CENTRAL BANKING AND MACROECONOMIC COORDINATION:

The Case of Colombia

(Abstract)

This short paper addresses the issues of objectives, organizational arrangements and policy instruments of autonomous central banks, with particular reference to Colombia. Instead of resorting to mechanical extrapolations of other countries' experiences, we discuss the institutional "checks and balances" existing in the new Constitution adopted back in 1991, when the Banco de la República was granted autonomy. We underscore the importance of coordination between the Ministry of Finance and the Central bank, if disinflation is to have a long-term effect.

The Banco de la República has the peculiarity of being, besides the monetary and credit authority, the exchange rate market manager and regulator. Hence, the degree of coordination required under such institutional arrangement is certainly above some other central banks. Under current circumstances, neither the number of Board Members (seven, below an international average of eight) nor its chairing by the Minister of Finance (with no veto power or tight-breaking vote) are serious obstacles to maintaining single-digit inflation, while recovering fast economic growth.

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I. Introduction

Since 1991, when the Banco de la República (Central Bank) received its prime Constitutional mandate of preserving the purchasing power of the peso, inflation in Colombia has been declining. Average annual inflation during 1999-2000 has been close to 10%, breaking the world's most stable moderate inflation (Dornbusch and Fischer, 1992), which had averaged 22% during the previous two decades.

However, disinflation has resulted mainly from a deep recession during the latter years, when economic growth also descended from a historical average close to 5% down to 1% (actually with a contraction of –4.3% during 1999). The Colombian economy consequently faces a complex dilemma over how to quickly reestablish sustainable growth (above the expected 3% for year 2000), abate high open unemployment (currently at 20%), and yet avoid going back to double digit inflation rates. This complex economic situation has been further aggravated by social turbulence involving powerful narco-guerrilla-paramilitary movements.

Our task at hand is to help assess the role that an autonomous Central Bank, like the Banco de la República, should play in this triad of objectives: recovering growth, generating employment, and maintaining low inflation.

The political economy of such coordination between the Central Bank and the Minister of Finance is no less demanding. On the one hand, the Colombian Congress has been constantly pressing the central bank for better and deeper coordination with the Minister of Finance (who chairs the seven-member Board of Directors). At times, these pressures have taken the form of Law Proposals (at odds with Constitutional principles of independence) intended to affect Board decisions. Law Proposals have included "mandates" to the Central Bank to increase its external indebtedness and to reform internal auditing. Fortunately, such initiatives have been short-lived.

On the other hand, well-known international analysts have been calling for several Constitutional reforms, namely, excluding the Minister of Finance from the Board; reducing the Board Members from five to three; granting tight-breaking vote to the Governor; and allocating financial supervision tasks to the central bank. See Alesina, et.al. (2000).

Three main topics can focus our discussion of the performance of the Banco de la República:

A. *The Central Bank's prime objective*, which currently aims at controlling inflation, but is mandated to coordinate with the government's macroeconomic plan;
B. *Its organizational structure*, where the presence and role of the Minister of Finance as Chairman of the Board has been constantly questioned, as well as the composition of the Board (a total of seven members, each with an equal vote, including the Minister and the General Manager of the Central Bank).
C. *Its instruments of economic policy*, which have the peculiarity of including the Central Bank as the foreign exchange manager and regulator, besides the traditional monetary and credit instruments.

This paper will emphasize how these topics affect the decision-making process and the consistency of policies. There has been an inclination to extrapolate the interesting experiences of other countries (Alesina and Summers, 1990), but sometimes in a rather mechanical fashion. In Colombia, historical speculations include the role of the Central Bank under the hypothetical scenario in which the Charter of 1991 would have excluded the Minister of Finance from the Board. Our approach, instead, consists of analyzing how to fulfill the mandate of coordination, while carrying out the current Constitutional mandate to control inflation.

If fiscal discipline is to be reinstated for the long-run, we conclude that Constitutional reforms in Colombia should aim at organizing territorial transfers under a per-capita basis and adjusting retirement benefits so as to moderate quickly the fiscal burden of pension liabilities. Estimated net pension liabilities currently surpass the value of the Colombian annual GDP (worth about US$90 billion). More details in Clavijo (1998a,b) and Restrepo (2000).

From an independent central bank's point of view, maintaining one digit inflation in Colombia, after several decades of moderate inflation (around 22% per-annum), clearly entails reestablishing fiscal and external macroeconomic balances. After floating the peso against the dollar in September 1999, the Colombian economy has experienced drastic adjustment in her external current account (currently around 1% of GDP), while regaining control of monetary policy.

However, the crucial issue in terms of achieving dynamic economic growth and low inflation hinges on curtailing public expenditure, along the lines above mentioned. Under these circumstances, neither the number of the Board Members nor its chairing by the Minister of Finance (with no veto power or tie-breaking vote) are serious obstacles to maintaining single-digit inflation, while recovering fast economic growth.

The three sections that follow will address, in turn, these issues of objectives, organizational structure, and the set of instruments available to the Banco de la República, with some concluding remarks. The backdrop for all this will be the experience gained over the first decade of central bank independence in Colombia (1991-2000).

II. Objectives of the Banco de la República

A. Fighting Inflation as the Prime Objective

The prime objective ordered by the New Charter of 1991 to the Banco de la República was to fight inflation. For that purpose, the Central Bank was designated as the monetary, financial, and foreign exchange authority. The Central Bank was also granted autonomy in the areas of capital provisioning, administrative matters, and technical decisions. However, the adopted model did not stipulate full independence, since the Central Bank policies have to be coordinated with the macroeconomic plans of the government, even while aiming at fighting inflation (See G. Hernández, 1997 p.87; Urrutia, 1999 p.7.)

Several Constitutional Court rulings have endorsed this principle of coordination, especially regarding the four-year Plan that every new government has to submit to Congress. Such coordination has enabled economic consistency between the disinflation program of the Central Bank and the National Budget. It should be underscored that, at the international level, is rather odd that the Central Bank alone sets the inflation target(s) and there are good reasons to expect best results out of a joint setting by the Government and the Central Bank. More details in Morgan (2000 p.5), Kenen (2000 p.60), and George (2000 p.26).

For instance, Constitutional Court Ruling C-481 of 1999 established that coordination between government and the Central Bank must respect the principle of autonomy, meaning that:

> "(The central bank) *can assess freely the monetary phenomena and designed, without interference from other authorities*, the instruments that their obligations demand in all areas that have the purpose of maintaining the purchasing power of the local currency, while assuring the security and reliability of the monetary system" (our emphasis).

In consequence, it is clearly incorrect to infer that if the government's development plan happens to threaten the Central Bank's disinflation program, then the government's plan would prevail (Alesina, et.al. 2000 p.17). Additionally, Law 31 of 1992 (articles 4 and 16i) supports the view that the Central Bank takes precedence:

> "In case of disagreement, the constitutional responsibility of maintaining the purchasing power of the local currency will take precedence." (See Banca Central en Colombia, 1994 p.210, our emphasis).

In fact, the disinflation program's pre-eminence generated discomfort among several Ministers of Finance during the years 1995-96 (Perry, 1997), but without altering any of the legal status that granted autonomy and precedence to the Central Bank (Junguito, 1995).

B. Macroeconomic Coordination

It should be said at the outset that, in our view, the task of coordination in no manner contradicts the central bank's main objective of fighting inflation, but complements it. Perhaps the critical debate around coordination has to do with the time-horizon over which such objective is expected to be reached. Those concluding that the task of reaching inflation levels lower than, say, 4% per annum is immediate would definitely step away from any coordination. Under this view, the central bank should immediately "jam the brakes", irrespective of aggregate demand stance or the state of the financial system. By contrast, for those of us who reckoned the mandate of dis-inflation as assuring a long-term path towards that goal, coordination is very important.

For example, if monetary policy happens to be subordinated to fiscal policy due to deep disequilibriums, coordination would help moderate the unwanted effects of "crowding-out" in the short-run. Somehow this has been the current position of The Banco de la República with respect to supporting the foreclosure of public banks during the financial crisis of 1998-2000.

The medium term requires coordination so that the Central Bank can help explain to Congress and the public at large the need for downsizing the State and improving the quality of public expenditure. This has, in fact, been the main subject of recent reports sent by the Banco de la República to Congress (2000 a,b).

Interestingly, the Board in this way supports the macroeconomic tasks of the government, while at the same time the Minister of Finance is committed to monetary and exchange rate soundness, given his one-vote (out of seven) to the policies approved by the Central Bank. This coordination clearly exists and has been successfully exploited in Central Banks with a good track record in terms of fighting inflation, such as those of Chile and Japan. Coordination sometimes takes place directly at the Board (Chile) or through the Open Market Committees (Japan), where the Ministry of Finance plays an important role.

III. Organizational Structure of the Board of Directors

A. Participation of the Minister of Finance

The issue of "one main objective" (fighting inflation), but mediated by the principle of "coordination" between the Minister of Finance and the Central Bank, ends up being consistent with this mixed organizative structure. The support for such blending stems out of the practical difficulties in distinguishing the so-called "political independence" from the "economic independence" at any Central Bank (Clavijo, 2000 p. 11) or in the distinction of "goal" from "instrument" independence (Alesina, et.al. 2000).

In Colombia, the Board of Directors of the Banco de la República has this mixed characteristic as it includes a total of seven members:

- The Minister of Finance (who chairs it, following a Constitutional mandate),
- Five full-time Directors, chosen by the President, of which two may be substituted every four years, with a maximum tenure of 12 years in the post, and

- The General Manager, who is elected by the Directors for periods of four years, up to a maximum of 12 years in the post.

Each member has one vote, with no veto power by the Chairman or tie-breaking vote by the General Manager (as the one granted in the Central Banks of, say, Brazil, Sweden or England). The Head of the Office of Bank Supervision (Superintendencia de Bancos), a governmental body with some autonomy, has voice but no vote in the Board meetings.

It has been claimed that the Minister of Finance has special power in that he chairs the Board. In practice, his unique edge stems from the fact that the Board can not be convened without his participation (or that of his Deputy, when Minister is away). However, there are clear provisions to avoid Board meeting delays for more than two weeks and any member of the Board can call for extraordinary meetings at any moment to address special issues. Board members decide the agenda and the staffs of the Central Banks and the Ministry work jointly on the technical issues. More details on procedures may be found in the Internal Resolution 1/2000, which recently modified similar provisions existing since 1993.

The very presence of the Minister of Finance in the Board of Directors has led renowned international analysts to assert that:

> "Often the idea of 'coordination' is nothing more than an attempt to loosen the government's budget constraint and open the door for political pressures on the central bank to monetize deficits. In fact, an explicit 'lack of coordination' may create incentives for the fiscal authority to follow more prudent policies …" (Alesina, et.al. 2000 p.6).

Such claim ignores limitations that the Minister faces as long as he is just one member out of seven. Such statement clearly disregards, for instance, the fact that credit in favor of the government requires unanimous agreement among Board members and that full repayment should occur before the fiscal year ends. During the period of the Central Bank's independence (1991-to date) not a single direct credit to the government has been approved.

However, some members of Congress and local analysts keep asking the Central Bank to print money for the government, especially after learning that the economy contracted by –4.3% during 1999 (the first GDP contraction in seventy years). In August 2000, the Board of Directors unanimously rejected pressures from Congress and some analysts to issue additional money to help financing central government expenditures (Banco de la República, 2000c). Meanwhile, the Central Bank of Venezuela approved an increase of nearly 30% in the monetary base to finance their government.

B. Transparency

In this regard, it is useful to revisit the thoughts of Mr. Lauchlin Currie, a renowned Canadian economist who lived in Colombia most of his professional life. Asked about the issues of autonomy, coordination, and communication to the public, Mr. Currie (1991, p.17) responded:

> "It is in the composition of the Board that a compromise must be worked out between the ideal of full autonomy of the monetary authority, on the one hand, and complete coordination of fiscal, monetary, and exchange policy, on the other hand.
>
> The experience suggests that the members be appointed to work full time on the Board, be technically qualified and not representative of any particular sector of the economy. With such a composition, the present provision for two technical advisers could also be eliminated. While, in the interest of coordination of economic policy, a strong argument can be made for the presence of the Ministro de Hacienda on the Board, this has <u>generally</u> led to a bias toward excessive monetary emission. Perhaps the most desirable degree of coordination will result from greater stability in the value of money. In any case, it would be desirable that the Gerente of the Banco be the president of the Board, and its spokesman …" (underscored in the original).

We interpret from this text that Mr. Currie wanted the coordination to take place "outside the Board", but he was not certainly against the Minister of Finance performing the tasks of coordination. As we have recounted, the Constitution of 1991 adopted the model of having the coordination "inside the Board". Given the fiscal adjustment priorities, some of which demand Constitutional reforms, we think that the most effective dis-inflation strategy for the long run is to let Congress work on the fiscal adjustment, while the Board enhances the required coordination among macroeconomic areas.

As to the issue of communications to the public, any Board member can currently be designated as spokesman (Art. 8 of Internal Resolution 1, February 2000), although usually the Minister and the General Manager operate as such. Regarding “transparency,” it has been in fashion to reveal publicly the Minutes of the Central Bank Board meetings. This has the double purpose of providing a framework for Board decisions, while illustrating to the public the internal debate. The current transition of the Banco de la República towards inflation targeting is an appropriate moment to debate thoroughly this issue of transparency (Uribe, et al. 1999; Clavijo, 2000a; Banco de la República, 2000 pages. 19-21).

In this regard, the international experience is mixed: the Bundesbank has never revealed their Minutes, but the Bank of England and the Federal Reserve have recently been inclined towards a more “market-based-accountability approach” by revealing their Minutes, with an appropriate lag. However, all these central banks have high reputation and accountability (Lastra y Wood, 1999).

The Banco de la República has used as a close substitute for revealing their Minutes press releases that come immediately after the Board decisions. Although short, they aim at revealing the essence of the economic debate, the reasons for altering the stand of policies, when that occurs, and interestingly, the reasons for not having reached consensus in that eventuality. The overall balance is rather satisfactory in terms of public information, but certainly the issue of revealing the Board minutes deserves further debate.

C. Taking Well-Informed Decisions

Given the fiscal priorities, it is rather naïve (from a real-politic perspective) to push at this moment for a Constitutional reform aimed at providing the General Manager of the Banco de la República with a tie-breaking vote, as recently proposed by Alesina, et.al. (2000 p.16). Apparently, the idea is to free the Manager from what has been coined in Colombia as his role of "vote-broker" among Board members (Marulanda, 1997 p.29).

Curiously enough, the very same Ministers of Finance have repeatedly explained to Congress the inconvenience of having the central bank printing money for helping in the financing of fiscal deficits (roughly 6% of GDP during 1998-2000, at the level of the central government). In this regard, it is certainly useful to have the Minister of Finance committed to sound economic policies for the long-term, instead of taking side with populist inclinations that undermine the Central Bank's independence. However, this has not always been the case in Colombia (Junguito, 1995 p.31; Marulanda, 1997 p. 23ss; Gómez, 1997 p. 17).

Other analysts have questioned the scheme of coordination "inside the board", although they recognize the need for a systematic interchange of information and ideas between the Minister of Finance and the Central Bank. Other countries use the scheme of "outside" coordination, as clearly occurs in the case of the Federal Reserve and the U.S. Treasury. Nevertheless, our point is that there is not a clear cut advantage between the "outside" coordination model vs. the "inside" coordination model (such as the one used in Chile, Japan, and with variations, in the case of Colombia).

D. Board Composition

It has also been suggested to reduce the number of Directors (elected by the President) from five to three (Alesina, et al. 2000 p.16). In this subject there is not either a clear benchmark. In a survey of 34 Central Banks, it was found that Board members fluctuated widely, between 3 (the cases of Denmark and Switzerland) and 18 (in the case of the European Bank), with an average close to 8 members per board. Sometimes the criteria used to determine the number of board members has to do with region representation (clearly the cases of Germany or US) and in others with a desired balance between “internal” members and “external” ones (in the cases of academic representation). For instance, in Poland 9 out of the 10 members of the Monetary Committee (the key body decision) are “external” to the Central Bank, mainly academics. Something similar occurs in Hungary or England (Morgan, 2000 p.4).

Hence, the case of Board members at the Banco de la República is clearly below international average (7 vs. 8). Additionally, some international institutions have expressed reservations about the idea of having pettit-comittees (of just 3) making crucial decisions on monetary and exchange rate policies.

The experience of the Banco de la República illustrates that the current membership of seven is ample enough to fit regional, partisanship, and ideological variety (although the President is in no manner limited by any of these criteria in his/her selection). Table 1 presents a tabulation of the profiles of the Board Members during the 1991-2000 period (including Ministers of Finance and the General Manager, with no particular weight given to length of membership on the Board.)

Table 1: Board Members' Composition at the Banco de la República
(including the Minister of Finance and the General Manager)

	1991-92	1993-94	1995-96	1997-98	1999-2000	Average 1991-2000
Government Affiliation:	Liberal	Liberal	Liberal	Liberal	Conservative	
Partisanship:						
Liberal	4	2	2	4	3	43%
Conservative	3	3	3	2	2	37%
Independent	0	2	2	1	2	20%
Regional:						
Northern	0	1	2	2	2	20%
Center	6	6	4	3	4	66%
Eastern	0	0	0	1	1	6%
Western	1	0	1	1	0	8%
Gender:						
Female	1	1	1	0	0	9%
Male	6	6	6	7	7	91%
University:						
Public	0	1	2	3	3	26%
Private	7	6	4	4	4	74%
Background:						
Public	1	4	5	6	6	63%
Private	6	3	2	1	1	37%
Inclination:						
Orthodox	4	4	5	4	5	63%
Heterodox	3	3	2	3	2	37%

Source: Our own analysis, based on information from the Board records.

Note first that the Liberal Party has had the largest representation (43%), compared to the Conservative Party (37), or the independents (20%). This fact is consistent with the majority of Liberal governments, since it is the President who appoints Board members (except in the case of the General Manager, appointed in turn by the Directors). Secondly, most board members have come from the Central Region (66%) of the country, but certainly the Northern-Cost Region (20%) ends up in good standing. Thirdly, note that gender representation has been clearly in favor of men (91%), while representation of private universities is rather high (74%).

The previous engagement of the Board members (as of one year before appointment) has been mainly in the public sector (63%), as seems to be the case in many central banks. In this sense, the proposal aiming at forbidding the immediate passage from the public sector onto the central bank would deprive the latter from experienced civil servants. At the more conflict-prone level of Ministers, existing laws already prohibit them to move either way, unless a year has elapsed). Interestingly enough, the development of "technopols" in Colombia in the late 1960s has generated a permanent rotation within the public sector, which has been useful in terms of building up the required "human capital" for the public sector (Meisel, 1996 p.15ss; 1997 p.114).

E. Board Preferences and Its Tasks

Some analysts have suggested that actual tenure of Board directors is on the low side and that their rotation has been rather arbitrary. In fact, any two of them can be removed, every four years, since none have yet reached the established tenure ceiling of 12 years (Alesina, et.al. 2000). Indeed, during the first decade of independence of the Banco de la República there have been a total of 12 co-directors, with an average tenure of almost 4 years (46 months). The longest stay has been 8 years and the minimum was a year and a half. Although the average stay has been short by international standards, it should be said that it doubles the time in office of the Ministers of Finance of Colombia and is four times that of the Ministers of Social Affairs.

Some have argued that before the tenure ceiling is reached, some Directors could be prone to be especially conciliatory towards the government as the time approaches to choose the two that will be removed from office. No evidence supports these claims, although the institutional arrangement clearly failed to set the appropriate transition to avoid such perils. However, as average tenures tend to increase with time, this inconvenience will be self-correcting.

The record points to directors acting with pragmatism and voting based on technical grounds, rather than based on partisan interest (Junguito, 1995 p.30). In this sense the professional behavior of the Board at the Banco de la República is along the lines of another central bank: "flexibility, receptivity, and agility" in making decisions seems to be the norm (Hosking, 1999 p.49).

Nevertheless, central-bank-watchers could find certain bias in board decisions, depending on topics and junctures. Our own subjective balance tells us that Board members in Colombia have been inclined to make decisions based on a rather "orthodox" economic framework in mind (63%), rather than an unorthodox framework (37%). We rather leave it to those central-bank-watchers the interesting tasks of finding out if, in Colombia, the above statement means that: "rules" have been imposed over "discretion", "monetarism" has prevailed over "Keynesianism", "neo-liberalism" has defeated "populism", or if "hawks" have devoured "doves". Institutional economics may now use sophisticated econometrics to tackle these issues with more rigor than we pretend here.

It is useful at this stage to briefly analyze the tasks expected from the Board at the Banco de la República, which include the rather unusual one of helping with the administrative guidelines of the institution. Among these tasks, Directors are expected to participate:

I. Weekly, in:

1. Coordination Meetings with Deputy Minister of Finance, in order to set the details of the agenda and the technical work;
2. Open Market Operations Committee, where monetary and exchange markets are analyzed, but decisions are not made here; representatives of the Ministry are invited;
3. Intervention Committee, whenever it is necessary to "fine-tune" the Board decisions, but always within narrow guidelines from the Board;
4. Board Meetings, where decisions are taken with the participation of the Minister of Finance (or his Acting Deputy) and at least three co-Directors.

II. Monthly, in:

5. Inflation Analysis, where inflation performance is screened and decisions planned;

6. Financial System Analysis, where solvency indicators and alike are screened and decisions or suggestions to the Superintendent or FOGAFIN are planned;
7. International Reserves Committee, where "yields" against benchmarks are analyzed and guidelines for reserve management agreed upon;
8. Administrative Council, where guidelines are given to the General Manager and his staff on internal labor matters and operative issues.

III. Quarterly, in:

9. Special Inflation Analysis, where detail econometric-model-driven analysis are performed and recommendations for medium-term are planned;

IV. Bi-Annual, in:

10. Consultative Regional Committee, where the Board interchanges ideas with the main private sector representatives, especially from the productive sector.
11. Report to Congress, highlighting policy actions, results, and strategy for the immediate future. Usually, this report leads to formal hearings at Congress, where the Central Bank policy is discussed at length.

F. Congress, Courts and Board Relations

Bi-annual reports to Congress have usually led to a series of Congressional hearings, where Board members of the Central Bank have been allegedly scolded for not doing enough in terms of policy coordination with the Ministry of Finance. We do not know of any records of congressional members asking for removal of the Minister of Finance from the Board of the Central Bank. Nevertheless, some members of the Board, after expirations of their terms, have called for Constitutional reforms aiming at removing the Minister of Finance from the Board (see Marulanda, 1997 p.22; also G. Hernandez, 1997 p.90).

Interestingly, several Ministers of Finance have also been scolded by Congress for not spurring growth and employment fast enough and for not increasing "social expenditure" in line with their expectations. In fact so-called "social expenditure" now covers more than 50% of the annual budget (a share which can not be decreased by Constitutional mandate) and its annual rate of growth has been close to 9% in real-terms during the last decade (details in Clavijo, 1998a).

Against this background, Central Bank accountability could not realistically be increased if, say, members of Congress were given the task of choosing Board members from a short list presented to them by the President. This process would certainly introduce unwanted politics in Board members' selection, undermining the technocracy that has been building up in Colombia since the early 1970s.

Furthermore, there exists some casual evidence that even those Board members that Congress once supported (informally) have suffered their scolding once they joined the autonomous Board of the Central Bank. Put simply, Colombian Congress dislikes the principle of autonomy of the Central Bank, but, luckily, the presence of the Minister of Finance in the Board has helped ease such dislike.

Congress's desire for additional and better coordination with the Ministry of Finance has at times taken the form of Law proposals aiming at undermining such autonomy. For instance, during 1999 some members of Congress supported reforms that looked for increasing foreign indebtedness on behalf of the Central Bank, so that the central government could use some of those resources for increasing public expenditure. Such initiative was clearly unconstitutional, and luckily never succeeded.

The principle of accountability of the Central Bank has indeed had an "institutional dimension" which should be assessed against the framework of "checks and balances" existing in each society (Lastra y Wood, 1999 p.38). In the case of Colombia, such accountability implies not only explaining to Congress the rationale and the results of the economic policy adopted, in coordination with the government, but the legal scrutiny of their actions by the Constitutional Court, the Office of the Comptrollers, and the Superintendence of Banks. Accountability clearly goes beyond "transparency" (just informing clearly and on time) in as much as positive economic results are expected from Board actions (other factors, beyond Bank's control, remaining constant).

Several studies support the idea that coordination is good in as much as it could set economies in a "virtuous circle" of low inflation, high growth, and income distribution improvement. In fact, in an 80-country sample analysis, maintaining inflation in the one-digit-level tended to favor the low-income population more than the rest. In this regard, better than increasing across-board "social expenditure", fighting inflation successfully is not only pro-growth but pro-improvement of social conditions for low-income citizens (Dollar y Kraay, 2000 p.19-23; Kalmanovitz, 2000).

The autonomy of the Banco de la República has also been challenged by some rulings of the Constitutional Court, although it has apparently honoured such an attribute in previous rulings (see Ruling C-481, 1999). Some dissenting members of the Court have expressed that recent rulings regarding the Housing Law, particularly Ruling C-995, 2000, have clearly invaded the Constitutional authority and control of Congress and the Central Bank.

In the latter ruling, for instance, the Court interpreted the Constitutional "right to a worthy house" (Article 51) as implying that *the State must provide house subsidies for all the population*. Not satisfied with such debatable interpretation, the Court also ruled that the Central Bank should establish a permanent real-interest-rate ceiling on housing loans *for all strata* of society in order to ensure that they are below the real cost of any other "normal" credit. Obviously, imposing such interest rate controls could imply significant fiscal costs --additional to those already existing for the poorer strata-- and impair the recovery of the housing sector in Colombia, with devastating effects on employment.

This institutional fragility brought about by actions of Congress and the Courts against the Banco de la República should help to clarify that the challenge to the central bank's autonomy in Colombia does not come from within the Board of Directors itself, although the Minister of Finance is part of it. On the contrary, as emphasis is given on co-ordinating the working out of economic policy between the Central Bank and the Executive, through the Minister of Finance, the principle of autonomy will gain strength and greater approbation (as is supposedly endorsed by the Court).

IV. Policy Instruments

A. Foreign Exchange

As commented before, the Banco de la República also has the task of regulating and operating the foreign exchange market. This setting is quite different from, say, that of the Federal Reserve of the US, where the Treasury leads exchange rate policies. In this context, Colombia turns out to have an institutional advantage in the participation of the Minister of Finance in the Board of the Central Bank (Urdinola, 1998), where foreign exchange decisions take place, and not a disadvantage as assessed by Alesina, et. al. (2000, p.11).

Can any economist expects foreign exchange policies to be successful without the firm support of the Ministry of Finance? In the events of the transition from the “crawling band” system towards the flotation of the peso against the dollar (September of 1999) maximum coordination was clearly required. The transition’s success proved that the current institutional arrangement of the Board, where coordination takes place “inside”, is particularly useful when the Board is also the foreign exchange authority.

B. “Rules” vs. “Discretion”

The framework of “inflation targeting” is ideal for those of us who interpret that policy decisions should take into account the external macroeconomic juncture, the fragility of the financial system, the internal economic cycle, etc. Under this approach, the multiannual inflation targets give the Central Bank some discretion to frame their daily operations with that medium term goal in mind (Bernanke and Mishkin, 1997; Morgan, 2000 p.8). Strict rules are not only difficult to apply, but tend usually to be on the blind side of policymaking (Blinder, 1998; Clavijo, 2000a).

For instance, the recent tendency to abandon strict monetary corridors or exchange rate bands in Latin America is clearly in line with the idea that Central Banks should do whatever is required to maintain inflation targets on track, not necessarily following monetary rules. Short-term deviations from targets may occur when clear justifications exist. Monetary analysis tends be more complicated than just maintaining the base inside the corridor, and often implies dealing with grey areas between liquidity and solvency problems.

The Banco de la República has been dealing with erratic behavior of the demand for money since 1997, when the Board decided to displace upwardly the base corridor due to "a surprising increase in the demand for cash…" (Hernández, 1998 p.56). In a similar fashion, the Board approved an upward adjustment of the base corridor in mid-2000 due to erratic behavior of high-power money components. Hence, the monetary policy of the Banco de la República is today under inflation targeting principles, although in operational terms much improvement is required regarding inflation forecasting procedures and regarding coordination to break fiscal dependence.

It is useful to quote here the view of the U.K. Treasury (1999) regarding coordination with the Central Bank in monetary policy issues, as well:

> "… On too many occasions serious mistakes were made, which often meant that inflation was higher and more volatile than it would otherwise have been. *This, in turn, created substantial economic instability that harmed the long-term performance of the UK economy*. Many of these policy mistakes were made because the aims and procedures of monetary policy were not properly defined …"

C. Bank Supervision and the Central Bank

Finally, it has also been suggested that banking supervision tasks should be allocated to the Central Bank (Clavijo, 2000b p. 31; Alesina, et.al. 2000 p.7), given than the current setting is a complex one. The Minister of Finance has the enormous task of coordinating bank supervision, prudential policies, and financial crisis management through the Superintendence of Banks, the Technical Branch of the Ministry, the Central Bank, and the Deposit Insurance Institute (FOGAFIN, recently entitled to deal directly with financial entities with solvency problems).

In other countries, grey areas of liquidy/solvency are tackled more easily if the Central Bank also performs the task of financial supervision. For instance, in OECD countries financial supervision tasks are carried out directly by Central Banks in 83% of the cases, but in Latin America it only occurs in 36% of the cases (Alesina, et.al. 2000 p.8). However, institutional arrangements are particularly hard to alter once Central Banks have been given their independence (Minsky, 1999 p.1530). This is a complex issue that certainly deserves more analysis for the medium term.

V. Conclusions

We have reviewed here the issues of objectives, organizational arrangements and policy instruments of autonomous central banks, with particular reference to Colombia. We underscored the importance of coordination between the Ministry of Finance and the Central bank, if disinflation is to have a long-term effect. The Banco de la República has the peculiarity of being, besides the monetary and credit authority, the exchange rate market manager and regulator. Hence, the degree of coordination required under such institutional arrangement is certainly above other central banks.

Well-known international analysts have been calling for several Constitutional reforms in Colombia aiming at: excluding the Minister of Finance from the Board; reducing the Board Members from five to three; granting tie-breaking vote to the Governor; and allocating financial supervision tasks to the central bank. See Alesina, et.al. (2000). We conclude that if fiscal discipline is to be reinstated for the long run, Constitutional reforms in Colombia should be aimed (instead) at organizing territorial transfers under a per-capita basis and adjusting retirement benefits so as to moderate the fiscal burden of pension liabilities rapidly.

The issue of "one prime objective" (fighting inflation), but mediated by the principle of "coordination" between the Minister of Finance and the Central Bank, ends up being consistent with this mixed organizational structure. The Minister faces strict limitations inside the Board as long as he is just one member out of seven, with no veto power or tie-breaking vote. Credit in favor of the government requires unanimous agreement among Board members and that full repayment the fiscal year ends. During the period of independence of the Central Bank (1991-to date) not a single approval of direct credit to the government has taken place.

However, as mentioned, some members of Congress and local analysts keep asking the Central Bank to print money for the government. Ministers of Finance have expressed to Congress the inconvenience of such proposals and have urged the importance of curtailing public expenditure and fighting tax evasion and elusion. In this regard, it is certainly useful to have the Minister of Finance committed to sound economic policies for the long-term, instead of taking sides with populist inclinations that undermine the Central Bank's independence.

Regarding this institutional fragility, we also analysed actions brought about by Congress and Courts against the Banco de la República. Such events should help to clarify that the challenge to the autonomy of the Central Bank in Colombia is not within the Board of Directors, due to the presence of the Minister of Finance. On the contrary, by emphasising that economic policy of the Central Bank is worked out in coordination with the Executive, through the Minister of Finance, the principle of autonomy should gain respectability (as supposedly endorsed by the Court).

It has also been suggested to reduce the number of Directors (elected by the President) from five to three. In this subject there is no clear benchmark. The case of Board members at the Banco de la República is clearly below international average (7 vs. 8). Under current circumstances, we have come to conclude that neither the number of Board Members (seven, below an international average of eight) nor its chairing by the Minister of Finance (with no veto power or tight-breaking vote) are serious obstacles to maintaining one digit inflation, while recovering fast economic growth.

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