The Democratic Accountability of the European Central Bank *

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Introduction

The European Central Bank (ECB), which has the task of conducting monetary policy for nearly 300 million European citizens and an economy of a size comparable to that of the US, will be one of the most, if not the most, independent central banks.[1] It is generally recognised that central bank independence should be accompanied by a high degree of accountability – the greater is the independence, the broader must be the scope for accountability. The accountability of the ECB has thus become an issue of increasing interest, not only in the academic world but also in policy fora.

This paper aims at examining the concept and the main reasons behind central bank accountability, in particular that of the ECB. The first two sections examine the concept of accountability. The third tries to define some of the procedures and requirements through which central banks may give account of their activity. The fourth section examines the extent to which the foreseen procedures and requirements are expected to be implemented by the ECB, as compared to three other central banks: the Fed, the Bank of Japan and the Bank of England.

The objective of the paper is not to rank central banks according to a pre-determined index of accountability. Accountability can be performed in different ways and through different practices and

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* The views expressed in this paper only reflect those of the author.

[1] See for instance Bini Smaghi (1996) and de Haan (1997).

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procedures, depending on the interaction between the central bank and the other institutions of society, their respective roles and the environment within which they interact, in particular the structure of financial markets and the instruments used by the central bank for the conduct of monetary policy. There is thus no 'model-fit-all' for accountability that one can apply to central banks in all cases and circumstances. It is nevertheless of importance to assess the extent to which these procedures enable the central bank to give an adequate account of its activities.

1. Democratic control, independence and accountability

This paper builds on the literature on central bank independence and legitimacy which has widely developed in recent years.[2] All caveats related to the limitations and simplifications of the theoretical underpinnings of this line or research have therefore to be kept in mind in reading this paper.

A couple of clarifications may be worth discussing as a preliminary step towards the analysis of central bank accountability: the first regards the concept of accountability itself; the second the complementarity with independence. Confusion is often made between the concepts of 'democratic control' and 'democratic accountability'.[3] Democratic control refers to the following three constraints on the exercise of government:[4]

- *ex ante control* defines the rules, standards and principles laid down in advance by a democratically elected body, to be followed by the accountable body in the exercise of the functions;

[2] See in particular Cukierman (1992) and Eijffinger and de Haan (1996).

[3] It is interesting to note that in the recent discussion in the European Parliament on "Democratic accountability in stage three of EMU", the French, Italian and Portuguese versions of the draft report initially referred to the term "contrôle démocratique", "controllo democratico" and "controlo democrático", respectively, while the Spanish version referred instead to "responsabilidad democrática". The texts were later harmonised with the use of the word responsibility.

[4] See *Roll Committee Report* (1993).

- *answerability* is the act of listening to criticisms and respond to questions about the past and future behaviour that may be put forward by a democratically elected body;

- *popular mandate* refers to the attribution of power through democratic procedures.

These criteria, which define the way democratic control is exercised over the executive government, cannot be fully applied to central banks. For instance, as concerns the third one, it cannot be agreed that independent central banks receive a popular mandate to conduct policy and select policy objectives, since this would imply that they would become a completely separate branch of democratic power. The legitimation of central banks is instead obtained through the appointment, by the government, to perform specific tasks in view of specific objectives, in an independent manner. Independent central banks are nevertheless subject to *ex ante* control and answerability, since they must give account of their performance, within the limits of the delegation of power specified by the law.

The way in which accountability is exercised is closely related to the concept of independence of the central bank. A central bank which is not independent is subject to *ex ante* control in the context of the general conduct of the government's economic policy. The rules and principles underlying such a control may be periodically revised, depending on the circumstances faced by the executive branch of government and on its policy goals. For instance, monetary policy may be geared in turn towards the objective of price stability or to that of stimulating economic growth depending on the wishes of the government. There is thus in this case no need to precisely specify in advance the tasks and objectives of monetary policy. For instance, before its recent reform, the Bank of England was not subject to precise rules or guidelines, as suggested by the *Roll Committee Report* (1993, pp. 48-49): "the so-called parliamentary accountability for monetary policy connotes no more than the presence of the topic in a general and continuing parliamentary debate about the Government's economic performance, a debate whose real constitutional function is to furnish information relevant to the quinquennial popular control by elections".

Ex ante control is instead essential for an independent central bank. The granting of independence requires that clear rules and principles are laid down to define the boundaries of central bank action. It is a necessary condition in order to delegate power. If such rules and principles were not clearly pre-specified, but rather left to the discretion of the central bank, the latter would become a political body with the possibility of choosing its own goals and policies. This issue has been widely examined in the literature, in particular with a view to define the 'optimal contract' for the central bank.[5] This has led to distinguish between 'instrument' and 'goal' independence.[6] This distinction is to some extent misleading, as it shifts the problem of time consistency from the central bank to the authority in charge of defining the objective of the central bank.[7] If *ex ante* control is applied in a way that enables the government to frequently change the underlying rules and principles for central bank action, according to its time-varying specific interests, the incentive-compatibility problem underlying the time-consistency dilemma for monetary policy is not resolved.

The second of the above criteria – answerability – aims at verifying that the rules and principles laid down for the central bank have been respected. The way in which answerability is performed is clearly linked to the way *ex ante* control has been specified. If the *ex ante* control is defined with a low degree of precision, or with escape clauses, the answerability can only be of poor quality. If, for instance, the objective of a central bank is not clearly specified in terms of price stability, the reporting can only be vague and does not allow to associate specific monetary policy decisions to the effective inflation performance. Another example is when escape clauses are set, through which the central bank is allowed under certain circumstances to deviate from its targets. Since these circumstances can never be precisely specified *ex ante*, the clauses may represent an excuse for justifying *ex post* possible deviations from the target. There is thus the risk, when the target is not precisely defined, that the public is presented with a broad picture of the economic situation but is not in a position to assess the effective contribution of the action conducted by the central bank to the achievement of the specific objective. When the

[5] See in particular Persson and Tabellini (1993) and Walsh (1995).
[6] See Fischer (1995).
[7] See McCallum (1995).

mandate of a central bank is instead clearly and precisely defined, the public can focus on the way monetary policy has performed, in view of its primary objective. Answerability will in this case concentrate on a few precise indicators of performance.

In sum, contrarily to what is sometimes stated, there should *a priori* be no trade-off between independence and accountability, if the two concepts are appropriately defined. Accountability can be seen as a complement, if not a necessary requirement, for independence: a central bank cannot be made fully independent if its objectives are not clearly and precisely defined; it cannot remain independent if it does not give public account of its actions with a view to its pre-specified objectives.

A further issue that has been discussed in the literature is whether accountability should be distinguished from transparency.[8] Accountability may refer to the legal obligation to give account, which arises from the delegation of power from the government to the central bank; transparency goes beyond the fulfilment of a given reporting requirement and refers to "more subtle forms of accountability" and defines a "way of doing business by the central bank". This distinction is to some extent artificial, at least in the case of the ECB, since its objectives and tasks are defined once-and-for-all in the Treaty. Although the ECB has precise reporting obligations, its accountability can be understood in a very general sense, to be exercised not only *vis-à-vis* the Council or the Parliament, but the public at large. This interpretation is consistent with article 2 of the ESCB Statutes, which specifies that "the ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources". This paper adopts a broad interpretation of the concept of accountability, which is not restricted only to legal requirements but to the broader concepts of transparency and openness about the conduct of monetary policy.

[8] See Briault, Haldane and King (1996).

2. The economics of central bank accountability

The way in which a central bank performs can be assessed by observing the final results in terms of the policy objectives. If the primary objective of monetary policy is price stability, the regular observation of inflation statistics should enable to assess how the central bank has performed. However, given the lags with which monetary policy affects the price level, the observation of the latter allows to assess actions taken about 2 years earlier. This is of little interest to market participants and the public at large.

Two further elements complicate the exercise of accountability. The first is that inflation may be a monetary phenomenon in the long run, but not necessarily in the short, as it is influenced by other variables, such as labor costs, import prices, taxes ... . These non-monetary variables and the underlying relationships between monetary and real developments are difficult to forecast. Monetary policy can thus ensure price stability in the medium to long run, not necessarily at every point in time, especially if it faces unexpected shocks. As a consequence, the central bank cannot be held accountable for temporary deviations from price stability, which are not due to its own behaviour. On the other hand, how can market participants know whether or not such deviations are temporary, and whether or not they are due to monetary factors? These questions are at the root of the problem of central bank accountability and have partly been addressed in the literature. The issues can be regrouped in three main broad lines of argumentation.

The first is the well-known issue of time inconsistency of the optimal monetary policy.[9] Although the price-stability-oriented monetary policy is optimal in the long run, in the absence of unexpected shocks, it is not optimal in the short term. Welfare could temporarily increase if the central bank deviated from its long-term objective, conducting an unexpected monetary expansion that would bring about higher growth and lower unemployment, even though at the expense of higher inflation. The incentive to deviate from the optimal long-term policy is known to economic agents, which anticipate this temptation. The central bank is thus led to conduct a more expansionary policy than desired, with a sub-optimal inflation result for society. The greater is the reputation of a central bank, the greater may be the gains from temporarily deviating from the long-term objective. The problem is made more acute by the fact that in the short term the rate of inflation may be affected by other factors than just monetary policy, such as wage shocks, changes in public expenditure or in the level of import prices. The simple observation of the price level does not enable market participants to understand whether the deviation from price stability, if and when it occurs, is temporary or permanent and whether it is due to an unexpected non-monetary shock or to the intention of the central bank to effect a surprise monetary expansion with a view to stimulate the economy.

[9] See Kydland and Prescott (1977) and Barro and Gordon (1983a, 1983b).

It is in this context that the literature has analysed central bank 'secrecy' or 'ambiguity'.[10] Disclosing only partial information may be interpreted by market participants as the wish of the central bank to keep some information private, so as to retain the possibility to create inflationary surprises, producing short-term beneficial effects on output and employment. According to this view, monetary policy is effective in influencing output and employment if the central bank avails itself of asymmetric information.[11] This line of reasoning has been used, in particular by the Fed, to justify the fact that information about the FOMC (Federal Open Market Committee) meetings should not be disclosed, as requested by some market participants.[12] This view is consistent with a central bank such as the Fed, which is not fully independent and whose primary objective is not limited to price stability but also to other objectives, providing a justification for active stabilisation policy. A central bank which must focus on price stability as its primary objective, and is not allowed to conduct active stabilisation policy, would benefit from disclosing information that may be used by market participants to interpret current developments. Accountability can be seen as a part of a commitment technology by which the central bank provides economic agents with symmetric information, and thus deprives itself of the possibility of following a policy different from the one it has announced, thus en-

[10] See Cukierman and Metzler (1986), Stein (1989) and Garfinkel and Oh (1995).

[11] See for instance Canzoneri (1985).

[12] Goodfriend (1986) presents in a critical way the arguments of the Fed in its case against Merrill.

hancing the credibility of its action. It is noteworthy that transparency has been promoted in particular by central banks whose statutes have changed and that had no track record on which market participants could base their expectations.

To summarise the above arguments, transparency increases the credibility of the central bank, especially when the latter does not benefit from sufficient reputation, and enables to conduct a less restrictive monetary policy than would otherwise be required.[13] Transparency and accountability increase the overall welfare of the economy.

The second argument for accountability is linked to the previous one and arises from the distributional effects produced by monetary policy decisions, in particular unanticipated ones. Unexpected interest rate changes can produce large wealth redistribution between debtors and creditors. For instance, the small increase in the Fed fund rate decided by the Fed in early 1994 was sufficient to wipe out most of the profits of the large investment funds in that year. Such distributional effects may take place not only across sectors and agents but also across regions. They may be exacerbated if different groups of society have different information about the intentions and the behaviour of the central bank. If the central bank is dependent from the government, the distributional effects may to some extent be linked to explicit political decisions, and possibly compensated through other policy instruments. In this context, the secrecy surrounding central bank decisions can be justified as a way to achieve the desired distributional objective. An independent central bank, with the primary objective of price stability, does not have distributional objectives. It must therefore avoid that private information concerning its actions are made available to certain groups of society but not to others, for instance because information is costly to acquire and to process. This aspect is particularly relevant in a highly decentralised economy such as the European one, where the decision-making process may be seen as distant and not be fully understood by some sectors of society. Without the necessary transparency, the suspicion may arise that the interests of some parts are given more prominence than others.[14] This would clearly be to the detriment of central bank credibility. In order to avoid such suspicion, information should be disseminated with similar intensity, frequency and depth across the economy. This can be more easily done under a policy of disclosure and answerability than one of secrecy.

The third reason for accountability is that it facilitates co-operative behaviour between economic agents, thereby achieving Pareto superior social welfare. In the presence of uncertainty, the availability of information from the central bank enables economic agents to extract information not only on aggregate developments but also on their own behaviour, relatively to the rest of society. Agents can thus modify their own behaviour, in particular if they observe that it is deviant from, and less profitable than, the others, or to influence that of the other components of society. This argument applies in particular to decentralised economies, where agents have difficulty in co-ordinating their actions and expectations. For instance, if the ECB anticipated that one of the large EU states was in the process of launching a major public expenditure plan, with effects on that country's budget and domestic demand and potential inflationary pressures for the whole union, it could consider increasing interest rates, possibly in a pre-emptive way. It would in this case be desirable that such policy intention was publicly spelled out, possibly in advance of the decision. This would give the opportunity to that member state to reconsider its policy action. The other countries would also have the opportunity to try to influence the undisciplined country, since the effects of the latter's policies would be borne by all. Indeed, the increase of the Union's interest rate would have restrictive consequences on all countries, including those 'fiscally disciplined'. The outcome of a re-consideration of the initial policy intention would lead to a more efficient solution than the Nash one, contemplated in the case of an *ex post* reaction by the central bank.[15] The same reasoning applies to other shocks or asymmetric wage and price developments, or even to asset price dynamics. In summary, central bank transparency favours the achievement of a co-operative equilibrium between economic agents, which is a Pareto improvement. Central banks are aware of this fact, and often use their communication channels with market participants to 'guide' them on possible policy developments. Central banks have often 'threatened' to increase interest

[13] See Faust and Svensson (1998) for a formal proof of these propositions.

[14] The issue is already debated in the literature; see Dornbusch, Favero and Giavazzi (1998).

[15] A formal derivation of this reasoning can be found in Demertzis, Huges Hallett and Viegi (1998).

ACCOUNTABILITY CRITERIA

	Federal Reserve	Bank of Japan	Bank of England	ECB
Ex ante				
1. Clear definition of the objective of price stability	no	no	Government (2.5% CPIX inflation for 1998)	Treaty/ECB (0-2% CPI inflation)
2. Announcement of the operational target	Fed fund rate	overnight lending rate	repo rate	overnight rate
3. Announcement of intermediate target	no	no	direct inflation target	yes
4. Announcement of indicators for assessing monetary policy	monitoring ranges for money and credit aggregates	no specific one	no specific one	monitoring or target ranges for monetary aggregates
5. Explanation of how monetary policy targets affect other policies and objectives	implicitly	implicitly	implicitly	possibly explicitly
Ex post				
6. Publication of data on intermediate target or indicators and explanation of possible deviation	money and credit aggregates	no	yes, inflation report	yes
7. Publication of inflation forecast and deviation from target	twice a year (for the HH reports)[a]	no	yes, inflation report	to be decided
8. Explanation of main policy measures (or absence thereof) and underlying reasons	yes	yes	yes	yes
9. Explanation of how these measures affect other policies	no	no	no	possibly
Procedures				
10. Regular (monthly, quarterly, yearly) public reports covering issues 1-8 above	monthly	monthly	quarterly inflation report	monthly/quarterly
11. Hearings in Parliament with Questions and Answers	at least twice a year	at least twice a year	yes, regular	at least quarterly
12. Participation of government representative at meeting of the decision-making bodies (as observers)	no	Ministry of Finance and of Economic Planning Agency	Treasury representative	President of Ecofin and Commission
13. Publication of summary minutes	7 weeks later	one month later	6 weeks later	to be decided
14. Publication of detailed minutes	5 years later	to be decided	–	no
15. Publication of the votes of the members of the decision-making bodies	7 weeks later	one month later	6 weeks later	no

[a] Twice a year the Fed President reports to the Congress, according to the Humphrey-Hawkings Act.

rates if the wage negotiations were concluded with pay raises that were out of line from price stability or if budget projections were overshot.

3. How to assess central bank accountability?

The easy way to assess central bank accountability is to create an indicator based on a set of criteria, as it has been done in the literature on central bank independence. Briault, Haldane and King (1996) have followed this route and created an accountability index, based on four criteria: *a*) whether the central bank is subject to external monitoring by Parliament; *b*) whether the minutes of the meetings to decide monetary policy are published; *c*) whether the central bank publishes an inflation or monetary policy report of some kind, in addition to the standard central bank bulletins; and *d*) whether there is a clause that allows the government to override a decision of the central bank. These four criteria do not seem quite satisfactory. They entail the risk of oversimplification, while not giving a complete picture of the framework within which accountability is exercised in practice. In particular, the last criterion seems more one characterising central bank independence than accountability. The possibility of overriding the central bank is unrelated to *ex ante* control or answerability, and thus to accountability. Cukierman (1992) includes this criterion in the index of legal independence. Criterion *c*) is also dubious; it is not clear why the publication of an inflation report necessarily adds accountability to that achieved through the publication of regular monthly reports, to the extent that the latter contain the necessary information.

We examine a different set of criteria, derived from the concepts of *ex ante* control and answerability discussed in Section 1, not with a view to creating a numerical index but to examine the ways and opportunities that central banks use to interact with the public opinion, market participants and the other institutions of society. We consider 15 criteria for central bank accountability, divided in three main groups (see Table). The first group refers to *ex ante* accountability.

The first criterion consists in *the clear definition of the objective of price stability*. This concerns in particular the way in which price stability is defined, the type of price index to be used as final target, the precision of the target (a point estimate as opposed to a range) and the horizon of the target. The more precise is the target, the more accountable a central bank can be held. This criterion has to be viewed against the well-known and documented difficulties to measure inflation. There is clearly a trade-off between the simplicity of the public announcement, which enhances transparency, and the complexity of the inflation phenomenon. Complexity can nevertheless not be used as an excuse and give rise to the suspicion by market participants that policy targets are not defined. This would lead to a loss of credibility for the central bank.

The second criterion is *the announcement of an operational target*. A clear understanding of the operational target used by the central bank to conduct its monetary policy operations enables market participants to frequently monitor the intentions of the central bank and to follow the impact of the policy actions on the market. Market participants should be able to clearly distinguish the difference between the operational target that is affected by the action of the central bank but is ultimately determined by market conditions, and the instrument of monetary policy, such as the 'official' or 'policy' interest rate. If such distinction cannot be made, market participants have less information about the effective intentions of the central bank.

The third criterion regards *the announcement of an intermediate target*. Given the lag, estimated to be around 18 to 24 months, between the time at which monetary policy is implemented and when it affects the price level, the observation of the inflation rate provides information only on past monetary policy. To assess current policy, one needs to compare it against inflation performance, one or two years ahead. An intermediate target is generally used to express future inflation developments through contemporaneously observable variables. Several variables can be used for this purpose, such as the exchange rate, monetary or credit aggregates, or other indicators of future inflation, depending on their effective relationship with the price level. The announcement of the target enables the public to monitor how the central bank is reacting to inflationary pressures, as reflected in these indicators, and to check how the latter sticks to its price stability objective. The setting of an intermediate target requires that there are variables that enable, with some degree of precision, to forecast future inflation. This is an empirical question, largely addressed in the literature. If there is no variable closely related to future price developments, the central bank may use its own inflation forecast as a target, as it is done under a direct inflation targeting strategy.

The fourth criterion is *the announcement of indicators for assessing the appropriateness of monetary policy.* Given that it is generally difficult to find one single variable that enables to target future inflation, central banks also use indicators to help them interpret possible deviations from the intermediate target and assess whether a policy reaction is granted. Disclosing information on these indicators helps market participants understand how the central bank interprets inflation forecasts and deviations from the intermediate target. An excessive amount of indicators may however confuse the picture and give the impression that the central bank wants to pick the indicator it prefers, depending on circumstances, to justify its own behaviour. The statement that central banks "look at everything", although to some extent correct, is not very informative for market participants.

The fifth criterion is *the explanation of how monetary policy targets affect other policies and objectives.* Even for central banks whose primary objective is price stability, there are other secondary objectives, such as to support the economic policies of the government or the safeguard of financial stability. Providing a forecast and an assessment of inflation, and of the other main objectives of economic policy, may help distinguishing clearly between the responsibilities of the various policy-making institutions and create transparency in the dialogue between them.

The second group of criteria (*the publication of data on intermediate variables and explanation of possible deviation from target; the publication of inflation forecast and possible deviation from target; the explanation of the main policy measures, or absence thereof, and underlying reasons; the explanation of how these measures affect other policies*; see Table) defines the *ex post* answerability of the central bank with respect to the pre-announced targets and indicators mentioned above. The publication of data and the explanation of the main developments related to the target variables and the analysis leading to the policy decisions is a way to enhance the transparency of the decisions and thus the accountability of the central bank.

The third group of accountability criteria refers to the procedures followed in fulfilling the criteria of the first two groups. The procedure may include *public reports*, through which the central bank provides data on its targets and indicators and explains its policies, their underlying reasons and how they have performed in view of the pre-announced targets. Reporting can be made also through *hearings held in Parliament of the members of the decision-making body*, where less technical details may be provided but, through the questions and answers session, the assessment may be more articulated and reflect the interaction with other policies. *The participation of the government in the meetings of the decision-making body* is another opportunity through which the institutions in charge of the different economic policies exchange information and views on each other's policies. Although market participants are not necessarily informed about such exchanges, it may be reflected in the respective policies.

Finally, the background analysis and reasoning for the central bank's decision making can be made available through *the publication of the minutes* of the meeting of the decision-making body, in an abridged version or in full. This information can be desegregated up to the level of each member of the decision making body, by making public the *votes of the single members.* This raises the question of whether accountability is required for the central bank as a whole or for each of the members of the decision-making body; this relates to the issue of collective vs. individual accountability, that will be addressed in the next Section.

As it was already mentioned, the above list of criteria should not be used to construct an index on which to assess the degree of accountability of a central bank. Indeed, some of these criteria are complementary and cover overlapping issues. Furthermore, the list is not exhaustive and has not been drawn on the basis of a normative analysis of accountability, but rather on the observation of certain practices in some central banks and the discussion that has taken place in academic and policy fora.

4. Assessing the accountability of the ECB

There is still little literature on the accountability of the ECB.[16] There are at least two difficulties with such an exercise. The first difficulty is that, as mentioned above, the assessment can only be in qualitative, rather than in quantitative terms. The criteria outlined in the previous Sections are to be considered as references to help understand the main issues at stake rather than pointers to rank central banks. Furthermore, these criteria need to be examined jointly, and in the broad institutional context within which the central bank operates. The second difficulty is that the ECB is not yet operational. The assessment can thus only be made 'on paper', based on the statutes and on the preparatory work conducted by the EMI.

In light of these caveats, we try to examine the possible accountability of the ECB, in comparison with the experience of the other major central banks, like the Fed, or the Bank of Japan and the Bank of England which have recently experienced a change in their statutes, in particular with a view to increase both their independence and accountability. Again, the comparison is not aimed at ranking the four mentioned central banks, but to assess the accountability of the ECB in the light of the others' experience.

The Table on pages 128-29 provides an indication on how the various criteria are met for the three major central banks and the ECB.

Concerning the first criterion, the precise definition of price stability, it should be noted first that the EMI, in its report on the elements of the monetary policy strategy of the ESCB, has given a few recommendations. First, the ESCB should announce to the public a definition of price stability, with a view to enhancing transparency and credibility. The harmonised consumer price index, as calculated by Eurostat, is expected to be, at least at the start of Stage Three of EMU, the main target variable. The EMI indicated that "there has been a broad consensus among central banks for several years that a range of 0%-2% inflation per annum would be appropriate".[17] This range should enable to take into account typical measurement problems encountered in measuring inflation. Since the objective of price stability is defined in the Treaty, the definition provided by the ECB is time-free. The Fed and the Bank of Japan do not announce precise objectives in terms of inflation rate. The Fed has developed a non-quantitative approach to the concept of price stability, defining the latter as the rate of change of the price level for which economic agents do not modify their behaviour. This concept is clearly not easy to use for market participants aiming at tracking down the policy intentions and the performance of the Fed. It should be recalled that the statutory objective of the Fed is not restricted to price stability alone but also to economic activity and employment.[18] The Bank of England has a clear target, in terms of price inflation, which is set by the government with the budget law, and can be modified year by year. The problem of time inconsistency of monetary policy has thus been shifted away from the central bank to the UK government. The time horizon of the policy objective is limited and can thus conflict with the constraints arising from political business cycle considerations.

Concerning the second and third criteria, related to the operational and intermediate targets, the EMI has indicated that "the ECB should publicly set targets against which its performance can be assessed and explain its policy action to the public with reference to its targets".[19] The operational target of the ECB will be the overnight money market rate. The instruments that the ESCB will have at its disposal to influence this target will be: the overnight lending and deposit facilities, whose rates will determine the ceiling and the floor for the overnight rate; the weekly repos, with bi-weekly maturity; and fine-tuning operations, largely based on repos. All operations of the ESCB have to be collateralised. It is not foreseen that the ESCB intervenes actively in the interbank money market, affecting directly the interbank rate; the latter will result only from operations between market participants. Agents can thus observe clearly the operations effected by the ESCB and its conditions, in particular the rates and volumes, and extract information on its behaviour, and eventually extrapolate future developments. This is not the case of the Fed, the Bank of Japan or the Bank of England, which all intervene directly

[16] See in particular Gormley and de Haan (1996) and de Haan (1997).
[17] European Monetary Institute (1997, p. 12).

[18] The tasks of the Fed, as defined in the Fed Act and in the Employment Act, is to "furnish an elastic currency [...] so as to promote effectively the goals of maximum employment, stable prices and moderate interest rates".
[19] European Monetary Institute (1997, p. 12).

and actively in the respective money or securities markets, at the market rate. Participants may in these cases have more difficulty in identifying the action of the central bank and the way it has contributed to influencing the market rate.

The intermediate target of the ECB will be announced publicly, either a monetary aggregate or an inflation forecast implicit in the direct inflation targeting strategy. The Fed and the Bank of Japan have no intermediate targets: the Bank of England publishes its inflation forecasts, which *de facto* represent its intermediate target.

As for other indicators of monetary policy, the EMI has indicated that this should incorporate all relevant financial variables (in particular the money market yield curve, money and credit aggregates, credit market conditions, bond yields, exchange rates and other asset prices) as well as various non-financial variables (price and cost variable, indicators of aggregate demand and supply conditions ...). Some of these indicators may possibly be given particular importance, with a view to establish a hierarchy of information variable in the eyes of market participants. The EMI has indicated that among the above indicators, the ECB should give monetary aggregates a privileged role in its strategy, by publicly setting either target or monitoring ranges for their growth, assuming that it is possible to characterise a stable long-term link to inflation.[20] The ECB will decide on how to make use of these indicators. The Fed has monitoring ranges for money and credit aggregates, although their importance has been strongly downgraded in recent years. The Bank of England also uses a set of indicators to assess its own inflation forecasts, but no specific one is given particular importance.

Finally, the ECB has been requested, in particular by the European Parliament, to explain how the conduct of its policy interacts with other policies and economic developments in the Community. This practice is undertaken more or less explicitly by all central banks, in the context of the co-operation with the other authorities responsible for the conduct of economic policy and with a view to ensure the consistency of the respective policy plans. The appropriateness of the policy-mix and its consequences on the economy as a whole are often a matter of public debate. In the European Community, the interaction between monetary and other policies will be an

[20] European Monetary Institute (1997, p. 13).

input to the regular multilateral surveillance exercise. Once a year, broad guidelines are defined by the Council of EU finance ministers for the conduct of the economic policies of the member states. The Council then monitors the policies of the member states, with a view to their consistency with the above guidelines. The monetary policy conducted by the ESCB represents an important reference for the definition of the guidelines and the monitoring procedure.

Turning now to the *ex post* criteria, it is foreseen that the ECB should not only announce its target and the details of its calculation, but should also "regularly publish the data and analysis relevant to monetary policy, as well as explanations of the deviation from the target and the policy response of the central bank".[21] This procedure is generally followed by central banks which have explicit targets or indicators. The precision of such a publication is partly linked to the definition of the target pursued by the central bank.

Concerning criterion 7, it is not yet clear whether the ECB will publish its own inflation forecast.[22] If the monetary policy strategy is based on inflation targeting, the publication of the inflation forecast, which represents the proxy intermediate target, is to some extent unavoidable, although demanding in terms of explanatory requirements. If instead the intermediate target is a monetary aggregate, the publication of the inflation forecast can be used as additional indicator to explain possible deviations from the target.

[21] European Monetary Institute (1997, p. 16).

[22] "In an inflation targeting strategy, such publications, if explicitly conditioned on unchanged stance of monetary policy, enhance transparency as policy actions can then be motivated by the difference between the (conditional) forecast and the inflation target. However, there are conceptual difficulties in formulating forecasts conditioned on unchanged policies since some financial market indicators which provide input to these forecasts are typically influenced by the markets' anticipated stance of monetary policy over the forecasting horizon. Furthermore, there is a risk that publishing inflation forecasts may, at times, have adverse effects on financial markets and wage and price setting and that the credibility of the ESCB could be damaged in the medium term if the conditional nature of the forecasts is not well explained. In this respect, it is seen as crucial that the ESCB be fully independent in its decisions on policy actions and not in apparent need of a published inflation forecast to convince the public about the appropriateness of its decisions. In view of such considerations, most EU central banks, including most of those targeting inflation directly, do not, at present, provide quantitative forecasts for future inflation rates to the public. Yet, even if quantitative inflation forecasts are not revealed, it will be desirable to publish some form of information on inflation prospects, and this should include a discussion of the perceived risks around the central inflation projection." (European Monetary Institute 1997, p. 16.)

The explanation of policy decisions (criterion 8) is an important factor to ensure accountability of the central bank. This is not a novelty. As shown in the Table, all central banks undertake this exercise. This task may be simpler, and better understood by the public, the more transparent are the targets and the operational structure of the central bank. The frequency and content of the decision-making process is also a factor that may affect the outcome of the exercise. For instance, in the case of the Fed, given that the FOMC meets every 6 weeks, the explanation to be provided to the public has to take into account the fact that the object of the decision is the policy guideline for the Fed fund rate for the following 6 weeks, a relatively long period of time. Such guideline needs to take into account contingencies for unforeseen possible developments and has therefore to be rather complex in nature. This complexity is one of the main reasons behind the request of the Fed to keep the guideline secret for at least one month.[23] If the Governing Council of the ECB meets with high frequency, the decisions regarding the main refinancing operations and the interest rate corridor (rates on marginal lending and overnight deposit facilities) to be implemented in the following period leave little scope for discretion in the interval up to the next meeting. The announcement of the key rates for the following weekly operations contains in itself important information on the ongoing policy, more than that contained in a broad guideline for a market-determined rates to be implemented in the following month. In summary, the frequency of the decision-making body and the operational framework adopted by the ECB ensures a relatively high transparency of its decisions, as compared to that of other central banks.

Turning now to the procedures for making the information available to the public or the other policy authorities, there is a broadly similar situation across central banks with respect to the regular public reports, with monthly or quarterly frequency, or to the hearings with the Parliament. The quality of this reporting may vary, depending also on the requirements of the receiving end, i.e. the public at large, the academic and market practitioner and the Parliament. In reference to the latter, it has been pointed out that the accountability of the ECB is impaired by the fact that the European Parliament is not sufficiently representative of the European constituency. Others

[23] See Goodfriend (1986).

have mentioned that the hearings are organised in a way that are less challenging to the ECB than those experienced for instance by the Fed with the US Congress. Only experience will tell how the European Parliament will live up to expectations.

Two issues are worth examining further. The first concerns the participation, without the right to vote, of a member or a representative of the executive branch of government to the meetings of the central bank's decision-working body. This is foreseen for the Bank of Japan and the Bank of England but not for the Fed. For the ECB, the invitation is extended not only to the President of the Council of the EU finance ministers but also to the European Commission. Two peculiarities may be discussed. The first is that the Presidency changes every 6 months. This creates a problem of continuity and of transmission of information across countries and across time. In addition, in case the Presidency is held by a country not participating in the euro area, a problem of confidentiality may arise. Furthermore, the President of the Council, if he attends, may be requested to keep the finance ministers of the other member states informed about the outcome of the ECB Governing Council meetings, with a view to ensuring a level playing field in terms of information. The ministers will also be kept informed by the central bank Governor of their respective country, who is member of the ECB Governing Council. Overall, the amount of information about the deliberations of the ECB Governing Council that will circulate in policy fora can be expected to be relatively large.

The second peculiarity is linked to the issue of the publication of the detailed minutes of the ECB Governing Council, in particular the votes of its components. Such a publication is foreseen in the case of the Fed (7 weeks later for the voting, 5 years later for the detailed minutes), the Bank of Japan (one month later) and the Bank of England (6 weeks later). The Treaty forbids the ECB from publishing the detailed minutes and votes, as Article 10.4 of the Statutes states: "The proceedings of the meetings shall be confidential. The Governing Council may decide to make the outcome of its deliberations public". Only the outcome of the decision, not the procedure for reaching the decisions, may be made public. It is thus the ECB as a whole which is held accountable as an institution, not each of the individual components of its decision-making body.

The reason for collective, rather than individual accountability, stems from several factors. The first is that the members of the ECB

Governing Council are nominated through different procedures: the Governors of the national central banks (NCBs) through the respective national procedures; the members of the Executive Board through a European procedure, specified in the Treaty (Art. 109a2). This is a rather different situation than for any other central bank. A second aspect is that the ECB's primary objective is that of maintaining price stability in the euro area as a whole. The ECB is not responsible for national price developments. Each member of the ECB Governing Council has thus the same 'European' objective. This is confirmed not only by the provisions related to the personal and institutional independence of the ECB's governing bodies inscribed in the Treaty, but also by the voting system: one man, one vote. It is often forgotten that the Governor of the Luxembourg NCB has one vote, just like the Governor of the German NCB and any other member of the ECB Governing Council. This is an important peculiarity to take into account when discussing the way the ECB should be accountable.

Considering the two above aspects jointly, a tension can be observed between the fact that the ECB has a 'European' objective (price stability in the euro area) while the nomination of the members of its decision-making body does not follow a fully 'European' procedure. A system of individual accountability, by which each member of the ECB Governing Council was individually accountable, would raise the problem of the body to which each of them should be accountable to. It would not be coherent if an NCB Governor had to give account of his actions, in particular his vote, taken with a view to a 'European interest', to a body such as a national Parliament or a national government, which is representative of the respective national interest. The national political body, e.g. the national Parliament, would have no legitimacy for judging how the accountee has performed in his 'European' task. The accountability of the ECB is not the sum of the national accountabilities of the members of its Governing Council.

It could be envisaged that each of the members of the ECB Governing Council be individually accountable only to the European Parliament or the European Council. However, this would pose a problem for the NCB Governors members of the ECB Governing Council. Indeed, the European political bodies (Parliament, Council) play no role in their appointment. Their membership in the ECB Governing Council is automatic, not subject to an act of confirmation

by a European body (as is instead the case of the Court of Justice or the Commission – see below). The European Parliament does not organise hearings to confirm the appointments of the Governors of the NCBs. It would thus be peculiar to request the NCBs' Governors to be accountable to it.

Only the members of the Executive Board could be individually accountable to the European bodies, by which they have been nominated. However, it would not make much sense that only the votes of the ECB Executive Board members are made public, while the others are kept secret; individual accountability would be requested only for some members. In summary, given the peculiar nature of the ECB and its decision-making bodies, its members cannot be individually accountable. The solution that has been chosen is to have a collegiate accountability for the whole ECB Governing Council to the European political bodies. Such collegiality makes confidentiality of proceedings necessary, as inscribed in the Treaty.

The interplay between the fact that the President of the Council participates in the meetings of the ECB Governing Council and the requirement of confidentiality of the voting system in the latter may create the peculiarity that confidentiality about the ECB deliberation is ensured only with the public at large, not with the Council of Ministers. Unless the requirement of confidentiality was extended to the President of the Council of EU Ministers, *vis-à-vis* the other EU finance ministers, there would be an asymmetry of information, as the governments of the member states, but not the public opinion nor market participants, would know the way in which the various members of the Governing Council have voted. This may not be fully consistent with collegiate accountability and transparency, and would encourage the search for private information about individual behaviour within the ECB Governing Council. Two solutions may be foreseen to solve this dilemma. The first is that the President of the EU Council is also bound by confidentiality concerning the deliberations of the ECB Governing Council. He would not attend the meeting when the voting takes place. The second is that participation in the meetings of the ECB Governing Council takes place only at rare occasions, for instance those preceding the Council discussions on economic guidelines or the publication of monetary targets. This suggests an attendance of about twice a year, as in the case of the EMI or the

Bundesbank. This would ensure equal treatment concerning information on the internal ECB decision making, for the ministers, the European Parliament and the public at large.

Conclusion

Contrarily to what has been suggested at times, the ECB looks 'on paper' as an accountable institution, at least in comparison with other central banks. This will have to be checked in practice, on the basis of the behaviour of the ECB itself, but also on the effective role played by the bodies in charge of ensuring this accountability, such as the European Parliament, the EU Council and the public at large. The hearings for the nomination of the ECB Executive Board held in May 1998 suggest that the European Parliament intends to give serious attention to this task. Another evidence that the ECB's policies will be the subject of thorough scrutiny in the near future is the creation, as of mid-1998, of at least three 'shadow ECB Governing Councils', inspired on the US model of 'Shadow Open Market Committee', with the task of assessing publicly the way in which the ECB conducts the single monetary policy.

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