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WEEKLY ANALYSIS

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WHO OWNS THE CENTRAL BANKS WHOSE MONETARY POLICIES GUIDE OUR ECONOMIES?

Foundations of central bank creation. The concept of decision-making independence. Roles, missions and objectives. Appointments linked to political power. Who are the shareholders? Who benefits from financial results? Real independence?

Key points

- Who owns the central banks whose monetary policies guide our economies?
- Reminder of the foundations of central bank creation and the concept of independence
- Who appoints central bankers?
- How independent are they from their shareholders?
- What are the main roles and objectives of central banks?
- Who benefits from their financial results?
- Independence remains fragile in times of acute crisis

Who owns the central banks whose monetary policies guide our economies?

There was a time when central banks acted in a particularly discreet manner, and did not openly communicate the basis of their analyses and expectations to the public in any detail. Their monetary policy decisions were communicated without specific precaution, the doctrine being that observers had to be surprised if the policy was to have the greatest impact. Today, the situation is very different, and central bankers have changed their approach in favor of steering market expectations. They communicate their analyses much more regularly, particularly since the recent financial crises, which have forced them to act more actively and decisively, developing new approaches such as quantitative easing, introduced after the 2008 crisis. As a result, they are obliged to be more transparent, in order to reassure the public of their ability to implement appropriate policies that will enable them to achieve the objectives set out in their mandates. As a result, central bankers are increasingly heard to express their views on the policies to be pursued, and their influence on investor sentiment is growing. The influence of central banks has become crucial in managing financial crises, as we saw again in March 2023 in the USA, with the crisis of confidence caused by several bank failures necessitating the injection of $500 billion from the US central bank to stabilize the financial system, or in Switzerland, with the decisive action that had to be taken by the SNB in organizing the takeover of CS by UBS. Since 2008, central banks' balance sheets have increased tenfold on average, underlining their growing role in steering economic cycles and financial crises. It is now clear to all that their role has become fundamental in ensuring financial stability. But the question of their independence from political power, often mentioned as a core value of their effectiveness, does not seem clearly established in all cases.

Reminder of the foundations of central bank creation and the concept of independence

The independence of central banks is rooted in American philosophy, which regards independence as one of the fundamental conditions for the functioning of democracy. History shows that the executive branch can sometimes be tempted by demagogic manipulations with severe social and political consequences. If left unchecked, the executive branch can provoke damaging instability and crises that are difficult to overcome. The U.S. and Swiss Constitutions echoed these concerns at the outset, by providing for control of the executive by the legislature. Where monetary policy is concerned, the fear of instability can therefore arise from the unleashing of passions and the particular interests of political groups who may seek a specific interest to the detriment of the general interest of the country and its population. The organization of institutions responsible for monetary policy must therefore take into account the future risks of demagogic impulses, in order to avoid and regulate conflicting interests.

Although the USA and Switzerland set up their central banks at roughly the same time, the two countries will decide to ensure the independence of their central banks from political power in very different ways.

The independence of the central bank is therefore a necessity in order to counter the risks of instability that could be caused by policy changes leading to major economic and social inequalities. At the root of the formulation of monetary policy principles, we naturally find the fight against the consequences of high inflation and the redistribution of wealth in society. In particular, the independence of central banks was strengthened to reassure the public and financial markets worried about the effects of the risks associated with the resurgence of uncontrolled inflation. All too often, the appearance of uncontrolled inflation caused by governments unable to react effectively had led to political excesses, social unrest and, in some cases, even instability at the root of major conflicts. In the United States, the Founding Fathers seemed perfectly aware of the redistributive effects of inflation, and were quick to address this issue in their Constitution, defining the principle of regulating the value of money in order to maintain its purchasing power.

It's worth remembering that, originally, the States of the Union did not have the right to issue money, even though there was no central bank yet. A sign of mistrust of the executive, confirmed by the fact that this role was originally performed by Parliament. When the FED was created, in the wake of the banking panics of 1907, it was vital to protect the new central bank from political and banking pressures by ensuring the highest degree of independence. This principle of independence still prevails today, and is often put forward as a guarantee of the success of monetary policies conducted in the sole interest of the population and the country. But independence is not always self-evident, either in national regulations or in the day-to-day work of central banks, due to external pressures or collusion with governments. The various financial crises of recent years have demonstrated, in some cases, a very clear relationship of interdependence between political power and the actions of central banks. Historically, this notion of independence has been reinforced at various times, depending on the country concerned, and since the end of the 20th century it has become clear that it must be guaranteed if central banks are to act effectively. The following is a reminder of the important periods when the independence of various national institutions was strengthened.

FED (1913): its independence has been strengthened since 1978

In the United States, the central bank was officially created by the Federal Reserve Act or Owen-Glass Act of December 23, 1913, following the banking crises of 1907 in particular. Its independence was reinforced during the currency instability of the late 1970s. Prior to this, the First Bank of the United States had been responsible for issuing the new American currency and regulating credit since 1791. Replaced in 1816 by the Second Bank of the United States to put an end to the hyperinflation resulting from the Second World War with the United Kingdom, it was dissolved in 1830 before a new financial instability, caused by the difficult cohabitation of regional monetary systems, led to the creation by the US Congress of the National Monetary Commission, whose historic task was to define the founding legislation of today's FED. As early as 1913, the U.S. government placed the FED under its control, appointing the Secretary of the Treasury as a member.

In the wake of the Great Depression, the passage of the Banking Act altered decision-making structures, notably creating the Federal Open Market Committee, whose purpose was already to regulate credit and steer interest rates. Since the Secretary of the Treasury was no longer a member of the FED, the central bank's independence was taken for granted. Particularly as the central bank is not owned by the government and receives no state funding for its budget. The definition of its mandate changed again in 1978, when the Humphrey-Hawkins Full Employment Act was passed. The Fed is independent, and its decisions are not subject to authorization by the President of the United States or any other federal government body. Congress does, however, have a right of oversight.

SNB (1907): independence enshrined in the Constitution

The SNB was founded in 1907 under the Swiss National Bank Act. The SNB is a public limited company listed on the Swiss stock exchange, whose activities are now governed by a new special law adopted in 2002. Although the SNB has been a public limited company since it was founded in 1907, the Swiss Confederation does not own any shares, which ensures its independence, even though its capital is partly held by the Swiss cantons, the cantonal banks and about a third by the public. The SNB is managed by its Executive Board, made up of three members appointed by the Federal Council. Article 99 of the Swiss Constitution guarantees the SNB's independence and obliges it to hold sufficient currency reserves, partly in gold, to reassure investors of the stability and value of the currency.

BoE (1694): independence of the Bank of England reinforced in 1997

The Bank of England is certainly the oldest central bank to mint its own currency. Founded in 1694 by Members of Parliament and merchants, it was then a private holding company controlled by financial interests from the City, before its capital was nationalized in 1946. Its independence was strengthened in 1997 by a vote of Parliament, and subsequently in 2013 by the Financial Services Act, which established an independent Financial Policy Committee. Since then, it has been theoretically independent of political pressure.

ECB (1998): independence guaranteed by the statutes of the European Monetary System of Central Banks

In Europe, the case of the European Central Bank is particularly interesting. Since 1998, the European Union's Central Bank has been based in Frankfurt, succeeding the European Monetary Institute (EMI), which was created to set up the new central bank along the lines of the Bundesbank. The German central bank model, which was to some extent imposed after the Second World War, was originally heavily influenced by the negative experience of the 1930s, the scene of hyperinflation caused by unlimited money creation to finance government spending. The Bundesbank's desire for absolute independence reflected its distrust of political power, which was naturally tempted to create too much money and credit, risking inflation and social instability in the process. The ECB was therefore originally set up as a body independent of EU member states or any supranational European institution. Its independence is guaranteed by the statutes of the European System of Central Banks, which stipulate that a governor can only be dismissed in the event of serious misconduct or incapacity. The ECB is, however, accountable to the European Parliament.

BoJ (1882): theoretical independence since 1998

In Japan, the Bank of Japan has been issuing currency on behalf of the government since 1882, but only acquired its theoretical independence from the government under the Bank of Japan Act of April 1, 1998. In fact, its independence from political power is not so great. Since the appointment of Prime Minister Abe in 2012, the monetary policy pursued by its Governor Mr. Kuroda, appointed by Mr. Abe, has been very clearly influenced by government policy, which is still the case to this day under the presidency of Mr. K. Ueda.

PBoC (1948): dependent on political power

The People's Bank of China was founded in 1948 and has never been independent of political power. It is owned by the Chinese state.

Who appoints central bankers?

Since the emergence of the financial crisis in 2007, and its media explosion with the collapse of Lehman Brothers in 2008, central banks have once again come to the fore, and are the focus of intense attention from the world's media and investors. There is no longer a word, a phrase, a slip of the tongue or a raised eyebrow from a central banker that is not instantly deconstructed and analyzed to derive new and decisive information, enabling a more accurate assessment of the future evolution of policy and doctrine. The salvation of the global economy is now clearly in their hands. The names of influential central bankers are now better known than ever to investors and the general public, even when the latter have only a limited interest in the economy or international finance. Mr. J. Powell (FED), Mrs. C. Lagarde (ECB), Mr. Jordan (SNB), Mr. A. Bailey (BoE) or Mr. K. Ueda (BoJ) regularly make the headlines and their interventions are relayed with fervor, so crucial has their role become to the health and development of the global economic system.

The election of central bankers is now a public affair, since in the case of the six central banks mentioned above, the choice of central bank president or governor is in fact a political decision.

In **Switzerland**, it is the Federal Council, acting on a proposal from the Bank Council (the central bank's supervisory body), which elects the President (Mr. Jordan) and the other two members of the Executive Board. The SNB's policy is thus set by an Executive Board of three politically-elected individuals.

In **the United States**, the Board of Governors is the governing body of the Federal Reserve (FED). It is made up of seven members appointed by the US President, a choice subsequently confirmed by the US Senate. The Chairman (Mr. J. Powell) is appointed for a four-year term, renewable without restriction, and the other members of the Board are appointed for a fourteen-year term.

In **Europe**, the ECB's Executive Board is made up of six members, including President C. Lagarde, elected by common accord of the heads of state or government of the eurozone countries on a recommendation from the Council of the European Union. This follows a consultative process with the European Parliament and the ECB Governing Council. The ECB Governing Council is made up of the ECB Executive Board and the governors of the national central banks of the eurozone countries.

In the **UK**, the Chancellor of the Exchequer appoints the Governor of the Central Bank.

In **Canada**, Mr. T. Macklem is appointed by the Minister of Finance, while in Japan, the appointment of the Governor is approved by the Senate on the proposal of the government. In **China**, the President of the People's Bank of China is appointed by the Premier and approved by the National People's Congress (NPC).

Central bank presidents are therefore appointed exclusively by governments.

How independent are we from our shareholders?

In **Switzerland**, the central bank is owned by the cantons, the cantonal banks and the public. The State is indirectly present in the capital, the Confederation elects the members of the Executive Board, the Bank Council responsible for overseeing the management of the business is made up of six members appointed by the Federal Council, and only five others are elected by the General Meeting. In the final analysis, independence is not fully guaranteed at institutional level.

In **Europe**, the ECB is clearly owned by the national central banks, the only ones authorized to hold its shares. The capital, initially set at 10.76 billion euros, is held in proportion to the shares of each EU member state, to the GDP and population of the Union. The Bundesbank, for example, holds 18%, while the Banque de France and the Bank of England both hold 14%. In theory, therefore, the ECB is independent of government power, but the central banks of these three countries are themselves owned by their respective governments. Independence is therefore not theoretically assured from this point of view.

The case of **the United States** is a little more complex. The US central bank is owned by the twelve regional central banks, which tends to give it the status of a federal institution, independent of government power, since the federal government does not hold any shares in the Federal Reserve. However, each of these twelve Regional Federal Reserve Banks has a shareholder base made up of commercial banks from their corresponding district, who elect some of the members of the board of each regional reserve. The Federal Reserve Bank of New York is naturally the largest, accounting for around 40% of the regional banks' assets. It also executes the financial market operations decided by the FED. The FED is therefore made up of bodies whose representation is sometimes public or mixed (the Board of Governors chaired by Mr. J. Powell, the Federal Open Market Committee, the twelve central banks, the member banks of the regional central banks and several advisory councils). The FOMC, which is responsible for monetary policy, comprises the seven members of the Board of Governors and five representatives of the twelve regional central banks.

The distinctive feature of the American system is that money creation is the prerogative of the Treasury Department, not the FED. Congress exercises its right of control and oversight.

In the **UK**, the BoE is an independent public body controlled by the Treasury Solicitor's Department. However, its operational independence is linked to the inflation targets set by the Treasury and included in the government budget.

In **Japan**, the BoJ is 55% owned by the Japanese government and 45% by private shareholders, whose shares have no voting rights but are listed on the stock exchange.

What are the main roles and objectives of central banks?

In **Switzerland**, the SNB has a mission defined by the Constitution and the National Bank Act. It is responsible for issuing currency and managing the country's monetary policy. It ensures the stability of the Swiss franc and of prices, taking into account the economic situation.

In **the United States**, the Federal Reserve Act defines the Fed's mission as maintaining growth in monetary aggregates and in the quantity of credit consistent with potential output growth, so as to achieve the goals of maximum employment, stable prices and low interest rates.

In **Europe**, the ECB is responsible for conducting monetary policy within the eurozone, in conjunction with the central banks of the eurozone member states. Its mission is to maintain price stability, manage reserves and conduct foreign exchange operations.

In the **UK**, the BoE is responsible for maintaining monetary and financial stability, foreign exchange policy, currency distribution and acting as lender of last resort to commercial banks.

In **Japan**, the BoJ is responsible for issuing money, directing monetary policy and ensuring the financial stability of the Japanese financial system.

In **China**, the PBoC is responsible for the country's monetary policy and financial stability. It regulates financial institutions and oversees tax regulations.

Who benefits from the financial results achieved ?

In **the United States**, part of the FED's financial results are paid out to member bank shareholders in the form of a guaranteed dividend of 6% ($583 million in 2021), while the federal government receives the remaining profits, which amounted to $107.4 billion, to the US Treasury.

In **Switzerland**, the National Bank Act contains specific provisions on the allocation of profits. It stipulates that a maximum dividend of 6% is to be paid to shareholders, and that one third of the profit in excess of the dividend is to be paid to the Swiss Confederation, and two thirds to the cantons. In 2021, the SNB paid out CHF 6 billion to the cantons.

In **Europe**, the ECB enjoys its own budgetary independence and can also freely use the profits generated by its monetary policy. In practice, it returns a large part of its profits to its shareholders.

Independence remains fragile in times of acute crisis

Since the emergence of the 2008 financial crisis, the independence of central banks has clearly suffered. In most countries, the independence of central bankers has been undermined by political and financial instability, and by the growing interventionism of governments. Political power has interfered in the conduct of monetary policy in countries that are perfectly democratic and respectful of the notion of independence, as laid down by those same governments. The risks of social unrest, which were supposed to stem from uncontrolled inflation, have taken another unexpected path, but one that is just as dangerous for the stability of the financial system and for social order, justifying the increasingly obvious collusion between governments and central bankers.

Finally, these events may simply highlight a situation that has always existed in practice: the independence of central banks is fragile and must be protected. The FED had already pursued an aggressive policy on the public debt market to enable the government to refinance itself more cheaply after the Second World War, and has been following a similar path indirectly since the adoption of QE. Today, it holds a high proportion of all US public debt, as is also the case in Japan and the eurozone.

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