BANK OF UGANDA

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Building consensus and public support for central bank policy objectives: experiences and challenges

How to build consensus around the primacy of the price stability goal?

The arguments for central banks according priority to the goal of price stability are largely technical, pertaining to issues such as the long run slope of aggregate supply curves and the role of expectations in shaping private sector behaviour. These arguments are not intuitively obvious for people not trained in economics. Hence central banks have to make the case for why they need to prioritize inflation over other objectives in terms which ordinary people, including politicians, can understand. This will be easier in countries with a past history of high inflation, where central bankers can point to the damage which it caused to the economy and he hardships suffered by the population. The fact that Uganda had suffered from triple digit inflation in the late 1980s and early 1990s contributed importantly to public and political acceptance of the priority which the 1995 Constitution gave to price stability in the mandate of the Bank of Uganda.

The strongest argument in support of the central bank prioritising the control of inflation over other policy objectives such as economic growth is not that the other objectives are of lesser importance, it is that, whereas the central bank has the tools to control inflation, it does not have the tools to achieve objectives which pertain to the supply side of the economy. Therefore, the various agencies of government should each focus on what they can do best, given their mandate and the policy tools at their disposal. Other public agencies should focus on promoting growth because they have the appropriate tools for tackling supply side problems.

How to build support for central bank independence?

The argument for central bank independence will only be convincing if central banks make explicit the ways in which they can be held accountable for their performance and in delivering their statutory mandates while at the same time enjoying operational independence. Central banks cannot remain aloof from politicians if they want to retrain public support for operational independence. It is important that they respect the rights of parliamentary committees to question central bankers about their policies and their performance. They should also be prepared to engage with the public and respond to criticisms, as the Bank of Uganda did recently when it organised a series of public meetings in the various regions of Uganda.

In the final analysis, the public will probably support central bank independence, even if they do not fully understand the concept, if they believe that the central bank is doing a good job and can be trusted. Support for central bank independence will be eroded if the central bank is perceived to be performing poorly, especially if it cannot achieve its primary objectives.

Is it possible to achieve price stability without central bank independence?

The importance of central bank independence depends on the monetary policy framework. In a purely rules based framework, such as Monetary Targeting, central bank independence is of less importance because, provided that the rules are publicly announced, everyone can monitor whether or not the central bank is complying with the rules (the growth rate of money supply) in implementing its monetary policy. The credibility of monetary policy is determined by whether or not the central bank sticks to the rules.

Central bank independence is much more important in a non-rules based monetary policy framework, such as inflation targeting where the central bank has “constrained discretion” to set monetary policy. In this framework, whether or not the public believes that the monetary policy decisions taken by the central bank are the correct ones for delivering the inflation target depend, at least to some extent, on the credibility of the central bank. In turn this credibility requires that the central bank is free of political interference. A discretionary monetary policy implemented by a central bank which is under control of politicians which have multiple, probably conflicting, objectives will not inspire public confidence that the inflation target will be achieved.

What is the role of transparency, accountability and credibility?

The credibility of monetary policy has to be earned by the central bank through a track record of delivering low inflation. Transparency and accountability cannot themselves provide credibility unless the central bank has demonstrated its ability to achieve its inflation targets over a sustained period.

However, once the central bank has earned credibility for its monetary policy, transparency can help it to achieve its inflation goals at less cost in terms of interest rates and output. A credible central bank can use its communications policy to influence public expectations about future trends in inflation. The ability to influence expectations provides another tool of monetary policy for the central bank, which complements its conventional tools, such as the policy interest rate, and thus reduces the burden on the latter. Consequently, a credible central bank with an effective communications policy should be able to achieve its inflation objectives with smaller changes in interest rates and at lower cost to output than would be the case if credibility were low and communications poor.