Pakistan's Monetary Policy:
Some Fundamental Issues

ZAFAR HAYAT

Over the last three decades, the landmark transformation of central banks from secrecy to openness and transparency has significantly enhanced their performance to successfully anchor inflation expectations and achieve price stability. The extent of such a transformation of the State Bank of Pakistan (SBP), especially in terms of statutory objectives, monetary policy mandate, conflicts of interest, disclosures, and dissemination of effective public economic information is assessed *vis-à-vis* the current popular central banking practices. The assessment indicates that the SBP is yet to be transformed to be able to achieve price stability which is a cornerstone for the achievement of sustainable economic growth. On the statutory front, such a transformation requires amending the SBP Act 1956, in line with the statutes for the best monetary policy frameworks by; (1) making price stability as the overriding objective of the SBP; (2) putting in place a clear mechanism for its accountability against price stability, consistent inflation targets, and; (3) elimination of the cushion for government's involvement with the monetary policy decision making processes. Some of the other areas like, institutional capacity building of the SBP, in terms of the relevance and level of the academic qualification, research profiles, and experiences of the Board, higher as well as lower tier management need special attention. Such transformations may not only enhance assimilation, creation, sharing, and funnelling of existing as well as new knowledge into monetary policy formulation, but may help change the static mindset at the SBP, hence allowing the institution to flourish.

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1. INTRODUCTION

The role of transparency in terms of a monetary policy decision making process and communication has been increasingly recognised, as an important component of the best central banking practices [Blinder, *et al.* (2008); Winkler (2002) and Fry, *et al.* (2000)]. The leading central banks such as the Federal Reserve (Fed), European Central Bank (ECB), and largely the inflation targeters including the developing countries have

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transformed into more open and informative central banks, since 1990s instead of being secretive until the 1980s.[1]

Motivation for this transformation from a secretive to a more communicative approach hinges on the non-trivial benefits—the transparency and effective communications confer. For instance, it allows the central banks to anchor inflation expectations more effectively [Geraats (2005)] and reduces uncertainty both from the perspective of financial and public markets. [Geraat (2007)]. It enhances predictability [see Swanson (2004) and Gerlach-Kristen (2004)] and enables economic agents to plan and take rational decisions. It also facilitates central bank's accountability, thereby paving the way for an increased central bank independence. This in turn helps to improve the quality of a central bank's own functioning through credibility build-up [Winkler (2002)]. Thus, by and large, the increased emphasis on transparency and communication has led the central banks to open up and communicate with clarity and precision, particularly in terms of their objectives, mandate, disclosures, and appropriate dissemination of public economic information. To what extent has the SBP progressed on these lines is an open question?

It is however pertinent to mention that although, some of the studies have evaluated the transparency and performance of Pakistan's monetary policy, none of them attempted to critically highlight the fundamental issues—related to the SBP's monetary policy statutory framework, decision making, the conflicts of interest, disclosures, and dissemination of public economic information with possible implications for the SBP's credibility and effective communication. For instance, Malik and Din (2008) attempted to assess the SBP's monetary policy, while evaluating its transparency against the scores given in Eijffinger and Geraats (2006). Ahmed and Malik (2011) have also attempted to assess the SBP's monetary policy performance by using counterfactual simulations. They employed a simple Taylor rule and concluded: had the SBP followed a rule, its performance would have been better. Hayat (2014a) empirically assessed the SBP's monetary policy performance for a period of 50-years from 1961–2010, with a focus on the evaluation of the discretion granted to the SBP for the achievement of its dual objectives, inflation, and growth. He found robust evidence that by exercising their discretion, the monetary policy makers at the SBP created excessive inflationary pressures in the economy that harmed the real growth for 62 percent of the time—hence, defeating both of its key objectives of inflation, and real growth.

Given this backdrop, the current paper intends to critically assess the SBP's monetary policy, while drawing on some fundamental issues largely from a statutory perspective with implications for the SBP's credibility and effective conduct of the monetary policy. Since there is no standard pattern of central banking practices that can be used as a benchmark for the underlying assessment, this paper mainly relies on the prevailing practices of leading central banks, as well as inflation targeters as a reference point. To fill the gap, the remainder of this paper is structured into the following sections. Section 2 critically discusses the statutory objectives in the SBP Act, 1956 which is set

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[1]For instance, the Fed in the 1970s was sued to give the first written defence for its secretive behaviour. The seminal paper of Goodfriend (1985) provides a detailed exposition of the case, the defence of the Fed for the secrecy and the weaknesses therein.

out for the SBP and elicit the problems therein that hinders its effective performance of monetary policy. Section 3 highlights the SBP's issues pertaining to the statutory monetary policy mandate, its potential both as a monetary policy guiding framework, as well as a design for its performance evaluation and accountability. Section 4 delves into the potential conflicts of interest originating from the dual supervisory and monetary policy role of the SBP, fiscal dominance, and the Board's market affiliations that might hinder the effective conduct of the monetary policy. Section 5 focuses on the disclosures of the profiles, minutes and voting records of the Board and assesses the efficacy of the SBP's performance in terms of dissemination of public economic information—especially forecasts, Monetary Policy Statement (MPS) and major publications. The last section concludes the paper.

2. STATUTORY OBJECTIVES

In case of Pakistan, Section 9A of the SBP Act (1956) vests the responsibility of the conduct of monetary policy with the SBP's apex body in these words:

> The Central Board, in order to secure monetary stability and soundness of the financial system—(a) formulate and monitor monetary and credit policy and, in determining the expansion of liquidity, take into account the Federal Government's targets for growth and inflation, and ensure that the Bank conducts monetary and credit policy in a manner consistent with these targets….. p. 10.[2]

The wording of the Act implies that essentially the SBP has dual objectives, i.e. inflation and growth. The government sets annual inflation and growth targets each year, and as per the statute the SBP is supposed to actively pursue it. Majority of the countries abandoned this kind of a framework back in the 1990s. The central banks no longer actively pursue ambitious growth targets such as the ones set by the Government of Pakistan (to be discussed in the next subsection). This transformation occurred largely on the back of the seminal research of Kydland and Prescott (1977). Hundreds of studies also [see Gartner (2000)] reveal that a central banker, who actively pursues the real growth in the long-term, ends up creating excessive inflation in the economy without any significant output gains. Another strand of literature shows that money is neutral in the long-run [see Weber (1994); Lucas (1995); Apostolos and Koustas (1998) and Bullard (1999)], which implies, creation of high average inflation without any corresponding long-term growth gain. To this effect, Hayat (2014d), while using the data from Pakistan for the period i.e. 1961–2010 found empirical evidence that monetary neutrality holds.

The maintenance of the status quo of the SBP Act regarding the duality of inflation, and growth targets even in the wake of the second decade of the twenty-first century is naïve. Active pursuit of dual mandate was not surprising until the 1960s, because prior to that the central banks were believed to be able to fetch higher growth

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[2]It is imperative to mention that the SBP is expected to take care of other objectives such as exchange rate and financial stability, however these are neither clearly defined as to exactly what they constitute nor there exist quantitative targets for such objectives. Therefore, the main focus in this section is on the SBP's dual objectives of inflation and growth, and the issues emerging from their numerical targets.

rates by accepting relatively higher inflation—a phenomenon commonly referred to as the Phillips Curve. However, lately the world has learnt that the Phillips Curve became less steep in the 1970s and flat in the 1980s. Later in the 1990s, overwhelming evidence has been found that higher average inflation, instead affects the real growth adversely [Barro (1995); Ireland (1999)]. Thus, in light of the new knowledge, the focus of many central banks—irrespective of the underlying form of monetary policy strategy, whether inflation targeting or otherwise—shifted towards price stability. It helps in attaining a sustainable possible level of real growth without affecting the society adversely. Part of the change is also an acknowledgement of the knowledge that real growth is a function of a range of other factors beyond the control of the central banks, such as initial endowments, human capital, research and development, law and order, and so forth [see Levine and Renelt (1992); Barro (1995-96)].

Amidst these developments, the Government of Pakistan continues to stick to the outdated tenets of the SBP Act and sets the inflation, and growth targets in a way, where it is hard to find any fundamental economic theory or a standard central banking practice that may lend support to the naivety in these targets. Based on the government's assigned inflation and growth targets, the chances of formulation of an effective monetary policy are remote. Instead of providing any guiding framework, these targets essentially misguide the SBP and its monetary policy. The discussion of issues associated with individual inflation and growth targets as well as with their combination follows.

2.1. The Government's Assigned Growth Targets

The government's assignment of growth targets to the SBP and the latter's subsequent pursuit for its achievement potentially induces inflation bias. As was argued by Kydland and Prescott (1977) and Barro and Gordon (1983a, b) that inflation bias results from the monetary policy makers' temptation to spur the real growth beyond its potential without any output gains. Since, the Government of Pakistan generally sets the real growth targets, beyond the potential rate of the economy (Figure 1), attempts on part of the SBP for its achievement that leads to the creation of undesirable excess inflation in the economy.[3]

For example, Hayat (2014a) found empirical evidence that the SBP induced excess inflationary pressures in the economy, which hindered real growth for around 62 percent of the 50 years from 1961–2010. This inflation bias over the period has resulted in undermining the SBP's credibility and effective conduct of monetary policy. Surico (2008) noted that in the case of the U.S., the Fed did tolerate even 1 percent inflation bias in the pre-1979 era, which they simultaneously eliminated by bringing inflation close to the 2 percent level. Whereas in case of Pakistan, Hayat (2014b) asserted that eight times higher average inflation bias than that of the U.S. has not been able to prompt either the government or the SBP to take long-lasting serious remedial measures for its elimination.

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[3]The natural rate of the economy is extracted from real growth using HP filter by employing the penalty parameter $\lambda = 100$, which is the recommended level for annual data.

Fig. 1. Annual Growth Targets and Natural Rate of the Economy
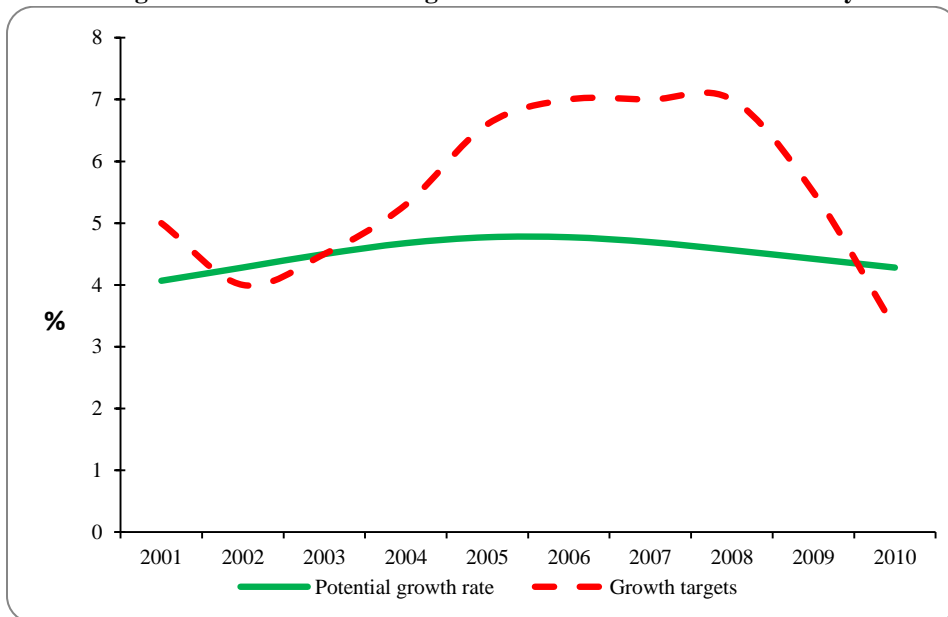
Given the limitations of monetary policy in terms of its ineffectiveness in stimulating the real growth, even the countries with dual mandate do not set any numerical growth or employment targets for the central banks. For example, in the case of the U.S. the statute requires the Fed to attain maximum possible employment, but unlike Pakistan, the government has no specific unemployment or growth targets, which the Fed is required by statutes to take into account, while formulating a monetary policy. Instead, the Fed maintains inflation at or close to 2 percent level, as in its view this rate allows the Fed to firmly anchor inflation expectations, which helps foster price stability and moderate long-term interest rates. In turn, it enhances the Fed's ability to promote maximum employment. Unlike the SBP, the Fed clearly acknowledges that the maximum level of employment is largely determined by non-monetary factors. Since, these factors may change over time and may not be directly measurable; therefore neither the U.S. Government nor the Fed specifies any numerical targets for maximum employment or growth.

Likewise, it may not be a beneficial practice in case of Pakistan to set binding numerical growth targets for the SBP, especially higher than the natural rate of the economy as shown in Figure 1, because it induces inflation bias without any growth-gain [Kydland and Prescott (1977)]. This is more likely due to the fact that non-monetary factors largely determine the growth beyond the direct control of a central bank. The SBP instead can pave the way for the achievement of a sustainable growth by ensuring 'price stability'.
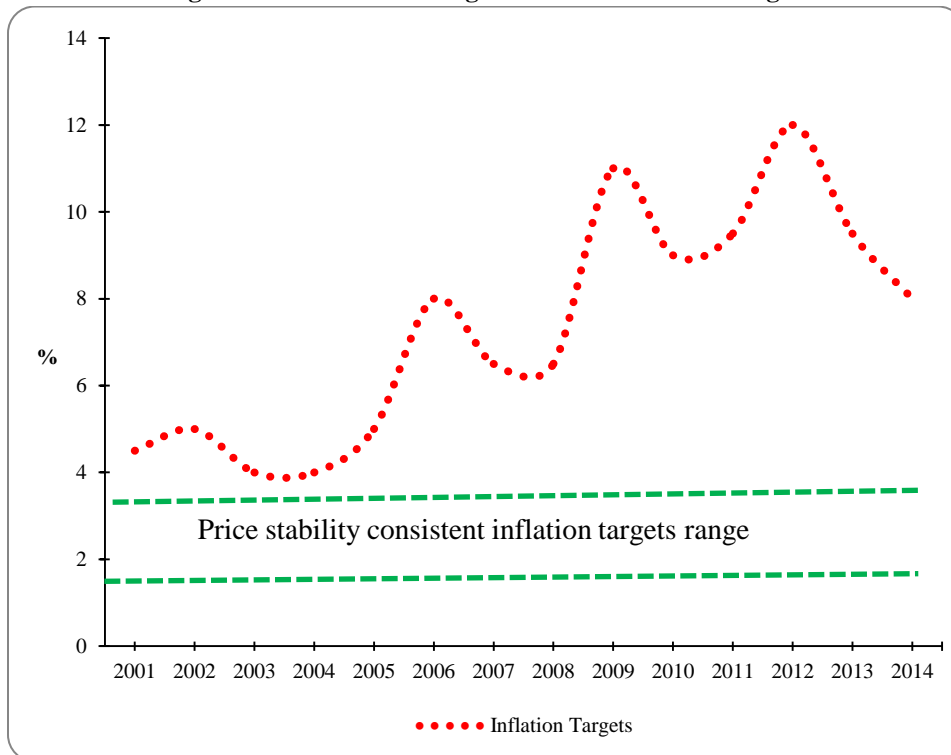
2.2. The Government's Assigned Inflation Targets

Quantitative inflation targets are set by the federal government each year. When observed over a horizon, these targets exhibit too high and erratic inflation rates to help

achieve short, medium or long-term price stability (Figure 2). The government inflation target-setting strategy is problematic from three perspectives.

First, as a starting point, a default inflation bias element is induced on the part of the SBP by creating an implicit floor inflation rate. For instance, as is shown in Figure 2, in the last one and a half decades, by and large, the government has set the inflation targets far above than the 4 percent level. This implicit floor automatically biases the SBP towards inflation, as it does not have to be wary to bring it down below this level to stabilise it in a narrow price stability, consistent range from 1 percent–3 percent in the medium to long-term. The price stability consistent inflation targets range in the Figure 2 is depicted by the dashed lines, where the government did not set inflation target(s) even once,, which allows more room for undesirably high and volatile inflation.

Fig. 2. Government's Assigned Annual Inflation Targets

These inflation targets seem to drive the behaviour of the SBP's monetary policy authorities. Hayat (2014d) observes the discretionary behaviour of Pakistan's monetary policy maker over a 50 year timeframe with the help of discretion indicator depicted in Figure 3. He notes that the turning points at the trough of the discretion indicator corresponds to a 4.4 percent observed inflation on average. He argues that this behaviour of the SBP for not allowing inflation roughly below 4 percent level is highly consistent with Cukierman's (2000) new inflation bias proposition—that such a central banker is wary that economy may sink into recession.

Fig. 3. Time Plot of the Discretion Indicator
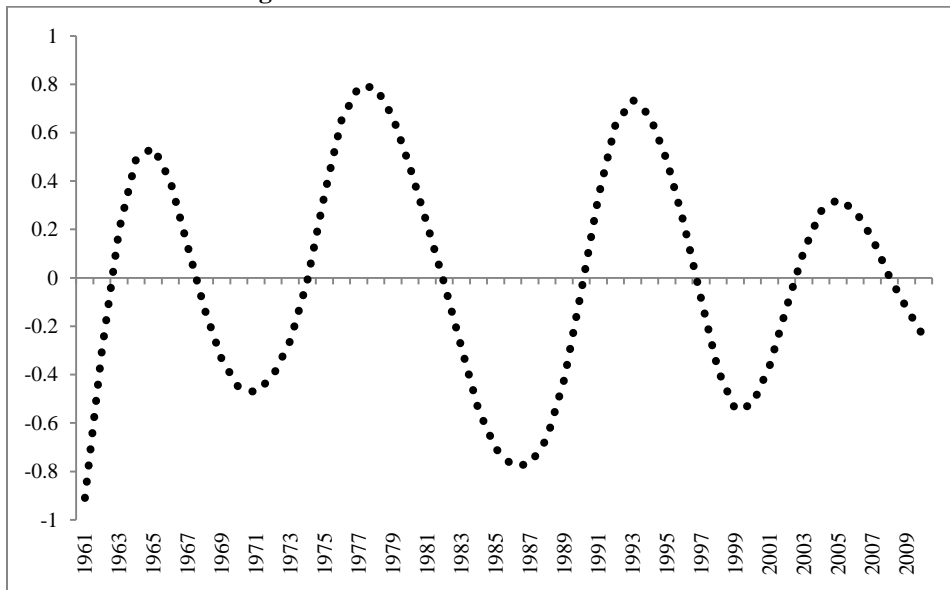
Source: Hayat (2014d).

Therefore, the government's high average numerical inflation targets coupled with the SBP's active pursuit of higher than natural rate of the economy undermines its ability to successfully anchor inflation to the extent to maintain price stability. Since at times the inflation targets are set as high as 12 percent, the inflation expectations are naturally anchored accordingly at higher levels. In other words, when it is announced that inflation is expected to be 12 percent, how can public expect that inflation would be lower, say at 6 percent? The inflation targets setting strategy of the government, thus potentially leads to a higher than equilibrium rate of inflation that is technically known as inflation bias.

Second, a nontrivial complication arises due to the government's naïve inflation targets as shown in Figure 2, in the sense that it is not possible to adjust monetary policy in response to such erratic inflation targets each year, and expect them being achieved; especially owing to the established fact that monetary policy actions takes effect with a lag [Friedman (1968); Havranek and Rusnak (2013)]. For argument sake, assuming even if no lags were involved in monetary policy, a perfect achievement of the government assigned inflation targets would instead have derailed the economy from the path of price stability. For example, average of the inflation targets for a 14 year period in Figure 2 is 7.32 percent and its variance is 6.98 percent, which is highly inconsistent with the standard definition of 'price stability'.[4] Normally 2 percent inflation rate is considered consistent with the notion of price stability. For example, in the case of the U.S., the Federal Open Market Committee (FOMC)'s mandate-consistent inflation rate is generally judged to be about 2 percent or a bit below. Similarly, price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the Euro Area of below 2 percent by the ECB. Further, the inflation targeters (both develop and

[4]Price stability refers to a state of the economy characterised by low inflation and a stable value of money.

developing countries) largely targets inflation in a range of 1 percent–3 percent. Thus for the attainment of price stability, the dashed lines in Figure 2 indicate that the inflation rates in Pakistan will have to be contained in the 1 percent–3 percent range.

Third, given the government inflation targets-setting strategy, unlike other countries, the SBP may neither be made accountable for the maintenance of price stability, nor its inflation performance can be evaluated. As a result, it is not possible for the SBP to build its credibility to anchor inflation expectations at lower levels, because it cannot send non-noisy signals of commitment to a low and stable inflation rate over medium and long-term. Since the public, especially the private sector is rational; they do understand the inherent flaws in the overall monetary policy framework and therefore adjust their expectations accordingly.[5] Thus given the current monetary policy framework, the SBP may not successfully delink the inflation expectations of the public from high and erratic inflation rates. Therefore, like the central banks in other advanced and inflation targeting countries, if the SBP has to be made accountable, while putting in place a mechanism for its performance evaluation, the government will have to set appropriate inflation targets in a short to medium term.

Precisely, the government should set the inflation targets close to 2 percent with a plus/minus 1 percent band to allow for a cushion to deal with unforeseen supply side shocks to the economy.[6] Debelle (1999) notes that an inflation band allows a reasonable cushion with the central banker to deal with shocks to the economy. The better inflation and growth performance of the inflation targeting countries in the wake of recent financial crisis provides anecdotal evidence to this effect. Another possible cushion with the central bank to deal with the shocks could be the targeting of core inflation, which excludes the effects of food and supply side shocks, hence easing off to an extent the strict accountability.

Therefore, if the government sets inflation targets for the SBP in 1 percent–3 percent range, it will (i) significantly enhance the real growth [Hayat (2014a)], (ii) pave the way for the achievement of price stability, (iii) provide a framework for the SBP's accountability and its performance evaluation, (iv) help the SBP build inflation fighting credibility, and (v) would make the SBP's communication with the private and public sectors easier and effective to yield the maximum possible monetary policy benefits.

2.3. The Inflation-growth Targets Nexus

As indicated earlier, in case of Pakistan, the government sets numerical inflation and growth targets on annual basis and the statutes [SBP Act (1956)] makes it obligatory for the monetary authorities to duly consider these targets in formulation of monetary

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[5]There is a wide consensus on the point that the public is rational as has been modelled by majority of the theoretical models such as Kydland and Prescott (1977), and Barro and Gordon (1983). Moreover, Hayat (2014c) and Abbas, *et al.* (2015) found some empirical evidence about the rational expectations behaviour of the public in Pakistan.

[6]Almost all the advanced countries' central banks set their inflation targets around two percent [Romer and Romer (2002)], as this rate is consistent with 'price stability' and even allows a sufficient cushion to trivialise zero lower bound in a world of small shocks [Blanchard, *et al.* (2010)]. Surico (2008) estimated a bias of 1 percent in the case of the U.S. for pre-1979 policy regime, and noted that inflation bias disappears when the inflation target is close to 2 percent. Hayat (2014b) using data from Pakistan found that inflation exceeding 2 percent level significantly constitute inflation bias.

policy. This framework is also problematic not only owing to the issues emerging from the individual inflation and growth targets, but also from a combination thereof in a particular year, or over a period of time. To understand, how such combinations are senseless, it is imperative to briefly highlight the literature on the inflation-growth nexus to be able to relate it to the government's inflation and growth targets mix.

The relationship between inflation and growth is far from straightforward. For example, up till the mid 1970s, the Phillips Curve (positive relationship between inflation and growth) was popular, while the empirical evidence in the 1990s suggests a negative relationship [see for example, De Gregario (1992-93); Barro (1995) and Ireland (1999)]. One of the aspects of empirical evidence in the 1990s and 2000s, suggest a nonlinear relationship between inflation and growth [see for example, Fischer (1993); Sarel (1996) and Khan and Senhadji (2001)]. Divergence in the long and short-term effects of inflation on real growth is yet another dimension. For example, long-term inflation is believed to be negatively affecting growth, however in the short-run, monetary policy can be used to stabilise shocks to the real economy, which suggests a short-term positive relationship between the two.

Nevertheless, as can be seen from Figure 4, the government's assigned inflation and growth targets neither follow a consistent pattern, nor can guide monetary policy in a particular direction. These targets do not depict any consistent relationship that can be related to or inferred from the literature on inflation growth nexus evolved over time—a positive relationship of the 1960s and a negative (or) a non-linear relationship on-ward. Naïve combinations of inflation and growth targets on annual basis in the existing fashion hamper the conduct of monetary policy in an appropriate manner. It does not allow an effective and beneficial conduct of monetary policy, because of the unavailability of any underlying fundamental economic theory or practice.

Fig. 4. Combination of Government's Annual Inflation and Growth Targets
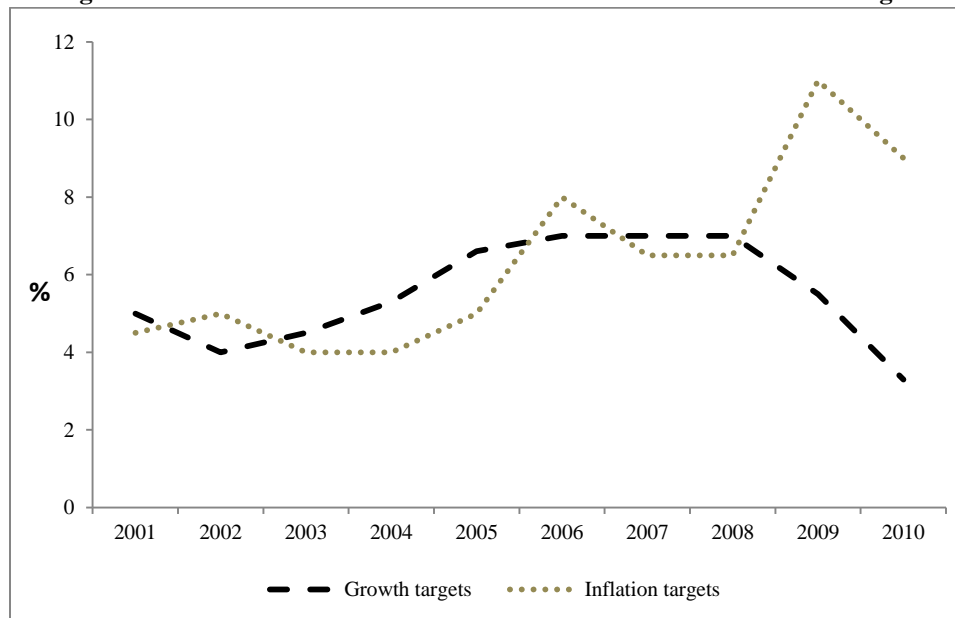
As highlighted earlier, the government's individual inflation targets does not provide an appropriate benchmark for the SBP's performance evaluation, a mechanism for its accountability on its basis therefore may not be designed. Similar is the case when combination(s) of inflation and growth targets at different points is considered. For example, a combination of divergent inflation and growth targets like that of Pakistan may not be achieved simultaneously on a period by period basis, especially, when there is a conflict between the achievements of the two.

Therefore, as a starting point, the fundamental flaws in government's inflation and growth targets-setting strategy need to be addressed. Indeed, the best way to do it is to set inflation targets in price stability consistent range of 1 percent–3 percent, while making the SBP strictly accountable for its achievement. As far as the growth side is concerned, the government may set growth targets for its own guidance. However, the SBP may not be required to take these into account due to monetary policy in effectiveness in terms of real growth [see Hayat (2014d) for empirical evidence on long-term monetary neutrality].[7] Nonetheless, like other central banks, the SBP may play its part to stabilise short-term shocks to the real economy, as long as the inflation stays within the price stability range and only that monetary policy intervention is deemed effective.

This will help build the SBP's credibility and in turn it may communicate with the public and private sectors more effectively for the achievement of price stability. However, all this would require amending the SBP Act to make price stability as the prime objective of the SBP, while holding it accountable for its achievement. Setting numerical inflation targets around price stability consistent rate of 2 percent from medium to long-term, could be an optimal strategy to help achieve both inflation and growth stability.

3. MONETARY POLICY DECISION MAKING

Section 9.1 of the SBP Act (1956, p.9) constitute that:

> The general superintendence and direction of the affairs and business of the Bank shall be entrusted to the Central Board of Directors, which may exercise all the powers and do all the acts and things that may be exercised or done by the Bank, and are not by this Act expressly directed or required to be done by the Bank in general meeting or annual general meeting.

One may clearly infer from the aforementioned statutes that the Central Board has been empowered hugely concerning the SBP's affairs. In light of the powers conferred via the Act, the Board is mandated to conduct the monetary policy, which is critically discussed in the proceeding sub-sections.

3.1. Mandate for Monetary Policy and SBP's Performance Evaluation

In case of Pakistan, Section 9A of the SBP Act (1956) vests the responsibility of the conduct of monetary policy with the Central Board to secure 'monetary

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[7]It is important to note that in practice central banks maintain clarity about inflation targets, whereas remain opaque about growth targets [Geraats (2006)].

stability and soundness of the financial system'.[8] The Board is undertaking multiple tasks, for example taking decisions related to the compensation packages of the staff, leave and promotion policies, budget approvals and so forth. Whether, it is the best practice for the SBP Board to spent time on such a huge portfolio, along with a highly specialised and demanding responsibility of the conduct of the monetary policy? In case of the Bank of England (BoE), such functions other than the monetary policy are instead, performed by the Court of Directors (composed of nine non-executive directors) appointed directly by the Crown. The court delegates day to day management of the bank to the governor and through him to other members of the executive, but reserves itself the right to agree on: the bank's strategy and objectives, expenditure budget, major capital projects, financial framework, risk management policies, approval of the accounts and the appointment of auditors. Also, the remit for management of the BoE's balance sheet, senior appointments within the bank, changes in remuneration and pension arrangements, the bank's succession plan, the establishment of sub-committees of the court, their terms of reference, and membership. The court keeps its procedures under close review and each year an annual effectiveness review is conducted on which a report is made to the court.

Further, in the case of the BoE, the Oversight Committee (a sub-committee of the Court) regularly reviews the performance of the BoE in relation to its objectives and strategy such as monetary policy objective, the financial stability objective, and any other objectives set by the court. Should there be such a practice of independent evaluation of the SBP's performance in terms of its objectives by a specialist body other than the Board is an open question. This needs a thorough intellectual debate on the appropriateness of the scope of the SBP Board given their capacity (see Sub-Section 3.3), formulation of any other independent specialist bodies and sub-committees, thereof in light of the best practices to ensure efficient and effective performance of the SBP's portfolio.

3.2. Issues with Monetary Stability as a Guiding Framework for Monetary Policy

Generally the central banks are given a certain mandate, predominantly price stability. Nevertheless, in some cases the mandate may be dual. For instance, in the case of the U.S., the Fed is mandated for price stability and maximum employment by statute. It is reiterated that the government do not quantify such a mandate, instead the FOMC considers 2 percent inflation as price stability consistent inflation rate, which in their view provides an enabling environment for the achievement of maximum employment in addition to other factors beyond its control. Therefore, the Fed despite being discretionary, in terms of duality of objectives has a clear inflation path to follow, the path of price stability.

Unlike the U.S., in case of Pakistan, the wording of the SBP Act when examined carefully, does not allow an appropriate path for the conduct of monetary policy. For example, the SBP Act (1956, p.10) says that:

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[8]The Central Board of Directors (also referred to as the 'Board') consist of the (i) the SBP Governor, (ii) Secretary, Finance Division, Government of Pakistan, and (iii) eight directors (at-least one from each province).

> The Central Board, in order to secure monetary stability and soundness of the financial system—(a) formulate and monitor monetary and credit policy and, in determining the expansion of liquidity, take into account the Federal Government's targets for growth and inflation and ensure that the Bank conducts monetary and credit policy in a manner consistent with these targets…...

Thus, the statutes guides that primarily the SBP should aim at 'monetary stability' and 'soundness of financial system'.[9] In order to assess if the Act provides a basic guiding framework for the monetary policy, a logical question arises that should 'monetary stability' be the prime objectives of the SBP's monetary policy instead of 'price stability'? If the ultimate goal of the monetary policy is to improve the living standards of people, is monetary stability or price stability the best way to raise their standards in an equitable fashion? To understand which framework between the two can best guide the monetary policy, they are assessed one by one as follows.

To start with, there is no tangible way to exactly define monetary stability for the purposes of monetary policy evaluation. Monetary stability is commonly referred to as the stability in prices, interest rate and exchange rate. Working with this definition, the main problem the existing framework poses is that it is hard to quantify monetary stability to provide an objective basis for conduct, evaluation and communication of monetary policy. Even if monetary stability is to be represented by stability in some measure of money, say growth in M2, then what is that particular growth rate or range of growth rates in M2 that would stabilise prices, interest rate and exchange rate at desirable levels? The flip side of the argument is that what are those unique rates in prices, interest rates and exchange rates that would help achieve monetary stability?

Another way to observe, if the notion of monetary stability can guide monetary policy is to analyse the issue in the context of the SBP's historical approach, which nevertheless—from an operational perspective—has been discontinued since August, 2009 after adopting the interest corridor system. The SBP used to set M2 targets consistent with the government's inflation and growth targets. Qayyum (2008) noted that if for example the government's targets for inflation and growth in a particular year are say 8 percent and 5 percent, respectively, the M2 targets would work out to be the sum of both the targets, which in this case would be 13 percent. Let's see if such a framework may help achieve monetary stability.

Figure 5 depicts the SBP's targets for growth in M2 along with the actual. Two observations are important. First, these targets per se; even if achieved 100 percent, may not represent monetary stability in anyway—as the spread of these targets is quite large ranging from 9 percent to 14 percent. Second, the volatility of the actual growth in M2 is very high—23 percent in terms of variance—to be deemed consistent with the notion of monetary stability. It therefore may not (1) induce any stability in the variables such as inflation, interest rates and exchange rates, (2) it is hard to be communicated to the public as it would not make any sense to them, and (3) it cannot be used as a benchmark for the purposes of monetary policy evaluation and accountability.

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[9]See Sub-section 4.1 for a discussion on potential conflict of interest that may arise due to the supervisory role of a central bank.

Fig. 5. Historical Performance of the SBP in Terms of the Statutory
Monetary Stability Mandate

M2-Targets (%) —— M2-Actual (%, Secondary axis) — —   Source: Omer and Saqib (2009)
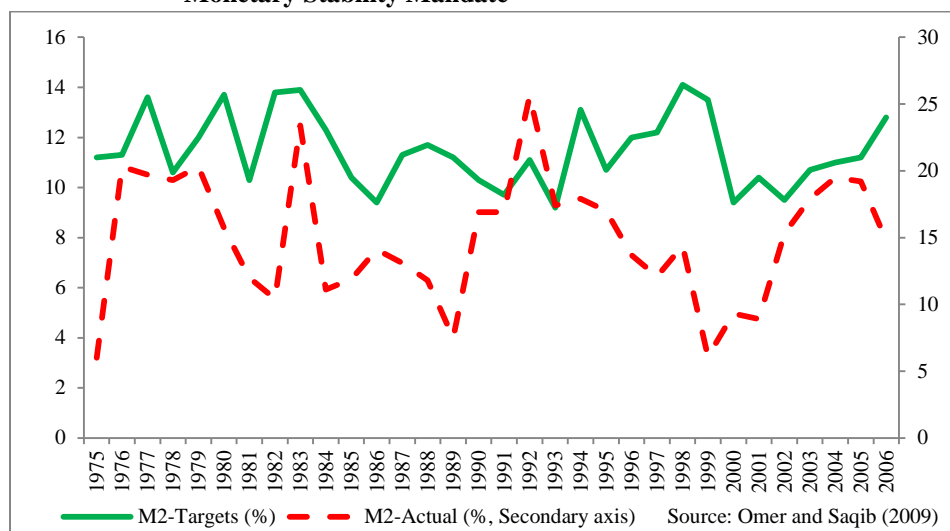
On the contrary to the SBP statute regarding monetary stability and soundness of financial system, a widely acknowledged and popularly practiced notion is that of 'price stability', as it helps raise the standards of living of the people. Price stability allows an economic system to operate more efficiently, while producing higher levels of output and rapid economic growth, [Mishkin (1997)] hence raising the standards of living of the society. Conversely, the absence of price stability generates high costs to society. These costs may be diverse, ranging from the 'shoe leather' costs [Bailey (1956)] to the loss of output [Groshen and Schweitzer (1996)].[10] Considerable work of both theoretical and an empirical nature has been done, either to justify the importance of price stability, or to highlight the costs associated with price instability [see Fischer and Modigliani (1975); Fischer (1981); Briault (1995); Hatch, *et al.* (1998) and Mishkin (2006)]. Indeed this is why the Reserve Bank of New Zealand (RBNZ) Act (1989, p. 27), unambiguously put it in the words that "the primary function of the Bank is to formulate and implement monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices".

On the back of the aforecited literature and practice, let's consider if the price stability in contrast to the existing monetary stability framework allows an objective basis for conduct, evaluation and communication of the monetary policy. As discussed earlier in Sub-section 2.2, that price stability is generally quantified in terms of inflation rate at or close to 2 percent. Hence, this is easily communicated to the public and at the same time, it allows a benchmark for monetary policy evaluation and accountability.[11] Since

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[10]Also see English (1996) for the shift of resources from productive use to non-productive use due to inflation.

[11]It may be noted that there may be a slight difference in the practice, for example some countries may consider a range of inflation say from 1 percent to 3 percent as appropriate for achieving price stability. The issues related to the choice of a particular indicator of inflation, i.e. headline or core inflation is beyond the scope of current paper.

price stability implies low variability in inflation, it in turn stabilises variations in the interest rate, exchange rate and money growth. The flip side is that the central banker should aim to stabilise interest rate, exchange rate and money growth at levels that ensure price stability. Therefore, the statutory primary goal of the SBP should be the achievement of price stability and the rest would automatically fell in place.

3.2. The Board and the Governor

Section 9.2.C of the SBP Act (1956, p.9) confers the responsibility of running the affairs of the SBP business with the Board (including the governor), "who shall be eminent professionals from the fields of economics, finance, banking and accountancy, to be appointed by the Federal Government". This covenant of the SBP Act to some extent appears consistent with theory, nevertheless, a brief discussion on the profiles of monetary authorities from other central banks as well as theory may help in inferring as to who such 'professionals' should be?

In order to draw some lessons from, a review of the profiles of some of the central bank's decision making bodies, explicitly indicate that their board members and the governors are eminent economists with impressive profiles, with the highest terminal degrees (PhDs) largely with relevant specialisation, and a wide range of research publications in high ranked international journals. For instance, in the case of the U.S., out of the 12 FOMC members, ten have completed their doctorates in Economics and also carry impressive research profiles in the field of monetary policy. Most of them are working as editors of esteemed economic journals and honoured for their publications in the world's highest ranked journals. Moreover, two members of the FOMC are eminent law professionals who have been serving as editors of esteemed law journals.

Similarly, taking an example of the developing economy like Turkey, all the members on their central bank board including governors have doctorates in Economics and have published research papers in highly ranked journals. Even in the Reserve Bank of India (RBI) four out of the 10 Board members have PhDs with profound profiles in terms of their publications and relevant research. Again, the governor (chairman) of a central bank is normally an economist of a high repute. For instance, in the case of the U.S., historically there have been big names like Alan Greenspan, Ben Bernanke and so forth. On a similar note, even the current governor of the RBI has a renowned profile with impressive publications and is an internationally recognised figure in the relevant field.

The theoretical literature on who should be granted the authority for the conduct of monetary policy can broadly take two forms that can practically be implemented. The first form is that of the incentive contract which is considered as an arrangement between the government and the central banker.[12] Under such arrangements, the policy maker is given a target rate of inflation and is rewarded or punished on the basis of its achievement/non-achievement.

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[12]Incentive contracts are covered in Canzoneri (1985), Garfinkle and Oh (1993), Persson and Tabellini (1993) and Walsh (1993 b, 1995b).

Second is the delegation of the conduct of monetary policy authority to a weight-conservative central banker.[13] For instance, Rogoff (1985) proposed the delegation of monetary policy authority to an independent central banker who is inflation-averse. Such a central banker puts more weight on inflation and less on the output resulting in lower inflation bias, but the output variability may increase, especially when the supply shocks are large. Several studies extended the idea of delegation including Flood and Isard (1989); Person and Tabellini (1990, 1993); Alesina and Grilli (1991); Lohman (1992); Cukierman (1992) and Svensson (1997a). Romer and Romer (1997) added that the conduct of monetary policy should be delegated to knowledgeable persons who are adept in the evaluation and maximisation of social welfare. Such experts can better and faster incorporate the advances of knowledge in the monetary policy decision making process. Therefore, in most of the countries, the authority of the conduct of monetary policy has been delegated to high profile economists normally to inflation fighters, who in turn demonstrated greater performance in terms of ensuring price stability. For example, after the great inflation of the 1970s, almost all the advanced countries, inflation targeters and most of the emerging and developing economies have managed to bring down inflation rates to 'price stability' consistent levels, and have successfully sustained them.

Thus, the world has learnt that vesting the responsibility of the conduct of monetary policy with eminent professionals, especially the 'hawks' instead of 'doves' have yielded beneficial results. Such results can be witnessed in terms of a reduction in inflation persistence [see Siklos (1999); Kuttner and Posen (1999-2001); King (2002) and Petursson (2005)], a reduction in inflation variability [Levin, *et al.* (2004); Lin and Ye (2009)], a reduction in inflation expectations [Johnson (2002)]. Similarly see Corbo, *et al.* (2001); Neuman and Von Hagen (2002); Levin, *et al.* (2004) and Peturson (2005) for a reduction in growth variability.

In view of the above, it is imperative for the Government of Pakistan to implement the relevant clause (in the SBP Act) in letter and spirit, regarding the delegation of the conduct of the monetary policy. It should be delegated to 'hawks' rather than 'doves' with terminal qualifications in Economics, preferably with specialisation in monetary policy along with a demonstrated research excellence and international exposure. This will greatly help improve the monetary policy practices at the SBP and hence its performance, and credibility to yield desirable results.

4. THE CONFLICT OF INTEREST

There are three major areas of Pakistan's monetary policy design, where potentially the conflict of interest issue may arise at different levels from different perspectives. Its' identification and discussion is nontrivial in the sense that it does affect the performance and the credibility of the SBP in conduct of monetary policy. First, the conflict of interest that originates due to the supervisory role of the SBP. Second, the conflict of interest that arises due to the explicit role of the government representatives in the affairs of monetary policy. Third, the conflict of interest that emanates from the market affiliation of the monetary policy decision makers. In any form, the conflict of interest is not deemed desirable, as it potentially risks the appropriate conduct of monetary policy.

[13]A weight-conservative central banker is the one who gives more weight to inflation as compared to output in the conduct of monetary policy.

4.1. The Conflict of Interest Due to the Supervisory Role of the SBP

Since 1990s, there has been a debate on the conflict of interest arising from the duality of the monetary policy and supervisory objectives of a central bank [Whelan (2012)]. The main theme emerges from the argument that the conflict of interest between the monetary policy, and the regulation of the banking sector may lead to inflation bias [see Noia and Giorgio (1999); Lim, *et al.* (2012)]. The idea is that a central bank will remain flexible on the inflation objective if it fears that tight monetary policy may affect the profitability and soundness of the banking sector [Goodhart and Schoenmaker (1993-95)]. Although, the debate is yet to reach to a conclusion, it is important to take into account, the potential inflation bias implications for higher average inflation in Pakistan as the SBP is also responsible for financial stability i.e., "The Central Board shall, in order to secure monetary stability and soundness of the financial system…" [SBP Act (1956)]. In case of a conflict between the inflation objective and financial stability, if the SBP chose to be flexible on the former, it may render its inflation fighting credibility tenuous, and in turn any communication to contain inflation would potentially be ineffective. As a solution to this problem, Blinder (2010) suggests that a central bank should rationally balance these competing objectives and who else other than the central bank can best do the job.

Since, there are divergent views as to whether the central bank should have both the monetary policy and supervisory objectives, the practice also varies. For example, in the case of the BoE, the Prudential Regulation Authority (PRA) is a separate body with distinct objectives from the Monetary Policy Committee (MPC).[14] Consistent with public law, its regulatory decision-making is rigorous and well documented, and its Board take the decisions while comprising the governor of the BoE, the deputy governors for financial stability and markets and banking, the chief executive officer of the PRA, and the independent non-executive members of the Board. The PRA Board is involved in the most important decisions on general policy and individual cases. Like the MPC, it is also accountable to the parliament. It is important to mention that the MPC in contrast to the PRA Board constitutes nine members including the governor, the three deputy governors, the bank's chief economist, and four external members appointed directly by the Chancellor. The appointment of independent members is designed to ensure that the MPC benefits from thinking and expertise in addition to what has developed in the BoE. Therefore, by construct, the room for the conflict of interest between monetary policy and banking supervision is minimised, because in the case of the MPC all the members have the right to vote.

On the contrary, in the case of the U.S., the supervisory role of the Fed is vested with the seven members Board of Governors, whereas the Fed's monetary policy decision making authority is the FOMC, which adds five non-voting Reserve Bank presidents to the Board of Governors. Although, these presidents attend the meetings, participate in the discussions, and contribute to the Committee's assessment of the economy, and policy options, they do not have the right to vote. Therefore, effectively the BoE is more insulated from the conflict of interest issue as compared to the U.S., as in the latter case, essentially the Board of Governors take the decisions both for monetary policy as well as for regulation.

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[14] It may be noted that PRA, although part of the BoE is the prudential regulator for deposit-takers, insurance companies and designated investment firms.

4.2. The Conflict of Interest Due to the Government Officials' Presence on the Board

Since long it is recognised that a central banker should be independent of the fiscal dominance, especially in an operational sense, but at the same time it should be strictly accountable in terms of its objectives. Most of the countries have therefore streamlined their legislative frameworks in a way that the role of the government in monetary policy making is eliminated. It is quite possible that the directions from government may undermine the monetary policy for the achievement of its short-term designs, which may be in conflict with the monetary policy objectives. In order to close the doors for such potential exercises, most of the governments through explicit legislation have discouraged the presence of government representatives in the monetary policy decision making process. In case of any such presence, the voting rights are not granted to the government official, but his (her) presence is meant for the provision of information on the fiscal side. For example, in the case of the BoE, a treasury representative is allowed to sit in the meetings to discuss policy issues, but is not allowed to vote. The purpose is for the MPC to be fully briefed about the fiscal developments.

As can be seen from Table 1, column (a), in majority of the standard monetary policy cases there are no government officials on the central banks excluding Pakistan, which does not seem to be in conformity with the relevant statutes in Pakistan. For instance, Section 9.2.C of the SBP Act (1956, p.9) clearly states that "those appointed to the Board shall have no conflict of interest with the business of the Bank". The presence of government officials on the board undermines the credibility of the central bank, and hence, the effectiveness can be achieved in monetary policy communications. The central banks in turn are not able to effectively anchor inflation expectations to maintain price stability.

In order to minimise the direct involvement of the government in central bank affairs, many countries have also designed the term structure of their boards and governors in a way that it is longer than the term of the governments per se. As can be observed from Table 1, columns (c) and (d), with a few exceptions including Pakistan, the term of the central bank's board members and governors is higher than the terms of the elected political parties in their respective countries.

Such legislative arrangement potentially frees the board members and the governor of the worries of reappointment. They are then in a better position to formulate the monetary policy more independently to achieve medium to long-term price stability, instead of pursuing government's short-term objectives that may not necessarily be beneficial for the society. It is also pertinent to mention that for better results, these countries have explicitly provisioned in their respective statutes for the accountability of their central banks (see Table 1, column (f)). If such provisions are not in place, there would be no pressure on the board and the governor to conduct monetary policy in the best possible manner to yield better results. Holding the central bank accountable for price stability is indispensable for better functioning of the SBP. It will lead to improve the inflation performance of the SBP, and will help in credibility build-up to enhance the effectiveness of monetary policy and its communication.

Table 1

Central Bank Laws and Practices: Policy Types

Country (See note below)	Government Officials on Board (a)	Final Authority (b)	Term of Members (c)	Term of Governor/ Chairman (d)	Proportion of Policy Board Appointed by Government (e)	Statutory Accountability of the Board/ Committee for Inflation Targets/ Price Stability (f)	Governor/ Chairman/and Deputy Governors (PhDs or not) (g)
Australia	1	g	5	7	1	Yes	Yes
Belgium	0	g	6	5	1	Yes	Yes
Canada	0	b(1967-) g(1967+)	3	7	12/14	Yes	Yes
France	0	g	6	U	12/13	Yes	Yes
Italy	0	g	3	3	1	Yes	Yes
Netherlands	0	g	7	7	1	Yes	Yes
Sweden	0	g	3	3	1	Yes	Yes
United Kingdom	0	g	4	5	1	Yes	Yes
Japan	0	b	4	4	1	Yes	Yes
United States	0	b	14 (N)	4	10/21	Yes	Yes
Germany	0	b	8	8	1/5	Yes	Yes
Switzerland	0	b	4	8	1	Yes	Yes
New Zealand	0	g	5	5	1	Yes	Yes
India	1	g	4	4	1	Yes	Yes
Pakistan	1	g	3	3	1	No	No

Source: Bade and Parkin (1988) and author's search from central bank's websites.

Notes: (a) number of (or their representatives) who sit on bank board.

(b) b = bank; g = government.

(c) years (N = not eligible for re-election).

(d) u = unlimited term.

(e) number represents proportion of members appointed directly or indirectly by the government .

4.3. The Conflict of Interest Due to Board Member's Market Affiliation

Given the sensitivity and demanding nature of the job, almost all the governments make sure that extremely competent and capable people are appointed on the boards of central banks. Normally, the board members including the governor are high profile specialists from academia or research organisations with demonstrated research excellence. Such appointments on one hand, allow mitigation of the conflict of interest, and on the other, ensure rational and long-lasting beneficial monetary policy decisions. The appropriate conduct of monetary policy requires an in-depth research base to be able to comprehend, understand and apply advancements in the knowledge, while taking policy decisions. Moreover, the board has to be technically sound as in some cases it has to review the performance of the bank as well as the governor. For instance in case of New Zealand, the RBNZ Act, 1989 on its page 50 Section 53 (1) binds the Board to (a) keep under constant review the performance of the bank in carrying out:

> (i) Its primary function; and (ii) its functions relating to promoting the maintenance of a sound and efficient financial system; and (iii) its other functions under this Act or any other enactment: (b) keep under constant review the performance of the Governor in discharging the responsibilities of that office: (c) keep under constant review the performance of the Governor in ensuring that the Bank achieves the policy targets agreed to with the Minister under Section 9 or Section 12(7)(b).

In case of Pakistan, however, contrary to the prevailing best practices across the globe, positions of the Board members including the Governor do not seem to be filled with eminent professionals in the field of Economics with terminal qualifications and high research profiles. Such appointments on one hand, allow a leeway for inefficient conduct of monetary policy and on the other hand, for the potential conflict of interest. For example, one of the current Board members has an explicit affiliation with a corporate financial and advisory house in the country. He has worked with various commercial banks being regulated by the SBP, hence pointing towards a potential conflict of interest issue. Similarly, another Board member has affiliation with a firm providing consultations in the realm of banking, mergers and acquisitions, corporate and financial restructuring, and Islamic modes of financing. The conduct of such activities, although in private capacity is somehow indicative of the conflict of interest, when viewed in light of the business of the SBP. Notwithstanding, the governor is not an economist, a non-specialist and is affiliated with the banking sector, which again is in clear conflict with the statutes. Such appointments to the Board, where potential conflict of interests are involved need to be avoided, in case it may adversely affect the credibility and the effective functioning of the SBP.

5. DISCLOSURES AND PUBLIC ECONOMIC INFORMATION

Given the fact that public demands transparency from public institutions and that information increase the expected utility of decision makers [Blackwell (1953); Issing (2005, p. 67)] asserts:

> A central bank should be well advised and even be legally obliged to publish all internal documents and data, in particular those that are instrumental in its monetary policy decisions and relate to its status of independence. Such obligations of accountability would then also encompass information regarding the decision making process itself, any differences of opinion, consensus agreements, a majority voting behaviour, etc.

The subsequent sub-sections assess the existing level of transparency and efficacy of public disclosures and economic information of the SBP.

5.1. Disclosure of Profiles, Minutes and Voting Records of the Board

With increasing transparency, proper disclosure is one of the increasing central banking practices. The disclosure of the profiles of board members, minutes of the meetings of the board, voting records, and in some cases even the transcripts are released for public consumption. The FeD, the BoE, RBNZ, Central Bank of the Republic of Turkey are a few glaring examples amongst others. Although, no consensus has been reached yet as to what constitute the optimal way of disclosure. Central banks today are more open and transparent, and are continuously in the quest to achieve the best possible standards.

Modern central banks share detailed profiles of monetary policy authorities as well as minute details of how they reached on certain policy decision(s) with the public. Nevertheless, exceptions such as SBP do exist where detailed profiles of the SBP's Board may not be tracked to determine, if the government has chosen eminent professionals

capable of discharging the important responsibility of the conduct of monetary policy to foster public's confidence. The SBP only display their names, photos and dates of their respective terms on the official website. Since, this opaqueness is in sharp contrast to the spirit of transparency which potentially undermines the SBP's credibility.

Like the disclosure of the detailed profiles of the board members, publication of detailed minutes of their meetings is equally important. In many countries the monetary policy decisions are taken by a committee/board. The minutes of such meetings give valuable insights into the arguments raised and the underlying considerations that drove the policy decisions [Geraats (2005)]. Advanced countries central banks such as the FeD, the BoE, Bank of Japan and ECB publish minutes to help the public develop a better understanding of the monetary policy implementation strategy, and predictability of monetary policy actions.

The SBP initiated publication of the minutes of the then MPC in November, 2009, however discontinued the practice in January 2011. The publication of the minutes has been resumed since January 2014 which might be due to encouragement by the IMF, while being in the programme in this period. The minutes of the Advisory Committee on Monetary Policy (ACMP) and the Board have been made available on the SBP's official website; however, these are as brief as one and a half pages. It does not provide sufficient information to understand the underlying motivation (justification) in favour of or against a particular monetary policy decision, hence compromises the very spirit of the publication of minutes.

As is practiced in the advanced countries, the monetary authorities go to great lengths to elaborate their thinking and decisions, which is reflected in minutes. They provide a full account of the policy discussions along with the differences in points of view. Such minutes are normally made available within a week or two after the meeting. Greater publicity of information reduces the costs of the market of being informed and helps intensify the debate about the way the policy decisions are made. It also makes it easier for the public to check the outcomes against intentions [Goodfriend (1986)].

Since there is no consensus as to what should ideally be the length of such minutes, streamlining this exercise in line with the international standard practices and acknowledging communication of minutes, and voting records as a part of the SBP's monetary policy communication strategy may be helpful. Of course that would first require a clear and well drafted, communication and disclosure policy in light of the recent research on transparency and practices of other central banks. Besides, publication of voting records could also add to the effectiveness of monetary policy communications. Further, the availability of transcripts of the important monetary policy related meetings could strengthen the credibility of the SBP.

5.2. Forecasts

Publication of the central bank forecasts gives the public and private sectors an understanding of the central bank's perception of the macroeconomic outlook, stochastic shocks, preferences, [Chortareas, *et al.* (2002)] as well as the future state of the economy. High levels of transparency in terms of information disclosure reduces information asymmetries that leads to effective conduct of the monetary policy and enhances market efficiency—because the market can better evaluate the risks and

therefore may take informed (optimal) decisions. Cornand and Heinemann (2008) noted that not only the market responds to central banks' signals but assigns it more weight than is justified by its informational content. This might be due to the superiority of the central bank information over the private sector [see Romer and Romer (2000) for empirical evidence].

Given that the public information is welfare enhancing both for the public and the private sectors [Morris and Shin (2002)], utmost effort should be made to attain the highest possible levels of precision as well as publicity. This is important not only for welfare enhancing reasons, but also for the reason that at the same time such disclosures may harm instead, if the expectations are coordinated away from the fundamentals [Amato, *et al.* (2002)]. As argued by Hayat (2014d) and can be inferred from the discussion in the current paper that Pakistan's overall monetary policy framework does not support a forward looking approach, but the SBP does publish projections of macroeconomic indicators such as GDP, CPI inflation, money supply (M2), workers' remittances, exports, imports, current account deficit, and fiscal deficit in its quarterly reports mainly covering a one year period. Some of these projections are model based forecasts such as CPI inflation, exports and imports. However, for the rest of the projections the mechanism is not clear.[15]

Other than the appearance of the projections of key variables in the quarterly reports, normally a one year projection for inflation appears in MPS. Since, a forward looking monetary policy mainly focuses on medium to long-term path of inflation, development of sophisticated DSGE models, GTAP, structural and nonlinear VAR models as well as ARDL models may be a useful exercise to start with and publish medium to long-term forecasts accordingly.

It is however important to note that due to the scarcity of quality human resources, highly equipped with sophisticated skills that can solely be dedicated to do the job (see next section for a brief discussion on this point). The SBP may not start publication of reliable medium to long-term forecasts unless serious measures are taken to retain, encourage and acquire quality human resources, such as PhDs to enhance the SBP's performance. This nevertheless is a structural issue, which requires a change in the mind-set of the SBP's top, upper and lower tier management. The SBP's job is mainly operational and its conduct does not necessarily require a full-fledged scientific research. This static approach has recently led the SBP to lose an incredible number of foreign qualified PhDs, having specialised in relevant areas to the SBP's functions, as they find the incentive structure and work environment outside the SBP, both in government and private sectors way more lucrative.

5.3. MPS and SBP's Major Publications

MPS is the major policy document issued by the SBP every six months. The first MPS appeared on the SBP website covered the period from July-December, 2005. This document gives a brief outlook of the global as well as domestic economy, and announces a monetary expansion of 13 percent to achieve the inflation and growth targets of 8 percent and 7 percent, respectively. Backward in nature, this MPS mainly discussed trends in sectors and indicators

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[15]It is also pertinent to mention that the practice of publication of these annual projections seems to have been discontinued after the second quarterly report for the FY14.

such as monetary and credit sector, external sector, and inflation and interest rate indicators. Nevertheless, a review of the most recent MPS for the January 2015, a 25 pages document, reveals a considerable improvement in terms of coverage and extensiveness of information. It discusses, relatively at a greater length, both the global and domestic developments and their outlook. It also covers a detailed trend analysis of all the key sectors of the economy such as, monetary, fiscal, external and real sectors and informs that the board has decided to reduce the SBP policy rate by 100 basis points.

It is however surprising to note that after the lapse of almost ten years that the SBP has started publication of the MPS, its quality needs significant improvement, especially in terms of the forward looking element, substantive coherent arguments and linkages. Khizar (2015) recently criticized the MPS issued in November, 2015 stating that:

> The narrative which accompanied the decision is poor as the policy note falls short of explaining its rationale. Instead, it reads as a sycophantic review of the glorious past. Year-to-date inflation numbers and other macroeconomic statistics are quoted but with little attempt to delve into any deeper analysis of their causes and impact….The policy note was silent on the global outlook implying that the country's economy is insulated from global factors…What is the MPS take on the pressures on the currency and its linkage to interest rates? How has the decision of the US Federal Reserve to raise rates in December impacted the economy? Will this hike impact global currencies and commodity prices and what will be its consequences on Pakistan's trade balance and currency? What is the future outlook and how will the policy decision in Pakistan manage these changes? Is the stance dovish or hawkish? What is the rationale behind maintaining status quo in the policy rate? The policy note is not depicting any leaning and there is nothing to read between the lines. This may imply that the central bank is either, short of good staff to set the policy or the lack of interest of the institution in spelling out, a meaningful policy note….

Improvement might not be possible unless a reasonable resource base is attained both in terms of human resources as well as technology.[16] For example, there are only a few PhDs in the monetary policy department as well as the entire SBP, which does not allow a thorough and robust research on bits and pieces to help provide meat for the MPS. On a head count, there are only five PhDs in the monetary policy department including the director, which is less than the Economics Department of the Institute of Business Administration (IBA).[17] The total number of the PhDs in the entire SBP is not even half the number of PhDs with specialisation in Economics and Finance in the Pakistan Institute of Development Economics (PIDE). The acute scarcity of quality human resource in the SBP is also evident from both the quality and quantity of the research outputs available on its website.[18] Further, one may hardly find references of the

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[16]In terms of technology, for example, in addition to the EViews, the provision of commonly used fundamental econometric research tools such as MICROFIT, SAS and GTAP, as well as referencing software like End Note may be helpful. Acquisition of the LATEX as well the training of the staff on such tools is crucial for policy research.

[17]The total number of PhDs in the Research Department of the SBP including Director is six.

[18]An independent evaluation of the quality and quantity of its policy notes, research outputs and regular publications by international specialists in the field may help the SBP to assess its level and efficacy. A similar evaluation is conducted by the Bank of Canada [see Meyer, *et al.* (2008)].

published research, either from the SBP staff or from academia in the SBP's major publications; such as Quarterly and Annual Reports to support the arguments made therein, which is a reflection of the poor quality of these publications. There is only one PhD in the SBP's relevant department—Economic Policy and Review Department (EPRD)—responsible for publication of Quarterly and Annual Reports on the state of the economy.[19] In contrast to this acute dearth of PhDs in the SBP, in the U.S., for example, there is a huge resource base even at the staff level with almost 350 PhDs—each one having a quality research capability as is reflected by their research profiles and research outputs.

Since, the monetary policy communications such as the MPS are crucial and at the same time meant to inform the public to build their confidence—that the monetary policy decisions were taken after having developed a thorough understanding of the underlying dynamics of the global and domestic economy and the linkages therein. A mere mention of the developments in the global economy, say for example in the case of Euro Area, Japan and the U.S., may not be sufficient, unless these developments and their potential impact could very well be connected to the domestic economy, and then to the goal variables. Similarly, a mere mention of the developments and outlook of the important sectors of the domestic economy may not constitute a useful central bank communication (MPS), unless properly linked together to indicate a support for the particular increase/decrease in the policy rate.

It is also important to connect more objectively (on the back of extensive impact analysis), whether the decisions taken previously were translated into the key macroeconomic indicators as well as to the goal variables such as, inflation and growth. Further, what would be the possible courses taken by the monetary authorities in case of any variations in the contemplated global and domestic circumstances as well as deviations from the targeted goal variables. Since, the MPS is essentially meant for the forthcoming six months period, the document should be able to provide some insights in a forward looking manner, while highlighting both the short and medium term projections, and the possible impact of the underlying monetary policy decision(s) over horizon(s). It should also review if the past decisions have been able to yield the desired results in terms of the goal variables, if not, why not and what steps have been taken to make the policy more effective?

6. CONCLUSION

There is a wide agreement that increased transparency in monetary policy decision making processes and communication has considerably enhanced central banks' performances across the globe. Today's central banks are in a much better position to anchor inflation expectations. This paper critically assesses the state of Pakistan's monetary policy transformation, in terms of transparency and openness, especially in terms of statutory objectives, monetary policy mandate, conflicts of interest, disclosures, and dissemination of effective public economic information.

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[19]It is important to highlight that EPRD hardly does any research-based analysis or review of existing economic policies as is envisaged by its name. Instead an ex-post backward-looking trend-based analysis of various sectors of the economy is provided in its Quarterly and Annual reports.

The assessment indicates that the SBP Act, 1956 does not provide any effective guiding framework in terms of monetary policy objectives and mandate. The inflation and growth targets setting strategy of the government is intrinsically flawed, leading the economy away from the path of price stability, which is considered crucial for a sustainable economic growth. It does not allow appropriate benchmarks for the monetary policy evaluation and accountability. Further, the Act does not put an explicit mechanism to insulate against the conflict of interest issues, originating from the dual supervisory and monetary policy role of the SBP, market affiliations of the Members of the Board and the Governor as well as fiscal dominance.

If the SBP has to adapt to the needs of the modern central banking practices, serious and constant institutional capacity and credibility building measures will have to be taken. This, in the first place requires a change in the static culture of the SBP. Implanting qualified human resources at the top, middle and lower tier managerial levels could play an instrumental role towards the organisational change.

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