

## **Some Thoughts on Central Banking in Developing Countries: The Art of Central Banking and its Prospective Challenges**

I would like to state that this recognition ceremony symbolizes interest in the affairs of financial economics, due to the significance of its applications (e.g. banking), compared to the basic aspects of traditional economics, and the important role it plays in the overall Kuwaiti economic structure.

As for the subject of my address, I take this opportunity to briefly cover a topic of practical and scientific significance in central banking, namely the art of central banking operations. I shall also seize this opportunity to present some concepts of central banking in developing countries, including the State of Kuwait, and the future challenges they are likely to confront.

### ***First: The Art of Central Banking***

The accumulated expertise derived from past experience provides the basis of the art applied by central banks in the exercise of their functions. It is necessary for central banks that knowledge of economic, financial and monetary theories and policies and their operations be enhanced through coupling that knowledge with art. It is therefore necessary that central banks have in their ranks experienced cadres with a broad knowledge of central banking operations, so that the art they will apply in conducting these operations becomes a feature of their contribution.

Professor **James Tobin**, in his acceptance speech for the Nobel Prize in economics in 1981, emphasized the fact that the art of conducting banking operations has an impact on the way changes in financial markets (money market and financial asset markets) influence real markets for final goods and services, thereby affecting decisions on consumption, production and investment in these markets.

The topic of art and innovation in central banking operations and their ensuing requirements in terms of skills and practical and scientific experiences recalls Euromoney magazine's recent award of the title of "Central Bank Governor for 1996" to the governor of the Bank of

Italy, Mr. Antonio Fazio. In accepting this distinguished award, the Italian governor delivered a speech entitled “The Art of Central Banking” after a book published in 1932 by the famous British economist R.G. Hawtrey. One of the reasons for my own choice of this title, first introduced by Hawtrey 65 years ago, is that it provides me with the opportunity to address a subject presenting an innovative approach to central banking and a clear insight into central banking skills.

Reference to the “art of central banking” and its requirements in terms of practical experience and the human touch recognizes the importance of monetary theory as a basis for the explanation and analysis of central banking operations. I concur here with Hawtrey’s reference to the areas of divergence between the uses of “the art of central banking” on the one hand, and the application of monetary theory and similar scientific rules of monetary policies and procedures on the other hand. Hawtrey says, “Among the special attributes of the art of central banking is that it specifically deals with the functions of an institution directly entrusted with upgrading man’s welfare. Man’s welfare, his motives and conduct are in fact disconcerting, indefinite and complicated. Thinkers and analysts are not, therefore, convinced that these issues can be dealt with only through the theories and scientific rules of adopted policies and procedures; hence, the importance of acquired art and skills and their practical contribution to man’s welfare.”

The State of Kuwait has had experience with the art of central banking within the context of crisis management. One instance was the effectiveness of the credit facilities program for difficult debts in 1986; another was the Central Bank of Kuwait (CBK) operations during the period of the brutal Iraqi occupation and after liberation.

Drawing on its expertise and skills, the CBK contributed to remedying the positions of the banking and financial system during these exceptional periods, along with achieving the required monetary stability aspired to, all in record time. These achievements, which were acknowledged by specialized international bodies such as the International Monetary Fund and an international rating agency, can be further highlighted in the following:

During the first period, the brutal Iraqi occupation, the CBK carried out its operations from outside the country. Extraordinary efforts were deployed by the CBK in two complementary directions, namely immediate and post-liberation needs. The implementation of urgent measures was continually monitored, and thus assisted in effectively confronting the consequences of the illegitimate practices perpetrated by the brutal Iraqi occupation.

The post-liberation efforts, which necessitated far-sightedness, were exemplified by the accurate preparation of a strategy for post-liberation activity which had as its objectives to achieve monetary stability in the country, enhance confidence in the Kuwaiti dinar and rationalize the position of the banking and financial sector.

The second period, post-liberation, witnessed the State of Kuwait's persistence and determination in carrying out the rebuilding process and re-establishing confidence in the domestic economy, especially the oil sector and the banking and financial sector. The CBK's course of action at that time was characterized by work intensity, quality, speed, and the art applied in carrying it out. Yet it is particularly appropriate to mention here the CBK's efforts in clearing the banking and financial system balance sheets of the difficult debt problem. These efforts were already noticeable in Law No. 32 of 1992 concerning the rehabilitation of the banking and financial system.

### ***Second: Future Challenges***

The future challenges that central banks in developing countries, including Kuwait, will have to face will necessitate drawing on their acquired skills and expertise in three main areas:

#### ***1. Restructuring and Reinforcing the Banking and Financial Systems in Developing Countries***

The nature of the coming phase, which will be characterized by the prominence of major economic blocs, increasing competition in world financial markets, and a drive for further globalization and rapid privatization, will necessitate upgrading and modernizing the activities of the banking and financial system and enhancing their capabilities so that they may keep abreast of

the latest requirements in this field, withstand foreign competition, and actively and objectively amalgamate with the world economy. This calls for granting urgent and increased consideration to some areas, most important among which are a disciplined financial policy and sound monetary policy and increased coordination between them, along with enhancing the level and means of banking supervision and providing adequate and safe means of capital and investment flows among developing countries. Such flows have to be established, along with granting foreign trade the importance and incentives it deserves, especially as economic reform programs in developing countries have to be accompanied by measures ensuring free foreign trade and an increase in exports.

2. ***Establishment of an Early Warning System against the Possible Occurrence of Financial Crises***

Financial crises negatively impact the stability of the purchasing power parity of national currencies in developing countries and the soundness of the positions of the banking and financial system in general. This has been demonstrated by the recent economic crises in the economies and markets of South East Asian countries and their political and social repercussions. Authorities must be aware of the means of preventing the occurrence of these financial crises by laying down early warning systems. The rationale underlying the application by central banks of effective banking supervision is the fact that preventing crises costs much less than remedying them. Should a crisis occur, there should be a pre-established strategy for confronting it swiftly, courageously and at the lowest possible cost.

Financial crises in developing countries can be traced to the adoption of unsound economic policies, insufficient banking supervision of local banks, and overlending practices by banking system units, particularly with regard to the granting of loans to be used for speculation in the stock markets.

3. ***Improving the Environment for Banking and Financial Operations in Developing Countries***

Successive economic developments and the dynamic nature of banking and financial sector operations call for reconsideration of many of the rules and regulations which govern economic activities, and which must play a role in establishing a banking and financial atmosphere that meets current and future requirements. Examples of these rules and regulations are those relevant to privatization and foreign investment programs and the independence of central banks, a matter which has lately attracted increased interest from all those concerned with central banking.

I would like to emphasize here that central banks which enjoy an adequate level of independence will be able to play a broader role in achieving the objectives of economic policies, along with developing, organizing and securing the soundness of banking operations swiftly and efficiently. This in turn will result in bolstering the credibility of central banks.

We must underscore two important issues of much relevance to both the art and the future challenges of central banking in developing countries:

***First :*** Central banks in developing countries should ensure that the banking and financial units are well prepared for the twenty-first century and have an effective and pre-set course of action formulated through short and long-term strategic planning. In the years ahead, success will be only for those who will follow an innovative approach and keep abreast of various banking and financial developments.

We are about to cross the threshold of an era which will encompass tremendous developments on all levels, including banking and finance, along with inevitable global integration and openness, as a result of rapid progress in thought, science and means of global communication, coupled with the advent of technological advancement and an information revolution which will reshape the world into what has been termed lately as a “unified global village”.

***Second:*** Central banks in developing countries should further encourage the intellectual and creative capabilities of their citizens in

the banking area. Such citizens are the nation's present strength and the elements of its preparedness for facing the future, and should thus be encouraged and provided with the opportunity to enhance their capabilities, skills and talents so as to equip them to face the issues and challenges in the years ahead in an efficient and advanced fashion, and to withstand competition with their counterparts worldwide.

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