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# IS THE ECB SUFFICIENTLY ACCOUNTABLE AND TRANSPARENT?

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**Lorenzo Bini-Smaghi & Daniel Gros***

Abstract

More than two years after its inception, the ECB is still perceived as lacking transparency by many academics and market participants.[1] Our analysis, based on a series of indicators, suggests instead that the ECB is, at least on paper, one of the most transparent and accountable central banks. The discrepancy between theory and public perception suggests that much remains to be done within the given institutional framework to improve the transparency of the ECB. What is the best way to achieve this goal? Several suggestions have been put forward, such as publishing the detailed minutes of the ECB Governing Council meetings. This would result in shifting the true debate to informal meetings of the Governing Council, while formal meetings would only record pre-packaged consensus with no or little discussion. In our view, the best way to make the ECB more accountable is to engage it in substantive discussions about its policy. The ECB should provide more information about the background analysis that leads to policy decisions. For example, the ECB should transform its 'staff projections' into true inflation forecasts and it should be more open about the arguments that shape the internal debates, which precedes decisions. Accountability cannot be ensured by the ECB alone. An important role has to be played by its counterparts, such as the European Parliament, the Council of EU Finance Ministers and the public at large.

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### 1. Introduction

The European Central Bank is formally, and also de facto, one of the most independent central banks in the world. Such an unprecedented degree of independence is considered by some, however, as a cause for concern unless it is accompanied by adequate accountability. The present paper examines the extent to which this is the case by focusing on transparency.

The basic motivation behind this paper is the desire to explain the fact that despite serious efforts by the Eurosystem to appear as transparent and accountable as possible, it is still perceived as secretive and lacking in transparency by both academics and market participants.

The paper is organised as follows: the first section explores the concept of accountability. The second section briefly discusses the role of accountability in the economics literature, which usually takes the form of the question whether transparency is always desirable. The third section describes the acts and procedures through which central banks perform their accountability in reality and thus arrives at a concrete indicator of transparency.

The fourth section discusses briefly the results from the indicator, which allows comparing the transparency of the ECB with that of three other central banks (the Federal Reserve Bank of the US, the Bank of Japan and the Bank of England) plus the Bundesbank. The aim is not mainly to rank central banks according to a pre-determined index of accountability. We provide such an index. But we also show that it can be misleading because, as shown in the fifth section the ECB is widely perceived as in transparent. Section 5 concludes with some ideas on how to improve the accountability and transparency of the ECB.

### 2. Democratic control, independence and accountability

This paper builds on the literature on central bank independence and legitimacy, which has been widely developed in recent years. All caveats, related in particular to the limitations and simplifications of the theoretical underpinnings of this line of research, must be kept in mind in reading this study.

A couple of clarifications may be worth making as a preliminary step towards the analysis of central bank accountability: the first concerns the concept of accountability itself; the second, its relationship with independence.

The concepts of democratic control and democratic accountability[2] are often confused. Democratic control refers to the following three constraints on the exercise of government:[3]

- 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 its functions.
- Accountability is the act of listening to criticism and responding 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.

The above criteria, which define the way democratic control is generally exercised, cannot be fully applied to central banks. The third criterion, in particular, is not relevant in that independent central banks do not receive popular mandates nor do they choose their own policy objectives. This would imply that the central bank had become a new separate branch of democratic power. Instead, central banks receive their mandate from the government or through a legal act, to perform specific tasks in view of specific objectives. The first two criteria (ex-ante control and accountability) however, do apply to central banks.

The way in which accountability is exercised is closely related to the concept of independence of the central bank. The ex-ante control over a central bank that is not independent can be effected in the context of the general conduct of the government's economic policy. The rules and principles underlying such control may be constantly 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 towards stimulating economic growth, depending on the wishes of the government. There is no need in this case to precisely specify in advance the tasks and objectives of monetary policy. Before its recent reform, the Bank of England was not subject to precise rules or guidelines, as suggested by Roll et al. (1993): 'The so-called

Parliamentary accountability for monetary policy connotes no more that 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.'[4]

For an independent central bank, the way in which accountability is exercised needs to be precisely defined. Independence can be granted only if clear rules and principles are laid down to define the boundaries of central bank action. Ex-ante control is a necessary condition for delegating power. If the central bank could choose its own goals and policies, it would become a political body that could not be independent from government. The issue is thus to define the 'optimal contract' for the central bank in a satisfactory way.[5] Such a contract must ensure that the central bank is given the appropriate incentives to pursue its statutory goals. The rules and principles for central bank action can thus not be continuously changed by the government according to specific and changeable interests.

Accountability aims at verifying that the rules and principles laid down for the central bank are respected. The way in which accountability is performed is linked to the way ex-ante control is specified. If ex-ante control is defined with a low degree of precision, for instance including escape clauses, accountability can only be of poor quality. If the objective of a central bank is not clearly specified, the reporting will only be vague and will not allow any association between monetary policy decisions and the bank's final performance. When escape clauses are set, which allow the central bank under unspecified circumstances to deviate from its targets, bad performance can be easily justified ex-post. The public is not in a position to assess the effective contribution of the central bank to the achievement of the specific objective. This undermines the accountability of the central bank. When the mandate of a central bank is clearly and precisely defined, the public can focus on its performance. Accountability can be exercised on the basis of precise performance indicators.

In sum, contrary to the views expressed in some quarters, there is no priori 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 a public account of its actions.

Another issue that has been discussed in the literature is whether accountability can be distinguished from transparency. Accountability refers to the legal obligation to give an account of a bank's actions and performance, which derives from the delegation of power.[6] Transparency goes beyond the fulfilment of a given reporting requirement and refers to 'more subtle forms of accountability' related to the 'way of doing business'. This distinction is to some extent artificial, at least in the case of the ECB, since its objectives and tasks are clearly defined in the Maastricht Treaty. Although the ECB has precise reporting obligations, its accountability can be understood in a very general sense, to be exercised not only to the Council or the Parliament, but to the public at large. This interpretation is consistent with Article 2 of the ECB Statute, 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...' A broad interpretation of the concept of accountability, not restricted to legal requirements but extended to the broader concept of transparency and openness of monetary policy, seems thus appropriate for the European Central Bank.

## 3. The economics of central bank accountability and transparency

Central bank performance can be assessed by observing the results of its policies. If the primary objective of monetary policy is price stability, the assessment of central bank performance can be based on the regular observation of inflation statistics. Given the time lag between the setting of monetary policy and its actual effect on price levels, however, observation of the latter enables us to assess actions taken about two years earlier. This of course 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 is a monetary phenomenon in the long run, but not at each and every point in time. In the short run inflation is dominated by a number of other variables, such as labour costs, import prices and taxes, which are beyond the control of the central bank and are difficult to forecast. The central bank can thus not 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 if such deviations are temporary or not, and whether they are due to monetary factors or to some other cause? These questions, which lie at the root of the problem of central bank accountability, can be regrouped into three main broad areas.

The first is the well-known issue of time inconsistency of the optimal monetary policy[7]. Although a price stability-oriented monetary policy is optimal in the long run, it is not usually optimal in the short term. Welfare may temporarily increase if the central bank deviates from its long-term objective and conducts an unexpected monetary expansion that would bring about higher growth and lower unemployment, even 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 stronger is the reputation enjoyed by a central bank, the greater may be the gains obtained from temporarily deviating from its 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 and changes in public expenditure or 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 a non-monetary shock or to the intention of the central bank to effect a surprise monetary expansion with a view to stimulating the economy.

In this context, the literature has analysed the issue of central bank 'secrecy' or 'ambiguity'.[8] If only unanticipated monetary policy is effective in influencing output and employment, disclosing 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 of springing inflationary surprises.[9] This line of reasoning has been used, in particular by the Federal Reserve, to justify the fact that information about the FOMC meetings should not be disclosed as requested by some market participants.[10] This view may be justified for a central bank such as the Fed, which is not fully independent and whose primary objective is not price stability but also to support economic growth. A central bank that is obliged to focus on price stability as its primary objective, and thus cannot conduct an active stabilisation policy, should benefit from disclosing information that might 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 to follow a different policy from the one it has announced, with a view to enhancing the credibility of its action. It is noteworthy that the issue of accountability has been promoted in particular by central banks whose statutes have changed and that have no track record.

To summarise the above arguments, transparency increases the credibility of the central bank, especially when the latter does not enjoy a particularly high reputation. It thus enables the central bank to conduct a less restrictive monetary policy than would otherwise be required.[11] 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 distributive effects produced by monetary policy decisions, in particular unanticipated ones. Unexpected interest rate changes can produce a significant redistribution of wealth between debtors and creditors. The small increase in the fed fund rate decided by the Federal Reserve in early 1994 was sufficient to wipe out most of the profits of the large investment banks for that year. Such redistributive 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 distributive effects may 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 income distribution objective. An independent central bank, which has no income distribution objective, must prevent a situation in which private information concerning its actions is made available to certain groups of society and not to others. 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 may not be fully understood by some sectors of society. Without the necessary transparency, the suspicion may arise that the interests of some parties are given more attention than others.[12] This would clearly be to the detriment of European Central Bank's credibility. To avoid this suspicion, information should be disseminated with similar intensity, frequency and depth across the economy. This can be more easily done in an atmosphere of disclosure and accountability than one of secrecy.

The third reason for accountability is that it facilitates cooperative 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, relative to the rest of society. Agents can thus modify their behaviour or try to influence that of the other components of society. This argument applies in particular to decentralised economies, where agents have difficulty in coordinating their actions and expectations. For instance, if the ECB anticipated that the government of one of the large EU states was in the process of launching a major public expenditure plan, with potential inflationary pressures for the whole Union, it could consider increasing interest rates, possibly in a pre-emptive way. In this case, it would be desirable to publicly spell out such policy intentions, possibly in advance of the decision. This would give the government in question the opportunity 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 'that are fiscally disciplined'. The outcome of a re-consideration of the initial policy intention would lead to a more efficient solution than the one contemplated in the case of an ex-post reaction by the central bank.[13]

The same reasoning can be applied to other shocks, such as for instance asymmetric wage and price developments. Central bank transparency contributes to cooperative 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 at times even 'threatened' to increase interest rates if wage negotiations were concluded that were inconsistent with price stability or if budget projections were overshot.

## 4. How to assess central bank accountability and transparency?

It is tempting to assess central bank accountability and transparency by creating an indicator as done in the literature on central bank independence. We have succumbed to this temptation, but only to show that indicators based on formal criteria are not useful in this field. Briault et al. (1996) have also 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 are published of the meetings in which monetary policy is decided; 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. De Haan and Eijfinger (1999 and 2000) also provide a numerical indicator, with an emphasis on accountability defined as the interaction of the central bank with political instances (government and parliament).

In our view, these criteria are unsatisfactory. They oversimplify the process and thereby give an incomplete picture of the framework within which accountability is exercised. In particular, the last criterion seems more appropriate for evaluating central bank independence than accountability. The possibility of overriding the central bank is unrelated to ex-ante control and thus to accountability. Cukierman (1992) includes this criterion in the index of legal independence. The third criterion is also dubious; it is not clear why an inflation report would necessarily ensure any more accountability than would be achieved through the regular monthly reports, if the latter contained the necessary information.

We examine a much larger set of criteria, derived from the concepts of ex-ante control and accountability discussed in the first section. We examine the ways and opportunities that central banks use to interact with public opinion, market participants and the other institutions in society.

We consider 15 criteria of central bank transparency, divided into four groups (see Table 1): the precision of the objective, the strategy to reach it, the data/forecasts published and the communication strategy.

The first criterion in the first grouping is simply what the objective of the central bank is supposed to be. Giving a central bank one clear task facilitates accountability. A score of two was thus given when maintaining price stability was clearly the main task of the central bank. A score of 1 was assigned when the primacy of price stability was not clear and a score of zero was assigned when the central bank had no clearly defined responsibility.

Accountability is further enhanced by a clear definition of the objective of price stability. This concerns in particular the way in which price stability is defined, a quantification of the target (whether a point estimate or 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 correctly 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.

Nevertheless, complexity cannot be used as an excuse for not defining the target, as this would give rise to the suspicion by market participants that other policy targets are being followed. This would lead to a loss of credibility for the central bank. A numerical target was given a score of 2 if it was in the statutes, a score of one was assigned if the target was chosen by the central bank itself (implying that it could be changed at its discretion) and a zero was assigned if no numerical target exists.

The second grouping concerns the strategy to reach the ultimate target. A clear understanding by market participants of which operational target the central bank uses to conduct its monetary policy operations enables a frequent monitoring of a central bank's actions. Market participants should know what model the central bank has in mind when it sets rates and be able to clearly distinguish between the instruments of monetary policy, such as the 'official' or 'policy' interest rate, and the operational target that is affected by a central bank's actions but is ultimately determined by market conditions. If such a distinction cannot be made, market participants have less information about a central bank's actions. A score of 2 was assessed when the strategy is announced openly. If not the score was zero.

This also applies to the announcement of an intermediate target. Given the time lag, estimated to be around 18 to 24 months, between implementation of monetary policy and its effects on price levels, 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 in the future, a statistic that is not available. An intermediate target is generally used to try to express future inflation developments in terms of 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 to 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. It can thus check whether the central bank is sticking 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. If there is no variable closely related to future price developments, the central bank may use its own inflation forecast as a target, as is done under a direct inflation targeting strategy. A score of two was assessed if the central bank announces an intermediate target, zero otherwise.

To the same group belongs the announcement of indicators for assessing the appropriateness of monetary policy. Given that it is generally difficult to find one single variable that enables the targeting of future inflation, central banks use indicators to interpret possible deviations from the intermediate target and to assess whether a policy reaction is granted. Disclosing information on these indicators helps market participants to 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' is not very informative for market participants. A score of two was assigned to central banks that announce 'prominent' indicators that are quantified, a score of one for indicators that are not, and zero if no indicators exist.

The next group concerns the explanation of how monetary policy actions interact with other policies and objectives. Even if the primary objective is price stability, central banks may pursue secondary objectives, such as supporting the economic policies of the government. During times of generally low inflation central banks are actually judged more by how they are perceived (rightly or wrongly) to contribute to growth and employment. Providing the model the model on which the central bank bases either explicitly or implicitly its decisions is a first step. A value of two was assessed when the model used to evaluate prospects was explicitly provided, a value of one for the case (the ECB) where the model can be inferred from an informal discussion and a value of zero otherwise.

Publishing data on intermediate targets and indicators in real time will also help the market and the public to understand policy. A value of two was assessed whenever this was the case, zero otherwise.

A forecast and an assessment of inflationary trends will also help the public to clearly distinguish between the responsibilities of the various policy-making institutions and to create transparency in the dialogue between them. Publication of data on intermediate variables and explanation of possible deviation from target will also help. A value of two was assessed for clear quantified inflation forecasts, a value of one for 'projections', which are not really underwritten by the central bank's decision making body (a special case of the ECB) and a value of zero otherwise (no inflation forecast at all).

The final group of accountability criteria refers to the procedures followed by the central bank to effectively communicate with the market and the public.

The procedure may include the issuing of public reports in which the central bank provides data on its targets and indicators and explains its policies, their underlying reasons and how well it has performed in view of the pre-announced targets. Reporting can also be made through testimony presented in hearings before Parliament[14] by members of the decision-making body. These presentations are generally less technical but allow, through the question and answer sessions, for a more articulated assessment. A score of two was assigned for regular hearings before Parliament, zero otherwise.

The frequency of reports can also increase transparency, especially when events are moving fast. A value of two was assigned to monthly publications and one for quarterly publications. Zero would have been appropriate for annual ones, but his was not the case in this sample.

Press conferences are an important element for allowing for real interaction between the central bank and the public. A value of two was assessed for frequent press conferences monthly), one in the case of quarterly ones, and zero otherwise.

A substitute for a press conference can be press releases in which the motivation for policy actions is summarised in a form that is accessible to the public. Most central bank do so, receiving a value of two. If press releases were the norm, but not always provided a value of one was assessed.

Another way in which the central bank can communicate its policy stance and its own outlook for the future is through statements on possible future moves. A value of two was assessed when this was as a rule, a value of one if this was done occasionally and a value of zero otherwise.

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 either an abridged or full version. This information could be dis-aggregated up to the level of each member of the decision-making body, by making public the votes of the individual members. This raises the question of whether accountability is required for the central bank as a whole or for each member of the decision-making body; it relates to the issue of collective vs. individual accountability, which is addressed below. Disregarding this issue for the moment a value of two was assessed when the minutes of policy making bodies are released (at least in summary form) within a time frame that is still useful for financial markets and the public (i.e. weeks, not years later), and zero otherwise.

Publication of votes of members of the decision making body is also potentially a two-edged sword. It raises delicate issues in the case of the ECB, but disregarding this special case it is clear that publication of the votes increases transparency. A value of two was assessed if votes are released (with a certain lag) and zero otherwise.

This is the way the criteria have been used to construct an index of central bank accountability. Such an index suffers from all the problems inherent in such an exercise as some of these criteria are complementary and cover overlapping issues. Furthermore, the list is not exhaustive nor has it been drawn up 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. But it provides one useful piece of information: how transparent should a particular central bank if its institutional framework is well managed?

## 5. How accountable is the ECB?

There is as yet little literature that attempts to assess the accountability of the ECB.[15] There are at least two difficulties with such an exercise. The first difficulty is that, as mentioned above, the assessment can only be of a qualitative, rather than quantitative nature. 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 collectively, and in the broad institutional context within which the central bank operates. The second difficulty is that the ECB has not been operating for a very long time.

In spite of these caveats, we try to examine the possible accountability of the ECB, in comparison with the experience of three other major central banks – the Federal Reserve in the US, the Bank of Japan and the Bank of England – the latter two having recently experienced a change in their statutes, in particular with a view to increasing both independence and accountability. The Bundesbank is also included as a useful reference point from the past.

The detailed scores are presented in Table A1, based on a qualitative evaluation done by the OECD. The quantification is entirely ours.

The overall score is the following:

*Table 1. An indicator of central bank transparency and accountability*

| | Total score | Total score without 14 and 15 (minutes and votes) |
|---|---|---|
| | | |
| Eurosystem | 19 | 19 |
| Federal Reserve | 16 | 14 |
| Bank of Japan | 14 | 10 |
| Band of Canada | 15 | 15 |
| Bank of England | 24 | 20 |
| Bundesbank | 13 | 13 |

*Source*: own calculations.

This table suggests that the ECB (or rather the Eurosystem) should be more transparent than the other major central banks, with the exception of the Bank of England. This is a first answer to the question posed above: just looking at the formal set-up suggests that the Eurosystem should do well.

We have provided the overall score in two ways: first a the simple sum of all the 15 different scores, and second, the sum without the last two items, i.e. the publication of minutes and votes of members of the decision making body. The reason is that on these points the particular structure of the ECB raises delicate issues, which merit a longer excursus. Given this we would actually prefer to concentrate on the indicator that leaves these two items out. But the values in the last row of table 1 only strengthen the impression that the set-up of the Eurosystem looks rather transparent. We will come back to this issue after the considerations on the special position of the ECB regarding the publication of minutes and voting records.

In the case of the ECB there is the question of collective, rather than individual accountability. This issue involves several aspects.

The first is that the members of the ECB Governing Council are nominated through different procedures: the Governors of the NCBs through 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 that of 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 should thus in principle have the same “European” objective. This is confirmed not only by the provisions related to the personal and institutional independence of the ECB governing body, but also by the voting system: one man, one vote.

Considering the two aspects jointly, a tension can be observed between the expectation that the ECB has a ‘European’ objective (price stability in the euro area) and fact that the members of its decision-making body are not nominated on the basis of 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 they should be accountable. It would not be consistent for an NCB Governor to account for 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 represents national interests. A national political body has no authority to judge 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 the members of the ECB Governing Council are individually accountable only to the European Parliament or to the European Council. The European political bodies (Parliament and Council) however, play no role in the appointment of NCB Governors. Their membership in the ECB Governing Council is automatic, not subject to an act of confirmation by a European body (as in the case of the Court of Justice or the Commission). 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 NCB Governors to be accountable to the European Parliament.

Only the members of the Executive Board could be individually accountable to the European bodies that have nominated them. But it would not make much sense to publish only the votes of the ECB Executive Board members, while the others are kept secret; individual accountability would then be required of only 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 called for in the Maastricht 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 on ECB deliberations is ensured only with respect to the public at large, and not with the Council of Ministers. Unless the requirement of confidentiality were 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. That is, the governments of the member states, but not the public or the market participants, would know how the various members of the Governing Council have voted. This might not be fully consistent with collegiate accountability and transparency, and would encourage the search for private information about the behaviour of the various members of the ECB Governing Council.

## 6. How does the market evaluate the ECB?

It is interesting to note that most criticism of the ECB has come from the academics and market participants, rather than the public at large or the press. The criticism from the academic side has already been referred to above; Buiter (1999) represents the most prominent example. It is more difficult to document the evaluation of the market. Anecdotal evidence suggests that market participants have difficulties understanding the ECB. Criticism of the lack of transparency of the ECB appears frequently in the publications of the major international institutions. See for example :

- J.P. Morgan Global Data Watch, March 17, 2000, ‘The ECB: More activist and less transparent’,
- Deutsche Bank, Europe Weekly, February 25, 2000, on conflicting statements from members of the Governing Council, and March 17 on ‘unfortunate comments’, and
- Goldman Sachs, European Weekly Analyst, June 25, 1999, ‘the ECB has not yet succeeded in giving an entirely clear and convincing message on monetary policy issues to financial markets’; February 25, 2000, ‘The ECB feels misunderstood; February 29, 2000, ‘Baffling signals from the ECB’, and European Daily Comment, ‘To avoid new misunderstandings, both the markets and the ECB should learn from this episode.’)

A more systematic way to assess whether market participants understand what the ECB does is to ask them directly. An exercise along these lines is reported in Gros et al. (2000) which report on poll of financial market participants in early, who was asked to rate on a scale of 1 to 5 how well they understand the reasoning behind monetary policy decisions at four central banks (a higher grade indicates a better understanding). The comparison included the Bundesbank, in many ways the ECB's predecessor. The sample was not scientific (only 113 responses were received, but from almost all business areas and regions). The sample of respondents is not representative, but it is rather diverse regarding the type of financial market activities the respondents pursue and their locations. Hence, it may well broadly reflect views held by a majority of financial market participants. Here are the results.

*Table 2. Transparency ratings of central banks*

| | % Distribution of ratings | | | | | Average Ratings |
|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | |
| Federal Reserve | 0.0 | 1.8 | 7.1 | 48.7 | 42.5 | 4.3 |
| Bank of England | 5.5 | 10.0 | 42.7 | 33.6 | 8.2 | 3.3 |
| Bundesbank* | 2.7 | 10.0 | 35.5 | 38.2 | 13.6 | 3.5 |
| ECB | 21.2 | 43.4 | 27.4 | 7.1 | 0.9 | 2.2 |

* Until 1999.
*Source:* Gros et al. (2000).

Given its track record and careful communication strategy, it is probably not surprising that all respondents give the US Federal Reserve (Fed) a top rating of 4.3 for intelligible monetary policy. Moreover, votes are relatively highly concentrated on the two top ratings (see Table 2). Clearly behind the Fed come the Bundesbank and the Bank of England. At 3.5 and 3.3, respectively, these central banks differ only slightly in transparency. Views of the Bank of England are a bit more homogenous than those of the Bundesbank, which show a somewhat greater dispersion around the mean. In fourth place comes the ECB with a rating of only 2.2. Views about the ECB are also more homogenous than those of the Bundesbank, but more widely distributed than those of the Fed. Considering that the ECB has operated for only a little more than a year and is, uniquely, a supra-national central bank, a lower transparency rating than for the other central banks should not come as a big surprise. However, the ratings do indicate that there is a communication problem, and that the ECB decisions seem less clearly understood than those of the other central banks.[16]

A survey conducted by Reuters in early summer of 2001 came to a similar result: In a survey conducted May 2001 62 analysts gave the five central banks within the Group of Seven nations, scores (out of 10) for transparency and presentation as well as policy effectiveness. The following Table 3 presents the results in more detail.

*Table 3. How financial market participants evaluate transparency, II*

| | Mean score | | |
|---|---|---|---|
| | Monetary policy effectiveness | Transparency | Presentation |
| European Central Bank | 6,2 | 3,8 | 3,4 |
| U.S. Federal Reserve | 7,3 | 7,3 | 7,9 |
| Bank of Japan | 4,6 | 5 | 4,6 |
| Bank of England | 7,5 | 8 | 7,8 |
| Bank of Canada | 7,2 | 7 | 6,8 |

*Source*: 'ECB ranked last among G7 central banks in transparency', Reuters report by Pratima Desai.

Here again the ECB is ranked lowest in terms of transparency (and presentation). This poll is even less reliable in scientific terms than the previous one (only 62 replies), but it confirms the results of the previous table for a different point in time. It is interesting to note that in terms of policy effectiveness the ECB scores relatively well, coming closely behind the other major central banks. This suggests that the negative rating in terms of transparency is not the result of a general lack of satisfaction with the ECB, but a well-defined separate problem.

The difficulty the market has in understanding the ECB can also be seen in another indicator, namely the volatility of short-term interest rates. Gros et ali. (2000) find that both actual and implied volatility from option prices is higher in the euro area than in the US, despite the more stable macroeconomic environment here.

What explains this discrepancy between high formal transparency (as emphasised by Issuing (1999) on the one hand, and, on the other hand, the lack of understanding by the markets documented above as well as the complaints from academics (Buiter (1999))?

The most convincing explanation is that the ECB does not use its policy framework efficiently because its decision making structure has not yet settled down and it does not have a clear strategy. The first point derives from the composition of the Governing Council in which the (now) 12 governors of national central banks have a majority. Nevertheless, the 6 members of the Executive Board have much stronger position than one would guess merely from their numbers because they have an advantage in terms of information. And because they are at the centre of the complicated web of relationships that links national central banks via a number of working groups within the Eurosystem. The importance of this information advantage is difficult to gauge for outsiders, which makes it in turn difficult for market participants to predict ECB decisions.

But a more important reason for the perceived lack of openness is possibly that the ECB does not have a clear strategy. The two-pillar approach is widely perceived as not credible because the ECB usually pretends that both pillars point in the same direction. There is a growing consensus among academics that the ECB is de facto following an inflation strategy (focusing on core inflation) although this is officially denied.

Finally, the ECB might simply be inefficient, in the sense that it has not been able to organise properly all the different avenues for transparency that exist. There might in fact be too many communications channels, which can at times lead to a cacophony of pronouncements which through the markets into confusion, as the events in 2000 surrounding a period of pronounced euro weakness show.

## 7. Conclusions

Our formal analysis based on the treaty’s requirements and the communication procedures of the Eurosystem, suggest that the ECB should be more accountable and transparent than most other central banks. However, the ECB is widely perceived as less transparent. This suggests that it is not the institutional framework that is lacking, but its proper use. The present situation that looks unsatisfactory could probably be improved with few changes.

The ECB should establish a hierarchy of occasions for public statements. For examples, occasional speeches by members of the Governing Council should be clearly subordinated to the speeches and reports to the European Parliament by the President. Moreover, there should be a common understanding and blueprint over what kind of statements are allowed. Members of the Governing Council should be allowed to express somewhat different views over their interpretation of the economic outlook, acknowledging that judgement of the economic situation need not be always unanimous. But they should deliberately refrain from commenting on priorities and goals for monetary policy, on the immediate policy outlook, and on market variables such as the exchange rate, unless such statements have been explicitly agreed upon by the Governing Council. Over such matters, the ECB should speak with one voice, to avoid sending conflicting signals and confusing market participants. Moreover, such views should be expressed preferably by the President, in its official hearings with the European Parliament.

One problem that is inherent in the structure of the ECB is that it is not a ‘one man show’ as the Federal Reserve (under its current Chairman.) Power is much more widely shared within the Eurosystem than in the Fed, where the entire staff at headquarters works for one person and where the other members of the FOMC by far do not have the same basis in terms of analysis and information as the Chairman.

Contrary to some suggestions, the way to improve the accountability of the ECB is not to ask it to publish detailed minutes of the ECB Governing Council meetings. This would only result in shifting the true debate to informal meetings of the Governing Council, so that the formal meetings would only record pre-packaged consensus with no or little discussion. The minutes would become irrelevant.

A better way to make the ECB more accountable is to engage it in substantive discussions where it is pressed to provide the relevant information about the background analysis that have led to policy decisions. For example, the ECB should be pressed to transform its ‘staff projections’ into true inflation forecasts. Moreover, the ECB should be more open about the arguments, both pro and con, that shape the internal debates, which precedes decisions. Its official publications give at present only the arguments for the decision that was taken.

Accountability cannot be ensured by the ECB alone. An important role has to be played by its counterparts, such as the European Parliament, the Council of EU Finance Ministers and the public at large. The record so far is encouraging. The hearings for the nomination of the ECB Executive Board held in May 1998 suggest and the subsequent quarterly appearances of the President of the Eurosystem before the European Parliament show that the latter intends to give serious attention to this task. However, much more is required to counteract the widespread impression of inadequate accountability, which would lead to constraints on the independence of the ECB if it were to persist for too long.

## Appendix

Table 1A

| | | Eurosystem | Federal Reserve | Bank of Japan | Bank of Canada | Bank of England | Bundesbank |
|---|---|---|---|---|---|---|---|
| | Objective | | | | | | |
| 1 | Ultimate goal | 2 | 1 | 2 | 2 | 2 | 2 |
| 2 | Quantification | 1 | 0 | 0 | 2 | 2 | 0 |
| | Strategy | | | | | | |
| 3 | Announcement of strategy | 1 | 0 | 0 | 2 | 2 | 2 |
| 4 | Announcement of intermediate target | 0 | 0 | 0 | 0 | 2 | 2 |
| 5 | Announcement of indicators | 2 | 1 | 0 | 0 | 0 | 0 |
| | Publication of data/forecasts | | | | | | |
| 6 | Macro model used | 1 | 2 | 0 | 2 | 2 | 2 |
| 7 | Data on targets | 2 | 1 | 0 | 0 | 2 | 2 |
| 8 | Inflation forecast | 1 | 2 | 0 | 2 | 2 | 0 |
| | Communication strategy | | | | | | |
| 9 | Parliamentary hearings | 2 | 2 | 2 | 2 | 2 | 0 |
| 10 | Frequency of reports | 2 | 2 | 2 | 1 | 1 | 2 |
| 11 | Press conferences | 2 | 0 | 2 | 0 | 2 | 1 |
| 12 | Publication of press releases | 2 | 2 | 2 | 2 | 1 | 0 |
| 13 | Statement of future moves | 1 | 1 | 0 | 0 | 0 | 0 |
| 14 | Publication of minutes | 0 | 1 | 2 | 0 | 2 | 0 |
| 15 | Publication of indiv. Votes | 0 | 1 | 2 | 0 | 2 | 0 |
| | Total | 19 | 16 | 14 | 15 | 24 | 13 |
| | Sub Total (1-13) | 19 | 14 | 10 | 15 | 20 | 13 |

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## Notes

[1] Buiter (1998) is the most prominent example for the academic criticism. Gros et alii. (2000) contains evidence that market participants do not seem to understand the ECB.

2. It is interesting to note that during the debate in the European Parliament on 'Democratic accountability in stage three of EMU', the French, Italian and Portuguese versions of the draft report initially used the term *contrôle démocratique, controllo democratico* and *controlo democrático*, respectively, while the Spanish version referred instead to *responsabilidad democrática*. The texts were later harmonized with the use of the word responsibility. The literal German translation of accountability would be 'Zurechenbarkeit', but Rechenschaftspflicht seem to get closer to the true meaning of accountability.

3. See Roll et al. (1993).

4. CEPR (1993), pp. 48-49.

5. See, in particular, Persson and Tabellini (1993), Walsh (1995) and McCallum (1995).

6. See Briault et al. (1996).

7. See Kydland and Prescott (1997) and Barro and Gordon (1983a and 1983b).

8. See Cukierman and Metzler (1986) and Garfinkel and Oh (1995).

9. See, for example, Canzoneri (1985).

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

11. See Faust and Svensson (1998) for a formal proof of these propositions.

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

13. A formal derivation of this reasoning can be found in Demertzis et al. (1998).

[14] The participation of the government in meetings of the decision-making body is potentially another opportunity through which institutions 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. But we concluded above that is rather an indicator of independence than of accountability.

15. See, in particular, Gorwley and De Haan (1996) and De Haan (1997).

[16] A survey of over 300 financial market participants organised by the ZEW in Germany came also to the result that the ECB was criticised for its lack of transparency, see Heinemann (1999).