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“Independent institutions: conditions and challenges”

Universidad de Navarra (Madrid) Colloquium

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Good morning and many thanks to the Universidad de Navarra for their kind invitation. I'm delighted to be here with my distinguished colleagues at this colloquium on the conditions and challenges independent authorities face.

Both the economic literature and practical experience in different countries underscore the idea of the independence of economic authorities and supervisors as something particularly relevant. Independent "economic supervisors" have, in fact, a long-dated tradition in the developed countries and are a key pillar of their institutional structure. This is why I believe we all concur that independence is a value that we should not only preserve but also strengthen for the benefit of these objectives.

Naturally, independence is not an end in itself but a necessary means to effectively attain objectives in the general interest with which institutions have been entrusted. In any event, it is imperative that independence should be inseparable from other principles, namely responsibility and accountability, which allow the appropriateness of independent authorities' actions to their mandates to be assessed, reinforcing their credibility and, ultimately, their effectiveness too. Independence also involves being up to the highest standards of transparency, integrity and governance.

How independence can be effective is a very significant question. But before replying, let me briefly pose a prior question: why must we make economic supervisors independent? I believe this prior response is important because, as I was saying, independence can never be an end in itself. Lastly, I would like to briefly cover the need to balance independence with the requisite accountability.

Reasons warranting independence

The functioning of "economic supervisors" is governed by mandates that reside in the general interest and which the public authorities have entrusted to them.

Simplifying somewhat, in the specific case of the Banco de España we have a mandate for price stability, as a monetary authority integrated into the Eurosystem, and for oversight of the health of the financial system and for safeguarding financial services customers.

Regarding the price stability mandate, the role of expectations in economic agents' behaviour warrants the delegation of the control of inflation to an independent body, to avoid monetary policies being geared to continuously stimulating aggregate demand in the short term, leading ultimately and solely to higher inflation. Empirical studies tend to corroborate the fact that a greater degree of independence correlates with a lower level of inflation, without this having entailed costs in the form of lower economic growth.

As to the banking supervision and consumer protection mandate, justification for supervision being exercised by an independent institution rests on the following: conflicts of interest between governments and supervisors; the need to avoid actions linked to the electoral cycle; the problems of time and regional inconsistency in the EU; and the eminently technical nature of the performance of supervisory functions. Reflecting this was the European Central Bank's assumption of supervisory responsibilities over significant European financial institutions as from 2014.

In short, the delegation of these tasks to independent bodies is so that the general-interest functions entrusted to these institutions can be most effectively met. Independence helps

effectiveness insofar as its exercise is impartial, in defence of the general interest and shielded from the influence of government and private interests alike.

As stated, the value of independence is particularly important when the effects of exercising it are only observed in the medium and long term and even entail short-term costs. Clearly, taking this long view can be difficult for the Government, which may be tempted to prioritise short-termist considerations linked to its re-election possibilities.

One additional matter, of significance for the entire general government sector, concerns the need to avoid so-called “supervisory capture”. Evidently, the supervisor should be independent not only of the Government, but also of the banks under its supervision; accordingly, it should always act in defence of the general interest, disregarding pressure from or the particular interests of specific banks or the banking sector as a whole. Naturally, acting independently is not the same as acting arbitrarily or unfairly.

Another problem I mentioned clearly associated with the lack of independence of institutions is what is known as “time inconsistency”. If the continued validity of a regulation depends on the will of the incumbent government, the latter may lack the incentives to maintain previous commitments; that can lead to regulatory decisions not having the desired effect if economic agents anticipate that such decisions might be revised in the future.

These problems diminish with independent regulators, since those responsible are usually appointed for a period of time longer than the electoral cycle and with long-term objectives.

Measures to ensure independence is effective

Focusing now on the main issue of this colloquium, I would say that for independence to be effective it must be (i) formally acknowledged and (ii) affect different facets of the body: namely, its institutional, legal, functional, organisational and financial dimensions and those relating to the staff of those in charge.

The independence of the Banco de España is stipulated in the 1994 Law of Autonomy, the Treaty on the Functioning of the European Union, the Statute of the European System of Central Banks and the Single Supervisory Mechanism Regulation. This independence is no mere legal formula but is fully fledged:

- 1 First, institutional independence confers capacity upon governing bodies to act autonomously. Indeed, as provided under its Law of Autonomy, the Government cannot issue instructions to the Banco de España, which in turn cannot seek or accept them, in the exercise of the functions derived from its participation in the European System of Central Banks. These principles are also applicable to the functions it performs as part of the Single Supervisory Mechanism.
- 2 Legal independence does not only take the form of the institution’s own legal personality to act on its own behalf, but also of its capacity to issue legally binding decisions within its remit. It suffices to say here that the Banco de España has its own legal personality, different from that of any other administration or institution.
- 3 The personal independence of its senior officials requires that their appointment, the exercise of their mandates and their cessation in office be previously and explicitly provided for, and subject to a series of guarantees

that shield them from any interference. The independence of the Governor, and of my own position, is reinforced with respect to the political powers and to the sector supervised by means of the following measures, *inter alia*: (i) our mandate is set at six years (longer than the electoral cycle) and is non-renewable; (ii) the setting of specified reasons for cessation in the office of Governor, Deputy Governor and the elected Council Members; (iii) the incompatibilities regime to which the Governor, Deputy Governor and Council Members are subject; and (iv) the prohibition on pursuing professional activity related to credit institutions or to securities markets over a period of two years following cessation in office.

4 Functional independence ensures the institution's ability to exercise all the functions and powers entrusted to it to fulfil its mandate.

5 Financial independence is vital for ensuring that the institution has sufficient financial and human resources and that these are duly organised and structured to ensure the mandate is achieved. In this respect, the Banco de España has its own budget enabling it to obtain economic resources needed to pursue its functions.

6 As regards organisational independence, the Banco de España enjoys the autonomy to establish its internal organisation and, especially, its personnel policy. I should in any event stress that the Banco de España, by legal imperative, selects its staff observing the principles of equality, merit, ability and transparency, with such staff bound to the Bank by employment contracts.

In short, the Banco de España's level of financial and organisational independence may be said to be appropriate to the attainment of its objectives.

Accountability as a counterweight to independence

To conclude, some brief thoughts on the importance of accountability. In a democratic state, transparency and accountability must be required of all independent bodies or authorities in respect of their decisions, as these are vital for conferring legitimacy upon them.

It is a fact that the global financial crisis has caused the demands on central banks in this area to increase. This is, first, because monetary policy has extended its tools, pursuing more complex measures; and, further, because central banks have assumed more responsibilities in respect of financial stability, in particular regarding macroprudential supervision.

Accountability by independent bodies and authorities for their actions and activities should preferably be before Parliament. In this connection, there is direct Parliamentary control over the Banco de España budget and over its balance sheet and profit or loss. The Bank also regularly submits reports to Parliament, e.g. the Annual Report, the Institutional Report, the Report on Banking Supervision in Spain and sanctioning measures.

Stipulated as part of this accountability before Parliament is the Governor's appearance before the Economic Committee of the Congress of Deputies, to present the Annual Report and to analyse the draft State Budget.

Beyond accountability, institutional transparency is also a basic principle in the proper functioning of independent public institutions, in particular given that the confidence in and credibility of these institutions are the basis of their effectiveness.

The Banco de España has a long-standing tradition in publishing reports of acknowledged rigour and prestige encompassing different spheres of action of the institution, seeking always to reach a broad spectrum of the public.

It is also our aim to broaden the Bank's participation in those academic, professional and social fora where our presence may prove beneficial. We further strive to use new communication instruments, such as the recent opening of a Twitter account, and regular contact with the press to explain the content of our reports more accessibly.

The Bank has also increased the information on its Transparency Portal. Greater details of the agendas and appearances of both the Governor and myself are included, as are those documents pertaining to the integrity expected of the senior officials.

In this respect, both the Governor and I, as representatives of the ECB Governing Council and Supervisory Board, respectively, have signed a new code of conduct. This increases our personal commitment to the highest ethical standards in order to ensure our independence from the public and private sector and avoid potential conflicts of interest.

Lastly, the Bank is in the process of devising a strategic plan, whose completion date is scheduled for the second half of this year and whose essential content will be made public. Aside from the importance of this exercise internally, I believe the drawing up and publication of this plan is a fundamental transparency-enhancing factor that will provide for assessment of the effectiveness of the Bank's actions.