**[Understanding SBP autonomy](https://www.dawn.com/news/1676959/understanding-sbp-autonomy)**

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State Bank autonomy is a topic that needs serious discussion rather than judgments passed out of context. Should there be reform in order to access loans from donors or the Extended Fund Facility from the [IMF](https://www.dawn.com/news/1673609)? The answer is that essential reform must take place without pressure of any kind.

For this, the appointment of an individual to head a regulatory authority must be based on the basis of skill and credentials. Once appointed, she/he must be allowed to work freely. According to C.C. Binder, a perceptive woman economist, even “[h]ighly independent central banks face pressure for loose monetary policy”. Political pressure is not a valid justification for statutory autonomy.

A debate is revolving around the fear that autonomy would lead to a State Bank that is subservient to the IMF.

The State Bank will be run, managed and governed by the IMF’ is the popular refrain. We signed up for liberalisation of the economy in the early 1990s. Our financial system is integrated with the international financial system.

The main question is: should the central bank be subservient to the shopping spree of politicians or the bureaucracy that is managing the real sector or international donor agencies?

The recent mismanagement of the real sector and consistent shortages in the goods market reflect poorly on the capacity of the political-bureaucratic elite to run the economy. We lack in all essential data. From data generation to the execution of analytics based on the data, we have to rely on international agencies.

It is not a secret that our bureaucracy relies on and takes all decisions based on research generated by international consultants. Data, which is not available with Pakistani authorities, is always available with international agencies.

In this age of free flow of information, we have to work towards transparent decision-making based on data. The success of the NCOC in implementing smart lockdowns in previous Covid waves is an example to follow.

**Also read:** [IMF wants SBP to roll back housing finance measures](https://www.dawn.com/news/1673609)

Information is a resource that can be used to modify human reactions. True, we all like certainty and react to mitigate risks. This is precisely the job of a central bank — to avoid or minimise shocks as a signal to the economy to grow on a sustainable path.

Whether a central banker or a politician is more loyal to the country is not the right debate.

In the modern era, nominal interest rates send signals to economic agents (households and businesses) to form inflationary expectations. For example, the central bank announces a future rate of inflation. If there are economic shocks, how would businesses and households react? If you expect prices to rise at a faster rate, the logical response from businesses and households would be to buy now rather than at a later date.

What would be the response of the central bank? One could be to do nothing; the shock would lead to demand that would cause the growth and inflation rate to increase faster. This type of shock would be harmful for sustainable growth and it would be better for the State Bank to send out signals for minimising the intensity of shocks.

Let’s assume that the government announces an increase in wages in the budget to win voters who know that budget is inflationary. They would adjust their reactions by following two simple rules — one, past performance is the reflection of the present; two, don’t base decisions on transitory movements.

Workers’ rationality can save the economy from inflation-unemployment trade-offs. The central bank sticks to its policy. Based on past economic performance, workers would know that a wage rise will be accompanied by a price rise and they will adjust their response accordingly.

In a country where financial literacy and financial inclusion is miserably low, it is a theoretical discussion whether or not this will work. Again, it calls for our own models and theories based on the observations of our economic agents. Based on these factors, the current debate on the autonomy of the State Bank has raised some key issues.

First and foremost is whether growth or price stability is the preferred objective. The answer is that these are aligned objectives in a framework where the nominal interest rate is modified to minimise the output gap and for achieving the announced inflation rate. This type of response brings certainty to the economy and generates a sustainable growth path.

The second issue is the choice of anchor for signalling to economic agents. People will react faster to changes in the nominal interest rate or the policy of open market operations. Interest rate announcements get instantaneous reactions.

The choice lies between price stability and money stability. Again, constant money supply is not the relevant policy choice, especially with innovations in plastic money and the development of the financial market. It would be even more difficult to control the velocity of money in times of uncertainty. Interest rate channels would allow growth in financial markets and bring stability to the banking system.

The third question is: who should take decisions — IMF, SBP or the politicos? Whether a central banker or a politician is more loyal to the country is not the right debate. It is an issue of who is knowledgeable enough to provide the right set of data for taking the right decisions.

In all countries, autonomous central banks are answerable to parliament. Missing the inflation target means an ineffective central bank and the governor has to explain the missed target. The issue is the credibility of policy that guides economic agents to take rational decisions. It is a simple system to implement performance-based policies.

Those still wondering which type of political system is good for sustainable development should know that the objective of the central bank has changed from money stability to price stability and with innovations in the virtual currency system and blockchain technology, there will soon be a change in the entire monetary system. The real challenge then would be to stop working in isolation. The [Raast app](https://www.dawn.com/news/1673190) is a step in this direction.

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