

Discussion of “Legal, Actual and
Desirable Independence: A Case
Study of the Bank of Israel”
Alex Cukierman

By
Zvi Eckstein
Bank of Israel, Tel Aviv University and
University of Minnesota

Main points

- Provide **legal** and **actual** (new) indices of bank independence.
- Use this method to analyze the impact and desirability of CB independence following the Israeli case.
- **Legal Independence:** An index of 16 indicators taken from the CB legal charter (law) – including main adjustments.

Main points (cont.)

- **Actual** Independence index: An index that is based on the same rational as **Legal** with items related to independence in: **monetary policy** (OMO, capital controls, etc.); **Lending** to the Gov't; **Objectives**.
- **Actual** index includes formal **legal** changes, **MOU** and **behavior**.
- **Main difficulty: Actual** is more subjective index than the **Legal**.

Table 2: Over time evolution of the actual independence of the Bank of Israel

Year	AVAW (actual)	Memo: LVAW (legal)	Year	AVAW-Actual	Memo: LVAW (legal)
Pre 1985	0.13	0.39	1994	0.51	0.46
Post 1985 -Average	0.52	0.46	1995	0.55	0.46
1986	0.50	0.46	1996	0.52	0.46
1987	0.44	0.46	1997	0.57	0.46
1988	0.39	0.46	1998	0.64	0.46
1989	0.32	0.46	1999	0.64	0.46
1990	0.39	0.46	2000	0.69	0.46
1991	0.44	0.46	2001	0.66	0.46
1992	0.43	0.46	2002	0.66	0.46
1993	0.46	0.46	2003	0.64	0.46

Figure 1: The inflation target, actual inflation and expected inflation

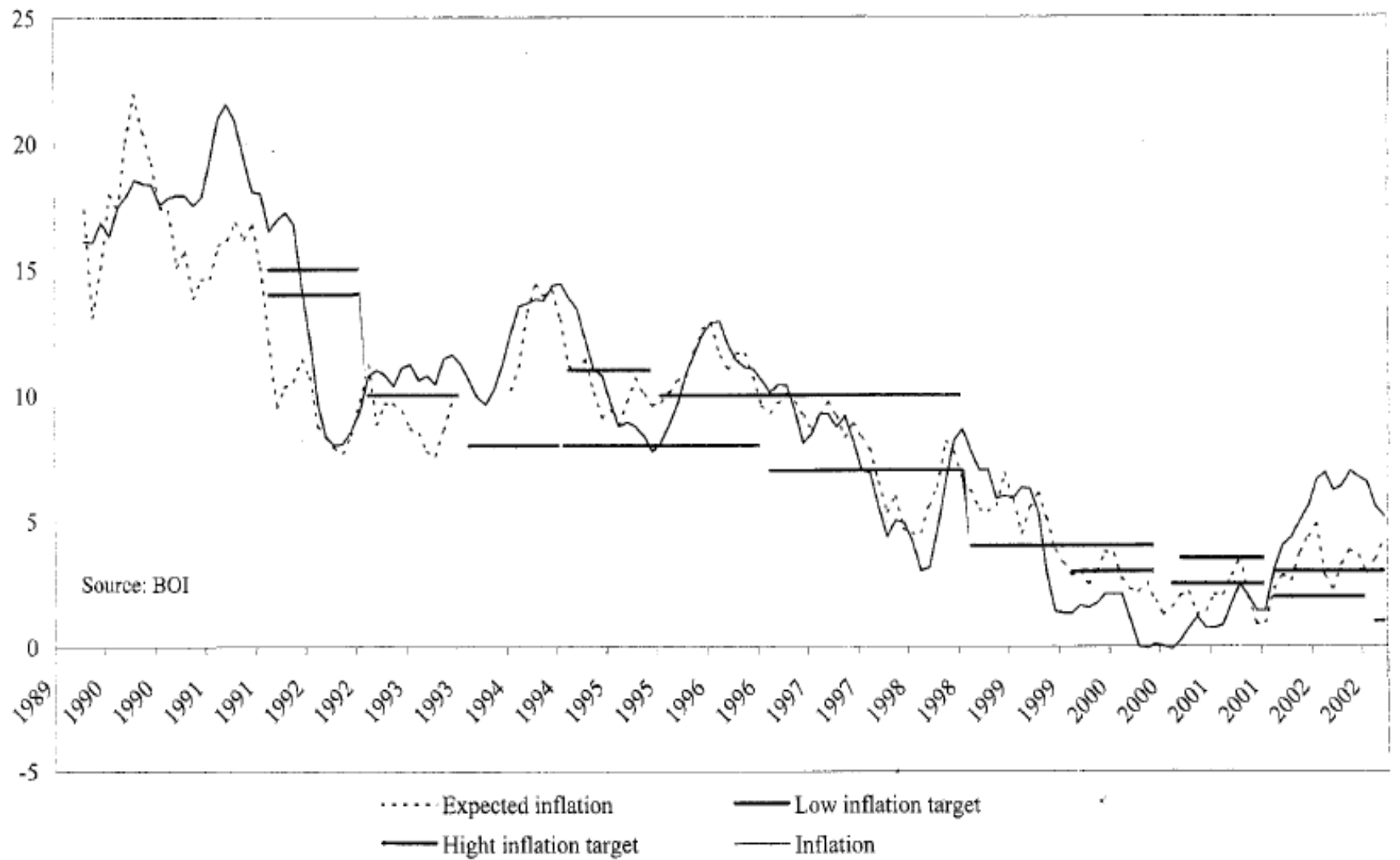


Figure 2: NIS exchange rate against the currency basket

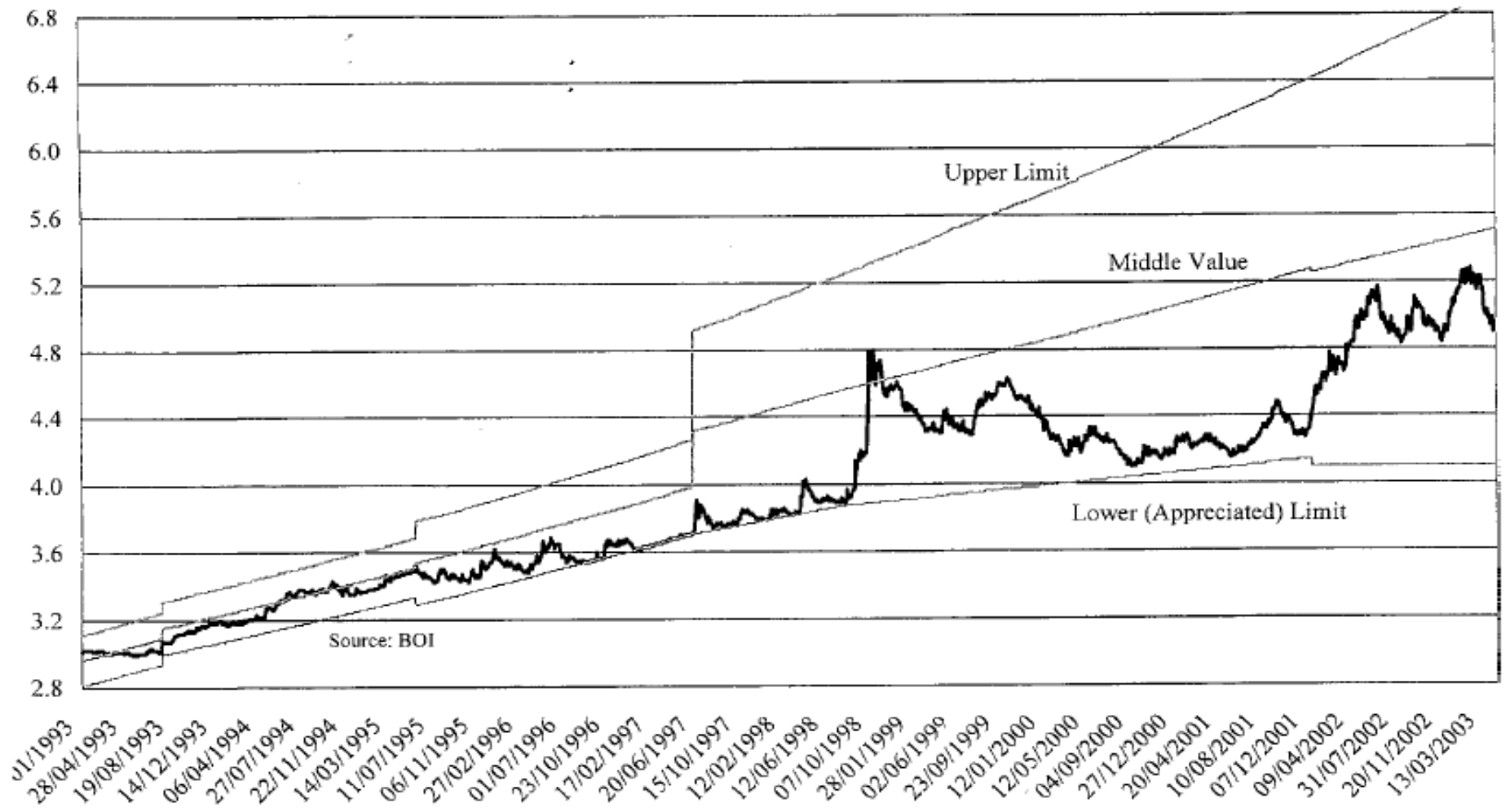


Table A4: The behavior of the ex ante real rate of the Bank of Israel since mid 1989

Date	Bank of Israel nominal rate of interest	Inflation expectations (for the next 12 months)	Bank of Israel real rate of interest	Date	Bank of Israel nominal rate of interest	Inflation expectations (for the next 12 months)	Bank of Israel real rate of interest
06/1989	10.92	12.14	-1.09	06/1993	12.76	8.68	3.75
07/1989	11.2	13.86	-2.34	07/1993	11.85	8.47	3.12
08/1989	10.29	14.31	-3.52	08/1993	10.16	7.75	2.24
09/1989	13.3	13.82	-0.46	09/1993	9.45	7.59	1.73
10/1989	16.85	17.43	-0.49	10/1993	9.48	8.63	0.78
11/1989	15.86	15.45	0.36	11/1993	9.75	9.70	0.05
12/1989	16.51	18.23	-1.45	12/1993	10.24	.	.
01/1990	18.2	21.62	-2.81	01/1994	11.04	.	.
02/1990	18.98	20.92	-1.60	02/1994	11.1	.	.
03/1990	18.16	17.39	0.66	03/1994	11.1	.	.
04/1990	15.87	13.13	2.42	04/1994	11.1	.	.
05/1990	14.5	15.10	-0.52	05/1994	11.54	.	.
06/1990	14.38	17.99	-3.06	06/1994	12.19	10.23	1.78
07/1990	15.19	17.42	-1.90	07/1994	12.81	11.14	1.50
08/1990	15.02	20.10	-4.23	08/1994	13.32	13.32	0.00
09/1990	16.54	21.97	-4.45	09/1994	15.07	14.39	0.59
10/1990	15.89	20.45	-3.79	10/1994	16.73	13.96	2.43
11/1990	15.11	19.24	-3.46	11/1994	16.78	14.15	2.30
12/1990	14.41	17.51	-2.64	12/1994	18.47	12.99	4.85
01/1991	15.2	17.37	-1.85	01/1995	18.51	11.17	6.60
02/1991	14.85	15.15	-0.26	02/1995	18.31	10.95	6.63
03/1991	14	15.72	-1.49	03/1995	17.23	11.39	5.24
04/1991	13.19	13.88	-0.61	04/1995	15.82	10.10	5.19
05/1991	13.65	14.63	-0.85	05/1995	15.02	9.11	5.42
06/1991	13.73	14.69	-0.84	06/1995	14.49	9.40	4.65
07/1991	13.88	15.95	-1.79	07/1995	14.44	8.81	5.18
08/1991	14.53	16.20	-1.44	08/1995	14.21	9.76	4.05
09/1991	15.08	16.85	-1.51	09/1995	14.18	10.67	3.17
10/1991	21.55	16.23	4.58	10/1995	14.80	10.03	4.33
11/1991	24.15	16.76	6.33	11/1995	15.26	9.59	5.18
12/1991	19.43	15.10	3.76	12/1995	15.19	9.75	4.96
01/1992	15.85	12.14	3.31	01/1996	14.70	10.13	4.15
02/1992	13.75	9.54	3.84	02/1996	15.04	10.58	4.03
03/1992	11.74	10.31	1.30	03/1996	15.05	10.75	3.88
04/1992	11.79	10.59	1.09	04/1996	15.24	11.78	3.10
05/1992	11.76	11.40	0.32	05/1996	16.01	12.62	3.01
06/1992	11.5	10.73	0.70	06/1996	17.01	12.84	3.69
07/1992	11.69	8.73	2.72	07/1996	18.58	11.55	6.30
08/1992	11.73	8.34	3.13	08/1996	17.69	11.06	5.97
09/1992	11.63	7.89	3.47	09/1996	17.11	11.66	4.88
10/1992	11.7	7.69	3.72	10/1996	16.81	11.62	4.65
11/1992	10.94	8.40	2.34	11/1996	16.44	10.70	5.18
12/1992	10.84	9.76	0.98	12/1996	16.36	9.58	6.19
01/1993	11.51	11.20	0.28	01/1997	15.82	9.30	5.97
02/1993	12.79	8.85	3.62	02/1997	15.22	9.69	5.05
03/1993	12.69	9.66	2.76	03/1997	14.96	10.06	4.46
04/1993	12.69	9.68	2.74	04/1997	14.96	9.72	4.77
05/1993	12.99	9.35	3.33	05/1997	14.99	9.20	5.30

Comments

1. **Actual vs. Legal:** Many of the actual changes are legal and these should be separated: Example.
2. **Suggestion:** Add (or provide a third) to the **Legal** the **actual legal** changes and MOU's.
3. Important actual change is the **personality** in charge: B, F, K and S. Add **personality** component to the **Actual**.

Comments (cont.)

- **Capital Controls** and Monetary Policy: The **last action** - In 1.1.2005 the tax on capital gains from Israeli and non-Israeli stocks are equalized. July 11, 2006 – 5% of liquid assets are abroad.
- How these facts expected to affect monetary policy in July 13 – as war erupted?
- **Economic Advisor**: formal channel of communication.