The Changing Face of Central Banking: the Great Reversal

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Motivation

- After the **Financial Crisis** politicians in several countries reconsidered – and still they are reconsidering - the features of their supervisory architecture and the role of the central banks
- Three **(intertwined)** key questions: How to **design** the supervisory architecture? How to **involve** the central bank? How to **define** the authority governance?
- Conclusion: We are observing a sort of "**Great Reversal**" which challenges the **Mainstream**
- Approach: Theory, Institutions and Empirics

Background Articles

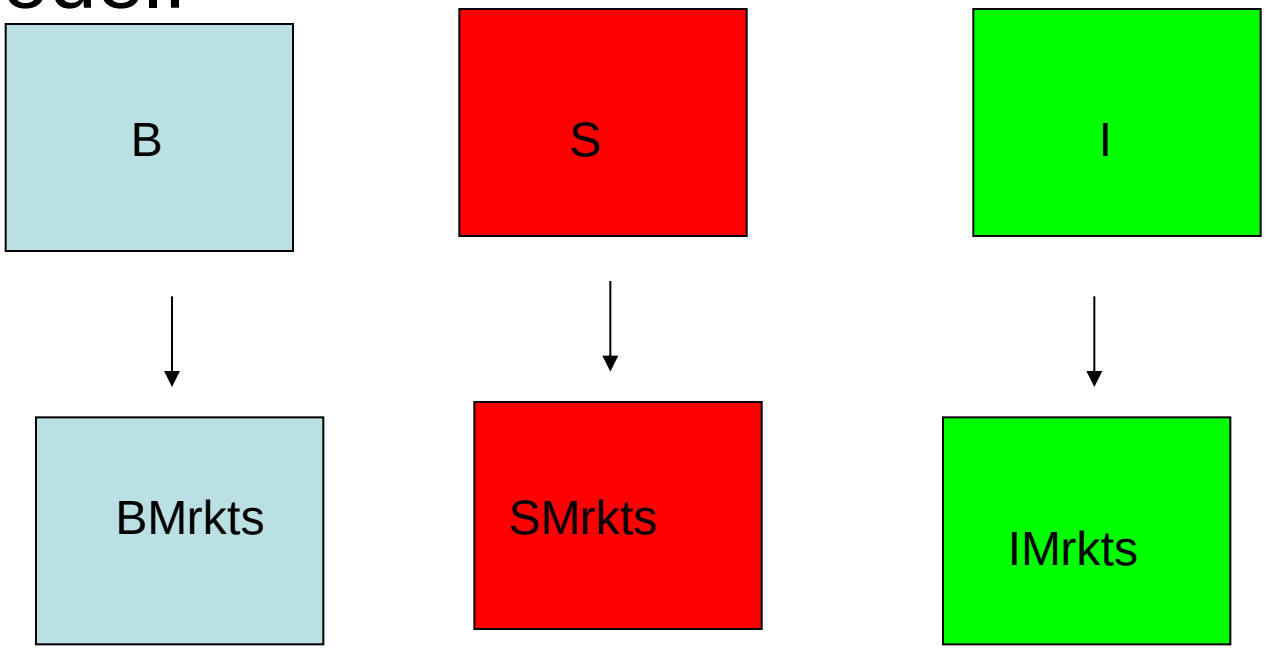
- Financial System Risk: Taxation or Regulation?, *Journal of Banking and Finance*, vol.37, n.2, 587-586, 2013, (with Francesco Passarelli).
- The Economic Crisis: Did Financial Supervision Matter? *IMF Working Paper Series*, n. 261, 2011, International Monetary Fund, Washington (with Rosaria Pansini and Marc Quintyn), forth. in *Journal of Financial Stability*
- Exploring Governance of the New European Banking Authority: a Case for Harmonization?, *Journal of Financial Stability,* .Vol. 7, n.4. 204-214, 2011 (with Maria Nieto and Marc Quintyn)
- Reforming Financial Supervision and the Role of the Central Banks: a Review of Global Trends, Causes and Effects (1998-2008), *CEPR Policy Insight*, n.30, 1-11, 2009, (with M. Quintyn)
- Politicians and Financial Supervision outside the Central Bank: Why Do They Do it?, *Journal of Financial Stability*, volume 5, n.2, 124-147, 2009
- Inside and outside the central bank: Independence and Accountability in Financial Supervision: Trends and Determinants, *European Journal of Political Economy.* Vol. 24, n.4. 833- 848. 2008 (with M. Quintyn and M. Taylor)

Before the Crisis

- **Three** Trends:
- Supervision: **Consolidation**
- Central Bank Role: **Specialization** as Monetary Policy Agent
- Governance: **Independence** and **Accountability**

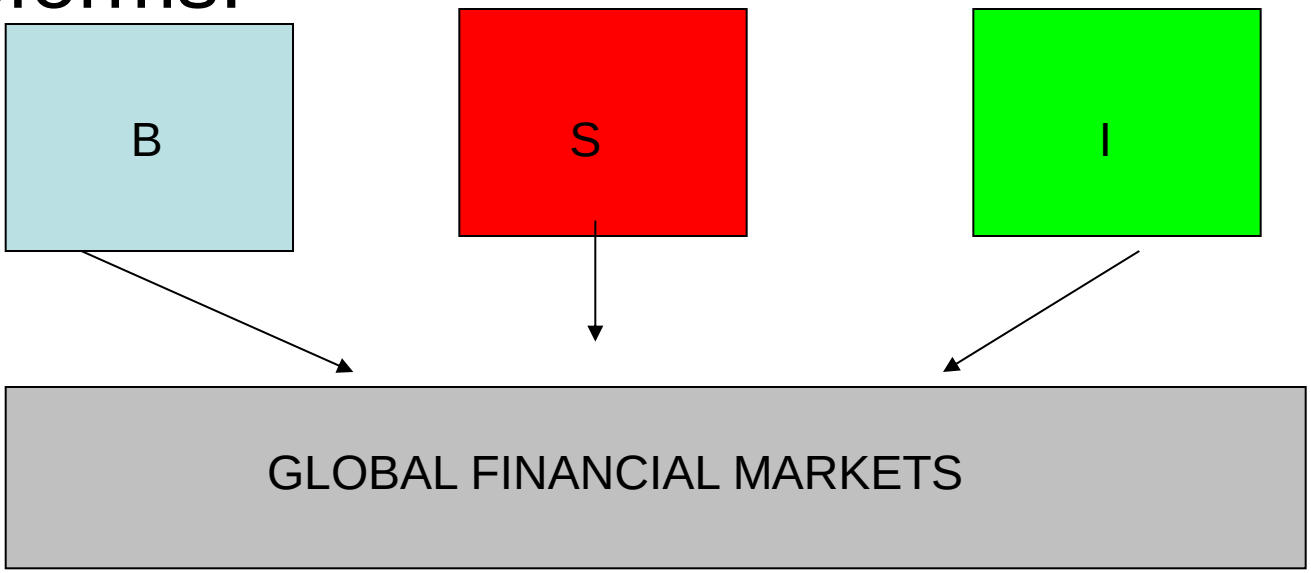
1) Supervision

- Traditional Model: Multi-Authorities (**Silos**) Model:



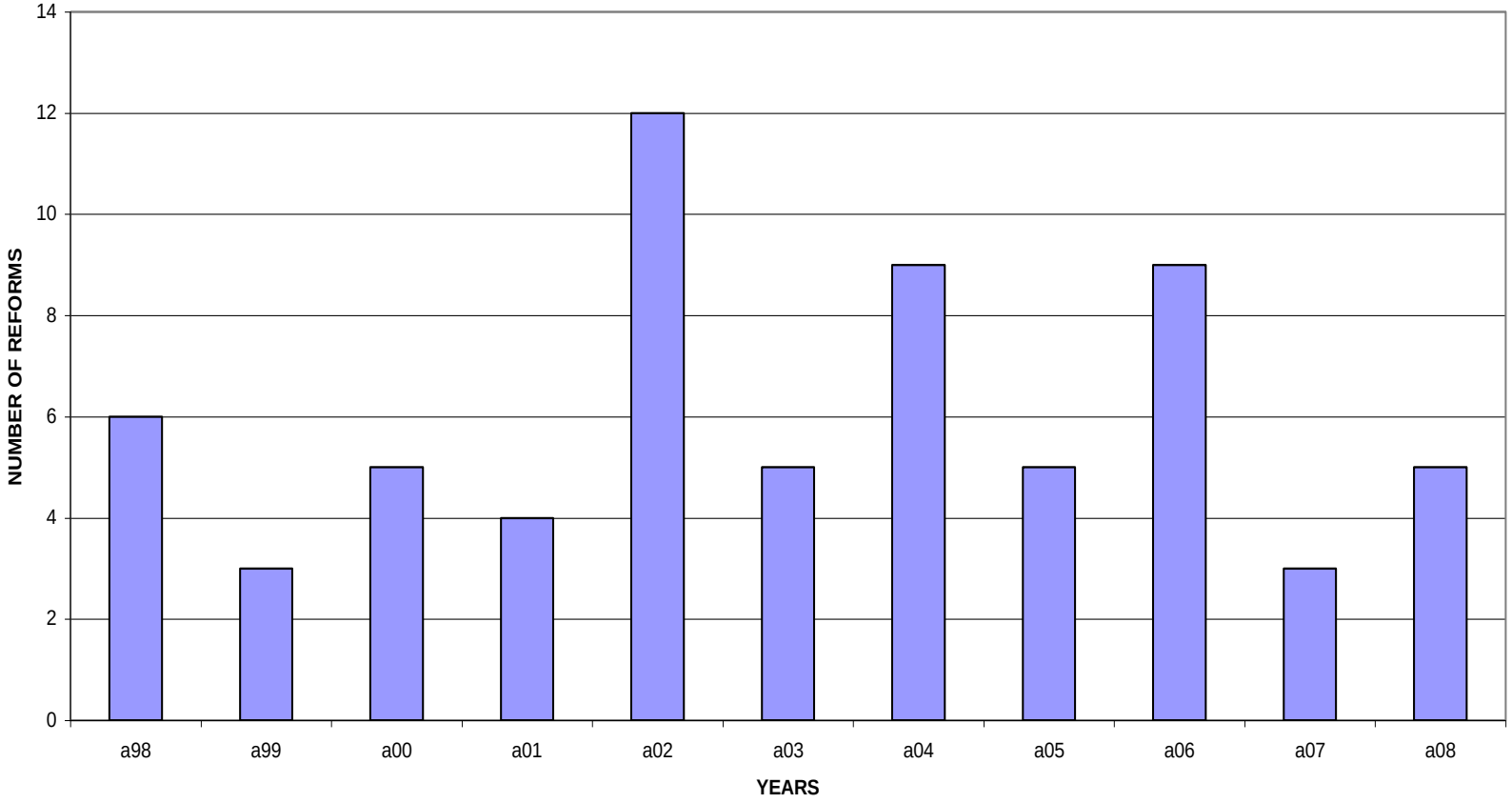
1) Supervision

- But integrated markets call for supervisory reforms:

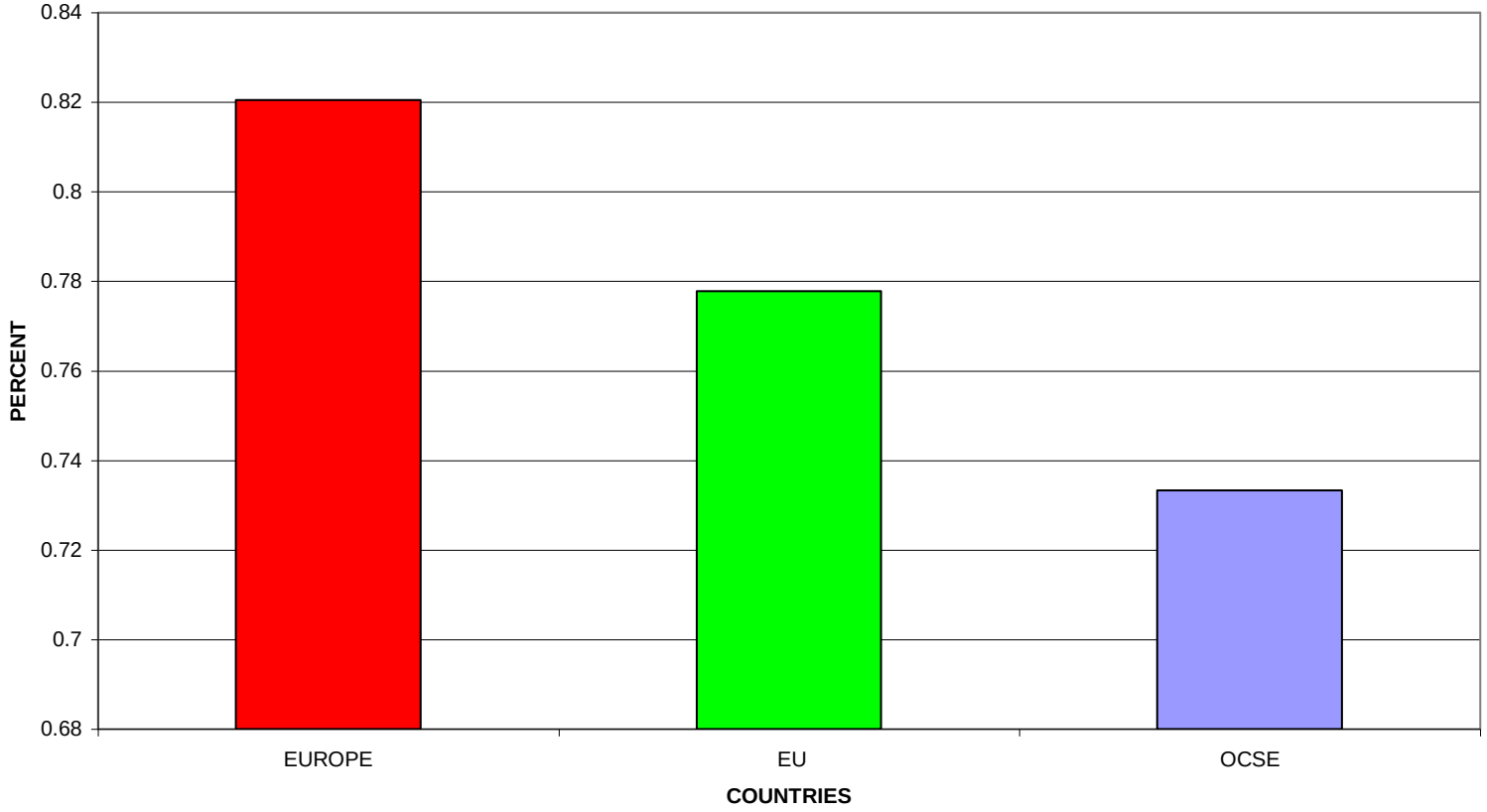


A wave of reforms …

FIGURE 1 REFORMS OF THE SUPERVISORY ARCHITECTURES PER YEAR (1998-2008)



… In the OECD countries

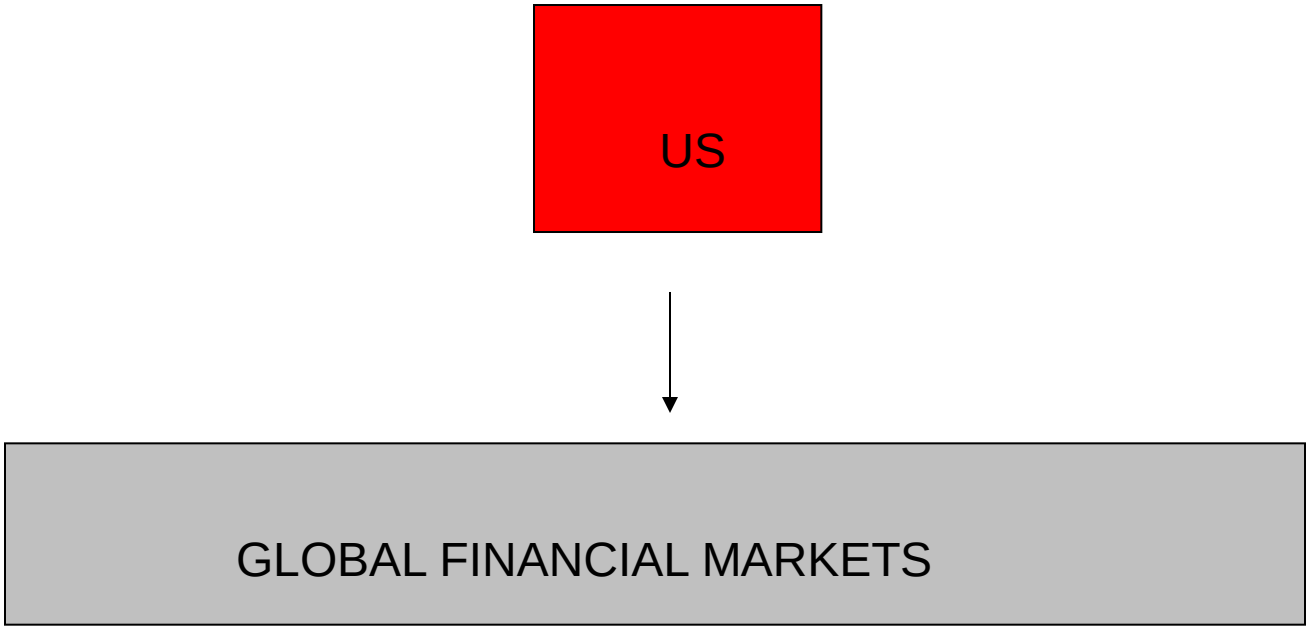


Supervision

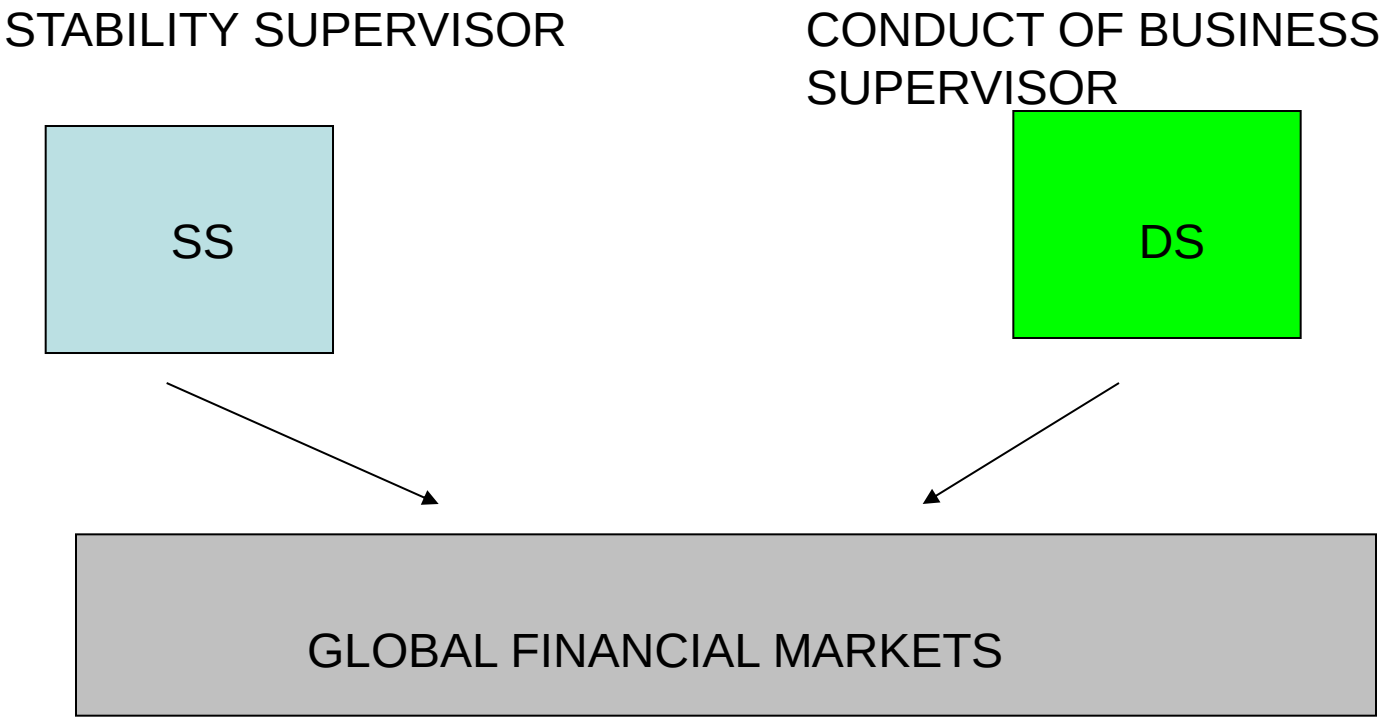
- Consensus: Light Touch Regulation
- Effects:
- 1) Splitting between Regulation and Supervision
- 2) Innovative (more Consolidated) Models:
- A) Single Supervisor (Unified) Model
- B) **Peaks** Model

The Unified Model

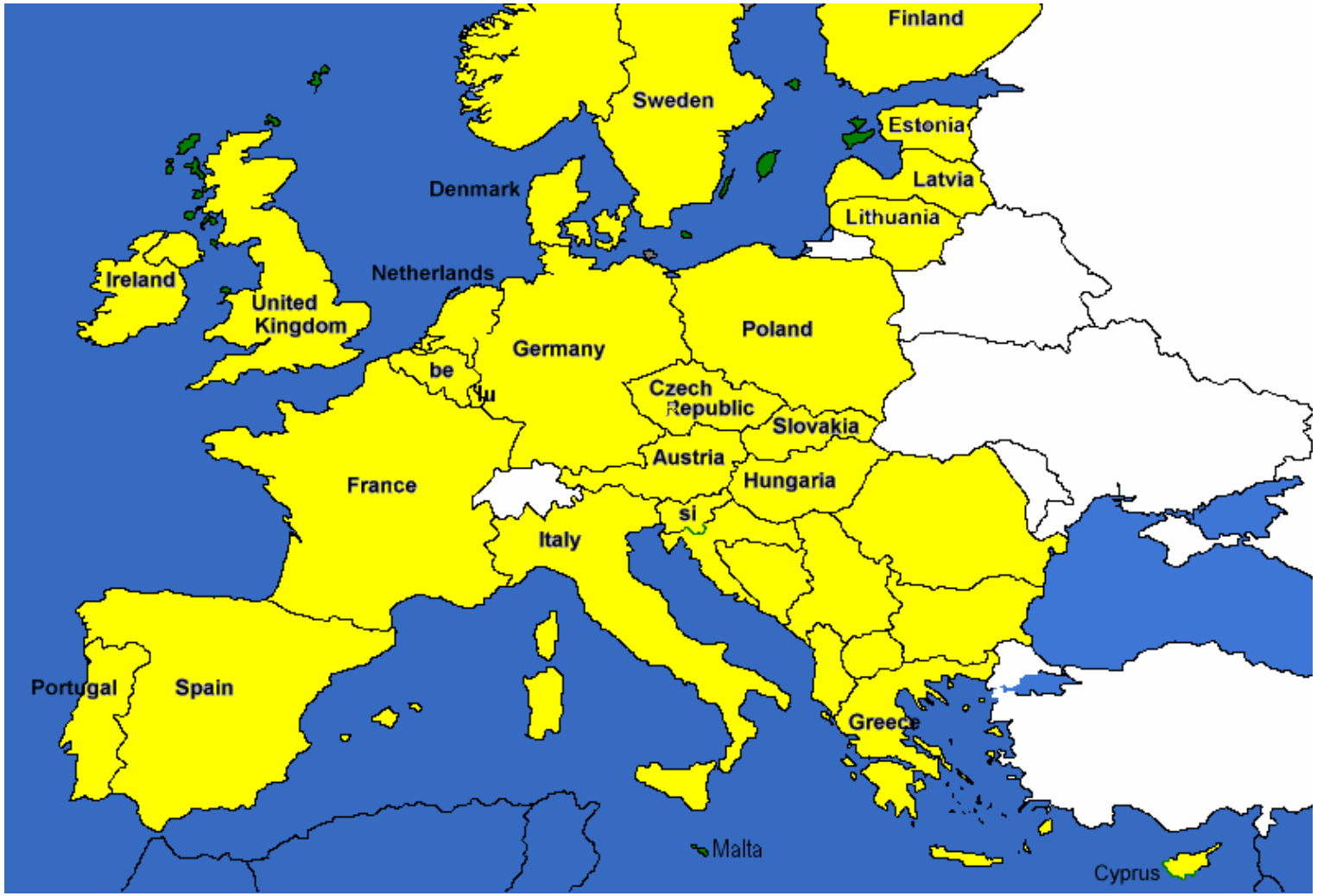
UNIFIED SUPERVISOR



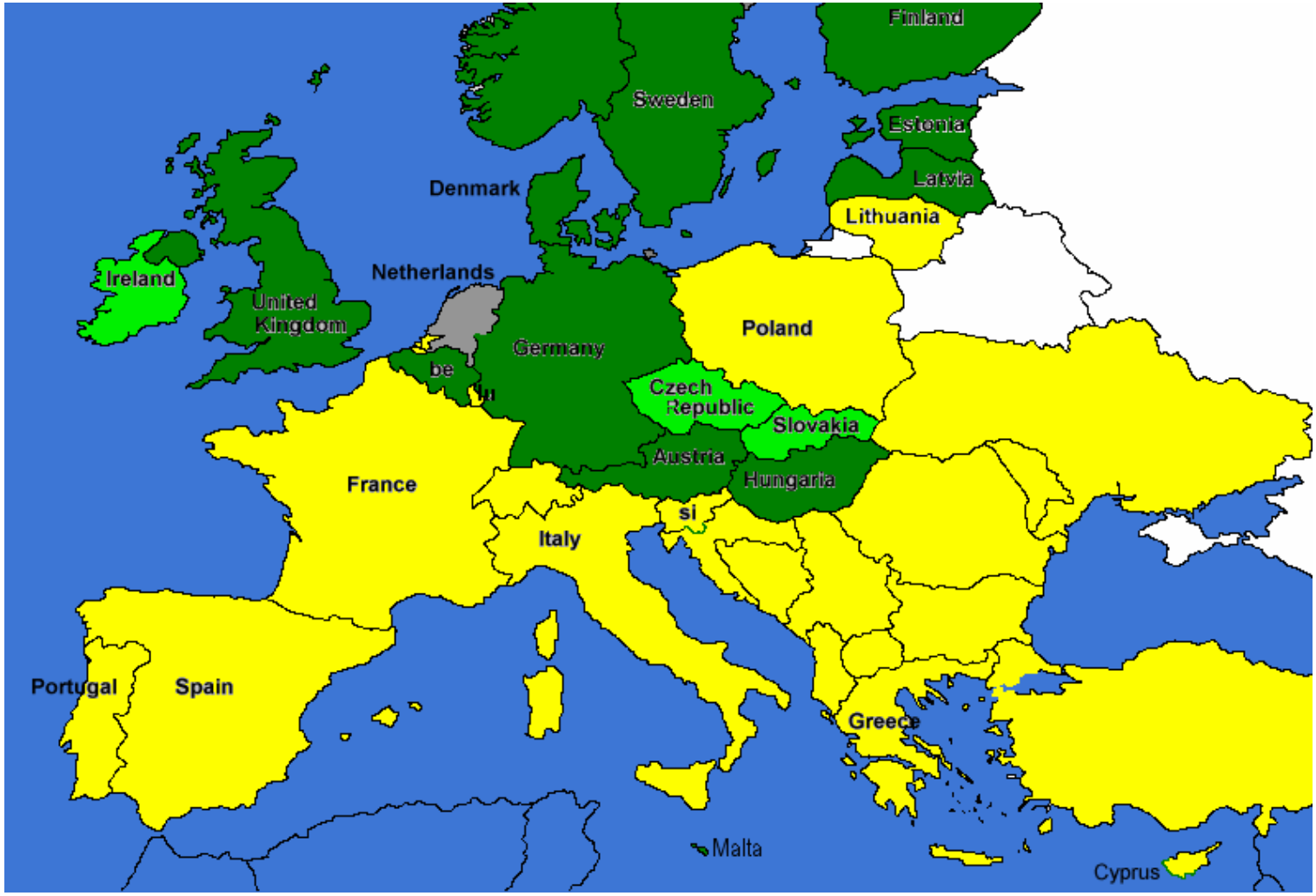
The Peaks Model



Europe: from Fragmentation …



… to Consolidation

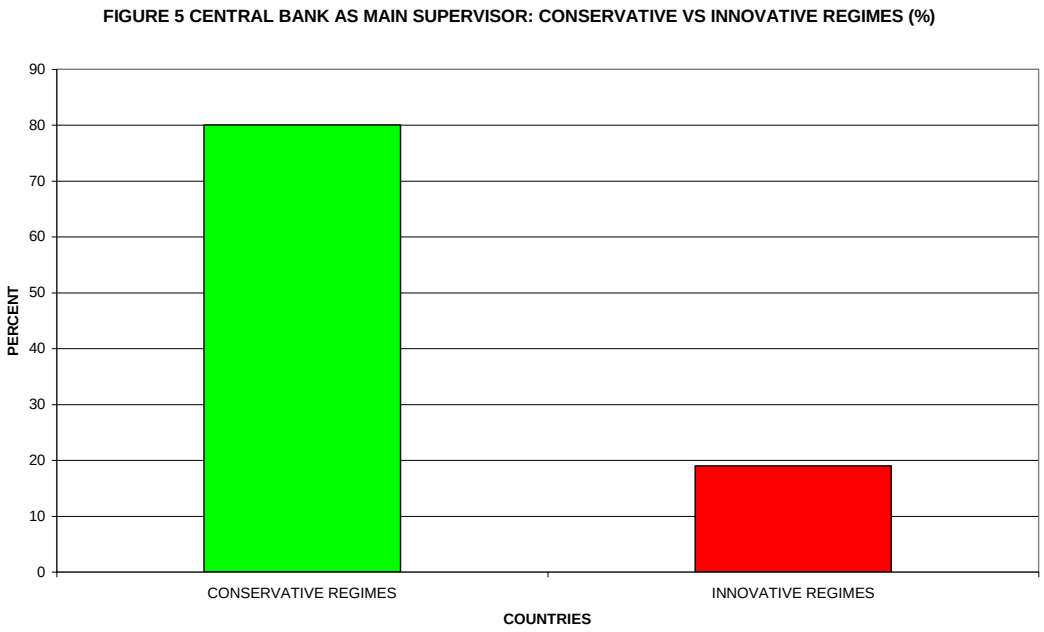


2) Central Bank

- Central Bank: Less Supervision

Specialization

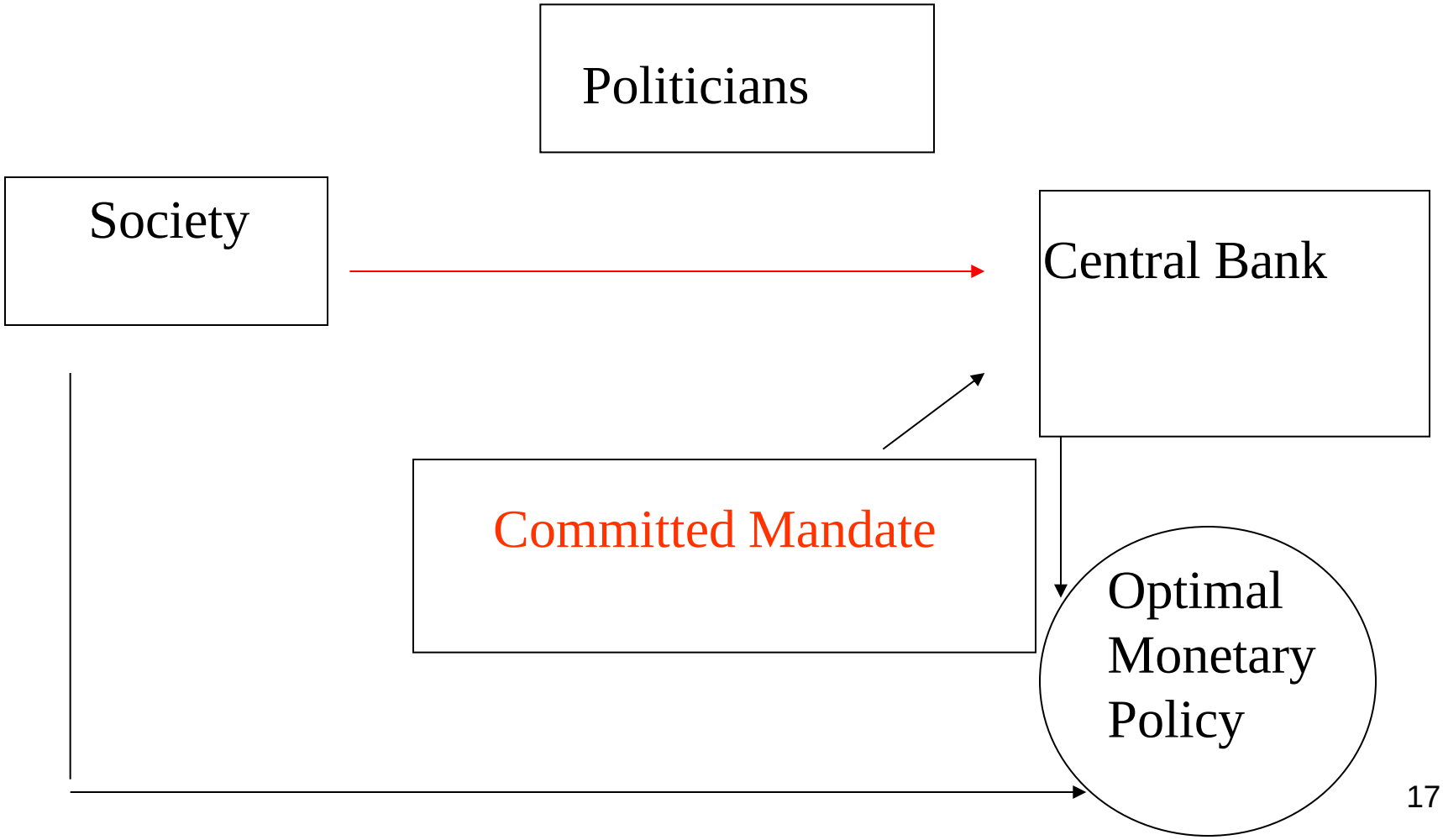
- The “traditional” countries show a common feature: the central bank is the **sole (or the main**) banking supervisor in the 80 per cent of the sample (61 on 76).
- At the same time, the adoption of an **innovative** model of supervision is centred on the role of the central bank in only very few cases (5 on 26 cases,20 per cent).



Specialization

- Traditional Model: Central Bank as Banking and Monetary Agent
- But:
- Monetary Policy Effectiveness needs a **Specialized** Central Bank
- Then: CB as Monetary Agent

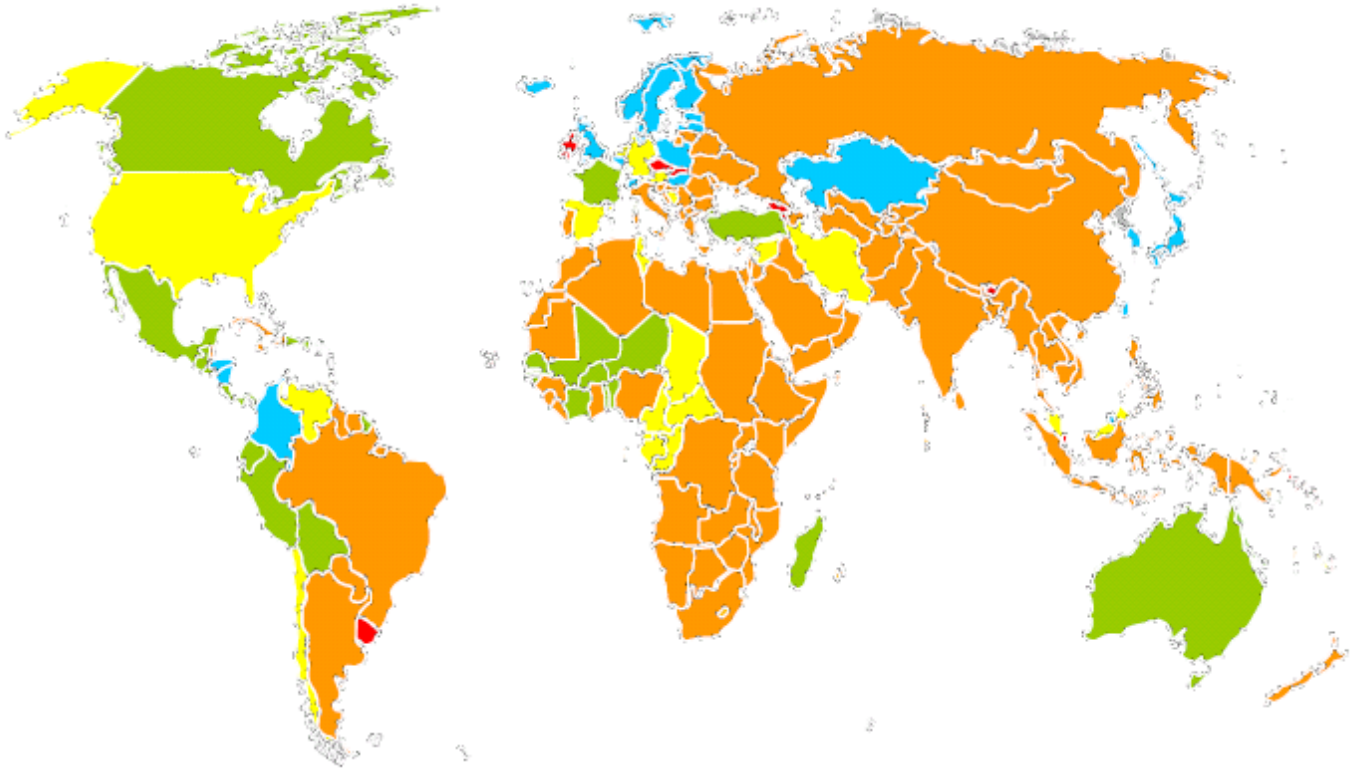
Reshaping the CB regime



Specialization

- Effects: 1) **Less Central Bank Involvement** in Supervision
- 2) **Governance Matters** (Independence and Accountability), before for Central Banking and then for Supervision

Central Bank and Supervision



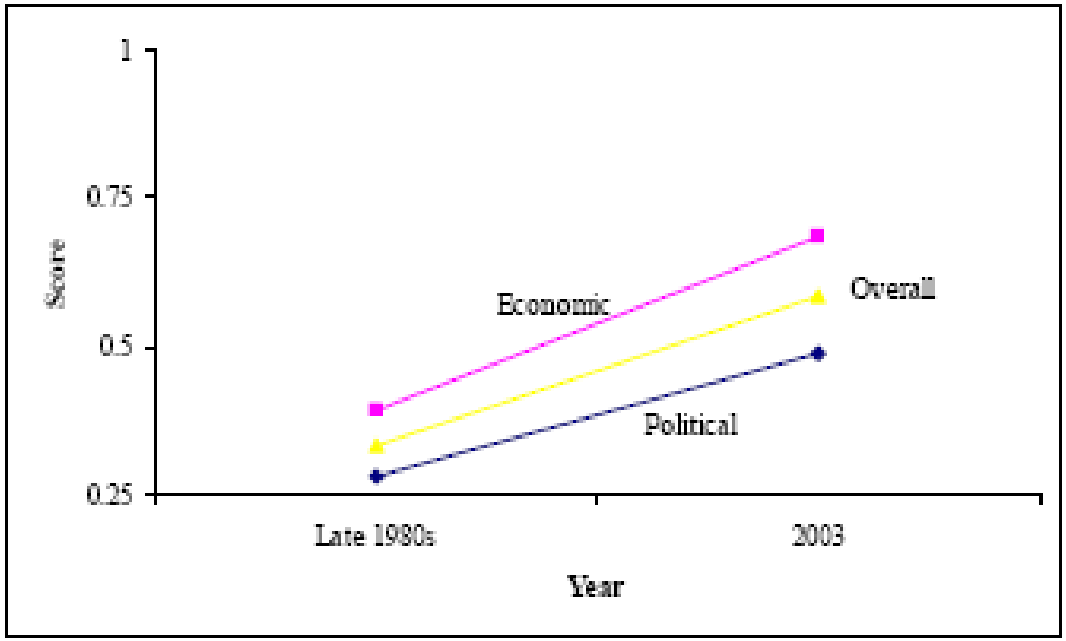
Source: Romelli 2012

3) Governance

- **Good Governance** = Ratings for **Independence** and **Accountability**

CBI: Global Trends

Figure 7. Global Trends in CBA

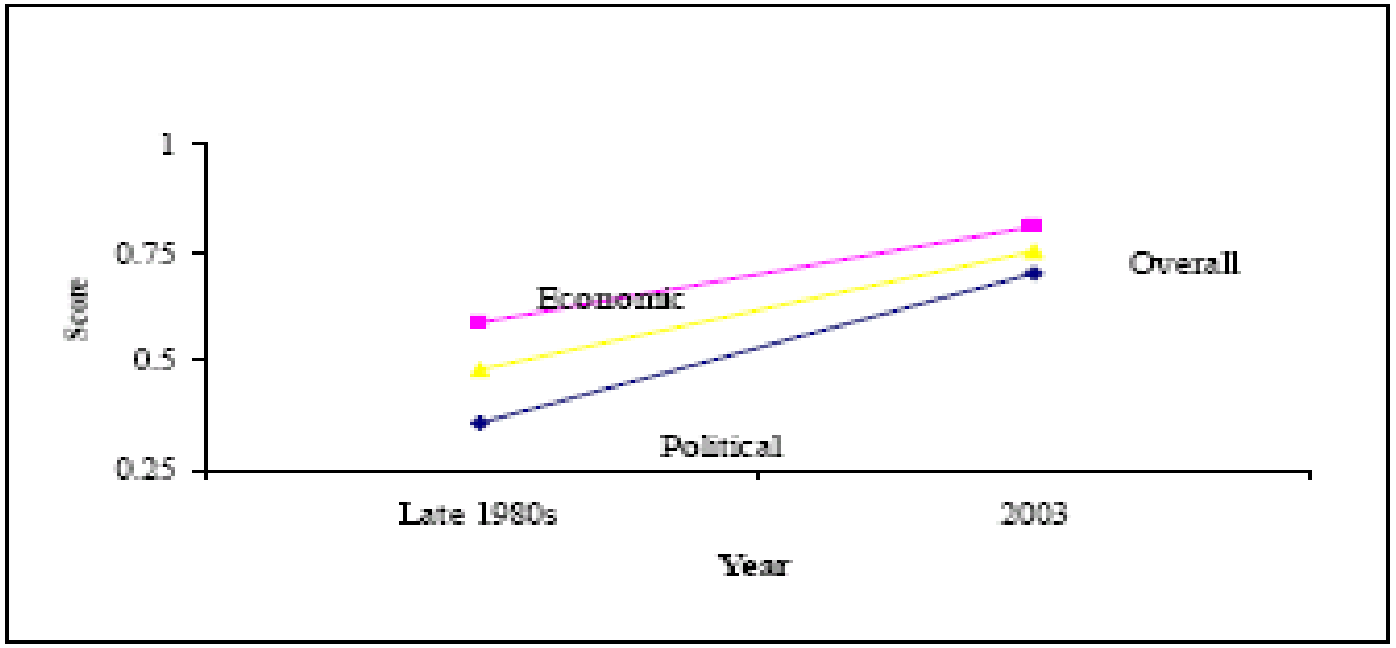


1980s: Cukierman sample narrow index.
2003: all countries full index.
Source: Cukierman (1992) and authors' estimates.

Source: Arnone et al. 2007

CBI Trends: Advanced economies

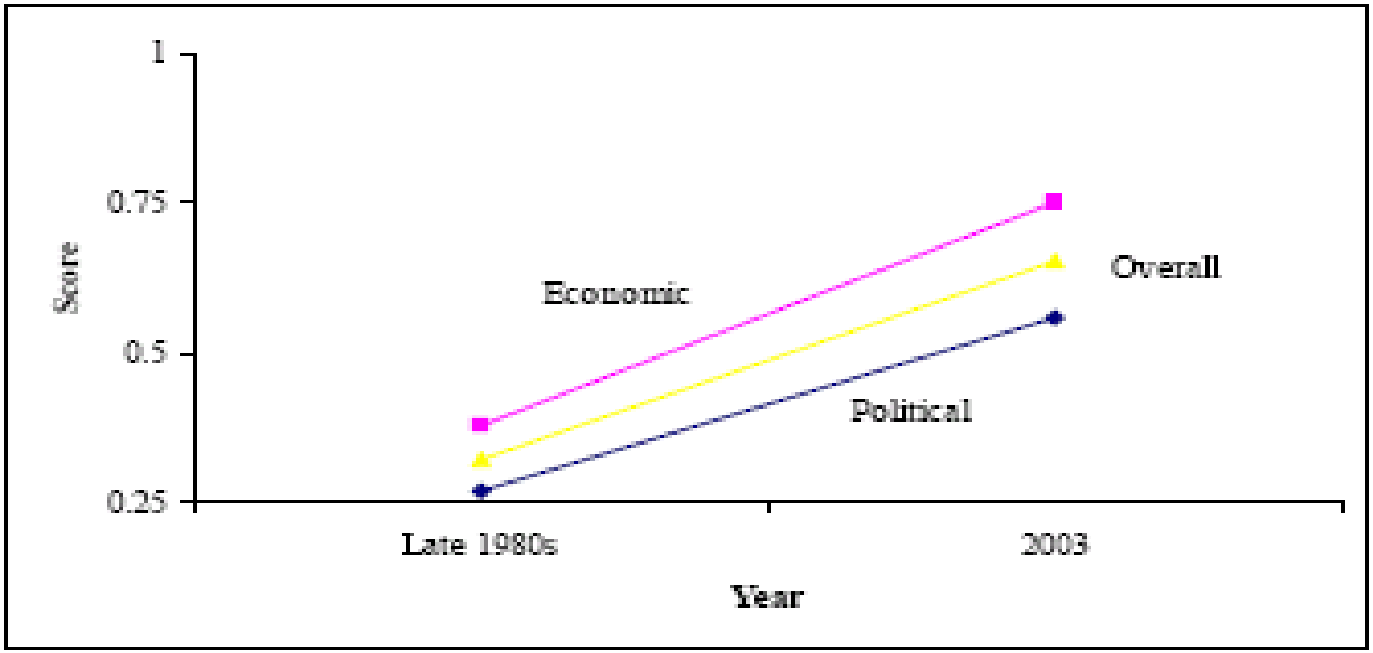
Figure 8. Trends in CBA for Advanced Economies



1980s: GMT sample full index.
2003: all countries full index
Source: GMT (1991) and authors' estimates.

CBI Trends: Emerging markets

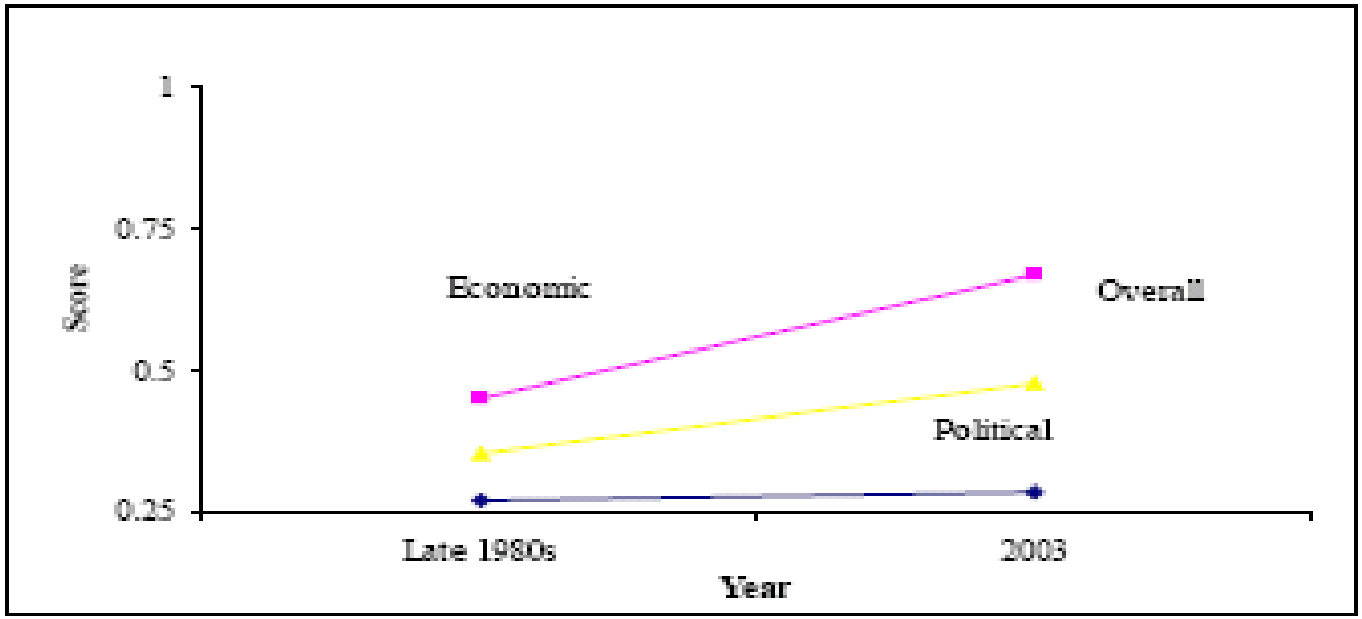
Figure 9. Trends in CBA Autonomy for Emerging Markets



1980s: Cukierman sample narrow index.
2003: all countries full index.
Source: Cukierman (1992) and authors' estimates.

CBI Trends: Developing countries

Figure 10. Trends in CBA for Selected Developing Countries



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Source: Cukierman (1992) and authors' estimates.

Before the Crisis: Follow up

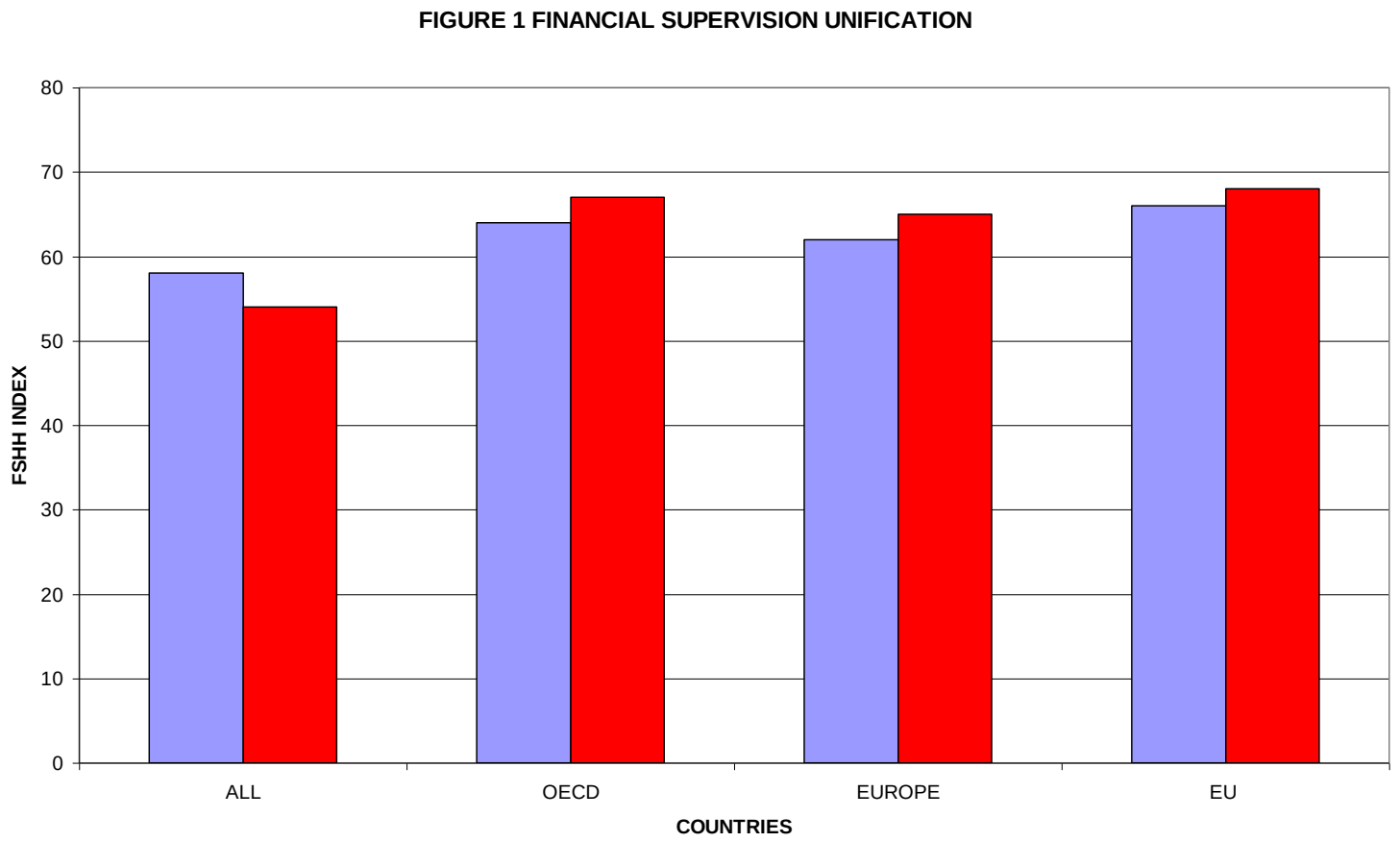
- A) **Supervisory consolidation** outside the central bank
- B) **Agency Specialisation**
- C) **Good Governance**: Independence, Accountability

  Therefore: **Convergence**
- NOTE: No distinction between **macro** and **micro** supervision

Crisis and Supervisory Indexes: Empirical Evidence

- Results:
  - Negative relationship between public sector governance and resilience dominates
  - Negative relationships between consolidation and governance index and resilience (most of the times significant)
  - Central bank involvement had no significant impact

After the Crisis: Consolidation in trouble



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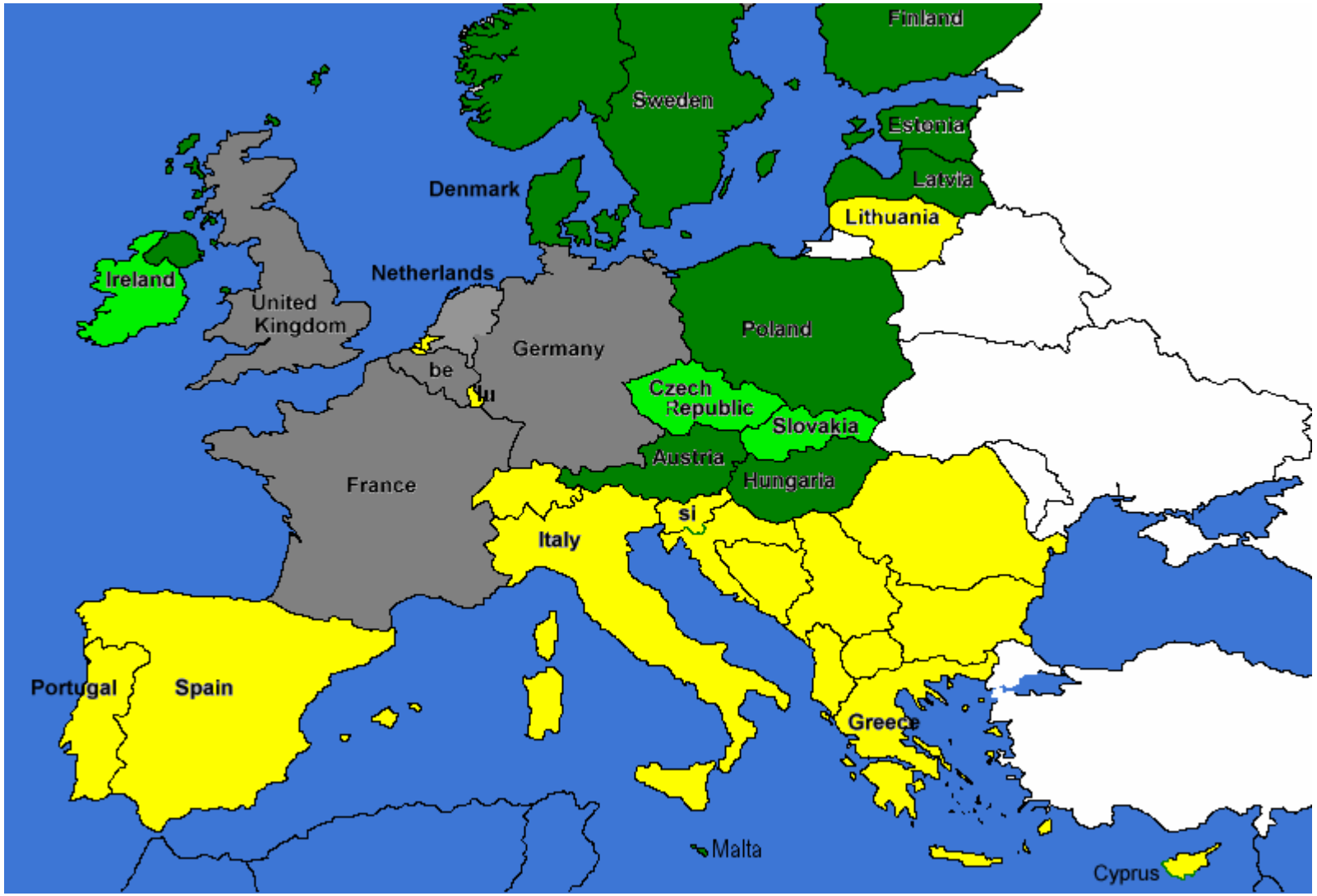

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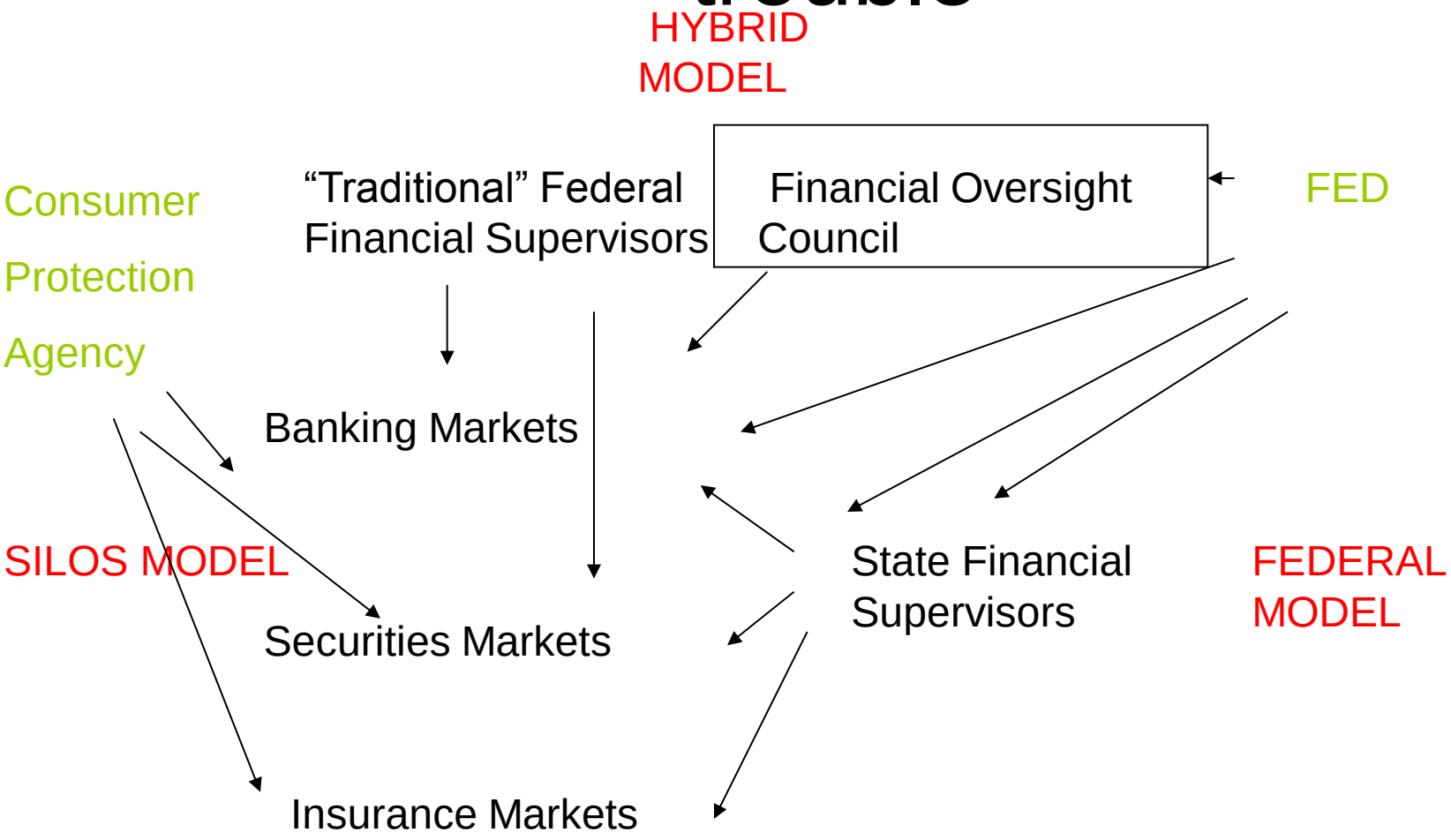

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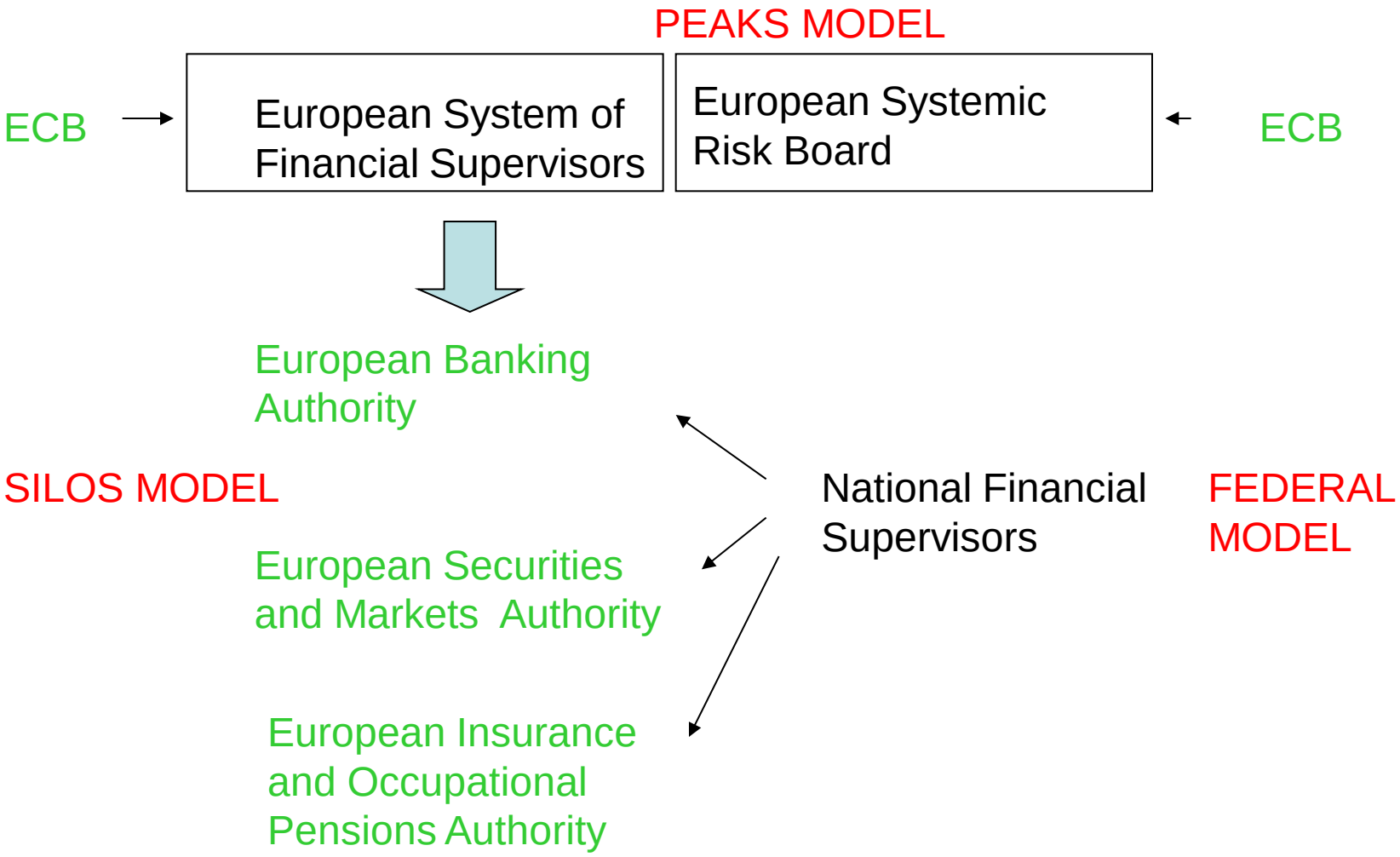
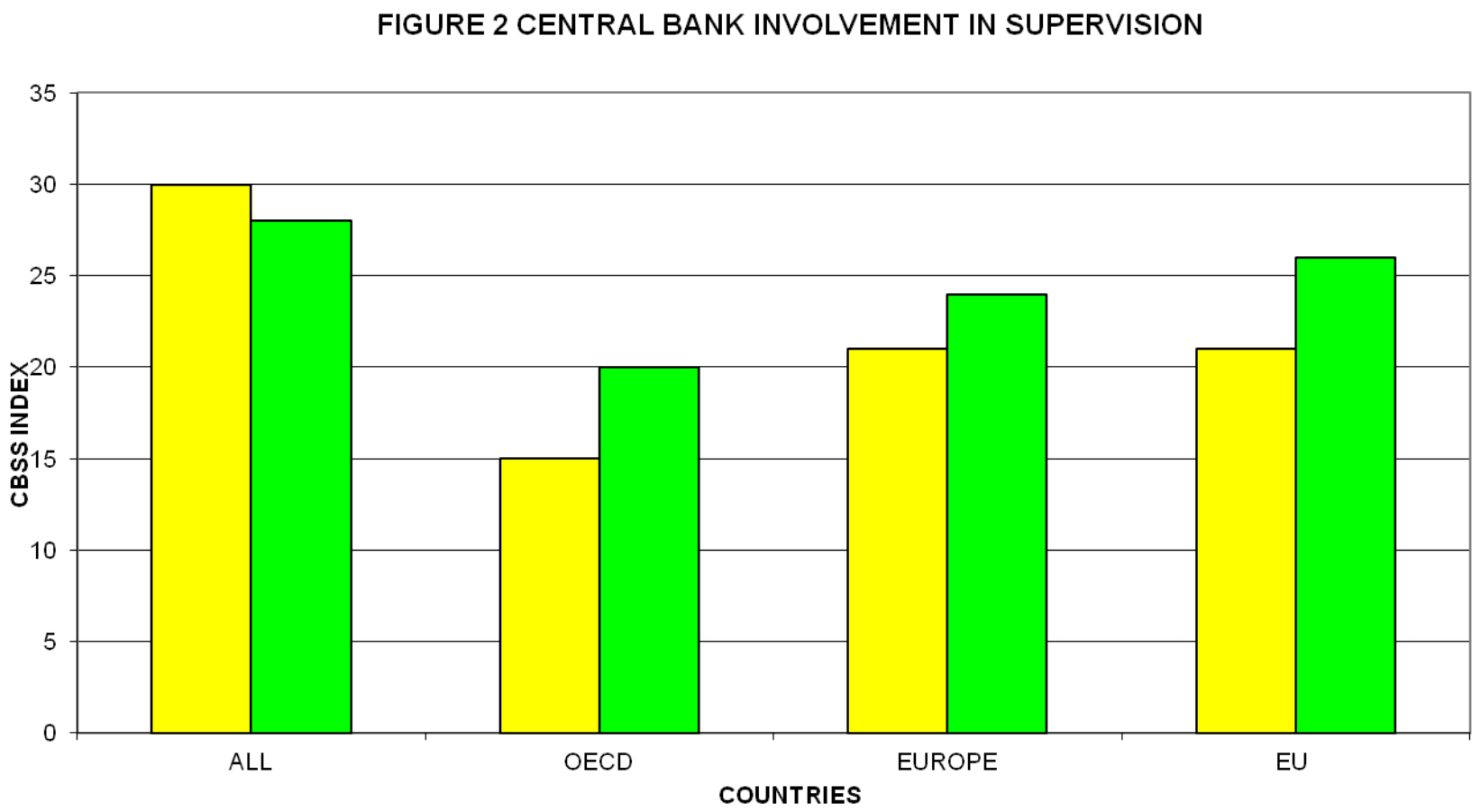


After the Crisis: Less Specialization



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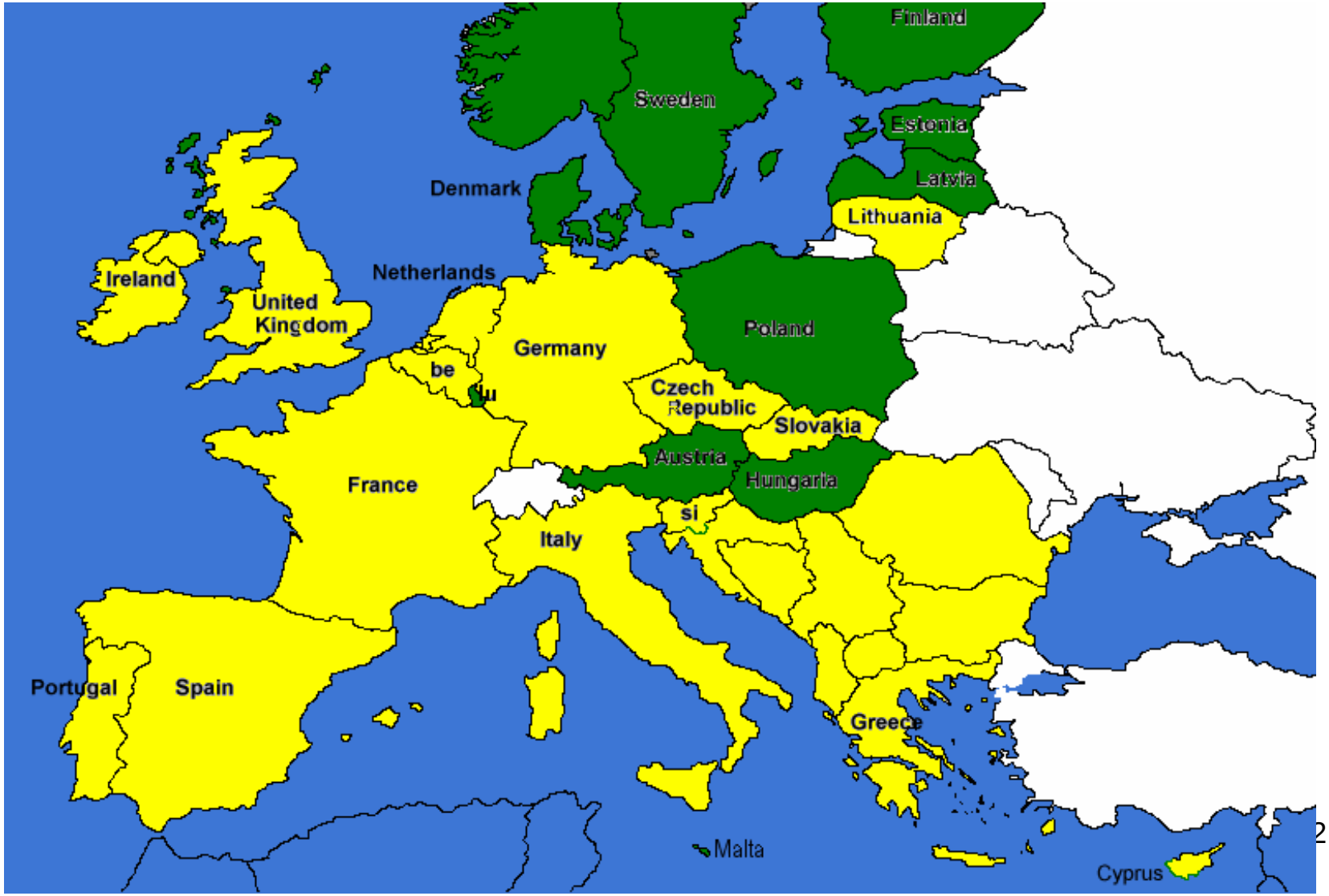
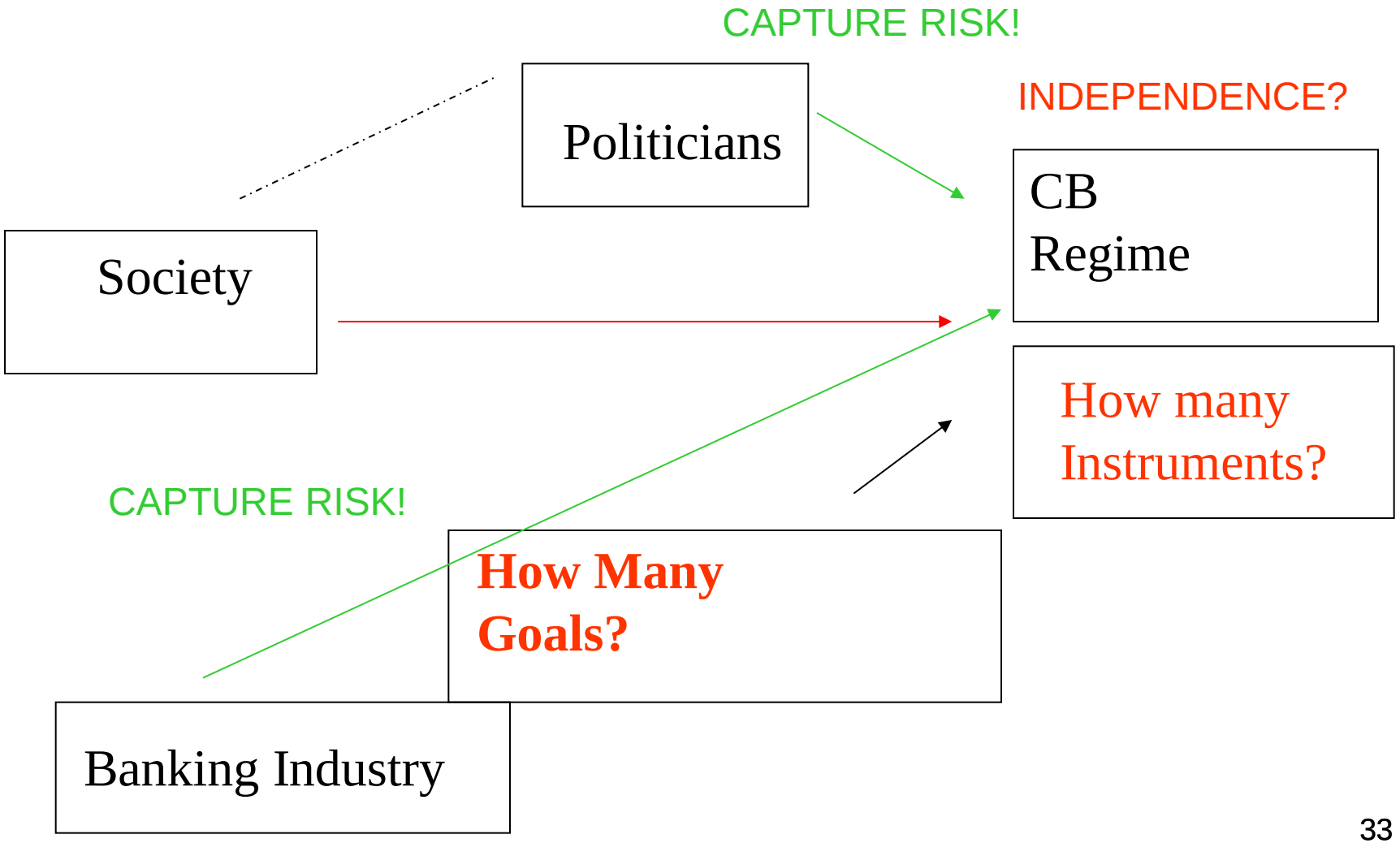


After the Crisis: Governance in Trouble?



Conclusion

- Before the Crisis: “Natural” Convergence
- After the Crisis: The Great Reversal
- Approach: More Political Economy, More Law & Economics, rather than Economics *per se*