ABOUT THE FUTURE OF THE INSTITUTION OF THE CENTRAL BANK

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Rezumat

Evoluția crizei financiare afectează din ce în ce mai mult viitorul băncilor centrale prin faptul că le forțează, în numele găsirii unor soluții la problema datoriilor suverane, să facă ceva ce până acum părea aproape imposibil. Putem presupune un astfel de viitor, dar pentru moment trebuie să observăm că băncile centrale, mai ales cele care emit monedă folosită ca valută pentru rezerve – de exemplu FED sau BCE – se confruntă cu scăderea puternică a instrumentelor lor financiare (dobânda lor de politică monetară se apropie de zero) şi cu o mărire puternică a balanței lor ca scuză pentru că sunt creditori de ultimă instanță.

În momentul de față, trebuie să discutăm despre efectele negative ale scăderii la minim a eficacității instrumentelor folosite de băncile centrale privite ca instituție şi nu numai ca factor de decizie politică cu o istorie destul de lungă de construire a credibilității şi independenței lor. Ultimul context al măririi balanței lor furnizează argumente puternice despre implicarea lor în politica fiscală, ceea ce le poate afecta credibilitatea într-un moment în care putem spune că problema fundamentală a economiei globale este lipsa de încredere a investitorilor. Acelaşi lucru este valabil şi pentru independența lor, ambele aspecte contribuind la problematizarea viitorului instituției băncii centrale.

Actualele realități, care acoperă deja peste cinci ani de căutări de soluții la criza care încă se manifestă, ne provoacă la a aborda

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problema viitorului băncilor centrale, având în vedere faptul că instituțiile care devin ceea ce noi simțim astăzi ca fiind băncile centrale se găsesc sub o anumită presiune care afectează exact trăsăturilor lor fundamentale care le dau măreția de care suntem mândri.

Abstract

The evolution of the financial crisis is touching more and more the future of the central banks by forcing them, for the sake of solutions to the sovereign debts, to do what in so far appeared almost impossible. We can presume such a future, but for the moment we have to observe that central banks, mainly those emitting money used as reserve currencies – for example FED or ECB – are confronted with a strong depletion of their monetary instruments (their monetary policy interest rates are around zero) and a great expansion of their balance sheet as an excuse for being the lenders of last resort.

At this point, we have to discuss the perverse effect of reaching the minimum efficacy of the instruments used by the central banks regarded as institution and not only as policy makers enjoying a quite long historical building of their credibility and independence. The latest context of the expansion of their balance sheet is giving strong arguments of their implication in fiscal policy, which might ruin their credibility at a time when we say that the core problem of the global economy is the lack of trust of the investors. The same thing is true with their independence, both issues being conducive to the challenge to the future role of the institution of the central bank.

The present realities, encompassing already more than five years of seeking solutions to the crisis still in evolution, incite us to tackle with the outcome for the central banks having in mind that the institutions becoming what we feel today as being central banks are under a certain pressure which is affecting exactly their core features giving to them the greatness we were proud of.

Keywords: central bank, crisis, monetary instruments, credibility, independence

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From the monetary perspective, the global financial crisis determined the reduction of the nominal short-term interest rates in the developed countries. The monetary policy measures aiming to correct the imbalances of the financial market and to stimulate the economies determined a spectacular increase of the central banks' balance sheets due to the higher issues of reserves by expanding the refinancing operations for the credit institutions. In some Euro Area countries, the fast increase of the public debt increased the interest rate differentials, and this triggered a spiral of adverse effects and expectations, increasing the amounts to be paid, thereby it amplified the increase of debts, and so on.

The financial crisis, by its effects and by the inefficiency of the taken measures, forced us to think about the necessity of ”breakthroughs” from the traditional policies which the period of the “Great Moderations” taught us. Moreover, it seems that everything should be rethought systemically, context in which experts and analysts advance changes of paradigm and a new international order. In this change required by a future less exposed to risks we are still speaking of divergences between the national priorities and a jointly assumed agenda which imposes globalization, we are speaking of the need for a leadership so that, at least within the G-20, the common objectives may be accomplished.

Since a new international order cannot elude changes in the international financial system, which also presumes a monetary system, the question as to how much are the central banks sheltered from these challenges is more than natural. But, since the core subject of this article refers to the central banks, we need to notice that in their obstinacy to fight the suite of crises currently confronting the national states, their mandate is somehow distorted by the conduct of the monetary policy, by the appeal to the so-called non-standard measures, which actually are non-orthodox.

If these measures are preoccupying us nowadays – we may enumerate here the decrease in collateral quality for the liquidity injections, the direct acquisition of state bonds, long-term access of the commercial banks to liquidity through monetary market operations (case of ECB), pre-commitment in setting a level of the monetary policy interest rate (case of FED), pre-commitment in setting a FX market intervention at a specific exchange rate (Swiss Bank) or the quantitative easing (QE) – they cannot be treated outside long-term trends, particularly when we are speaking of the central banks which issue national currencies used as international reserve.

We remind, for the necessity of understanding our demonstration, that there are five conditions for a currency to become acknowledged internationally and thus used by other states too as reserve assets: it must be the product and the symbol of strong economies with an expanded network of externalities and with low financial transaction costs; it must be the exponent of a deep, open and efficient national financial market; it must presume a good quality of the political and macroeconomic governance; it must represent the currency of a state of law in the true meaning of the word, which means the unconditional protection of the private property rights of an investor; it must benefit of the geopolitical influence of a politically-stable issuing state.

Let us retain, for the time being, out of the five conditions mentioned, those which refer to the **state of law** and to **guaranteeing the private property**, because historically, the credibility of any central bank issuing fiduciary currency derives from them. Without credibility we cannot speak of the efficiency of the instruments which a central bank uses and of the expected impact of a particular conduct of the monetary policy.

We are currently confronted with the fact that the central banks whose currencies are international reserve assets reached the **minimal level of efficiency of the instruments** they may use. These central banks used at maximum both the **nominally positive interest rate** (by successive reductions), and the **balance sheet expansion** (by buying bonds issued either by the public or by the private sector) so that they can play the **role of last resort lender up to the limit of credibility.**

Nevertheless, the results of the central banks actions expected by the public opinion, yet during the crisis which still is in progress, are different of their meaning. However, contrary to the most spread perception, it is not the efficiency of the instrument used by the central banks that is questioned, but its more profound causality, the manifestation of an **internal contradiction** more imbedded in the central banks looked upon as institutions. They are evolving slowly for a long time and now are becoming much more visible. We are actually witnessing the unveiling of the **contradiction within the very nature of the institution called a central bank**, the contradiction between **its role** and **its action**. This contradiction, as we will see, is related particularly to the **time horizon** on which the two aspects are defined.

The opposition between the historical core purpose of the central banks and their mandatory monetary policy (e.g. price stability) is more important, because the evolution of the central banks in general, and particularly after World War Two, showed that the inefficiency of the monetary policy instruments can be overcome by a proper and in time reformulation of the economic policies mix in relation with the monetary policy and the definition of new instruments for the implementation of the monetary policy.

Thus, the future of the central banks, as institutions, seems to be less affected by the efficiency of their instruments, but certainly more by the lack of correlation between their **role** of **depositor of the long term growth reserves of an economy** and the necessity of a **conduit** of their policy **encouraging indirectly the sustainable development** by maintaining price stability. We think that the erosion of the central bank credibility about its historic role for the **future development of an economy** (national, or regional, such as the Euro zone) is the major danger for their institutional existence, at least as it is define presently. They may eventually disappear, while other people speak about of their further utility (among whom we cite Mises, De Soto, Cerna).

Institutionalism and the stat of law

The central banks have a history of their institutionalization: they were bestowed a role in the social life, in the broadest meaning. There is a list of thinkers, starting maybe with the British humanist Richard Taverner[1], who argued convincingly that the **history of the institutions determines the modern results of a nation**. On this thing, at least the people working in the central banks, have no doubt, considering that at present central banks function are complying with

[1] Richard Taverner (1505 – 1575) supporter of the religious reform in the United Kingdom, translated the Bible in English and also wrote the famous book „The Garden of Wisdom". This book is a collection of facts, events and historic jokes which emphasize the wisdom and humanism of the monarchs, philosophers and leaders from antiquity to the contemporary period. The source of these facts and events is Erasmus, the famous teacher and tutor of the future king Henry the VIII. (Source: DeWitt Talmage Starnes „Richard Taverner's "The Garden of Wisdom", Carion's "Chronicles", and the Cambyses Legend", University of Texas Studies in English, Vol. 35/1956, pp. 22-31).

the **pattern passed in 1844 in the United Kingdom, by Peel' Law**. This is the law which sets the bases for the system of monetary emission from the perspective of a central bank contribution to the long-term development of a nation.

This pattern is properly described in the book coordinated by Angela Boariu – *Functions and role of the central banks*[2] – from which we cite: "The appearance of the central banks in the 17th -18th centuries relied on the existing commercial banks which were entrusted by the governments of the particular states with the role of "banker" of the state (...). In other countries, the central banks were established in order to issue the currency needed to finance wars or in order to increase the monetary stability after the expenditure generated by wars, by issuing governmental bonds. The chronological analysis of the central banks shows that they were established by converting some commercial banks, by the gradual entrusting them with monopoly rights on the emission of currency and by accepting the responsibility of lender of last resort", aspect to which we will revert.

Maybe the most important event of the world economic history – beside the industrial revolution - took also place in the United Kingdom. However, this was the result of another revolution – the *Glorious Revolution* – which shattered and resettled the British institutions in 1688, after James the Second of England was overthrown. This change in the British society brought along a novelty which gave England the opportunity to become world power – **the state of law**, by the introduction of the British Parliamentary democracy, in opposition with the monarchical voluntarism. The state of law ensured that all the subsequent institutionalizations, which presumed the separation of state administration from the will of the monarch, became credible by predictability of the law enforcement.

The state of law allowed England to become the **first sovereign state** which could borrow no matter how much, even when the level of the public debt reached 260% of the GDP, as it was the case immediately after 1815. The reason resides in the fact that the **promise that the British state will pay its debt was credible because the very British state was built on the principle of**

[2] *Source: http://www.scribd.com/doc/48182080/Functiile-si-Rolul-Bancilor-Centrale. Document retrieved on 15 September 2012.*

protecting the private property rights. De facto, this means that it was forbidden not to pay the debts, and the **institutional guarantor** of this promise – I owe you – was the Bank of England, established in 1694, not too late after the moment of the Glorious Revolution. This is the major significance of the long-term institutional credibility of a central bank, beyond the reputation of the day to day actions, **the Bank of England being built on the principle of the state of law**.

Central bank independency

Anyone who wishes to understand the way in which the banking system works should read "Lombard Street" by Walter Bagehot (1826 – 1877), editor of "The Economist". The criticism which Bagehot made to the activity of the Bank of England was rather aggressive, but the repeated crises of liquidity after 1846 were motivating his opinions. The convincing analysis built up by Bagehot brought at least **two new notions** which entered in the technical vocabulary and started to feature the current activity of the central banks: lender of last resort and central bank independence.

Peel's Law from 1844 had forced the **central bank to make a clear division between the resources and activities of the departments** in charge with the emission (including the administration of bank's gold reserves) and **the pure commercial activity of the bank** (discounting). This division of responsibilities was intended to allow the efficient intervention of the bank in moments of *solvency crisis* or of *economic difficulty* (offer shocks, as they are called today).

However, this specialisation of the various departments from the Bank of England was not enough to help it during the *liquidity crises,* as a different situation to solvency crisis. At that time, it was not the bankruptcy of trading companies or of local banks seen as the failure of an economy and/or of the policy lead by the Bank of England. It was rather the **decrease of the gold reserves of the Bank of England**. The volume of the gold reserves was essential because they counted as the basis for crediting and they allowed the **long-term development**.

Thinking of the numerous liquidity crises which affected the City after the 1844 implementation of the Bank of England Law, **Bagehot proposed that the Bank of England to be turned into a last resort lender,** relying on its gold reserves. Bagehot's words ***„lend freely at***

***high rates"*,** remained famous, but these loans required **good quality collateral**. The interest rates had to be so high, that they would deter the debtors which didn't really needed liquidity. Until today, the central banks are last resort lenders, as Bagehot proposed.

This measure would have been superfluous, however, if the Bank of England has not had the real power to impose the interest rate without any influence from outside the institution. In other words, Bagehot also set the **principle of the central bank's independency**, which is so important today for the conducting and the stance of the monetary policy.

Individual prudency

Prudence in the action of a central bank can be overlooked in maintaining its credibility in its institutional role towards the nation and the reputation of accomplishing this role. The establishment of any individual bank, of the National Bank of Romania (BNR) included, **viewed the future of the nation**, as it had happened with the Bank of England, almost two centuries before. The most important name in BNR history is probably that of Eugeniu Carada, because his name is strongly linked at least with **two important activities** of our central bank: the **credit development in national currency** as a necessity for the progress of the nation and the simple and clear **regulation**.

Consequently, Eugeniu Carada, as most of the people who contributed with their political support for the establishment of BNR, saw in this institution an **instrument to develop the nation** (it is not an accident that the name of the institution is the National Bank of Romania, not just the Bank of Romania). One of the methods used for the long-term development of the country, as properly emphasized by the Parliament speech of Brătianu, was the introduction and stimulation of the credit in the national currency.

Could this be done anyhow, without the qualified oversight of the debtors, as we call it today? Carada, who dedicated his life to this institution after its establishment, did an extraordinary thing for that time: he was visiting at least once a month the top four branches of BNR (Iaşi, Brăila, Galați, Craiova). The purpose of those frequent visits was to check personally, once more, as well as BNR headquarters in Bucharest, the **quality of the companies involved in the discounting operations of BNR**.

Carada was doing a thing which the commercial bankers of our days completely forgot, with serious consequences for all of us. The regulations existed at that time too, but they had the advantage of being simpler and clearer. However, Carada knew that regulation by itself (or over-regulation, bad regulation or the populism) was not enough for the **individual prudency**: the banker had the responsibility to know closely his debtors.

The exemplification of the attention paid to prudence aspects by BNR history reveals the present day mystification of the power of the banking regulation extended to the entire international financial system, in which a written text, irrespective of the level of coercion it imposes, is worthless without the honest involvement of the enforcing entity.

The inter-generations contract

The idea of an institution whose financial role is to ensure the **continuity of the inter-generation development using the reserves of the state of law** (the reserves of precious metal included), has not appeared by accident during the generation of Bagehot or Carada. That generation had been exposed to the democratic ideas of the promoters of the economic liberalism, such as Edmund Burke (1729 – 1797), a great politician and speaker, outstanding representative of the conservative liberalism.

Burke, one of the most critical analysts of the 1789 French Revolution was saying that the **true contract within a society is not that between the sovereign and its subjects** (as Rousseau considered), **rather a contract between generations**. For Burke, only such a contract can ensure the state of law which is the guarantor for the public goods. His reflection regarding the will of the people is famous: *"I venture to say no war can be long carried on against the will of the people"* – having this connotation of the contract between generations.

Within this context of philosophical approach, we may notice that after the 2007 financial crisis, the measures adopted in order to avoid the economic collapse increased the public debts to unsustainable levels. The governments were not able even before the crisis to take measures to decrease the public debt in a convincing manner, while the decisions adopted presently only **push the burden of the debt of**

the present generations on the shoulders of the next generations.

The problem is even more complicated as the debt considered by the markets is not the sum of all public debts. The debt is much larger because the governments were never asked to publish the current value of the future liabilities resulting from paying the pensions, social assistance and health care systems.

The palliative used by an increasing number of countries – stating that the simple principle of a balanced budget should be enacted even in the fundamental law, as the Constitution – does not solve the basic problem of the unsustainable level of the public debt. **The core problem is that pushing the public debt towards the future generations only breaches their right of property**, which also touches the perception towards the state of law. Which is the real debt of state today which borrows at the expense of the future generations?

Over-regulation

The answer of the national and international authorities to the financial crisis of 2007 tends to be **reduced to the increase of the amount of regulation**, although the most regulated part of the financial system, before the crisis, was the banking one.

One of the most famous and contradicted professors of economic and financial history of our days is Niall Ferguson (born 1964). He argues that over-regulation is not the key to the problem unveiled by the 2007 crisis, rather the contrary. For instance, Ferguson says that even if the *Glass Steagall* Act (actually the *Banking Act of 1933*, which was limiting the right of the commercial banks to run activities of securitization or affiliation to securitization companies, replaced by the *Gramm-Leach-Bliley Act of 1999*, during the presidency of Bill Clinton) would have been in force at the onset of the financial crisis, the Lehman Brothers would still have gone bankrupt in 2008.

Following the same line of arguments, Ferguson says that the large international banks (of systemic importance) still are and had been over-regulated before the crisis too, but they went bankrupt anyhow (aren't we speaking today of banking crises?), while the hedge funds, among the few still unregulated areas, next to the *credit default swaps* (CDS), had little to suffer.

What Ferguson means is that **regulation is not always in agreement with the activities it has to keep in order**. On the contrary, too many regulations within a complex system, such as the global financial system is today, **regulation itself becomes a source of systemic risk**, according to the law of the unintended consequences.

The financial system turned extremely complex, both in terms of markets and institutions, and in terms of operations and instruments, particularly after the 1970 years. The lesson of the impossible planning learnt by the people who experienced the fall of the centralised economy, should also be transmitted to the people sustaining that over-regulation is the solution to the stability of the global financial sector. The purpose of regulation (improvement by simplification and clarity or over-regulation and increased costs) still is an open issue for the G-20, despite the consensual directions of action. It is the field of theoretical and practical debates which are still far from finishing, because they impede the interests of some financial centres that cannot be dissociated from the interests of the states where they are located.

Is the nature of the central bank institution adrift?

The historic review of the central bank's basics and of the financial environment basics, leaping back into history and then back to the present, necessarily draws attention on the doubts whether a central bank may someday cease to be an **independent, efficient and credible institution**.

Accepting the existence of increasing sovereign debts raises a lot of questions, concerns and even worries, by the multitude of witnessed facts and reaction to these facts. The most debatable case is, maybe, that of the European Central Bank which, from the onset of the financial crisis until now, "amazes" either by excessive conservatism or by looseness circumscribed to some political ideas/pressures, depending on the discourse of the former president (Claude Trichet), or of the present president (Mario Draghi).

The **independency of the central bank is endangered by the necessity for fiscal activism**, imposed in a way by politics. The salvaging of the financial sector presumed expanding the central banks balance sheets so that they indirectly are involved in fiscal policy. Furthermore, the persistence of the large public debts and of the low economic growth seems to prompt the central banks to maintain the interest rate at a low level, but this didn't help the economy to start again. Therefore, the central bank policy is no more quite independent.

Furthermore, the **central banks also became surveyors** of the financial system, their mandate being completed – not necessarily by law, but by opinions – with that of the financial stability and macro-stability which forces another type of coordination, different from the traditional mix of policies. This means involving them in an activity of over-regulation, in which the **exertion of the role of regulator and controller at the same time will induce new systemic risks**. This might decrease the **efficiency** of the core central bank activity.

The involvement of the central banks in over-regulation poses one more risk. The recent years have shown that few of the bank employees have been found guilty for cheating the trust of their clients (breach of contract) and even fewer were sentenced to specific terms behind bars. Bob Diamond (former Barclay's official) will probably not be convicted; he may just receive a smaller package of benefits from his contract with Barclay's. The **fail to enforce the provisions of the state of law by enforcement of the law** (exemplary punishment of the culprits) may cause the central banks to lose **credibility**.

Strategy of monetary policy

The post-WW2 evolution of the theory and practice regarding the role of the monetary policy and of the instruments of monetary policy shows a significant mutation. The central bank no longer plays a direct role in the economic growth, but only for the macroeconomic stabilization, in ensuring the support for the future sustainable economic growth. Its instruments are no longer strictly related to amount of credits (to the monetary aggregates), but to the price of money (interest rate). Hence, a change in the concern for the mechanism and transmission channel of the main monetary impulse given by the price of money, the monetary policy interest rate.

There are at least two currents of opinion regarding the grounds for changing the central bank role and implicitly, its mandate. The first one, the standard one, shows that this evolution occurred through a natural process of learning from mistakes. Thus, the international monetary system set by the Bretton Woods agreements eroded with the international consolidation of the US economic and military strength (due to the interests generated by the position of the USA, the US dollar) could no longer be the basis for the fixed exchange rates. The reason for this was that the US decision-makers no longer could take decisions strictly on the basis of the economic criteria: the geopolitical and geostrategic criteria also had to be taken into account. The new volatilities triggered by the increasingly complex interdependencies between states also changed the mandate of the central banks.

Then, the monetary policy get out from the shadow of the fiscal policy (*the fiscal dominance*) and the economic adjustment done on the basis of the signals given by the aggregate offer replaced the adjustment determined by factors of the aggregate demand. Finally, the central banks became the **leading actor of the economic stabilization** with the main mission of **preserving price stability** and thus alleviating the multiple volatilities.

The other current shows that the gradual transition of the central banks to limited responsibility of the price stability by inflation targeting was done on pragmatic grounds: pressure of IMF adjustment programs for the external imbalances. The reason of this argument is that IMF researches were sure that using econometric models, which were, nevertheless, insufficiently developed and tested, the decrease in the inflation volatility would have diminished GDP volatility too, an effect which increases the probability to recover IMF loans given to the states in difficulty, in other words a better preservation of IMF resources by their further borrowings.

Inflation targeting has, however, more subtle and profound implications **regarding the time horizon** of the central bank's policy and the **pace** it imposes to the economy. The modifications mentioned above cut short considerably this time horizon (at least shorter than two years). **The main problem of the shorter time horizon is related to savings** or, more precisely, to the decreasing perception that the central bank is the main source for the future development.

There is a lot of talk about the mismatch between the time horizon of the deadlines for savings and of the loans, particularly in terms of ensuring the crediting resources. If the internal saving is not enough, the external saving may be used, through lines of financing. In all cases, regarding either the stimuli of the monetary policy or its instruments or the transmission channel, we encounter the predominance of the short term.

Stimuli of the monetary policy

The first proof that the time horizon of the central banks' activity shortened much more, in the case of the central banks applying explicitly inflation targeting, is the enumeration of the factors which determine/mobilise the intervention of the central banks. In principle these factors are **the inflation expectations, inflation as such and the movements on FX market**.

In principle, the most "tangible" perception of the public and of the business environment regarding the **inflation expectations** is somehow around an interval of 3 months; this may be the time horizon for which the public at large may forsee most accurately all its activities.

Following the same idea, the most tangible representations of the public at large about the **inflation rate** are for an interval not exceeding six months; probably this is the past period for which the public at large has the "correct" memory of its economic activities.

In the case of the **dynamics of the FX market**, the perceived time interval is even shorter, maybe even less than one month. For instance, IMF calculated that, for Romania, the longest time interval across which most of leu depreciation reaches the prices is of 3 weeks, and the public perception verifies this time horizon through the reactions to the change of the exchange rate of the leu (unfortunately almost exclusively depreciation).

Monetary policy instruments

The analysis of the whole set of instruments available to the monetary policy is directed towards the same goal of shortening the time horizon. Before passing to inflation targeting, the economic theory considered that the monetary policy instrument was a specific amount of monetary mass which resulted from an exogenous relation built by the central bank. Actually, what the central banks were doing in an obscure manner before adopting inflation targeting and in a transparent manner after inflation targeting was adopted was to set the cost of the overnight credits on the monetary market. This interest rate is sued for the monetary market operations and its signal is given by the interest rate as main instrument of monetary policy.

The minimum reserve requirements, the other important instrument of the central banks, don't contribute to the prolongation of the time horizon of the monetary policy because they play their role within the span of a month. The interval at which the central bank verifies their establishment is no longer identical with that of the proof of their permanent existence during the required period of time.

The transmission channel of the monetary policy

The central banks have expectations regarding the lag of the monetary policy instruments, being concerned with the fluidity of the transmission channel and with the way in which the impulses are received by the real economy via the commercial banks. The main mechanism by which the monetary policy influences the real economy is the interest rate, but via the banking and financial sector.

In principle, the statistics show that most credits have maturities equivalent to the medium term (1-5 years), but the behaviour of the debtors from the company sector is to renegotiate the credits in order to fit the conditions of the monetary market. In this way, both the aggregate offer from the real economy and the balance sheet assets of the banks are pushed to get oriented financially towards the short term, less than one year.

On the other hand, the saving behaviour of the companies is getting to be limited to a horizon no larger than 6-9 months, because the credits can be renegotiated annually. Furthermore, the saving behaviour of the households is limited to the period of one year because of the short time horizon of the economy.

There are two consequences of this interference of the short horizon of the monetary policy within the saving behaviour. First, the households, in their quality of labour offer, are no longer interested in making investments from their own medium-term savings, but instead we witness the propensity not to save anymore. Second, the economic progress, which depends much on innovation, is threatened at each short-term cycle. The reason is that the company sector doesn't have enough medium and long-term deposits for the research-innovation activities.

Interactions of the monetary policy

In accomplishing its role of macroeconomic stabilization, the central bank acts (or should act) next to the fiscal policy through the policies mix. In other words, the redistribution from the budget must be balanced by the revenues obtained through taxation and inflation.

The fiscal policy time horizon is of one year because of the law of the budget which also is annual. Despite the multiannual European budgets, the fiscal year remains the basis of the fiscal policy. On the other hand, as shown above, the monetary policy has time scale effect shorter than one year, practically three-month cycles. Therefore, the economic policies induce an annual volatility in economy by their very nature.

The monetary policy interacts permanently with the real economy and assumes, via the exchange rate, signals external to its area of influence. In the case of this interaction, the frequency of the modifications increases with the economic openness. Or, it has been shown that the influences of the exchange rate mobility to this interaction have a time horizon of less than one month.

Central bank’s policy

The time horizon in which the instruments available to the bank are set in action forms the time horizon of the overall policy of a particular central bank. There are at least three reasons why the central bank’s policy focuses on the short term.

First, the role, mandate and instrument available to the central bank lead toward a monetary policy on the short term. Second, the influence of the monetary policy both through the transmission channel and through the interaction with the other policies or with the real economy focuses on the short term. Third, the responsibility of the central bank is defined on a short time, one year, because the objective of the central banks using the inflation targeting strategy is to achieve a particular level of inflation over one year, even if the target is communicated two years earlier.

Conclusions

The two parts of this article aimed to show that the **central banks are increasingly closer to a moment of crisis in their existence.** The crisis comes from the fact that **their institutional role is to support the long-term development of an economy**, while **their actions through the monetary policy denotes a short-term concern**.

Two extreme scenarios can be foreseen for the evolution of the central bank institution. One extreme, boosted by the present pressure of the need for answers to the crisis of the sovereign debts and by the resumption of the sustainable economic growth, is the change of the institutional role of the central bank, its possible "contraction" to an appendix of the fiscal policy, with the only responsibility of the **public debt management.** The other extreme would be the resumption of **their initial role as guardian of the future saving**, but this entails finding a new way of controlling the current inflation.

Reality shows that the extremes are not the scenarios with the highest odds of turning real; hence, the **central banks will actually drift** along the current crisis, with a more difficult mandate of price stability, financial stability and public debt manager. But, even this presumed evolution may **erode rapidly the credibility of the central bank institution**, which came from the fact that **they were the guarantor for the state of law**.

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