credibility is secured by fostering the development of a strong fiscal opposition to independence, investing in central bank reputation and lengthening board appointments. Goodhart (1994) argues that "independence, once granted, can only be maintained and effectively utilized by an unrelenting and continuous political and educational campaign to explain what monetary policy can and cannot effectively do."

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