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"Challenges for Central Banks Governance in The Context Of A Deeper Economic And Monetary Union"

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Abstract

The paper examines some of the challenges posed for the central bank governance model in the new unorthodox normality. While significant progress has been made debating conventional ideas about central bank orthodoxy, issue like institutional adaptation of central bank governance modelto better face the new reality is still subject to consideration. Can adaptation improve the overall quality of the governance model? This article suggests first, that adaptation calls forrebalancingkey functions without leaving aside two of much-prized features achieved in pre-crisis era of conventional consensus: maintaining price stability and independence; second, that adaptation requires innovation to prevent the governance model disruption and to boost public perception of the central bank.

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*Keywords:*central bank member of the European Systems of the Central Banks; central bank independence; sole primary objective; central bank functions; central bank credibility andpublic perception;central bank institutional quality

1. Introduction

The recent crises and the risk for the stability of the European Union (EU) have underlined the interdependence among EU economies and exposed the weaknesses and vulnerability of Member States (MSs), in particular inside the euro area. Fiscal discipline, competitiveness gapsand private sector imbalances are also a matter for the EU as a whole. This is why there is a need to establish stronger economic governance in the European Monetary Union (EMU). At the core of the new approach is a framework for enhanced cooperation and co-ordination of

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MSs'economic policies built on widened country surveillance which covers all relevant macroeconomic and structural policy areas in an integrated fashion.This paper discusses the reaction of a national central bank member of the European System of the Central Banks (short, NCBs) to these challenges mainly from the perspective of the impact observed at the level of the central bank governance model. The governance model is here identified with a conservative central bank (Rogoff-type central bank) (Rogoff, 1985), characterized by: a sole primary objective-price stability; principles of operational, financial, personal and institutional independence; tasks and functions guaranteed by the Treaty on the Functioning of the European Union (TFUE) and secondary legislation; the European Central Bank (ECB) and the German Central Bank (Bundesbank) are used as institutional sources of reference for this type of central bank governance model.

The overall purpose of this article is to investigate why (the purpose) and how (the mechanism)some of the central bank key functions need to adapt to the new unconventional times by rebalancing their institutional profiles in such a way to boost more actively the institutional quality and the overall governance performance. However, for a holistic view of the NCBs governance model a deepassessment of these functions need future consideration.

This paper is organized as follows: section 2 discussesmain challenges posed for the NCBs governance model in the new unorthodox normality which could possible disruptthe institutional profile of some key NCB functionsSection 3 describes the mechanism of institutional adaptation and delivers the practicalities of theseinstitutional disruptions; it raises arguments in favour of rebalancing two keyfunctions by reviewing some empirical evidence from studies examining similar institutional and policy issues that should be preserved in the unorthodox times.Next section elaborate on why promoting ex-ante coordinationthrough cooperation with national and European shareholders should be a purpose for institutional adaptation.Section 5 deals with the institutional determinants for improving the central bank institutional quality, as a solution for fixing the mismatch between the need to improve public perception and the reluctance to allow a higher degree of transparency.Section 6 concludes about the importance of innovation for preventing the NCBs governance model disruption and fragmentation.

2. Discussing main challenges for the central bank governance model

The 2008 global financial crisis spurred a series of financial sector governance reform in the European Union to complete its Economic and Monetary Union, culminating with establishment of Banking Union (BU), jointly supervised, regulated and invested with the authority to shut down failed banks and to provide deposit insurance to prevent banks run. Similarly, in the field of the future fiscal union, the ongoing European debt crisis has triggered a series of reforms pushing the EU leaders to build from the scratch their crisis-fighting capacities and bail out institutions: the European Financial Stability Facility and subsequently the European Stability Mechanism, the 6-pack and the 2-pack legislative packages, including the European Semester aimed at the introduction, at the European level, of a comprehensive economic and fiscal policy planning cycle to reform EMU, and, ultimately, to ensure tighter economic coordination and stricter budgetary discipline in the EU (Amtenbrinck, 2012, 2014).

2.1. From fiscal dominance to expectations dominance

The challenges and pressures these EMU reforms posed on the NCBs have intensively been discussed in the academic literature much more in terms of economic, monetary and financial implications rather as an issue of adaption of the central banking principles or the central bank governance model to better face the new realities.
Carujanatalked about the changing nature of these challenges for the central bank independence, saying that "in current circumstances, we need to broaden the concept beyond insulation from political pressures, including "fiscal dominance' to include insulation against pressures from financial markets and indebted agents ("financial dominance") and against unrealistic expectations of what central banks can do ("expectations dominance). Central banks should be in a position to normalize policy without being unduly constrained" (Carujana, 2013, p.1). So far the academic debate has exanimated systematically the first two categories of dominances mostly from an overburdened monetary policy perspective concluding that an independent monetary policy is not suitable for structural and labour policies, for fiscal reforms or for stronger capital buffers, therefore, overreliance on an independent monetary policy is bound to disappoint politicians expectations. This article deals with the third category of "expectations dominance", from another angle than analysing expectations of the future path of the policy interest rate. Thus, in sections 4 and 5, expectations are seen as a driver of innovation and a multifaceted concept of public perception in which (i) individual facets are defined by a variety of potentially conflicting tensions