12. Why populism is risking independence?

Case of Albania

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Populism has been on the rise during the recent decade. Here, I would like to make a qualification on what I perceive as populist politics in government, its associated policy perspective and the implications it can have on central bank independence. Practically, most majoritarian governments are inherently populist as they do represent the central voter, hence the majority of the population. This term can be extended to the policy perspective of any coalition government. Nevertheless, here, I perceive populist politics and policy agenda as an antagonistic paradigm to liberal centrist politics that is at odds with its central philosophy of free movement of labour, capital, goods and services. A populist political force would strive to restrict such freedoms and additionally exhibit autocratic tendencies in order to pursue such a populist policy agenda.

Populist politics and policy rise to prominence has intensified after the global economic and financial crisis but I will argue here that its foundation was not a direct consequence of it. The proliferation of populist, largely right-wing or far right, politics has deeper underlying economic roots. The economic prowess of large segments of society in the developed world was eroded by the loss of manufacturing jobs as a result of accelerated globalization and robotisation of means of production. This preceded the financial and economic crisis. The low skilled workforce felt the bite of rapidly expanding global-value chains and of rising inequality within their nations. As the crisis hit, developed economies experienced deep economic downturns and austerity policies ensued. Discontent at the establishment grew and populist governments promising economic prosperity for voters left behind were next.

Why is this all relevant central banks and their independence? What do these global forces mean for us small-open economies and how do they alter the signaling mechanism of global policy spillovers?

Many central banks are legally mandated the goal of achieving price stability and have full independence on the policy and operational framework in use to achieve this goal. After the global economic financial crisis and with the move to fiscal consolidation in many developed and developing countries, central banks bore

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the brunt of economic stabilization. Consequently, policy rates have reached their zero lower bounds, in some instances moved to negative territory, and central banks have expanded their policy toolkit with the adoption of a wide range of unconventional monetary policy measures. In many developed and developing countries, the sense of permanence of nominal and real interest rate levels have pushed for search-for-yield behaviour and over-borrowing at the lower-end of the maturity spectra despite debt-ratios not low enough to absorb future reversals of interest rates. Furthermore, added attention to financial stability has instigated the delegation of macro-prudential policies and other financial stability related policies to the central bank. This has increased the risk of interference with the natural flow of funds in the economy, whereby specific sectors of the economy or social categories might have become or perceived more advantaged. The latter coupled with proliferation unconventional monetary policies have expanded central bank mandates and have made them broader, blurry, with potentially multiple conflicting goals. This has complicated the exercise of accountability of central banks and has raised concerns over the legality of such expanded mandates. Both above factors pose challenges to central bank independence in a world of rising populism, shifting bureaucratic norms where attacks on an unelected technocratic institution can be easily normalized. The latter can be exacerbated further by the start of policy normalizations. Monetary policy normalisation is inherently at odds with the promise of rapid economic growth of populist governments and the glimpse of the potential attacks on central bank independence we have already seen from several global powers (USA, UK, etc) and large emerging economies (Turkey, Brazil, Poland, Hungary, etc).

12.1. THE POST-CRISIS POLICY EXPERIENCE IN ALBANIA

The Bank of Albania has a legal mandate to achieve and maintain price stability as stipulated in the "Law on the Bank of Albania" of 1997. With this law, the Bank of Albania was given a substantial degree of operational, institutional and financial independence. I am making a reference to the year the "Law on Bank of Albania" was passed, as the substantial improvements in central bank independence are primarily lessons learned from the developments in Albania in 1997. During this year, many small and large pyramidal Ponzi schemes operated in the country, promising unrealistic high returns and attracting a large pool of savings. For as long as the pyramidal schemes could maintain their operations, fuelling private consumption and easing the pressure on the labour market, politics was a staunch supporter of them. Bank of Albania's warnings and advices were ignored, and, paralelly, it was the target of vicious attacks from populist rhetoric and the political discourse. Needless to say that the collapse of the pyramidal schemes wrought havoc in the Albanian economy, society and politics. However, it also provided the impetus to radically change the functioning of the central bank.

Today, the Bank of Albania has defined inflation target as a 3% annual change of consumer price index to be achieved over the medium term. A free floating exchange rate complements the IT framework. At the same time, the Bank of Albania is responsible for achieving and preserving financial stability, the latter a crucial element in safeguarding the efficiency of the transmission mechanism. Monetary policy conduct is forward-looking and pro-active, in that it reacts today to future expected deviations from target. The efficacy in maintaining price stability in the medium term is crucially interconnected with the degree of independence we have and how we translate this into an effective level of accountability and transparency. For us, being accountable and transparent is not only important in maintaining a great level of public support for the policy trajectory we select, consistent with the inflation target, but also in increasing the credibility of our policies and operations. The latter is a key component in guiding medium and long term inflation expectations and anchoring them around the target.

Albania entered a cyclical downturn in the aftermath of the global economic and financial crisis. We experienced a substantial slowdown in the pace of both actual economic growth and its potential, due to decelerating of productivity and falling investment rate. Domestic inflationary pressures receded and coupled with falling import prices, headline inflation fell below target. Similar to what happened in other regional countries and beyond, Albania lacked fiscal space due to pro-cyclical conduct of fiscal policy prior to the crisis and increasing debt levels. The structural weaknesses of the financial market were exposed. Credit risk started to accelerate as a result of rapidly increasing NPLs and the high euroization of bank balance sheets hampered the effectiveness and scope of the transmission mechanism. Additionally, the banking sector started a deleveraging process largely as a result of restrictive policies at the EU core. Due to all these factors combined, credit slowed down markedly compared to pre-crisis levels.

In response, fiscal policy switched to a consolidation stance with the aim of improving resilience through lowering the public debt from over 70% of GDP to more sustainable levels. Additionally, the Government adopted a strategy of extending the average maturity of the public debt in order to minimize potential rollover risks. As such, monetary policy stimulus was the only available tool left to stabilize the economy.

The Bank of Albania initiated an expansionary monetary policy trajectory in order to prop-up domestic demand and strengthen inflationary pressures. We lowered the base policy rate from 6.25% in 2008 to a current historical minimum of 1%. To reinforce the monetary policy stimulus, we started to make extensive use of forward-guidance in order to guide the market and anchor inflation expectations. We communicate the likely future monetary policy path with respect to the inflation target and the economic conditions that would warrant a policy change.

Furthermore, last year, we used exchange rate interventions as an additional unconventional monetary policy tool. The domestic currency initiated a rapid beyond-trend appreciation in early to mid-2018 as a result of some idiosyncratic shocks. These led to one-sided appreciation expectations and to disruptions in the exchange rate market. We estimated that the continuation of the appreciation at similar pace would endanger the achievement of price stability in the medium term and decided to intervene in the market. Again, our intervention was purely linked to monetary policy considerations for as long as calming the forex market and bringing the behaviour of the exchange rate within normal parameters served the purpose of not complicate the conduct of monetary policy.

To complement and support the conduct of monetary policy and strengthen the transmission mechanism, we have implemented a wide range of countercyclical macro-prudential measures and of structural reforms. We introduced a range of macro-prudential measures targeting credit expansion by reducing risk weights for credit portfolio growth above a specific threshold, reducing debt service burdens by encouraging early loan restructurings and discouraging bank funds' outflows. We introduced a comprehensive NPL resolution plan in 2015 to reduce the stock of bad loans and to improve the credit environment in the country through reviewing the Bankruptcy Law, the Law and the functioning of the Bailiff Offices, the fiscal treatment of debt write offs and the design out-of-court debt resolution strategies. As a result, NPLs have decreased from a peak of a quarter of the loan portfolio to about 11% in 2019 and credit extended to the economy is in an upward trend. In early 2018, we initiated a de-euroisation strategy to promote intermediation in domestic currency and make lending in foreign currency more expensive. The latter is expected to have a long-term impact in removing frictions in the transmission mechanism and in increasing the scope of monetary policy.

12.2. Conclusions

The conduct of monetary policy in Albania after the crisis, both conventional and unconventional, and the range of macro-prudential and other financial stability measures undertaken would have not been possible if the Bank of Albania had not enjoyed full independence in designing its policy tools and implementation framework. Populism has not taken roots into Albanian society and politics and as such, we have experienced no political interference or pressure from interest groups to influence our decision making.

However, this is not to say that we are immune from future attempts to infringe our independence. The instances of attacks on central banks in the developed world, to which small developing countries like Albania look up to, can normalize such behaviour regardless of rule by populists or not. Furthermore, in the process of taking up more responsibility at the Bank of Albania to not only to affect the business cycle but also the financial cycle through macroprudential policy and financial stability measures, our mandate has been expanded and capabilities over-stretched. Lastly, I believe the start of monetary policy normalization after a protracted period of low interest rates will be a delicate moment during which we need to tread with care and caution. Many market actors have internalized the low interest rate environment as a permanent phenomenon and will have difficulty fathoming higher interest rates. As such, the start of policy normalisation has to be communicated transparently, in a timely manner and above all be anticipated ahead of time by market actors, be it public or private. Policy surprises in this juncture would be detrimental and would attract criticism and ire at the central bank, regardless of whether populists have the upper hand in society or not.

In a nutshell, the rising tide of populism in the developed and developing world has given the first glimpse of danger it poses to central bank independence. For central banks, the best guarantee on preserving and safeguarding independence is to ensure targets are fulfilled in the most transparent and accountable manner. Furthermore, while populist rhetoric and policy can exhibit short-term pressure, for as long as central banks stick to their principles and deliver on their mandates, in the long-run, they will be immune to potential external interference.