

75th Anniversary Oration of the Central Bank of Sri Lanka



Why Central Bank Independence Matters

– in Crisis, in Recovery, and Beyond

by

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Establishment of the Central Bank of Ceylon

Seven and a half decades ago,
in **1950**, our nation took a
momentous step towards economic
sovereignty with the establishment
of the **Central Bank of Ceylon...**



John Exter, Founder Governor, Central Bank of Sri Lanka

OUTLINE

Understanding Central Bank Independence

From the MLA (1949) to CBA (2023)

Addressing Common Myths and Criticism

Concluding Remarks – Preserving Independence

Understanding Central Bank Independence

- What is central bank independence?
- Why does independence matter?
- Role of Accountability
- Global Case Studies

From the MLA (1949) to CBA (2023)

Addressing Common Myths and Criticism

Concluding Remarks – Preserving Independence

What is central bank independence?

**“Independence is part of
the DNA of central banks”**

–Joachim Nagel, President of Deutsche Bundesbank

“The record is pretty clear” that central bank independence is “a good institutional arrangement that serves the public well.”

– Jerome Powell, Chairman of the Federal Reserve

**Empirical evidence shows that central bank
independence is associated with
LOWER AND MORE STABLE INFLATION
without THE TRADE-OFF OF LONG-TERM
GROWTH STAGNATION...**

Why does independence matter?

**Central bank independence matters because it
allows monetary policy to be shaped to support**

LONG-TERM ECONOMIC STABILITY

without being subject to

SHORT-TERM POLITICAL PRESSURE...

**Central bank independence is also a critical
requirement for maintaining
FINANCIAL SYSTEM STABILITY...**

Role of accountability

“Because monetary policy actions have profound effects on the lives of ordinary people, a central bank in a democracy owes these folks an explanation of what it is doing, why, and what it expects to accomplish. It’s their economy, not ours.”

- Alan Blinder, Former Vice Chair of Federal Reserve (1998)

**Central banks must ensure that the public and
politicians see our decisions as
UNDERPINNED BY OUR MANDATE and the
BROADER INTEREST OF SOCIETY...**

TRANSPARENCY helps bridge
INDEPENDENCE and **ACCOUNTABILITY**...

“For society to appreciate our roles, we... have got to take society along with us, such that when central banks come under attack, it is not just going to be us defending our independence”

– Lesetja Kganyago, Governor of South African Reserve Bank



Global case studies

When Independence has worked: Some examples



When Independence was compromised

“Through history, we have had quite substantial episodes where monetary policy mismanagement has led to devastating effects – in inflation, in financial systems, affecting the wellbeing of individuals and firms, oftentimes bringing countries to the brink.”

– Agustín Carstens, Former General Manager of BIS

When Independence was compromised: Some examples



Germany



Argentina



Zimbabwe



United States



Note: Images are sourced from the web

The ability of a central bank to
ACT DECISIVELY,
MAINTAIN CREDIBILITY,
and provide a STEADY ANCHOR in the storm
of economic uncertainty, is the result of
INDEPENDENCE...

OUTLINE

Understanding Central Bank Independence

From the MLA (1949) to CBA (2023)

- Pressing need for new legislation on central banking
- An Aside: What if the new CBA had been in place during the crisis?
- How the Central Bank helped stabilise the economy following the crisis – even under the MLA

Addressing Common Myths and Criticism

Concluding Remarks – Preserving Independence

Pressing need for new legislation on central banking

The MLA was a

PIECE OF LEGISLATION FAR AHEAD OF ITS TIME

It incorporated many forward-looking features and provisions designed to facilitate sound central banking practices and principles – some of which that remain relevant even today...

While the MLA had served its purpose for decades, it had
NOT UNDERGONE A COMPREHENSIVE REVIEW

in line with the evolving challenges of
monetary and financial stability

...key deficiency of the MLA was that the success of
polycymaking was person dependent...

“The effectiveness of co-operation and coordination between the Monetary Board and the Government will depend more upon the men occupying the key positions at particular times than upon any legal formula, no matter how carefully or elaborately it might be worked out.”

– John Exter

While the autonomy of the Central Bank was compromised from time to time, there were notable instances where the

**MONETARY BOARD EXERCISED INDEPENDENT
JUDGEMENT**

**– even with the Secretary to the Treasury
as a member...**

**Recognising the deficiencies and evolving needs,
the CBSL initiated a process to modernise its
governing legislation in 2017**

In April 2018, a **CABINET MEMORANDUM was
submitted seeking approval in principle for
reforms to the country's Central Bank law...**

The drafting of the CBA was guided by three overarching objectives:

- 1 Strengthening the governance of the institution**
- 2 Securing independence and accountability to support the adoption of FIT and ensure durable price stability**
- 3 Enhancing financial sector oversight and resilience**

An Aside: What if the New CBA had been in place during the crisis?

**The failure to enact the new CBA in 2019
was a **MISSED OPPORTUNITY**
of historic proportions...**

Under the revised framework, the CBSL would have been empowered to resist **EXCESSIVE MONETARY FINANCING, maintain a credible **COMMITMENT TO PRICE STABILITY**, and allow **GREATER EXCHANGE RATE FLEXIBILITY**.**

...These institutional safeguards could have prevented the build-up of vulnerabilities that ultimately pushed the economy to the brink...

**Even if the crisis, rooted in fiscal mismanagement,
could not have been entirely avoided, an empowered
and independent Central Bank would have acted
SOONER and MORE DECISIVELY,
MITIGATING THE SEVERITY OF THE
ECONOMIC DISTRESS...**

**Sri Lanka's recent experience has reaffirmed
a fundamental truth:**

CENTRAL BANK INDEPENDENCE

IS NOT A LUXURY – IT IS A NECESSITY...

How the Central Bank helped stabilise the economy following the crisis – even under the MLA?

“Price stability and prevention of crises are indeed the core goals of central banking. But it is the central bank’s ability to react effectively to crisis situations that most test their skills and preparedness. Over the years, failure to contain financial crises has entailed enormous economic costs.”

– Patrick Honohan, Former Governor of Bank of Ireland

**Sri Lanka encountered
an **UNPRECEDENTED CRISIS** in 2022
marked by severe balance of payments
pressures, social and political unrest, and a
profound loss of confidence in institutions, all
while an external debt default loomed...**

The Government eventually sought
IMF ASSISTANCE
and
ANNOUNCED A DEBT STANDSTILL
as an interim measure, paving the way for debt
restructuring negotiations...

**The Government and the Central Bank
implemented a bold
STABILISATION PACKAGE**

**Notably, replacing the MLA with the new CBA
enshrined greater independence and
accountability in the new legislation...**

Still under the MLA, the CBSL adopted
AN EXTENSIVE ARRAY OF MEASURES
to stabilise the economy and recover from its dire
straits since the onset of the crisis in early 2022

As a result, inflation was brought down from a peak of
nearly 70% in September 2022 to single digits by
mid-2023, with price stability maintained since then...

SRI LANKA AVOIDED A SYSTEMIC BANKING CRISIS

– a **REMARKABLE ACHIEVEMENT**

given the depth of the economic and debt turmoil...

CBSL worked tirelessly to

RESTORE PUBLIC CONFIDENCE

**– through frequent communications,
press briefings, and transparent explanations of
policy decisions...**

Provisions for independence and accountability in the New CBA

**The enactment of the CBA in 2023
marked a
LANDMARK STRUCTURAL REFORM,
significantly strengthening the
independence of the CBSL
to perform its streamlined mandate...**

Key provisions on independence and accountability

Objects of the Central Bank

Section 6

Monetary Policy Board (Under a FIT framework)

Section 11

Fiscal-Monetary Coordination

Section 83

Prohibition of Monetary Financing

Section 86

Monetary Policy Framework Agreement

Section 26

Monetary Policy Report & Annual Economic Review

Sections 27 & 80

Administrative and Financial Autonomy

Section 5

Appointment of the Governor and other appointed members

Sections 15 & 19

How do CBA provisions on independence and accountability, and activities since the introduction of the CBA benefit the nation?

Monetary financing
NO LONGER OCCURS
under the CBA...

**Several provisions have been made in the CBA
to increase the **ACCOUNTABILITY** of the
Central Bank under the FIT framework...**

As the **MACROPRUDENTIAL AUTHORITY**
in Sri Lanka, the CBSL is empowered
to independently monitor systemic risks and
proactively safeguard financial system stability...

Strengthening the BROADER LEGAL FRAMEWORK governing Sri Lanka's financial sector...

Banking (Amendment) Act, No. 24 of 2024

Banking (Special Provisions) Act, No. 17 of 2023

CBSL has intensified its efforts to advance
FINANCIAL INCLUSION and
enhance FINANCIAL LITERACY...

OUTLINE

Understanding Central Bank Independence

From the MLA (1949) to CBA (2023)

Addressing Common Myths and Criticism

- Is there no coordination between the Central Bank and the Government?
- Is the CBSL beyond Sovereignty and accountable only to external agencies?
- Is the CBSL's financial independence a new concept?
- Independence vs. expectations: What can the CBSL truly deliver?
- The Central Bank's role in conducting agency functions

Concluding Remarks – Preserving Independence

“Any public job involves both undue praise and unfair criticism... yet it is the latter that is probably more useful in helping you sharpen your message.”

- Raghuram Rajan, Former Governor of RBI (2017)

Myth 01:

Is there no coordination between the Central Bank and the Government?

**Coordination between monetary and fiscal
authorities remains **ESSENTIAL****

**The CBA ensures this through the
establishment of a statutory
COORDINATION COUNCIL...**

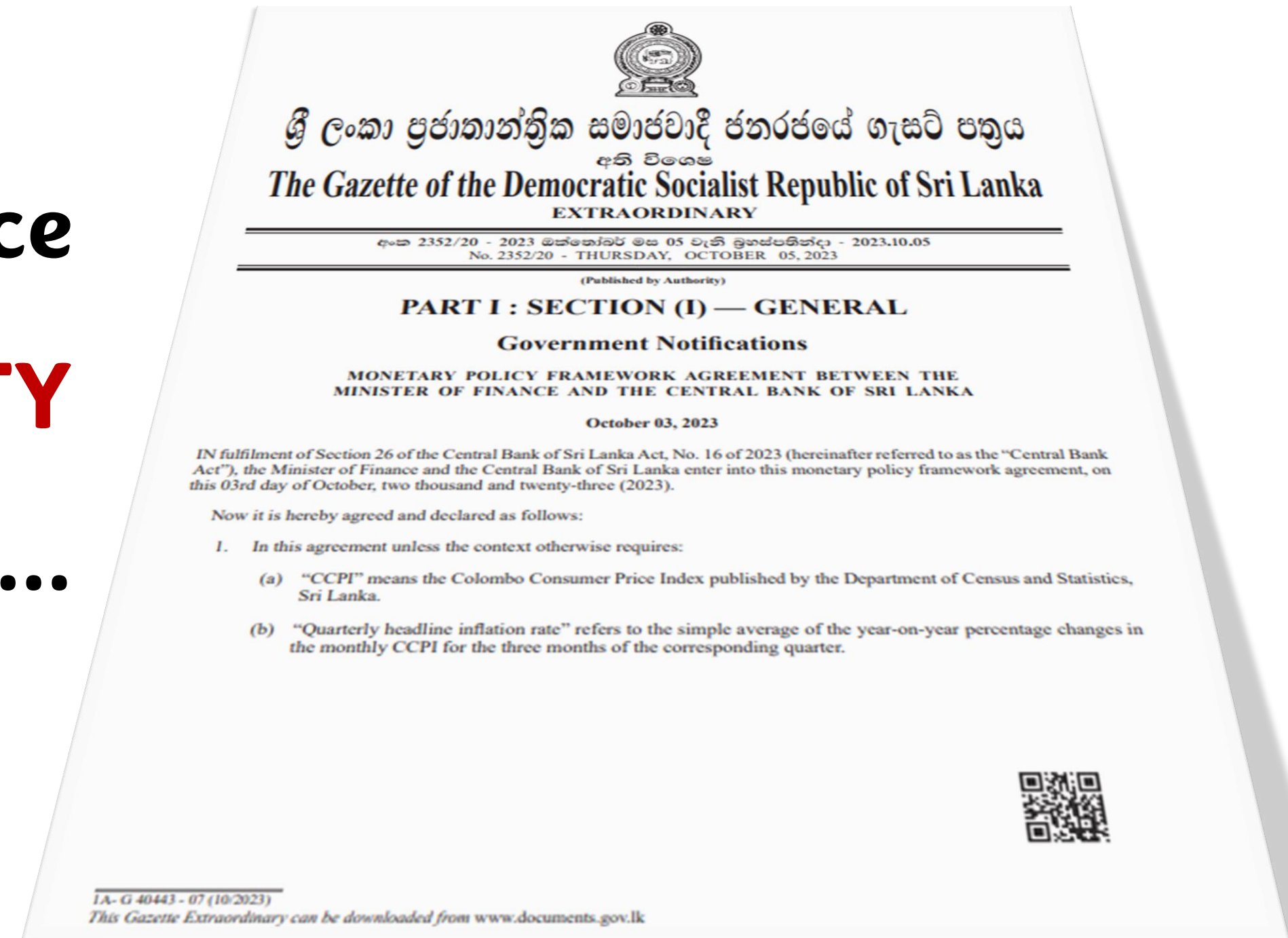
**CBSL works closely with the Government,
international financial institutions, and
other regulators, particularly in the areas
of **CRISIS MANAGEMENT** and
FINANCIAL SYSTEM OVERSIGHT...**

Myth 02:

**Is the CBSL beyond Sovereignty and accountable only
to external agencies?**

The CBA provides a
ROBUST FRAMEWORK
to ensure the CBSL's accountability to
Parliament and, ultimately,
to the people of Sri Lanka...

Ministry of Finance **SHARES RESPONSIBILITY** for setting the inflation target...



CBSL also serves as the
GOVERNMENT'S REPRESENTATIVE
in fostering international relations
with institutions such as the IMF...

Myth 03:

Is the CBSL's financial independence a new concept?

**The CBSL's independence is
not entirely a new thing, but it has been
SIGNIFICANTLY STRENGTHENED
under the CBA**

**Even under the MLA, the CBSL was vested with a
high degree of financial independence...**

Myth 04:

**Independence vs. expectations:
What can the CBSL truly deliver?**

Core objective is to achieve and maintain

DOMESTIC PRICE STABILITY

...also tasked with securing

FINANCIAL SYSTEM STABILITY...

**CBSL's role is to create an
ENABLING ENVIRONMENT OF STABILITY,
within which the Government and other
authorities can implement
growth-oriented policies...**

**Under the current flexible exchange rate
regime mandated by the CBA, the value of
the Sri Lanka rupee is determined by
MARKET FORCES...**

Myth 05:

The Central Bank's role in conducting agency functions

CBSL has been ENTRUSTED through various statutes with the responsibility of carrying out VARIOUS AGENCY FUNCTIONS on behalf of the Government...

This has arisen due to the
PUBLIC TRUST,
as well as the absence of
other acceptable
INSTITUTIONAL ARRANGEMENTS...

Concluding Remarks

Preserving independence is indispensable to safeguarding the stability and prosperity of a nation

History and global experience demonstrate that central banks with **clearly defined mandates are best positioned to deliver on their promises.**

Transparency and **open communication** are essential to building public trust

Effective macroeconomic management requires **constructive dialogue and coordination** between the Central Bank and the Government, particularly on fiscal, monetary, and financial sector policies

“While recent research suggests that de jure central bank independence has never been more prevalent than it is today, there is no doubt that the de facto independence of central banks is being called into question in several parts of the world.”

– Christine Lagarde, President of ECB

“Central bank independence is a fine institution that ought to be preserved where it exists and emulated where it does not.”

– Alan Blinder

It is the
**RESPONSIBILITY OF FUTURE
GENERATIONS**
to
PROTECT, PRESERVE, and PROMOTE
the independence of the Central Bank
to serve as a steadfast anchor of stability
for sustainable growth and
shared prosperity...



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Thank you