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In Defense of Central Bank Freedom
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The Central Bank, for a number of reasons, has been receiving a lot of attention from economists of late. Most recently, a bank document outlining the main points of its monetary policy for 2007 flatly admitted that it could not hold inflation down and at the same time prevent the ruble from appreciating, given the ever-increasing influx of petrodollars and rapidly rising levels of government spending. This is a Russian version -- or, more accurately, an oil-exporting state's version -- of the age-old question faced by any central bank: Is it better to target inflation or shoot for higher growth rates? Russia's Central Bank has chosen to try to keep inflation in check, although President Vladimir Putin recently identified a different priority -- namely, preventing real ruble appreciation. The statement from the president creates a test of character that the current Central Bank team has not previously had to face.

During the 1990s, the Central Bank was one of the most heavily scrutinized of all state bodies. Passions ran to extremes. In the early post-Soviet period, Central Bank Chairman Viktor Gerashchenko tried to stave off a fall in production by providing credits directly to companies and, as a result, fanning inflation. In June of 1998, First Deputy Chairman Sergei Aleksashenko denied that the ruble was overvalued and that a devaluation was unavoidable, virtually accusing his opponents of being traitors to the motherland. There followed unexpected redenominations, wild fluctuations in exchange rates, the "Black Tuesday" of Oct. 11, 1994 and, ultimately, the default of Aug. 17, 1998. Since 2002, under the chairmanship of Sergei Ignatyev, the bank has gradually faded from television screens and the front pages of newspapers. To some degree, this is a positive development, as it is an indicates the new team's professionalism.

But it has also happened partly because monetary policy -- along with the Central Bank's independence -- has not had to face a really serious test during the past five years.

Now, the vertical of Kremlin power has developed to such a point that the Central Bank's independence appears to be coming under threat. It is easy to forget that independence is not just a political question as in, for example, Tatarstan or Abkhazia, where a significant degree of independence is the result of a weakening of state power over the last 20 years. An independent Central Bank is a basic institution in a market economy, and the idea that it has to be independent is not just some theoretical conjecture on the part professional economists. (The Nobel Prize for economics in 2004 went to Edward C. Prescott and Finn E. Kydland for their work on monetary policy, part of which provides a foundation for the argument that central banks need more freedom.) The 1970s generation in Latin America, indeed around the world, spent a good deal of its time and energy fighting for the independence of central banks. Certain political considerations -- to pump up growth ahead of the elections or maintaining an exchange rate that gives certain economic sectors an advantage over others -- do not always coincide with a country's economic interests. Central bank independence is indispensable to addressing these economic concerns.

The independence of any central bank -- be it in Russia, Britain, or the United States -- is only independence from disastrous political intervention. The chairman of the Central Bank is nominated by the president and confirmed by the State Duma, so there are actually ways of influencing its policy.

But we all, including the president, should then stand back and let the Central Bank decide for itself what to do in 2007. This approach will be better for the economy, the president and the man on the street.

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