

The Concept of Independence of Central Bank on the Example of the National Bank of Poland

Agata Tarnacka¹

¹ Faculty of Law and Administration, University name Jagiellonian University,
Gołębia 24, 31-007 Kraków - Poland

Abstract— The need for independence of a central bank results from the fiduciary nature of modern money. Independence of the central bank is generally understood as depriving the executives of the influence on the bank's decisions, while depriving the legislative authority of the right to interfere in the pursued monetary policy. The most important areas of freedom are financial, functional and institutional independence. The results of independence studies of the National Bank of Poland (the NBP) quoted in the article show that the level of the NBP independence is high, often close to or equal to the maximum values for given measures. However, it should be noted that these studies relate to the formal (legal) independence of the NBP, and not the real one, because independence guaranteed by legal provisions does not necessarily correspond to the actual independence of the central bank. The legal regulations shape the conditions of actions of monetary authorities, while the final result of these actions depends on the individuals who perform them.

Index Terms— the central bank, independence, the National Bank of Poland.

I. INTRODUCTION

The degree of independence of the National Bank of Poland (hereinafter called the NBP) has changed over time. The first significant changes in this matter were introduced by the Act on the National Bank of Poland adopted on 31 January 1989. The act defined the goal of the central bank which was to strengthen the Polish currency “Złoty”. Then, an amendment to the Constitution in force was introduced, by virtue of which the President, not the Prime Minister, was designated to submit a motion to appoint the President of the NBP to the Polish Parliament (called Sejm). Another important step towards reinforcing independence was the amendment to the Act on the National Bank of Poland of 14 February 1992 which introduced the office of the President of the NBP. However, a breakthrough in that matter came in 1997 when the new Constitution of

Poland was adopted. The Constitution granted the NBP the exclusive right to set and implement a monetary policy. In addition, the issue of the stability of Polish currency acquired a constitutional status. It should be added, that the Constitutional Tribunal, in its judgment of 2003, stated that the provisions of the Constitution relating to the NBP indicate that the legislator took into account all aspects of the independence of the NBP. The Act on the National Bank of Poland of 1997 specifies the constitutional provision, stating that the basic goals of the NBP activities are to maintain a stable price level while supporting the government's economic policy, provided that this does not limit the basic goals of the NBP.

II. THE CONCEPT OF THE CENTRAL BANK'S INDEPENDENCE

The independence of the central bank results from the fiduciary nature of modern money whose purchasing power and functions are determined by a widespread acceptability based on public trust (Baka, 2001). An independent central bank certainly has greater credibility than a dependent one. Professor Hanna Gronkiewicz-Waltz claims that the general public opinion on the consistent and convincing policy of the NBP is of significant importance (Gronkiewicz-Waltz, 1994). The postulate of the central bank independence arose when economic experts, especially monetarists, questioned the government's ability to stimulate the economy and to increase employment through monetary expansion in the long run. Moreover, monetarists claim that the permanent effect of such a policy is higher inflation, which negatively affects the economy and the fulfilment of human needs (Baka, 2001).

Independence of a central bank is generally understood as depriving the executive power of the ability to influence the bank's decisions, as well as depriving the legislative power of the right to interfere into its monetary policy (Huterski, 2000). In the literature a number of definitions regarding this issue may be encountered. According to Professor A. S. Blinder, the



independence of a central bank means; firstly, that the bank has freedom of deciding how to achieve its goals and, secondly, that its decisions are very difficult to revoke by any authority (Blinder, 2001). In general, it is difficult to formulate a precise definition of independence. An eagerly cited metaphorical, taken from "the Economist", says that the only decent central bank is the one that can say no to politicians.

However, in the literature, there are many attempts to assess the degree of independence of the central bank. According to prof. Manfred Neumann, there are five basic features that define, in a working manner, the independence of a central bank:

- 5) Bank is prohibited from financing public sector directly.
- 6) Bank is not a subject to government institutions.
- 7) Bank is sovereign regarding exchange rate policy.
- 8) Provisions guarantee personal independence of members of the management board and the council.
- 9) The statute of the central banks has constitutional rank (Blinder, 2001).

Some authors mention other elements affecting independence of the central bank:

- 1) Legal definition of the goals of the monetary power.
- 2) Competence for the definition of goals.
- 3) Competences for the formulation of monetary policy.
- 4) Independence in achieving goals.
- 5) Ban on financing the budget deficit.
- 6) Independence when appointing the management of the Bank.
- 7) No restrictions regarding communication with the environment (Sobol, 2008).

The Polish Constitution does not explicitly formulate the principle of independence of the central bank (Zubik, 2002). However, art. 227 of the Constitution, which gives the NBP "the exclusive right to issue money and to determine and implement monetary policy" provides sufficient support for the independence of the NBP. This provision indicates the independence of the NBP in implementing and shaping of monetary policy and other aspects of activities of the Polish Central Bank (Mikos, 2006). It is worth mentioning that the Constitutional Tribunal stated, in its judgment of 2003, that the provisions of the Constitution relating to the NBP indicate that the legislator took into account all aspects of independence. The Tribunal emphasized that the demand for independence of the NBP frequently raised during the work on the Constitution, repeatedly determined the wording of the provisions regarding this body. The Tribunal further pointed out that it was obvious that this particular priority was achieved by the adoption of the procedure for the mode of appointing the Monetary Policy Council. Under the parity principle three separate authorities (the Sejm, the Senate and the President of the Republic of Poland) have an influence on appointing members of the Council whose tenure was set for a period of six years. This period is longer than the term of office of the appointing organs. In publications dealing with the issues related to central banking, independence of central banks is discussed in various

aspects and is subject to various classifications (Huterski, 2000). The most frequently mentioned areas of independence refer to financial, functional and institutional side. According to the Tribunal, in order to perform its tasks the central bank needs to be independent.

III. FINANCIAL INDEPENDENCE

Financial independence of the central bank means the exclusion of the possibility of exerting financial pressure on its decisions or eliminating the possibility of financing government expenditure (budget deficit) directly or indirectly from central bank loans (Judgment of the Constitutional Tribunal, 2003). This independence refers to the financial management of the central bank which includes the creation and use of its own funds, profit distribution, financial links with commercial banks and settlements with the state budget. Article 220 of the Constitution states that the Budget Law may not provide for paying off the budget deficit by incurring liabilities in the central bank of the state. Previously, when such a provision was not in force, state authorities tried to exert pressure on the central bank regarding the financing of the budget deficit (Kraś, 2006). Limitations with respect to financing budget expenditure by the central bank is an important aspect of financial independence, however the limitations also extend to the other end - losses of the central bank may not be covered by budgetary funds (Ziółkowska, 1999).

Professor C. Kosikowski rightly points out that financial independence of the central bank should not be confused with its financial independence as a separate legal entity responsible for the results of its operations. Financial independence of the central bank cannot be identified with the freedom to accumulate and spend the bank's funds and the lack of state control over the financial management of the bank. Financial independence of the central bank should serve its functions, although the central bank's financial management should be controlled and supervised by the state (Kosikowski, 2002).

However, the Polish Central Bank undertakes actions aimed at weakening the ban on crediting the government. In accordance with the Act on the National Bank of Poland, those actions include: conducting banking services for the state budget, organizing trading in Treasury securities (Article 48, para. 2-3), the possibility of servicing a state loan (Article 49) incurred in the form of issuing securities, keeping state budget accounts (Article 51, para. 1, item 2), keeping accounts of the Bank Guarantee Fund (Article 51, para. 1, item 3) and the possibility to perform the function of a government financial agent in the scope of concluding and implementing credit agreements and servicing foreign debt (Article 52 (3)).

Creation of yet another bank for the purposes of the state budget only would translate into the NBP losing its access to current information on government activities in financial matters (Huterski, 2000). In addition, an independent central bank should ensure cooperation with the government to achieve the highest possible level of harmonization (Judgment of the

Constitutional Tribunal, 2003).

IV. FUNCTIONAL INDEPENDENCE

Functional independence is a broad term embracing independence in performing other statutory functions of a central bank (Judgment of the Constitutional Tribunal, 2003). Functional independence of the NBP is manifested in its powers to shape and implement monetary policy. Independence in setting goals regarding monetary policy can be observed when the goals of the bank are not precisely defined in legal regulations (Fisher, 1995). It means that in this particular field the bank is not a subject to any regulations imposed by the parliament, the president or the government (Baka, 2001). Thus, the constitutional definition of the mission of the central bank, freedom to formulate its goals, selection of monetary policy instruments and the possibility of conducting sovereign exchange rate policy (Musielak, 2006), are factors which determine this independence. According to the Act on the NBP, assumptions of monetary policy are established by the Monetary Policy Council and then submitted to the Sejm but only for information (Article, 12 paragraph 1).

The bank is self-reliant in shaping its monetary policy tools if it has a free choice of means to achieve its goals (Huterski, 2000). The NBP decides independently how to use its monetary policy instruments. Furthermore, it is not obliged to finance the budget deficit, which does not limit its freedom to choose instruments by means of the same provision. In contrast, a central bank which is obligated to follow a monetary policy rule or is required to finance the state budget deficit is not an independent central bank (Fisher, 1995) (Musielak, 2006). However, independence in setting the monetary policy goal does not exclude government's participation in this process. Therefore, operational independence which means freedom to achieve goals is more important for the monetary power (Musielak, 2006). Moreover, the cooperation of the NBP with the government, which is responsible for the implementation of the economic and financial policy, is significantly important because the NBP deals with monetary policy which is an important part of the economy (Jaworski, 2000). An analysis of provisions adopted in the Act on the National Bank of Poland shows that the provisions correspond to typical solutions used in developed market economies (Kraś, 2006).

V. INSTITUTIONAL INDEPENDENCE

Institutional independence primarily concerns the position of a central bank in the system of state organs and the mode of appointing and dismissing bank authorities (Judgment of the Constitutional Tribunal, 2003) as well as term of the office and irremovability (Baka, 2001). Thanks to such independence, the government cannot directly influence the bank's monetary policy (Huterski, 2000). The government does not have formal influence on the election of the NBP authorities, and only

democratic state organs i.e. the Sejm, the Senate and the President of the Republic of Poland have such competences. In addition, the term of office of the President of the NBP and members of the Monetary Policy Council is longer than the term of office of the government. Shortening the term of the office of the NBP bodies may take place only in situations specified by an act. Such a situation can guarantee the stability of the NBP bodies that is necessary to achieve long-term monetary policy objectives (Góral et al., 2006).

VI. INDEPENDENCE LEVEL OF THE NBP

The level of independence of the National Bank of Poland has changed over the years. The Polish central bank has been acquiring more and more features of an independent central bank in line with international standards since 1989. The Act on the National Bank of Poland, adopted on 31 January 1989 introduced significant changes to the functioning of the Bank. It stated that the goal of the Central Bank is to strengthen the Polish currency. Under the amendment to the Constitution in force at that time, it was the President, not the Prime Minister, who was to submit to the Sejm a motion to appoint the President of the NBP. The amendment to the Act on NBP of 14 February 1992, introducing the term of the office of the President of the NBP, was the next step towards strengthening the independence of the NBP. However, a breakthrough came in 1997 when the New Constitution was adopted. The new Constitution in Article 227 granted the NBP the exclusive right to establish and implement monetary policy. It also transferred responsibility for the value of the Polish currency to the Central Bank. Thus, the issue of stability of the Polish currency has acquired a constitutional status. On 29 August 1997 the Act on NBP came into force.

VII. ASSESSMENT OF INDEPENDENCE OF THE NBP

So far, a number of methodologies to examine the level of independence of a central bank have been developed. Doctor R. Huterski has researched the issue thoroughly and presented his own study on the independence of the NBP using the methodologies developed by:

- 1) Bade and Parkin,
- 2) Alesina,
- 3) Eijffinger and Schakling,
- 4) Grill, Masciandra and Tabellini,
- 5) Alesina and Griulle,
- 6) Cukierman, Web and Neyapti,
- 7) Cukierman (Huterski, 2000).

The calculations show that the level of the NBP independence is high, often close to or equal to the maximum values for given measures. This was pointed out by authors of many studies. However, as the author emphasized, it should be noted that these studies concerned the formal (legal) independence of the NBP, and not real independence because

independence guaranteed by legal provisions does not necessarily correspond to the actual independence of the central bank. Importantly, legal independence does not take into account a significant factor affecting real independence, which are the personalities, characters and views of persons holding the highest positions in the central bank. Legal regulations only shape conditions for the monetary authorities to operate, while the final result of these actions relies on individuals who undertake (Huterski, 2000).

Legal and actual independence are important when the bank puts a different emphasis on policy objectives than the government does. Furthermore, as the author rightly points out, high independence of the central bank allows the central bank and the government to engage in a specific type of game called "game of chicken", in which actions of one party forces, at least in part, counteraction or some kinds of specific behaviours from the other side. It is a game in which the other player is not under pressure and strives to implement its strategy. As a result, each player tries to continue its policy for the long time in order to coerce expected behaviour from the other side (Huterski, 2000)

VIII. PROS AND CONS OF INDEPENDENCE OF A CENTRAL BANK

The literature on the subject of independence of a central bank is quite abundant (Baka, 2001), (Musielak 2006), (Pietrucha, 1994) and features two opposing lines of argumentation.

A. Arguments for the independence of central bank (pros)

- The Bank in fulfilling the task of combating inflation constitutes the institutional basis for ensuring price stability. That is why, in many countries, appropriate legislative changes are introduced, which triggers higher levels of independence (Musielak 2006);
- The Bank is responsible for slower price growth and better macroeconomic results (Pietrucha, 1994);
- The Bank helps keep inflation low and has a positive impact on long-term economic growth (Posen, 1995). In addition, public announcement of monetary goals is also conducive to lower inflation (Przybylska-Kapuścińska, 2003);
- The Bank was established as an independent representative to fight inflation, therefore it can be a means for the government to implement its anti-inflationary commitments (Wojtyna, 1998);
- Moreover, the increase in central bank independence increases the rationality of budget expenditure. When the independent central bank sets its own goals and assumptions for monetary policy - even before the government determines the level of budget spending - then we can observe rationalization of government purchases (Doi, 1998);
- The Bank has much more opportunities to gain public

confidence and high credibility in the society, which greatly facilitates the implementation of a real and effective monetary policy (Baka, 2001);

- The Bank is more resistant to the effects of politics, including the political election cycle, which is expressed in pressure to lower interest rates and increase the money supply above the permissible limits (Baka, 2001). The Bank makes monetary policy decisions on its own and does not allow authorities to use monetary policy for their own purposes, e.g. an increase in the amount of money can lead to an increase in employment at the price of subsequent inflation. This kind of action may force the government to increase fiscal discipline (Pietrucha, 1994);
- The Bank makes decisions in a shorter time, without government's involvement, contributes to shortening the bank's response time to shocks and disorders occurring in the economy, which also contributes to increasing the effectiveness of monetary policy (Baka, 2001);
- The Bank has the ability to act on a long-term basis, it can base its decisions on objective assessment of the situation and realistic forecasts and rational reasons for choice, therefore it can better protect money stability and contribute to solving real socio-economic problems. In an ideal case, monetary policy would be determined by a constantly standing group of experts who immediately make the necessary decisions (Pietrucha, 1994).

B. Arguments against the independence of central banks

In contrast, arguments against independence show that an independent central bank:

- given such large competences, can become a "foreign body" in a democratic society, because it is a state authority which is not subject to democratic elections (Baka, 2001);
- also undertakes actions that cannot be isolated from the influence of the government e.g. ensuring stability and security of the financial system, managing foreign reserves, conducting exchange rate policy, controlling cross-border movements of capital (Musielak, 2006);
- having too much powers, limits the possibility of a flexible economic policy response to unforeseen "economic shocks" (Pietrucha, 1994);
- becomes a monetary policy body artificially separated from the centre implementing fiscal policy, and yet, the effectiveness of monetary policy depends on the overall macroeconomic policy (Pietrucha, 1994);
- is one of two centres having the same policy, because monetary policy is a part of economic policy, that is why two independent centres have one policy: the government - general economy, and the central bank -

- monetary (Baka, 2001);
- being part of the political and economic system, the Bank is not an apolitical body of experts or an impartial observer (Pietrucha, 1994).

IX. CONCLUSIONS

Due to the existence of many for and against arguments of the independence of a central bank, it must be concluded that independence of a central bank is one of many ways of shaping the monetary policy which leads to an ultimate goal i.e. low and stable prices. There is a number of ways in which the monetary policy may be implemented in order to maintain low interest rate: the strategy of a constant exchange rate, currency management, the strategy of direct inflation goal or functioning of a central bank on the contract basis. The indicated paths have already been successfully implemented and most of them has equally good (or even better) theoretical grounds as the concept of independence of a central bank. Nevertheless, each cited way of shaping monetary policy has its positive and negative aspects. Therefore, it can be said that there is no perfect model of monetary policy which would be appropriate in every place and in all circumstances.

X. REFERENCES

- Act of 29 August 1987 on the Polish National Bank as published in Journal of Laws of 2013, item 908 consolidated text as amended.
- Act of 31 January 1989 Banking Law as published in Journal of Laws No. 4, item 21.
- Amendment of the Banking Act and some other Acts of 14 February 1992 as published in Journal of Laws of 1992, No. 20, item 78.*
- Baka, W. (2001). *Bankowość centralna. Funkcje, metody, organizacja*. Warszawa.
- Blinder A. (2001). *Bankowość centralna w teorii i praktyce*, Warszawa.
- Decision of the Constitutional Tribunal of 24 November 2003, K 26/03, OTK-A 2003, No 9, item 95 (Journal of Laws No 209, item 2035).
- Decision of the Constitutional Tribunal of 28 June 2000, K 25/99, OTK 2000, No 5, item 141 (Journal of Laws No 53, item 648).
- Doi, T. (1998). Central Bank Independence Promotes Budgetary Efficiency. *Discussion Paper*, F-68.
- Fisher S. (1995). Modern Approaches to Central Banking. *Working Paper No 5064*, National Bureau of Economic Research, Cambridge, pp. 40–41.
- Fraser B. W. (1994). Central Bank Independence: What Does It Mean?, *Reserve Bank of Australia Bulletin*, No 2, Sydney, pp. 6–8.
- Góral, L., Karlikowska M., Koperkiewicz-Mordel K. (2006). *Polskie prawo bankowe*. Warszawa.
- Gronkiewicz-Waltz H. (1994). *Bank centralny. Od gospodarki planowej do rynkowej. Zagadnienia administracyjnoprawne*, Warszawa.
- Huterski, R. (2000). *Niezależność banku centralnego*. Toruń.
- Jaworski, W. (2000). *Bankowość. Podstawowe założenia*, Warszawa.
- Kosikowski, C. (2002). Pozycja Narodowego Banku Polskiego i jego organów w prawie polskim (stan obecny i postulaty na przyszłość). *Państwo i Prawo*, 11, pp.15-16.
- Kraś, I. (2006). Powstanie i status Narodowego Banku Polskiego, *Seminare 2006*, vol. 23, p. 219.
- Mikos, A. (2006). *Ustrojowa pozycja banku centralnego w Polsce*, Warszawa.
- Mordwiłko, J. (2002). Opinia w sprawie statusu centralnego banku państwa (art. 227 Konstytucji Rzeczypospolitej Polskiej). *Przegląd Sejmowy*, 5.
- Musielak, M. (2006). Tendencje w polityce pieniężnej na przełomie XX I XXI wieku. *Ekonomia i Prawo*, 2(1).
- Pietrucha, J. (1994). Autonomia banku centralnego z punktu widzenia ekonomicznej teorii polityki. *Bank i Kredyt*, 12, pp. 16-17.
- Posen, A. (1995). Central Bank Independence and Disinflationary Credibility: A Missing Link?. *Federal Reserve Bank of New York. Staff Reports*, 1, pp.1-2.
- Przybylska-Kapuścińska, W. (2003). Niezależność banku centralnego i jej dylematy w Polsce. *Polityka Pieniężna i Rynek*, 26, pp. 13-14.
- Sobol, M. (2008). *Polityka pieniężna Narodowego Banku Polskiego – w drodze do Euro*. Warszawa.
- The Constitution of the Republic of Poland of 2nd April 1997 as published in Journal of Laws No. 78, item 483.
- Wojtyła, A. (1998). Za i przeciw, *Życie gospodarcze*. In: W. Jaworski, ed., *Współczesny bank*. Warszawa.
- Ziółkowska, W. (1998). Niektóre dylematy koordynacji polityki monetarnej i fiskalnej. *Bank i Kredyt*, 7–8, pp. 123-124.
- Zubik, M. (2001). Narodowy Bank Polski (Analiza konstytucyjno-ustrojowa). *Państwo i Prawo*, 6.