Aims and Scope
Understanding Monetary Policy Series are designed to improve monetary policy communication as well as economic literacy. The series attempt to bring the technical aspects of monetary policy closer to the critical stakeholders who may not have had formal training in Monetary Management. The contents of the publication are therefore, intended for general information only. While necessary care was taken to ensure the inclusion of information in the publication to aid proper understanding of the monetary policy process and concepts, the Bank would not be liable for the interpretation or application of any piece of information contained herein.

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Central Bank of Nigeria

Mandate

- Ensure monetary and price stability
- Issue legal tender currency in Nigeria
- Maintain external reserves to safeguard the international value of the legal tender currency
- Promote a sound financial system in Nigeria
- Act as banker and provide economic and financial advice to the Federal Government

Vision

“By 2015, be the model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development”

Mission Statement

“To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector”

Core Values

- Meritocracy
- Leadership
- Learning
- Customer-Focus
MONETARY POLICY DEPARTMENT

Mandate
To Facilitate the Conceptualization and Design of Monetary Policy of the Central Bank of Nigeria

Vision
To be Efficient and Effective in Promoting the Attainment and Sustenance of Monetary and Price Stability Objective of the Central Bank of Nigeria

Mission
To Provide a Dynamic Evidence-based Analytical Framework for the Formulation and Implementation of Monetary Policy for Optimal Economic Growth
The understanding monetary policy series is designed to support the communication of monetary policy by the Central Bank of Nigeria (CBN). The series therefore, provides a platform for explaining the basic concepts/operations, required to effectively understand the monetary policy of the Bank.

Monetary policy remains a very vague subject area to the vast majority of people; in spite of the abundance of literature available on the subject matter, most of which tend to adopt a formal and rigorous professional approach, typical of macroeconomic analysis. However, most public analysts tend to pontificate on what direction monetary policy should be, and are quick to identify when in their opinion, the Central Bank has taken a wrong turn in its monetary policy, often however, wrongly because they do not have the data for such back of the envelope analysis.

In this series, public policy makers, policy analysts, businessmen, politicians, public sector administrators and other professionals, who are keen to learn the basic concepts of monetary policy and some technical aspects of central banking and their applications, would be treated to a menu of key monetary policy subject areas and may also have an opportunity to enrich their knowledge base of the key issues. In order to achieve the primary objective of the series therefore, our target audience include people with little or no knowledge of macroeconomics and the science of central banking and yet are keen to follow the debate on monetary policy issues, and have a vision to extract beneficial information from the process, and the audience for whom decisions of the central bank makes them crucial stakeholders. The series will therefore, be useful not only to policy makers, businessmen, academicians and investors, but to a wide range of people from all walks of life.

As a central bank, we hope that this series will help improve the level of literacy in monetary policy as well as demystify the general idea surrounding monetary policy formulation. We welcome insights from the public as we look forward to delivering content that directly address the requirements of our readers and to ensure that the series are constantly updated as well as being widely and readily available to the stakeholders.

Moses K. Tule
Director, Monetary Policy Department
Central Bank of Nigeria
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Introduction

Monetary authorities, mainly the central banks, have several instruments in their toolbox in the conduct of monetary policy to achieve specific statutory mandate. The mandate usually comprises of price stability, and may sometimes include economic growth and development on a wider scale. The monetary policy tools or instruments are used to control interest rates, inflation, exchange rate and other macroeconomic aggregates, in order to achieve price stability. Moral suasion is one major policy instrument that is used by most central banks or monetary authorities in the conduct of monetary policy, and for ensuring compliance of the different economic agents with monetary policy guidelines. It is, however, rarely mentioned or discussed as a policy instrument primarily because of its rare application in most jurisdictions, and partly because it is hardly a major policy instrument in those jurisdictions.

Moral suasion is a strategy used by a monetary authority (e.g. Central Bank of Nigeria) to influence and pressure, but not force, banks and other economic agents into adhering to its policy and guidelines. It is a qualitative, not-measurable but direct instrument aimed at pressuring different economic agents to comply with monetary authority’s policy guidelines.

An understanding and application of moral suasion as a policy instrument is, therefore, critical to the effectiveness and implementation of monetary policy for two main reasons:

1. This publication is not a product of vigorous empirical research. It is designed specifically as an educational material for enlightenment on the monetary policy of the Bank. Consequently, the Central Bank of Nigeria (CBN) does not take responsibility for the accuracy of the contents of this publication as it does not represent the official views or position of the Bank on the subject matter.

2. David E. Omorogie is a Principal Manager in the Monetary Policy Department, Central Bank of Nigeria
Firstly, the recent global financial crisis and its consequences have led different monetary authorities to adopt alternative non-traditional policy instruments to address the crisis, leading to the application of non-conventional policies in the new normal. A major aspect of the new normal policy is an apparent strong reliance by some jurisdictions, especially in the developed economies, on the use of direct pressure on the financial institutions to comply with monetary policy guidelines. Moral suasion is one major direct policy instrument.

Secondly, the use of moral suasion can be viewed as a catch-all policy instrument, which must be present in the policy toolbox of a modern monetary authority, given the incessant failure of the well-known, well-used and well-tested traditional instruments.

This paper defines and discusses moral suasion and its application as a monetary policy instrument in the twenty-first century. It focuses on its meaning and purpose as a policy instrument, and dovetails to its key effectiveness and drawbacks.

Following the introduction, section 2 discusses the concepts and definitions of moral suasion as a policy instrument. Section 3 presents moral suasion along with other monetary policy instruments. In Section 4, the various methods for implementing moral suasion are presented and discussed on a wider context, while section 5 discusses the effectiveness of moral suasion, listing factors that determine its effectiveness. Section 6 contains some practical examples of the use of moral suasion as an instrument of monetary policy in a selected number of countries. Finally, section 7 concludes the discussion, and presents a key policy implication for developing countries.
MORAL SUASION AS A MONETARY POLICY INSTRUMENT

SECTION TWO

Moral Suasion Concepts and Definitions

Moral suasion is known by different names in different jurisdictions. It is called 'window guidance' in some parts of Asia, and in the U.S., 'jawboning', indicating that it involves the use of the persuasive power of talk instead of legislation. Colloquially, it is referred to as 'Open Mouth Operation' (OMO) as against open market operations, a different quantitative monetary policy instrument. The 'moral' aspect derives from the need for institutions to operate in a way that is consistent with 'moral responsibility' in order to enhance the good of the economy. Often simply termed 'Suasion', it is a persuasive strategy used by monetary authorities (i.e. Central Banks) to influence and pressure, but not force, banks and other economic agents to adhere to policy. It usually involves closed-door meetings with bank executives, appeals to community spirit, escalation of supervision and inspection, and sometimes vague threats.

Moral suasion is, technically speaking, an instrument by which policy makers or leaders encourage or discourage particular behaviors of consumers, businesses, and other economic agents, without resorting to formal actions such as laws or legislation. The use of moral suasion is somewhat more effective during short-term crises such as wars, energy shortages, or financial instability. Moral suasion is often used as a monetary policy when the monetary authority (e.g. central bank) does not want to, or have the time to, use other monetary policy tools. It is also used when other monetary policy instruments failed or cannot be used to persuade economic agents to adopt certain policy guidelines.

As moral suasion involves the use of various persuasion methods, it is aimed to motivate economic agents (e.g. banks, businesses) to adhere to specific policy guidelines or procedures. It works effectively to influence outcomes by appealing to morals and ethics, and often identifies specific actions that are the right thing to do for the good of all. Although moral persuasion is popularly used by governments to influence the business activities and functions of banks and other financial institutions, it can also be used in a wide range of other situations.

Moral suasion also implies exerting pressure on the banking system, or other economic agents, without any strict action to ensure compliance with the rules. In many cases, it is a suggestion to banks to do or not to do something. Moral suasion is used to inform the commercial banks about the expectations of the central bank through a monetary policy guideline. Using moral suasion, the central banks can issue directives, guidelines and suggestions for commercial banks regarding what action to take or not to take.
In many jurisdictions, moral suasion is mostly used to persuade financial institutions (especially banks) to adhere to official policy guidelines issued by monetary authorities.
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SECTION THREE

Moral Suasion and other Monetary Policy Instruments

In the conduct of its monetary policy, the central bank uses several instruments, depending, of course, on its adopted policy framework. Broadly, there are two categories of monetary policy instruments used by most central banks to achieve their statutory mandate (mainly price stability). Meyer (1980) identified the instruments as either general or selective controls. On the one hand, general controls have their primary effects on either the net monetary base or the money multiplier, and are price-based and indirect (market) instruments such as reserve requirements, interest rates (central bank policy rate); open market operations (OMOs), central bank bills, discount window standing facilities.

On the other hand, the selective controls are quantity-based instruments, which are almost all direct and non-market by design. Selective controls primarily affect the allocation of credit among alternative uses, such as margin (or down payment) requirements for loans to acquire securities and interest rate floors/ceilings on rates paid by banks on savings accounts or charged by banks on loans. The selective controls include instruments such as credit ceiling, sectoral allocation of credit, interest rate controls and moral suasion.

Therefore, moral suasion is a direct, non-market based policy instrument used mainly as a last resort in monetary policy implementation. Moral suasion is a catch-all monetary policy instrument used when other instruments have ceased to function, or are known to be traditionally not capable of encouraging or forcing the economic agents to adopt a moral stance, judged to be in public interest.

Historically, the use of moral suasion dates back to several centuries, and it became increasingly popular in the 20th century, especially in the developed nations. Over the years, however, monetary authorities have increasingly realized that their traditional "command and control" technique of moral suasion is no longer effective. During the 1950s and 1960s, it was still possible for monetary authorities in the industrialized countries to use moral suasion to administer interest rate ceilings, and successfully enforce quantitative control of the growth in credit and monetary aggregates. This continued until as recent as the late 1980s, in the case of Japan. However, for most central banks in the industrialized world, the days of direct controls are over. The world has moved to a market-driven era, where "control" has been replaced by "influence."
Up until the late twentieth century, it was a popular view that the central banker must use those instruments that can be used to “move” or “control” the market, to achieve stated objectives. In the wake of the 21st century, the events and aftermath of the 2008 global financial crisis have redefined the monetary policy terrain forever. During the crisis, the traditional policy instruments failed to forestall the onset and check the consequences of the crisis. As a result, monetary authorities resorted to a mixed-grill of policy instruments, many of which were non-traditional, but direct and persuasive. For instance, during the financial crisis, the UK government used persuasion to stop short-selling of certain banking stocks. That was a direct intervention to stop the falling of the price of the equity market. The US government used similar direct measures to help stabilize the equity market and restore public confidence in the financial system. Therefore, the use of instruments such as moral suasion that “control” rather than “influence” is now a function of the failure of traditional instruments. Presently, the cycle has repeated itself, moral suasion is coming back again and still remains a very relevant monetary policy instrument in the 21st century.
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SECTION FOUR

Implementation of Moral Suasion
Moral suasion can be implemented with several methods, depending on the nature of the policy guidelines or objectives to be achieved, and the size and number of economic agents to be persuaded to adopt a desired moral stance in the interest of the public. A number of methods have been adopted by different jurisdictions in the use of moral suasion to motivate compliance with monetary policies. The following methods have been commonly used:

Meeting
This involves face to face meeting between the monetary authority's officials and different stakeholders, and is used where the stakeholders are small in size or number. It is commonly used for soliciting and persuading the banking system to adopt certain moral stance, as banks are usually few in number in many jurisdictions. A general method involves private meetings with bank executives and other stakeholders associated with the institutions. The meetings help to secure the participation of banks or those institutions in the implementation of the directives issued by central monetary authority. In Nigeria, this is similar to the meetings of the Bankers Committee and the officials of the Central Bank of Nigeria. The meetings usually provide the forum where new policy guidelines by the CBN that need the cooperation of the banks are discussed and sold to the bankers firsthand. It allows the bankers to present their views, especially where there are envisaged bottlenecks to successful implementation of the guidelines, and showcases the monetary authority’s preparedness to overcome all such bottlenecks.

Inspections and Visitation
The monetary authorities may also decide to request and inspect records and activities of selected stakeholders such as banks, in order to ensure that certain policy guidelines are adhered to. In some instances, moral suasion may involve more regular and comprehensive inspections of records or other material evidence relating to the overall business operation of the institutions. In other cases, frequent and purpose-driven visitation by officials of the monetary authorities can sometimes present moral persuasion of the banks and other stakeholders to adopt and implement policy guidelines.

Letters or Guidelines of Threats
Monetary authorities can also resort to the use of outright threats in order to secure the cooperation of certain economic agents in the implementation of policy guidelines. In rare situations, moral suasion may involve some form of
indirect threats worded in a manner that leaves little doubt as to the original intent. Proponents of moral suasion claim that it is effective when backed by a threat of more positive action by the central bank, if its advice is not heeded.

Public Statements
In other cases, moral suasion may include a form of appeal to the general public. In that case, the appeal is usually proposed and led by a government official (e.g. central bank governor), who is seen by the public as both an expert and worthy of trust. The appeal is usually made on behalf of the monetary authorities, to ensure that there is a buy-in of the public as a stakeholder in the implementation of certain policy guidelines. A popular example of moral suasion occurs anytime the Fed Chairman comments on developments in the markets. In this case, his opinion and comments on the general economy can move the financial markets down or up.
Effectiveness and Criticisms of Moral Suasion

The effectiveness of moral suasion as a monetary policy instrument varies from one jurisdiction to another. It is also a function of the type of policy objective desired and the number of economic agents being persuaded to adopt a certain moral stance. Apparently, the degree of application of moral suasion and its effectiveness also vary between developed and developing countries. A priori, it appears that the developed nations have been more consistent and effective in using moral suasion in encouraging economic agents (especially the banks and other financial institutions) to comply with policy guidelines of their monetary authorities. In many developed jurisdictions, there is a conscious and deliberate use of moral suasion as a policy instrument to ensure smooth implementation of certain monetary policy guidelines. The US example presents solid cases of the widespread application and effectiveness of moral suasion as a monetary policy instrument. On the other hand, there is not enough evidence to suggest that developing nations have a systematic and procedural means of using moral suasion as a policy instrument. As a result, moral suasion is not particularly effective, and hardly used in many developing jurisdictions.

Effectiveness Issues

The effectiveness of moral suasion is dependent on a number of factors, namely:

- **Degree of Moral Responsibility**: The success and effectiveness of moral suasion as a monetary policy instrument will depend largely on the degree of moral responsibility in a country. Generally, the higher the overall sensitivity to moral responsibility in a country, the more effective moral suasion is as a policy instrument. It is the highly developed moral sensitivity and responsibility in the developed nations that makes moral suasion a more effective policy instrument in those nations. Compared to the developed nations, moral suasion is not a common monetary policy tool in the developing countries. It is largely ineffective as a policy tool, due to the low degree of moral responsibility in those nations.

- **Size and Number of Stakeholders**: The number of stakeholders involved in the implementation of monetary policy guidelines will dictate to large extent the effectiveness of moral suasion. Moral suasion is a tool that is suited for securing the compliance to policy among a few stakeholders or economic agents. Moral suasion as monetary policy instrument is difficult to use where a large number of stakeholders are involved. The smaller the number of stakeholders, the more effective moral suasion will be as a policy instrument. The number of economic agents to be persuaded must
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be few. Fewness implies easy identification of economic agents to persuade, and increases the possibility that non-compliers are easily identified and penalized. More generally, moral suasion is commonly used in ensuring that banks and other financial institutions comply with monetary policy guidelines. It has been effective in doing so where the number of banks is very few as in the UK and less effective in the US, where the number of banks is much higher. This is so because moral suasion works inequitably between those who are patriotic and those who are not.

- Moral suasion is also more effective in periods of financial crisis and emergency situations such as war. During the last global financial crisis in 2008-09, the UK government repeatedly used moral suasion in implementing several policy guidelines aimed at ensuring financial system stability. The investing public was cautioned and advised to desist from short-trading banking stock, as most banks were dwindling under the weight of massive sell-off of their stock.

- Moral suasion seems to be more effective in jurisdictions where there is a high degree of trust between the government and the economic agents. To enhance effectiveness of moral suasion, governments should possess a high level of trust with the market participants, which may be achieved by ensuring clear communication, good governance and fulfillment of their declared promises. In addition, governments should ensure that their threats are perceived credible enough by acting on them, and publishing their actions, in order to deter non-compliance in the future. In general, for moral suasion to be effective, government policies must earn the support and cooperation of citizens, thus creating the congruence between the monetary authority using moral suasion and the economic agents, whose behaviour should be modified.

- Moral suasion can be an effective monetary policy instrument when the anticipated costs of noncompliance are intentionally made to exceed the costs of compliance.

- Moral suasion is more effective when accompanied by a vigorous use of other monetary policy tools. Moral suasion is rarely used in isolation. The government and monetary authorities may use moral suasion in addition to a mixed-grill of other policy instruments to achieve stated objectives. So moral suasion is not the first instrument of choice when implementing monetary policy. Rather, it is a back-up policy tool, where other policy
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Instruments have failed or are ineffective in achieving the goals of monetary policy.

- **Degree of Competition in the Business Environment**: The degree of competition in the market will determine to a large extent the effectiveness of moral suasion as a policy instrument. Generally, a low degree of competition amongst economic agents (e.g., banks) in the economy can enhance the effectiveness of moral suasion. This explains why moral suasion is more effective in the UK, where there are few banks and may not be as effective in the US, where there are many banks. In the banking system, for instance, banks that have been "morally persuaded" to adopt costly but morally superior stance, appear to be less competitive and may face undue disadvantages compared to their competitors who did not adopt the policy guidelines in a fierce competitive market.

**Criticisms of Moral Suasion**

Moral suasion is not without criticisms or drawbacks. Notably, it has been criticized as immoral, because those that adopt the government policies (and incurring extra costs) are usually penalized, while non-compliers are not punished. This is largely so, because moral suasion does not have the force of laws or official regulation, which can give penalty and sanctions to erring institutions. Besides, the use of moral suasion faces other objections, including the fact that it may involve extra-legal coercion by the monetary authority, it accentuates uncertainties in the regulatory process, and may delay or even undermine effective implementation of certain economic policies.
MORAL SUASION AS A MONETARY POLICY IN STRUMENT

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Application of Moral Suasion: Country Experience

Different countries use moral suasion as a monetary policy instrument to different degrees. Below, cases and examples of the use of moral suasion are presented and discussed first for Nigeria, and second for the UK and the US in that order.

Nigeria

Prior to 1986, the Nigerian fiscal and monetary authorities adopted some skeletal forms of moral suasion in the management of macroeconomic policies, especially in the areas of credit allocations to the real productive sectors. After 1986, the Nigerian monetary authorities began to adopt indirect approach to its implementation of monetary policy as part of economic liberalization at that time. In particular, the use of OMO and other indirect instruments became relatively successful but moral suasion and other direct methods appeared to have been de-emphasized. Moral suasion, already considered by many policy makers and scholars to be a weak monetary policy tool, appeared not to have worked in Nigeria because of the lack of trust by financial market operators in the monetary and fiscal authorities. This was largely due to the fact that the CBN did not have its independence from the federal government, leading to several complications. Moral suasion that is supposed to promote understanding and confidence between the CBN and financial market participants failed to do so. Primarily, the Nigeria’s financial markets seemed unable to differentiate between the proclamations of the CBN officials and those of the federal government. Hence monetary policy in Nigeria seemed to be held hostage by the continued instability and distrust of the Nigerian government.

The 2007 Act granted autonomy to the CBN. As the CBN relishes in its operational and instrument independence, it is now able to give clear-cut policy guidelines. The CBN is taking steps to encourage banks and other financial institutions to cooperate with and implement those policy guidelines for the good of the economy. This process involves the use of moral suasion to persuade various stakeholders to adopt and implement the CBN guidelines to ensure smooth monetary policy implementation.

The UK

Moral suasion is a very powerful fiscal and monetary policy tool in the UK. Every now and then, the UK government engages the power of its well-developed and tested moral suasion procedure to secure the necessary cooperation of the UK banking oligopoly. Nowhere else has moral suasion been as successful as in the British banking sector, and it has allowed the Bank of England (BoE) to control the...
banks by persuasion and directive. As discussed earlier, one main reason for the success of moral suasion as a monetary policy instrument in that jurisdiction is the fewness of the major high-street banks that need to be persuaded to adopt BoE monetary policy. As a result, it is easier to identify non-compliers compared to, say the United States, which has many commercial banks.

After the recent global financial crisis of 2007, for instance, many UK banks became risk-adverse and were not willing to lend to businesses, especially the SME’s. The UK government and its monetary authority went on massive moral suasion campaign, and got several of the high-street names to sign up to lend to the SME’s. Many of the banks signed up to several government initiatives such as Funds for Lending Scheme (FLS), leading to increased lending to the real sectors. It could be said that the success achieved in banks’ lending, and the resultant economic growth, which helped the UK to get off recession, were a proof of the power of moral suasion in that jurisdiction.

Excessive investment banks’ staff bonuses constitute another hot issue that has been partly resolved by moral suasion by the UK fiscal and monetary authorities. Moral suasion, in the form of public rebuke and general apathy, has been used to curb the excessive bonuses paid to certain professionals in the UK financial sector. In particular, the threat of additional increase in taxes was used along with moral suasion to persuade many investment banks to comply.

The UK government and its monetary authorities have been using moral suasion for several decades. In December 1964, the British financial markets were affected by the increased outflows of sterling, further adjustments to the rise in Bank rate, increased uncertainties about prospective taxes on capital gains and company profits, and a prospective credit squeeze by the Bank of England. On December 9, the Bank of England wrote to the commercial banks, requesting them to exercise more selectivity and caution in granting advances, with lending for real estate and consumer finance specifically identified for curtailment. Moral suasion of this type has worked successfully on previous occasions, though it has not been effective when coupled with measures aimed to reduce over-all bank liquidity.

**The US**

**The Use of Moral Suasion in Supervising the Payments System**

In the US, the Fed does not have a statutory responsibility for the regulation of settlements and payments system. However, the operational performance of key payments and settlement system, and its ability to manage market and counterparty risks, are critical to the stability of the overall financial system. The
stability of the financial system is critical to the success of monetary policy implementation. Therefore, the Federal Reserve uses moral suasion in ensuring that the payments and settlement system possess the necessary controls and procedures to mitigate their risks. In contrast, most other major central banks have an explicit statutory mandate that underpins their oversight of the payments system, and in recent years, an increasing number of them have also attained statutory authority for oversight of the securities settlement systems. The fact that the US Fed relies on moral suasion in ensuring an effective payments and settlement system goes to prove the effectiveness of moral suasion in the discharge of the statutory and non-statutory responsibilities of the US monetary authorities.

The Use of Moral Suasion to Reduce Bank Lending Overseas in 1965
In the US, the application of moral suasion dates back to very many decades. Below is an excerpt from the Minutes of the Federal Open Market Committee (FOMC).

“At February 2, 1965 meeting of the Federal Open Market Committee (FOMC), a Committee member was pleased to note that the US Administration was coming to grips with the fact that the country had a serious balance of payments problem and he awaited the proposed remedy with interest. He then suggested several remedies. One broad approach would be the application of selective controls over many sectors of the balance of payments. Another approach would be the classical one of monetary restraint coupled with, in this case, reduced military and economic aid, and perhaps some use of moral suasion to reduce bank lending overseas. He leaned towards the latter approach, but without much hope that it would be chosen”.

From the above comment, the FOMC member recommended the use of moral suasion to reduce bank lending.

Using Moral Suasion to Reduce Capital Outflows
In another FOMC meeting, a Committee member stressed the need to apply moral suasion to discourage capital outflows from the US.

“Capital outflows from the U.S. had been large, and considered in conjunction with the net balance on other U.S. transactions, they were of serious proportions for the U.S. international liquidity position. In his judgment monetary actions had played a significant role in limiting capital outflows and additional steps might still be needed. However, it was doubtful that any general monetary actions which the Federal Reserve, standing alone, might take could substantially reduce the capital outflows. Although he disliked the interference in individual market
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decisions that followed from attempts at moral suasion or from selective controls, under existing international payments mechanisms these actions might be necessary if more fundamental actions to improve the balance of payments were not taken soon”.

Moral Suasion in Reduction of Savings and Loans Rates

In the submission of a member of the FOMC, he stated that Home Loan Bank Board used moral suasion to roll back increases in rates.

“During the first quarter of 1963 net inflows to savings and loans were in record volume, following increases in dividend rates announced by a sizable number of associations around the start of the year. But in the second quarter, with which year-over-year comparisons are now being made, net inflows dropped back somewhat, as the Home Loan Bank Board sought (through moral suasion) to roll back rate advances and as some associations experienced difficulties investing their increased savings flows”.
Conclusion

Monetary authorities use alternative policy instruments to control interest rates, inflation, exchange rate and other macroeconomic aggregates, in order to achieve price stability. Apart from the proven and popularly used instruments such as OMO, interest rate, discount windows, etc., moral suasion still remains one major policy instrument in the toolbox of most monetary authorities in the conduct of monetary policy and for ensuring compliance of the different economic agents to monetary policy guidelines.

Moral suasion, as a policy instrument, is predominantly used in the advanced nations due to the higher sensitivity to moral responsibility in those jurisdictions. Although moral suasion has long been a direct monetary policy instrument, its application has increased in recent years in the developed countries, due primarily to the recent global financial crisis and incessant policy instrument failures. Across many jurisdictions, moral suasion is implemented in various forms including face-to-face meetings, inspections, visitations and public statements.

Moral suasion has been seen to be very effective in many jurisdictions, especially in the developed world. The primary factors that affect its effectiveness include the degree of sensitivity to moral responsibility, number of economic agents to be persuaded, the degree of competition in the industry being regulated as well as the level of trust between the monetary authorities and financial market in the economy.

There is a need for the developing countries to develop a well-thought out and proven strategy for using moral suasion as a major instrument in the implementation of their monetary policies. More than anywhere else, the developing nations need to have some degree of direct controls in their policy framework. Moral suasion is one major instrument that would allow their monetary authorities to rein in on the economic agents and ensure their compliance with policy guidelines.
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