Abstract

Territorial appointees to an independent central bank (e.g. District Federal Reserve Banks' presidents, Governors of national central banks at the ECB's Governing Council) are liable to confront a "role conflict" stemming from a duality of loyalties and allegiances - to the home regional territory to which they owe the appointment and to the central bank to which they are appointed. This essay examines the issue of two "principals" for a given "agent", within the framework of a "common agency" model in European monetary policymaking.

Territorial appointees cannot afford being unresponsive to their country-specific monetary preferences – as dictated by idiosyncratic social and economic structures, political orientations, cultural factors, and other determinants. Local preferences may conflict with the central bank's mandated objectives, its social and political environment, the constellation of institutions gravitating in its orbit, which shape a given mindset and culture to which the territorial appointees are also prone to conform.

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Summary

I contend that territorial appointees to an independent central bank are prone to a duality of loyalties and allegiances – to the home actors and institutions to which they owe the appointment and to the central bank to which they are appointed. The analysis builds upon information on regional participation in national central banking, as that of district Federal Reserve Banks sitting at the FOMC, which underpins the arguments foreshadowing an issue of that sort for the ECB.

Home-specific monetary preferences are liable to conflict with the central bank's area-wide policy. A uniform targeted inflation rate cannot be optimum to each and every territories involved as business cycles are not necessarily synchronous throughout the monetary area; sector concentration, territorial magnitudes, financial market volumes, political orientations, diverge also from mean values. Factors like the outcome of demand or supply shocks, local performances, endowments, social and economic structures and institutions, accrued seignorage, inflation-aversion patterns and other cultural factors often show substantial diversity across countries or regions and are a magnet for time-consistent adaptation of inflation rates. Further diverging preferences stem also from the inhibiting fiscal limitations of the "European Stability and Growth Pact", as well as from the absence of significant fiscal stabilizers and a poor rate of labor mobility in Europe.

Discordant or different time-frame preferences reverberate on territorial appointees. For all the independent status from their home countries or regions the appointees are institutionally granted, they are organically prone to wheedle the web of national policy-makers, institutions, and networks (the "core executive" – see note [1]), particularly so as they have participated in their appointment. These factors contribute to the make a territorial appointee an "agent" of his/her home country and be delegated critical duties in the monetary area.

However, the "agency" qualification is also applicable to his/her relations with the central bank. Central bank's social and political environment, its formal instruments and mandated objectives, a constellation of institutions gravitating in its orbit (particularly its closeness to the financial community), the historical determinants of the central banking decentralization process, a peculiar culture, mystique, and inertia, may transcend the scope and purposes for which the bank was created. The central bank delegates on them the task of whipping up support for its agenda to their respective countries and expects them to make choices attuned to its institutional mandates, inflation control objectives, a stifling international environment and the relative inefficiency of monetary measures over unemployment and output variations, except short term. This

environment shapes a given mindset to which the territorial appointee is inevitably prone to conform, while at the same time he/she is divested from home and political affiliations.

One “agent” with two “principals”: the setting of a “common agency” and “role conflict” models is thus in place. The models (and plain common sense) predict the weakening of the principals’ power of incentives, the distortion of the information transmitted to the principals, and a subdued accountability to either of them. Muted commitments grant a larger leeway to the appointees’ own personal preferences and motivations in policymaking. There is then a potential incentive to cheat (so to speak) on conveying home country preferences (with the alleged reason of orthodox, long-term, non-partisan, benevolent welfare philosophy) – and a parallel incentive to cheat on central banking preferences (because of a better knowledge of home problems, intimidation, or absence of it, by the majority council members, a sense of interdependence among them). These personal and institutional constraints may explain the split of territorial appointees between the “activists” and the “free riders” – and seriously challenge at the same time the concept of a Rogoff-type[2] central banker, lesser vulnerable to political influences but fully devoted to collective well-being. In either group, the organizational and rentier context in which the appointees are embedded, their personal social, political, academic backgrounds and convictions, would then be given more prominence in monetary decision-making than that generally recognized in the current debate over monetary policy and its determinants.

Further empirical or theoretical speculations on that subject should not neglect this aspect of policymaking. To predict the European governors’ behavior in light of national experiences in the U.S. or elsewhere has not been the aim of this paper. The aim is rather to anticipate a “role conflict”, whose ingredients are similar in the national and multinational peculiar context of interests, political and social environment involved in monetary policymaking - and to outline its possible outcome.

Summary of sections 1 and 2

The original version of this paper included a first section with an outline of actual or potential sources of conflict between individual regions or territories and central monetary authorities. Conflicts are apt to breed pressures on national central banks by the affected territorial entities and their respective political bodies, economic sectors and the society at large.

The conflict exacerbates in poorer and depressed regions or nations, where debt load is generally greater than the average, in relative or absolute terms, and the increased debt service that tight monetary policy brings about puts an additional burden to local economies. More than this: the so-called Balassa-Samuelson effects predict higher inflation rates in the relatively weak economies that have rapidly tried to catch up to the average – namely, those showing stronger growth than countries where growth had already reached higher levels. This effect may well be felt in EMU region, where levels of national development are uneven. To be sure, growth patterns result in a strong demand expansion on non-tradable goods and services, while the productivity in those areas grows at slower pace than that of tradable products. This structural inflation difference, if met by ECB’s tighter monetary policy, would conflict with the interests of stronger economies.

A further source of potential disagreement across territorial entities stems from the idiosyncratic time lags before monetary decisions affect the economies concerned. Money-transmission mechanisms or differences in responses to policy-induced interest rate changes show indeed significant territorial variations (deHaan, Toolsema, Sturm (2001); Kuttner, Mosser (2002)). Asynchronic productivity developments and national money demand functions disparities suggest also that area-wide money policy will also fail to accommodate individual national preferences (Dedola, Gaiotti, Silipo (2000)).

Basically, optimality of monetary policy underlies a concern for local inflation/employment proportions when they differ from average values. To the extent that monetary measures are thought to correct those proportions, at least short term, and bring about lower social and economic costs, conflicting views with the monetary authorities may be expected. More generally, the optimality of monetary policy and its effects on inflation/unemployment combinations have been associated with three factors: 1. The “optimum currency areas” concept (Mundell, 1963); 2. The territorial, often diverse, anti-inflation culture and public consensus on monetary stability; and 3. The political preferences and electoral constraints of local governments.

Section 1 of the original paper provides some analysis of those different issues, including the role of sectors geographically concentrated, and their breakdown into tradable and non tradable commodities, manufactures, and services is different. Either the production structure is homogeneous with that of the rest of the area or widely diversified or costs derived from those conflicts are bound to be important. Other factors contributing to costs are lack of a suitable degree of factor mobility and a deficient extent of trade among the countries, as well as flexibility of wages and prices, so that the need for relative price adjustments are met by movement in domestic prices rather than exchange rate movements or unemployment (Tootell (1990); Chamie, DeSerres, Lalonde (1994)).

Heterogeneous cultural and political features across regions aggravate the effects of inadequate “optimal currency area” conditions and bear also on distinctive preferences over a possible trade-off between inflation and unemployment (Hayo (1998)). The importance of these features is particularly relevant where historical backgrounds manifest themselves in differentiated languages. Taste differences and anti-inflationary attitudes, stemming from cultural and historical profiles, are potential sources of conflict between individual countries and the Eurosystem.

Different market and institutional frameworks may also influence social stress with a resulting disagreement over the optimality of monetary measures and preferences. Local traditions in respect of saving and investment patterns and styles; attitudes towards entrepreneurship, and other social and political circumstances also differ across regions and dictate region-specific monetary inclinations and preferences. Even differential crime rates, the scope of social welfare institutions and their unemployment insurance schemes, the extended family networks in Southern Europe, are also factors weighting on preferences over unemployment and inflation and on implications on monetary policy stances (Bentolila, Ichino (2000); Tullio, Quarella (1999)).

Territorial ruling parties are committed to distinctive monetary orientations. The American experience bears out this opinion. The two parties in the United States have shown different preferences over inflation and unemployment which reflect those of the constituencies these parties represent (Hibbs (1977); Alesina, Sachs (1988)).

A second section of the original version of this paper assumes that the vulnerability of the bank to external pressures and in particular its resistance to claims channeled through the appointed members to its governing body hinges to a large extent on the bank’s personality, authority, commitments and constrains – as shaped by its social and political environment. The central bank’s formal instruments and mandated objectives are also relevant indeed (Issing (1999); Andrews (2000)). However, important as these instruments are in the definition of their authority, structure, and personality, they do not account for the whole complex elements underlying the monetary policymaking. A constellation of institutions gravitating around its contested terrain have largely shaped the central banking structural, organic environment and its “agenda” – its style, purposes, objectives, strategies and even semantics (Epstein (1992); Bowles, White (1994)). The combination of these elements has contributed to create a central bank’s environment all its own which is bound to modulate the margins of decision of the governing members and even to make them “agents” of sorts of the bank (next section).

Professional reputation has contributed to central banks’ aura of ‘soundness’ and public service” and to a favorable environment. “An aggregation of expertise, its control over information, its privileged links with important constituencies such as domestic financial and business leaders or international financial agencies, its influence in the corridors of government, the connections of its key officials” are innate attributes of central banking.

Three additional elements are explored in section 2 to explain the environment of an independent central bank and the extent to which it shapes its agenda. The environment has first to be found in the historical determinants of the central bank’s decentralization process. A credible, fancied interpretation of the decentralization process and its underlying forces and interests is that the process has been an instrument for co-opting and absorbing peripheral forces (regions, sectors) into the central banking system so as to neutralize their potential hostility by incorporating them within the organization structure. (Broz (1997, 1999); Friedman, Schwartz (1963); Lohmann (1998); Woolley (1984)). A Byzantine question on this matter is whether the process permitted special-interest and territorial groups to be just listened to in the formulation of the central bank’s agenda – or has the process been promoted by interest groups, sectors and territories and let them in this way to shape the central bank’s agenda?

The second point involves the closeness of the central banking environment with the financial community and other special interests groups. The commercial banking sector, in particular, maintains strong organic linkages with central banks and wield reasonable power over them. In fact, influences are both ways. To the extend that financial structures and markets have increasingly spread to reach national dimensions – in terms of geography and financial deepening - regional separations of the banking sector have dwindled and so have been their individual regional (district) specificity. This argument may have an important bearing on the European context – just replace regions by nations, national by multinational - at a time when the financial sector is transnational and increasingly ignores national borders.

The question of a peculiar central banking culture, mystique, and the inertia that are common to groups (section 3) is also to be reckoned as elements of a central banking environment and assertiveness, which transcend the scope and purposes for which it was devised. A similar opinion arises in respect of the influences of academic circles – I mean, the intellectual and bureaucratic comfort provided by sticking to highly regarded theoretical models implying a set of rules, hence narrowing margins of discretionary powers and stifling national initiatives (Mayer (1999); Grenville (2001)).

3. The "common agency" issue

Section 2 suggests that the functions of territorial policymakers in an "independent" central bank are generally performed in a context of institutional, social, and political environment that has gradually shaped statutory, operational, and organic features. That environment in turn is apt to mold the appointees' loyalties and commitments. I also contend (section 1) that the appointees' are also committed (implicitly or not) to the interests, constrains and conditions of their home territories and their respective administrations. A conflict of interests or "role conflict" would then arise as monetary preferences do not necessarily coincide. This section examines the interaction of either "principal" in the policy behavior adopted by their common "agent". (A short reference of recent formal analysis of interactions between national macroeconomic players and the ECB Council is included in note [3]).

(i) The home country's agent.

The crucial role of monetary policy in national agendas makes the appointment of the country's central banker a central issue in the government's strategy and electoral planning. The government (principal) has an incentive to induce its central banker (agent) to be responsive to its preferences and electoral constrains – and so it will be to the extent that the agent shares the principal's basic political and social agenda and expects it to come forward with adequate rewards, such as reappointment, post-central bank employment opportunities, political positions in the "core executive" circles, avoidance of public criticism, and other perks.

Some authors contend that the kind of dependence thus established leads the central banker to create a socially inefficient inflation bias by accommodating the political stances of the current administration. However, for all the possible incentives, a basic postulate is that the "agent" generally holds different views on optimal measures and that he/she is apt to stick to low-inflation pre-committed plans and to abstain from time-inconsistent opportunism which the government is inclined to. Divergences may result from personal political or intellectual outlooks, time frame and professional skills over monetary preferences. In fact, divergences of this kind are welcome as a solution to the inflation bias characterizing discretionary policies resulting from political or electoral motivations. (Alesina and Grilli, already in 1992, found striking political disagreement between the median voter in the EC countries and the Brussels policymakers (see note [4]). Both the government (or core executive, or public opinion) and its agent consider unemployment, output gaps, inflation, as evil outcomes of monetary disorders, but to the extent that, in the short term, a trade-off exists among them and monetary measures aimed at alleviating one of them aggravate the other, the question of minimizing the global cost arises. In formal terms, both the government and the central banker minimize a quadratic loss function of policy targets. The respective individual preferences are shown as weights that the various bodies place on these targets. Different weights would imply social costs and a democratic deficit[1].

However, not only preferences diverge but also the determinants of the respective loss functions may be biased or falsified by incomplete or asymmetric crucial information, which is assumed to be better known by the policymaker than by the government[2]. The assumption here is that the former has an informational advantage over the central government and that there is no way for the central government to extract the information acquired by its central banker. This assumption, quite common in the standard literature on decentralization (Laffont, Zantman (2002)), is particularly manifested when delegation is only partial, i.e. when the agency problems are managed not with incentive contracts but by keeping the government/principal involved in the decision process, that is, by limiting delegation (Marino, Matsusaka (2001)). The key tradeoff is that delegation allows the principal to reject those projects he dislikes, but causes the agent to distort the information he transmits to the principal. In particular, only the agent knows information which determines the principal’s optimal action, while the principal may not have a clear idea of what it or its constituency calls for as an optimum outcome of monetary policy. This involves a moral hazard when the principal is not able to stipulate nor directly observe, nor prove breach of action. (This issue and its conflicting derivations have been aptly portrayed in rational political economy models, as that set out in the Barro-Gordon’s social loss function. See note [5]).

Particular institutional designs are said to ease the problem of divergent preferences and asymmetric information between the central banker and its core executive. Fratianni et al.(1997) argue that the central banker’s personal independence from the government or performance-oriented compensation packages can achieve both optimal stabilization and the elimination of the inflation bias, and thus alleviate the negative outcome of power delegation on monetary matters. The degree of independence of the central banker from the appointing institution permits the agent

[1] For an analysis of suboptimal stabilization policies of Rogoff-type, conservative central bankers, motivating the request for formal accountability mechanisms, see Castellani (2002). The author perceives accountability as a desirable feature of monetary institutions and focus her reflection on the means to achieve it.

[2] “Each additional piece of relevant information [the central banker] reviews may reduce the uncertainty that policy makers face”. (Gary H. Stern, President, Federal Reserve Bank of Minneapolis).

to integrate his/her own preferences in policy making or to maximize a weighted sum of the principal's objectives and his/her own. But the main ingredients of the agency issue subsist or become more relevant to the extent that the agent still relies on the principal for incentives and reappointment or when other elements of subordination are at work.

In this respect, Fatum's (2002) theoretical game model considers the possibility of an appointee being concerned with policy outcomes that differ from the preferences of his/her government. Divergences are nonetheless designated only as a disguised means to achieving the government's policy goals - depending on the preferences of the other delegates. The speculation is that the appointing government choosing its preferred delegate with a "Rogoff-central banker profile" would not permit a necessary "manipulation" of the council's monetary policy decision towards a better policy outcome from the perspective of member state.

Drazen (2000) has also investigated the possibility of a government appointing deliberately a national central banker whose objectives are different from its own as a means to achieve what it considers an optimal objective. The relation between the principal and the agent is chosen by the principal to maximize its expected utility. If anything goes wrong, the principal may attribute failure to the agent's incompetence or sabotage (including the possibility that he/she is actually behaving as the subordinate for someone else) or from unforeseeable exogenous shocks. "The key insight is that the government may find it optimal to act strategically when faced with agents who also act strategically". The more accommodating monetary policy that the electorate may be calling for in given circumstances will only be avoided, as a sub-optimal medium-term measure, without the government reputation being tarnished, by delegating authority to a conservative central banker. (A reference to Drazen's and other relevant analysis on this subject is included in note [6]).

The above has been the subject of profuse analysis in national central banking frameworks. Projecting the determinants of the national conflict thus analyzed to the ECB as a supranational monetary and political structure may not be an idle exercise - for all the ambiguity that apparent similarities may entail. The governors of the twelve national central banks (NCBs), together with the members of the Executive Board[3], are members of the Governing Council, the highest decision making authority in the

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[3] Members of the Executive Board are to be "appointed from among persons of recognized standing and professional experience in monetary or banking matters by common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the Council after it has consulted the European Parliament and the Governing Council. Their term of office shall be eight years and shall not be renewable" (article 11 of the Statutes).

ECB system (article 10 of the Statute). All members have obviously the national identity of one of the ECB's member countries, while NCB's Governors explicitly carry the affiliation of their country of origin. NCB's Governors thus perform two distinct functions, at a national and at a multinational levels. As national governors, they have control over a complex organization involved in a variety of tasks, including the coordination and execution of the directives stemming from Frankfort, to which they provide experience and logistics, the operational aspects of monetary policy, open market operations, administration of the minimum reserve system, and management of the standing facilities. (More than half of the ECB's staff have been recruited from NCBs, a fact that sheds additional light to the duality of the governors' functions). While functions related to the determination of monetary policy rest with ECB, heads of NCBs making the bulk of its governing body continue to be organically integrated in their home institution and remain therefore an integral part of national administrations.

Integration to, or independence from, the national administrations is then key to what it may be speculated over the heads of NCBs as their country's agents to the ECB's governing body. The modalities of such independence, as laid down in national legislations, procedures, and traditions, the appointment systems, their terms of office, and the various institutions that integrate the "core executive" participating in the selection and appointment of candidates are main factors determining binding relationships and delegation of duties between governments and their central bankers. Appointment modalities differ across the twelve Euro-area countries, but it is widely recognized that in all of them the government is directly involved in the decisions. (See note [7]).

The agency and subordination problem becomes more complex as the government itself is held accountable to still other superiors (e.g., the parliament, the unions, the media, specific financial sectors and other special-interests groups) and tries to accommodate the interests and preferences of its own alongside to those on whom it relies for reelection or approval. A similar issue of identification of "superiors" of independent banks has been addressed in national contexts. In the U.S., for example, Woolley (1984, ibid.) attempted to discern "Who is the superior?". "It is not entirely clear who is or should be the Federal Reserve's superior. Who should be giving orders to the Federal Reserve? Does the independence formula mean that no one should do so? Who does give orders? The president? Congress? Economists? Bankers?". And he rightly concludes: "Asking who the superior is means asking whose preferences count". (Additional quotations are included in note [8]).

Now, whatever the influence of the "principal" over its "agent", it may be expected that it is going to be felt when specific national conditions (of the type included in section 1) warrant. These conditions surely underpin the political and electoral incentives that prompt national governments to induce their “agent” to adopt selected decisions at the ECB’s boardroom. Severe unemployment rates in the home country or idiosyncratic shocks would enhance the incentives. And obviously the political and financial weight of individual members will be a further important incentive to pressure their representatives at Frankfort. Given the strong economic interdependence across the area, representatives of major countries may be tempted to push their national case as a remedy that will spill over the whole area. One may speculate on other elements apt to setting off pressures. Commitments taken by governments to trade votes within the EU system, with a potential for decisions in the monetary field, cannot be dismissed. To these incentives should be added the appointee’s own awareness of their better knowledge and experience of the nature and intensity of his/her territory’s problems than those elsewhere in the Euro-zone.

All in all, therefore, reasonable speculations on difficulties arising to the appointees being indifferent to their core executive or government’s policy guidelines. “The issue is not that bank presidents take or solicit direct instructions from their patrons, but whether they are cloned and then sent on their mission. When an issue of difference arises, a French appointee would vote in the style of France, and a German, as predictably, in the way of the Bundesbank.” (Dornbusch, Favero, Giavazzi (1998). Apparently, this is not an empty gossip but an opinion borne out by empirical analysis. Meade and Sheets (2002) find that “the majority of ECB Council members typically voted on monetary policy changes in a manner that can be justified by the differential between their national inflation rate and the EMU average”. Confirmation of the data would then suggest that national appointees consider their local interests or biases at least as much as the bank’s agenda in deciding on the single monetary policy.

Information on the U.S. system also suggests regional influences and inputs being integrated in policy decisions more than current literature admits. Not all consider this as a positive feature but a factor to be taken as inevitable in a context of the peculiar system that aims at ensuring a balance of powers. Everyone at the governing councils is committed to defending the currency - a commitment which would entail a common outlook and uniform approaches to policy measures - and yet “the regional representation of Bank presidents in the formulation of FOMC policy … (does) not attempt to maximize social welfare but rather are seemingly influenced by the narrow and shortsighted interests of their primary constituency”.

Analysis of responses of presidents of district federal reserve banks to specific regional shocks with unpleasant effects (unemployment, mainly) has identified some critical periods across the nation - and how crisis have manifested themselves among the various regions in terms of unemployment. For the period 1978-1980 the cross-sectional variance of state unemployment, in percentage points, grew from 2 to 3 percent; the period 1981-1983 reached 7 percent; in 1986, the increase was from 3.8 to 5.5 percentage points. Around 1991-1991, the figure went up from 1.6 to 2.8. The corresponding percentages of variance were compared to the dissenting votes at FOMC. Gildea (1992) concludes: "Federal Reserve policymakers would like to be viewed as objective independent expert technicians who decide monetary policy issues in the country's best interest. Many recent studies have questioned this description and have provided considerable evidence to the contrary”. (See note [9] on Gildea’s and other analysis).

The above analysis calls for some qualifications. First, votes on monetary policy, assenting or not, may not be taken as an unfailing signal or measure of policy’s positions and responsiveness to individual home conditions, as voting may underlie coalitions, compromises or commitments which are meant to only be cashed at a later state or engage further planned action - decisions on voting may be an ambiguous response to a reciprocity constraint. Reciprocity gambling or vote trading – the agent’s commitment to giving support of demands of counterparts in the future in exchange for similar concessions he/she receives from them today - may also mute or erase individual regional action insofar as this permits to elude any future constraint when demands will be put forward by other board members (Buchanan and Tullock (1962); Monticelli (1999)). See note [10]).

Second, it would also be wrong to take regional unemployment or output gaps as the only regional parameters apt to spur voting action by a regional representative. For regions with a high concentration of tradable goods and services industries, monetary measures bearing on exchange rates are also given high priorities.

Back to the European central banking system: The Growth and Stability Pact, imposing virtually automatic penalties on member states running budget deficits above 3 per cent, may exacerbate pressures on the appointee. Commitment to fiscal austerity is a political obstacle to dealing with rising unemployment during a recession through the existing structures of welfare states. These constrains may induce the governments to put larger emphasis on expansionary monetary policy; corresponding pressures to their central banker may be forthcoming, with concomitant threats of penalties or rewards.

(ii) The central bank’s agent.

> “While serving on the FOMC, I was vividly reminded of a few things all of us probably know about committees: that they laboriously aggregate individual preferences; that they need to be led; that they tend to adopt compromise positions on difficult questions; and

> - perhaps because of all of the above - that they tend to be inertial. Had Newton served on more faculty committees at Cambridge, his first law of motion might have read: A decision-making body at rest or in motion tends to stay at rest or in motion in the same direction unless acted upon by an outside force".
> Alan Blinder (1998).

The U.S. pattern of delegation of duties by the Federal Reserve System and its Chairman to FOMC members puts some perspective on related developments unfolding in the European context. (Some basic facts are included in note [11]). Functions assigned to those territorial appointees embody a number of delegation of duties and agency features. First, territorial appointees participate in the definition and implementation of a monetary policy whose mandated objectives are clearly specified and for which they will be held accountable (to their peers, to the financial community, and other interests beyond their home constituency). The publication of minutes and records of FOMC formal meetings, provides an ostensible responsibility for policy decisions and opinions expressed at these meetings (a feature not replicated in the European system). Second, appointees are given an unambiguous role a communication link between their respective territories (U.S. districts) and the central banking structures. Third, they are conspicuously divested from their home district and political affiliation to be fully incorporated in the central administration apparatus. Fourth, while they are elected by their local (district) boards, they are effectively appointed by the Federal Reserve Board of Governors, which can thereby exercise a veto – something which does not exist in the European system.

Whether regional or national, U.S. or Europe, territorial appointees are integrated in the central banking apparatus and are (collectively or not) held responsible for the attainment of the bank's objectives[4]. Substantial differences, however, do not permit drawing outright parallels with the European context. ECB has not come into being from the socio-political context as that of the national central banks examined in this paper; its organic and bureaucratic structures are not identical; its international environment is not similar; its appointment prerogatives are not comparable. All in all, FOMC regional members are not the sort of (regional) central bankers that are their (national) ECB counterparts. ECB is deprived from a main attribute of the "principal" concept enjoyed by the Federal Reserve: the command over appointments of members of the governing body, with which to penalize or reward them and as an incentive to make those members abide by its preferences. Unlike their European counterparts, the territories that peripheral appointees are meant to represent in the United States do not coincide with single political entities (nations enjoying a large level of political autonomy). The

[4] "We are collectively accountable and not individually accountable", says Tommaso Padoa-Schioppa, a member of the ECB's Governing Council (and of its Executive Board). ("The Region", Federal Reserve Bank of Minneapolis, December 2001). Collective accountability severs links with home countries and helps explain why the bank does not publish voting records of the meetings of its Governing Council.

dissociation between the district geography and the state political territories and constituencies deprives the representative of a U.S. central bank district the political weight and backing enjoyed by European governors and does not allow for a more assertive, region-oriented action. In the U.S., in addition, social divisions and feelings of alienation are much less correlated with geography than are European countries.

At the same time, the Euroland may face a much more serious problem of territorial pressures than do national central banks in respect of those stemming from regional territories. ECB's members exhibit strong national loyalties, sovereignties, languages, and powerful histories of rivalries and independence, thus making it easier to organize national pressure groups than it is for the regional ones in a country like the U.S. where those who want to bring pressure on the central bank are able to work not necessarily through the states, but through economic and social special-interest groups, such as labor unions and Washington sectoral lobbies.

For all the dissimilarities, however, the ECB may be sharing with national monetary institutions three additional factors - also relevant to the agency issue: The bank's institutional independence; the political fragility of the independent status, particularly when manifested in bank's bashing by aggrieved territories and interests, with a resulting solidarity among council members; a particular central bank culture; and the influence of academic theoretical models in monetary policy.

First, the institutional independence of the bank and its organs from national member countries, together with the accepted commitments on objectives, provide the appointees with the incentives to assume some degree of subordination to the bank and to take upon themselves its delegated duties. Independence is reflected in the obligation imposed to appointees to act in a fully independent personal capacity, and not as national representatives – and corroborated by the principle "one person, one vote" (Eijffinger and J. De Haan (2000)). The provision is considered as a necessary condition for achieving the bank's primary objective (price stability) – thus ruling out "short-term considerations of a political nature", says René Smits (…). "When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any members of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks. (Articles 105 and 107 and Article 7 ESCB Statute)."

"The provision on central bank independence works in two ways: it impresses upon the entities composing the System and on the members of its decision-making bodies not to seek or take any instructions from any body and it enjoins the Community institutions and bodies and Member States' Governments to refrain from seeking to influence the members of the System's decision-making bodies". Note that when this provision is not met to a satisfactory extent, concerned ECB Council members do not fail to point the finger at the culprits.[5]

The absence of publication of the minutes and voting records of the Governing Council provides the anonymity that shields the appointees from accusations that could be levied by their home countries if their decisions ran counter the national preferences. Anonymity on votes is expressly provided for in the Treaty as a means to ensure the independence of the appointees and prevent pressures from their home authorities – a legacy from the Bundesbank, contrary to that featured in the U.S. system.

Second, the fragility of the bank's independence status and the absence of political control enhance the risk of disruption when one or several member countries are stung by asymmetric shocks or feel otherwise neglected in monetary policymaking. Indeed, the Bank's independent status is under constant threats by countries or governments which may feel affected by the bank's policies and strategies. It can be assumed that vulnerability to these threats stirs a move of solidarity and esprit de corps by all the actors concerned with the independence of the bank and glosses over their internal differences. Whatever their political or territorial origin, all members will feel committed to solidarity and consensus as a way to avoid in particular any serious confrontation with the political bodies in Brussels and the national governments[6].

This issue brings to mind the fact that "independent" central banks have nurtured their status by a highly political behavior and an active cultivation of their autonomy. "The ECB would not be wise to rely exclusively and passively on its protected status

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[5] As reported by Reuters (International Herald Tribune, June 15-16, 2002) "Nout Wellink, a member of the European Central Bank council, said large European countries tend to vote in their national interest in the bank's policy-making council, questioning the official line that ECB decisions are reached by consensus rather than by vote. His comments also contradicted the bank's stance that national interest should play no role in rate decisions, which are taken in the interest of the 12-nation euro zone as a whole".

[6] Precedents of national central banking political strategies in this line of thinking are plentiful. "The Bundesbank knows that it can endanger the legitimacy of its independent status if it quarrels publicly with popular elected officials; in one case its resistance to the popular policies of a chancellor ended with the resignation of the Bundesbank president". Lohmann, Susanne (1988).

in EU law, in the treaties and the statute, but will have to cultivate this constituency as adroitly as the U.S. Federal Reserve and the Bundesbank have done"[7]. Who else better than the national appointees to be delegated the task of keeping alive in their respective countries the esteem of the bank's monetary measures and protect in this way the latter's independence. And not only this. The argument developed in this paper is that a depressed country can see the Frankfort central bank as an instrument for a more accommodative monetary stance; its appointee is mandated to broker a move in this direction. However, first, the instrument can only work as long as it keeps its independence from governments and other pressure groups. Central bank independence stems mainly from historical successes in meeting commitments towards currency stability, a commitment adhered to by the society and respected by governments. So that pressures upon the bank by a territorial appointee, if ever pressures were feasible and enough bargaining power was available to him/her, will probably not be stretched to the point that the bank's primordial merits and societal support are lost in the process and, with them, the credibility and reputation it enjoys with the public and the government.

A bank's confrontation with Brussels or its member countries could indeed go as far as the very bank's independent status or its institutional structure, including the national participation in its governing body, being called into question. Anyone interested in organizational structures knows that organizations survive because powerful constituent alliances continue to derive benefit from them. This opinion aptly applies to the existence of the independence status in a central bank which is so much intertwined with local and sometime contradictory interests of its constituency. As commented by Goodman (1991), the preservation of independence calls for "successful management, especially knowing when to give in to political pressure and sustain societal support". Success and popularity of central government's economic policies would enhance the risk. Hence, the bank's interest in avoiding embarrassing initiatives from member nations or regions, an interest that appointees themselves may well share. Permanent conflict-avoiding efforts by the government and the bank are not spared when the alternative is the involvement of the public opinion or the media in the solution of the frictions[8]. To be sure, efforts to stave off conflicts put further limitations to the regional capacity and political determination to bring up to the Council specific territorial problems.[9]

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[7] C.Randall Henning, in an IMF forum on "The Euro: Ready or Not", 10 January, 2002.

[8] When conflicts become critical or too emotional, the public "play the role of an umpire". (Susanne Lohmann (1993)).

[9] Thomas Havrilesky & Robert Schweitzer (1990): "The Fed is a bureaucracy whose transactions with the administration, Congress and

And third, as pointed out in section 2, the cultural features surrounding the central banking functions and bureaucracy, its governor or president's prestige and personality, the influence of the Academy and its models that contribute to the adoption of consensual paradigms (often as a result of political drives) - reinforce the identification of the bank as a main "principal" in the scale of values of the various agents, to whom the bank's agenda is delegated. These and other elements that underpin the agency situation do not necessarily stem from formal conventions but rather from unwritten agreements that have force, such in social contracts and social norms that apply in many other social and political structures – "a pattern of behavior that is customary, expected and self-enforcing. Everyone conforms, everyone expects others to conform, and everyone wants to conform given that everyone else conforms" (Young (1993), cited in Drazen ibid, p.137).

More on this: "A currently fashionable belief is that independent central bankers can do no wrong. According to an influential tenet of modern monetary thought, a high level of central bank independence together with a clear focus on inflation would make for an efficient conduct of monetary policy. Arguably, the European Central Bank (ECB) is the most independent central bank in the world. Moreover, the ECB's mandate prescribes price stability as its primary objective" (Bibow (2002)) – a kind of opinion that may not be absent from the bank's professional and social environment and that enhance its principal's role.

Inertia, culture, mystique of central banking are also elements of the subordinated links of appointees to the institution they serve. As Karl Brunner said: Central Banking [has been] traditionally surrounded by a peculiar and protective political mystique.... The mystique thrives on a pervasive impression that Central Banking is an esoteric art. Access to this art and its proper execution is confined to the initiated elite. The esoteric nature of the art is moreover revealed by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences (Alan S. Blinder (1998)).

I would venture that peripheral appointees, irrespective of their origins and political colors, could well be numbed by the central bank's sort of institutional culture and the weight of traditions. Assertive, individual actions, already repressed by a blurred accountability and confusing and contradictory messages from home, may be further diluted by the dignified and sophisticated intellectual and political prestige of the

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its constituencies in the financial-services sector are made more beneficial, more advantageous to it, when Fomc members do not dissent... The manifestations of such disutility range from the mere discomfort in interactions with colleagues to alienation from the Fomc."

institution they serve. Their initial political commitments to the home constituency and the underlying political interests to which they are tributary run the risk to gradually give way to the pure fascination of central banking and its models – and often the mighty stature of its presidents (section 2). The bank's institutional settings are no more subordinated to the policy impact of its commitment framework, but rather the other way out – if the American Federal Reserve System and the Bundesbank serve as precedents from which conclusions may be drawn.

Greider (1987) commented that when exceptionally a female, liberal Keynesian economist (Nancy Teeters), was appointed to the Federal Reserve Board, "she felt membership in a special club. 'At a dinner party in 1978, she recalled, (Board President) Arthur Burns was talking to me, asking me questions and it sounded like a job interview. I said 'Arthur, you don't want someone like me on the Board of Governors with my liberal background.' Arthur said, 'Don't worry, Nancy. Within six months, you will think just like a central banker'. Arthur was right. I think I'm very much a central banker now. You're in a position where your views on money, credit and banking are not really a reflection of your political party or your positions on economic issues. It's not really a political job. I understand the whole milieu of what we are doing, the continuous decisions, the mystique of central banking."

A reasonable assumption (difficult to check with reliable empirical data) is that no peripheral appointee will feel totally immune to the mystical attraction Mrs. Teeters spoke about. Lohmann (1998) shows that attraction of this nature and internal peer group pressures can only drive the appointee to a further depolitization and de-regionalization of his/her role and to a larger empathy with the interests, philosophy and milieu of the Bank and the pressures to which it is submitted. Commitments and mandated inflation/unemployment preferences of his/her home territory are likely to progressively fade away.

In the U.S. context, a utility-maximizing model developed by Havrilesky and Schweitzer (1990) captures well by implication the potential conflict confronted by a peripheral appointee, between his/her loyalty to the home territory preferences and the stiffening effects of dissenting from the majority of Council's peers. In that model, the utility of a dissent voting is determined by moral values and convictions (one could here integrate the home mandated message and preferences), but the utility diminishes rapidly for reasons relating to career-proximity to central government. The disutility of dissent, on the other hand, stems from an open pressure to "close ranks" (see later) and the threat of punishment by the System. "The manifestations of such disutility range from the mere discomfort in interactions with colleagues to alienation from the committee, loss of self-esteem, and perceived erosion of future career opportunity sets.”

Something of this kind may apply to the ECB’s context. Dissenting by a member in its boardroom may be taken as an evidence of excessive or egoistic ambitions, of little respect for cooperation. This is believed to be particularly damaging to the career of potential dissenters. Beyond the mere attraction of financial and career rewards, incentives for social and professional approval may also contribute to an aversion to dissenting from peers’ general positions (Fehr and Falk,(2002))[10]. It may also be interpreted as a sign of dysfunction of some kind and thus bring about a negative reaction of (forward looking) financial markets. In any case, dissents will aggravate decision-making difficulties “which typically favour the status quo”, with debilitating effects over “the main task of a central bank – taking difficult decisions at the right time” (Baldwin, Berglöf, Giavazzi, Widgren (2000)).

More on Central Banking culture: Group pressure from peers at the governing bodies and encouragement to free riding; "consensual expectations" emerging from the central bank's mystique and inertia. The central bank’s personality, prestige, interests and political role may repress individual initiatives of Council members. Inertia could also be a major inhibiting determinant (particularly if it rests on a historical successful path).

> Schumpeter’s (1942) words come inevitably to mind: “Things economic and social move by their own momentum and the ensuing situations compel individuals and groups to behave in certain ways whatever they may wish to do - not indeed by destroying their freedom of choice but by shaping the choosing mentalities and by narrowing the list of possibilities from which to choose” – which closely translates 17th century Spinoza’s aphorism: “Tout être tend à preserver dans son être”.

(iii) One agent, two principals.

A number of features present in regional involvement in national central banking are potentially present in the EMU context. A common factor of both regional and national models is a dual principal/agent or “common agency”, or “role conflict” issue that the appointee is bound to confront. Recognition of national central banks as “dual institutions, national in certain respects, federal in other respects”, (Padoa-Schioppa, one of its

[10] An aversion to dissent is implicitly recognised by Adam Smith in the “Theory of Moral Sentiments” (1759) where he wrote: “We are pleased to think that we have rendered ourselves the natural objects of approbation, … and we are mortified to reflect that we have justly merited the blame of those we live with.” (Cited in Fehr and Falk, 2002)

Council members) suggests a similar duality for the national governors. Monticelli (1999) has well captured the duality:

> "Monetary-policy making in a collegiate body involves a different type of incentives. For each of the participants in the decision-making process pursues his objectives under the constraints stemming from the strategic interaction not only with the private sector, as in standard analyses, but also vis-à-vis his colleagues in the competent board. In the case of a monetary union consisting of several countries that retain political and economic sovereignty while relinquishing monetary powers, members of the board may entertain objectives with reference to the country they represent or come from, notwithstanding the provisions of the Statute of the ECB that assign only Union-wide objectives to monetary policy".

Rogoff's ideal "conservative" central bankers, which is considered by many as a condition for collective well-being, become in this way a blurred or misleading concept. One may ask: "conservative" under whose influences and interests? "Well-being" when and for whom? At one time or another, territorial appointees are expected to make decisions to accommodate irreconcilable or different time horizon preferences of either principal - preferences which are further obscured by imperfect and asymmetric information on monetary issues and outcomes.

The exacting rules that have been set for the ECB are liable to aggravate the clash between the bank's objectives and national interests. As Wyplosz (2001) has pointed out, the 0-2% inflation target set by the ECB corresponds to a range which may raise the natural unemployment rate. This rate should rise by some 2 to 4 percentage points in about the middle of the ECB's inflation target range. In order to significantly reduce the effect, the ECB ought to aim at an inflation rate of more than 5%, a rate clearly beyond the current range of acceptability. (The author, however, warns the reader to keep in mind that his is a preliminary study, calling for more work, and that the results presented here would be open to considerable caution).

The U.S. experience sheds an interesting light on the ambiguities of the inputs that district bank presidents (peripheral appointees to the FOMC) are committed to deliver at the monetary committee. Available information implies that district central bankers, when casting their votes at the FOMC, are sensitive to specific territorial problems, as assessed by their local business and financial community and political institutions, as well to the commitments and objectives laid down in the Federal Reserve structures. It also suggests, however, that when latent divergences exist between the center and the territorial periphery (the two principals) they are likely to weaken the principals' respective power of incentives to their common agent. In between the two principals, the appointees' accountability to each of them is expected to thin further - an intuition formally corroborated in accepted models of the “common agency” issue.

In 2000, the district Federal Reserve Banks provided the following responses to a request from the Financial Markets Center (2002) for: “a description of the process that the Bank’s board of directors employs to discuss and vote on discount rate recommendations[11]. Please include an explanation of the role played by the Bank’s branch bank boards in formulating discount rate recommendations. Also, please explain to what extent the Bank’s president takes the board’s discount rate recommendation into account when participating in discussions and/or votes on policy directives at Open Market Committee meetings.” Most of the responses coincided in signaling a distinctive independence from either the district and the bank’s agenda – and an assertion of personal views and perceptions. (Additional information is included in note [12]).

It could be expected from the peculiar Fed’s structure that discount rates (proposed by the district banks) would parallel the federal funds rate adjustments (that their presidents vote at the FOMC), as both use the same set of analytical reference points and seek similar overall objectives. But the votes and requests do not always follow this pattern. Indeed, in comparing the FOMC actions of Reserve Bank presidents and the discount rate requests submitted by their Banks from 1993 to the present, the Financial Markets Center found that Bank presidents’ FOMC votes frequently deviate from the policy advice reflected in discount rate recommendations. [12] (More information in note [13])

On a theoretical side, a general conclusion of models with multiple principals corroborate indeed that the power of incentives to control the agent are very much weakened, sometimes dramatically so. (Bernheim and Whinston (1986); A.Dixit (1996)). The effect of asymmetric or incomplete information between principal and agent yields an equilibrium characterized by inefficiency relative to a situation of full information. The political constraint on policymaking is that the policy must have the support of the political authority to make decisions. The principals not only choose to delegate decisions to an agent, but

[11] Discount rates, the rate for bank borrowing at the Fed’s discount window, remains an important part of the Fed’s overall policy dynamic although it no longer plays a major role in implementing monetary policy like that of the federal funds rate which serves as the targeting mechanism for open market operations. Every two weeks, by law, directors at each of the 12 Federal Reserve Banks submit to the Board of Governors a recommendation – initiated by their Bank president – to adjust or maintain the discount rate.

[12] Unfortunately, there is no European equivalent of the Beige Book that conveys a description of economic conditions in the twelve Federal Reserve districts in the U.S. and which can then be contrasted with the positions of their presidents at the FOMC.

must support the choices he/she makes, which may significantly affect the policies that can be carried out relative to what is socially optimal.

As pointed out in Woolley (1984), “When many actors are trying to shape the behavior of a given organization, none of them may succeed in dominating its behavior. Thus, in terms of the definition of [the central bank’s] independence previously offered, behavior might be observed that differs from that preferred by a given actor, but it would not be clear whether that difference reflected the refusal of the organization to comply or was instead an organizational response to preferences expressed more effectively by others”. Moreover, while the appointee’s action and performances are hardly punishable by removal from office or absence of reelection at the end of the term – mainly because of the political and credibility costs this would entail - larger action may be expected from the appointee’s own personal preferences, whether they stem from opportunistic (the appointee’s objective being to remain in office) or to partisan (or to implement a specific program) motivations (Drazen (2000, p.220)). In either case, common agency models predict that the partial delegation of duties stemming from the existence of two or more principals allows the principals to hinder the appointee from adopting policy measures they dislike, at the risk of causing the appointee to distort the information transmitted to his/her principals (see note [14]).

This paper assumes that both the home country and the bank will have the incentives to influence decisions of their common agent (the appointee). However, they are both involved in the monetary decision process in a variety of ways and mechanisms, so that their reliance on the agent’s decisions and delegation of duties to them is only limited. A plausible conclusion from the organizational context and the “common agency” issue in which the appointee is embedded is that his/her social, political and education backgrounds will be given more prominence in voting styles and patterns than that recognized in the current literature on monetary policymaking - where, at most, a simple principal/agent relationship with national governments is acknowledged. As Gildea (1990) pointed out, in the particular case of the appointees’ preferences for more expansionary policies as a reaction to increases in unemployment, these preferences stem generally from his/her own social backgrounds, career variables and other personal features more than other determinants and commitments. Tests on expansionary preferences show that it has manifested itself in FOMC’s members with substantial experience in private industry or government service. Conversely, “an Ivy League education, a Ph.D. in economics, and being a Federal Reserve Bank president tended to describe those FOMC members who voted more conservatively over their tenure” (my underlining). (On dissenting votes at FOMC see note [15]).

There are enough similarities with the European context to make a reasonable guess that personal views on optimal policy, its time frame, particularly in respect of a possible trade-off between unemployment and output, political and intellectual outlook, professional skills (the very factors implicated in the agency problem between the national central banker and his/her home country) are also potentially interfering in the relationships with the ECB. In addition, irrespective of the weights the policymakers' principals put on targets, other factors may also bear upon them - recent analysis show that they gradually shift their policy outlook towards more concern to inflation according to his/her time left in office and not how long he/she has served or what he/she has already done (Sibert (2001)). On more general terms, the ability of the agent to take action affecting the principal, the fact that those actions might not be observed by the principal, that the principal is unable to prove breach of contract, are meant to be present in the relationships between the bank and the appointee. Vote trading and free riding practices, are examples of how these conditions can be brought to reality when the opportunity arises.

A "free rider" situation, in particular, has often confronted the unfettered expression of individual opinions. Goodfriend (1999), who knows well the U.S. system from the inside, has warned that the influence of regional representatives is small so that they may be inclined to free-ride on the preparations of others more interested, expert, or responsible for monetary policy, such as, in the U.S., the Chairman and the Board staff – and I would add the Federal Reserve Bank of New York. The free rider problem is dangerous because it is hard to detect as free riders can continue to participate with thoughtful-sounding statements. "Widespread free riding would weaken the Committee in much the same way as the tendency to think alike". Goodfriend points also to similar pitfalls of the negotiating process on account of the bonding that takes place as a consequence of repeated meetings that can cause Committee members to begin to think alike[13]. "As a result, the FOMC could be blindsided by a risk or side effect of a policy stance that it had not taken into account".

[13] Commenting on this issue, Professor Thomas Mayer intimates that much might depend on where the peripheral appointees are located. If their offices are at the ECB offices in Frankfurt they are less likely to be influenced by regional conditions than if they work out of their national central banks. He rightly asserts that "Who you have lunch with does matter".

An improbable conclusion

Is there any conclusion from the above information that could apply to a multinational central banking like the European institution? Probably not – and this was not the intention. This paper concentrates on a set of institutional, personal, social experiences, having been driven by conjunctural factors in a national central banking context. This context points to a situation where a group of monetary policymakers are involved in a “common agency” issue and where the weights put on their decisions by either of the two principals are not uniform. These circumstantial features and the absence of information on individual positions at the Council’s room explain the failure (so far) of my intent to elaborate or make use of any existing formal model.

If the appointees’ behaviour and voting patterns hinged only upon structural and institutional factors, any parallel on their possible behaviour between the national central banking systems and a multinational one like ECB would clearly be farfetched. Political, social, institutional features are just not the same in a national and a supranational framework. All the same, the arguments developed in this paper refer to a territorial system of representation in independent monetary policymaking that has a parallel of sorts in the European framework - territorial appointees in both cases are confronted to two principals and are driven by similar considerations over monetary policy and its distributive outcome.

Within these strict analytical limitations, some reasonable speculations emerge. It is expected that policymakers split into two categories: the “activists” (those for whom monetary policy is not only more important in their home countries than in their counterparts’ but also those representing countries with higher weight in political, financial, economic terms) and the “free riders” (for whom economic and financial interaction with more important countries makes their monetary preferences closely dependent on the latter’s). Beyond this consideration, the appointees’ personal political and social backgrounds, convictions, and preferences are likely to be given larger prominence or even prevail over the two principals’ respective agendas.

Further empirical or theoretical speculations on that subject should not neglect this aspect of policymaking. To predict the European governors’ behavior in light of precedents in national central banking systems has not been the aim of this paper. The aim is rather to anticipate a “role conflict”, whose ingredients are parallel to a large extent in the national and multinational peculiar context of interests, political and social environment involved in monetary policymaking - and to outline its possible outcome.

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Notes

[1] The term “core executives” encompass the whole structure of national political power and its connecting links with the economy and public media, in the interpretation of Robert Elgie and Helen Thompson (1998).

[2] Rogoff (1985) suggests that, in the presence of market distortions, an independent and inflation-averse central banker reduces average inflation although increases output variability; the conservative central banker reduces the inflation bias, due to the time-inconsistency problem, but stabilizes less.

[3] In a formal treatment of the interaction between Euroland’s national macroeconomic players and the ECB Council, Grüner (1999) proposes two alternative assumptions on the behaviour of members of the ECB council: (i) they all are concerned about Euroland's macroeconomic aggregates and (ii) they are mainly concerned about their individual domestic macroeconomic conditions. A more realistic assumption, i.e. members accountable to a dual constituency with distinct preferences and commitments of their own, is not considered in Grüner’s paper.
Another recent noteworthy paper (Fatum (2002)) argues that a decision making mechanism based on the median voter theorem (which imply the council members being equally split between those preferring a more inflation averse policy and those with less inflation averse preferences) is too restrictive for capturing important aspects of monetary policy in the European Monetary Union, particularly because intensity of preferences cannot play a role when only the median voter matters. Replacing the median voter mechanism by a less restrictive “weighted mean mechanism” (which captures the individual voting weight (or influence) of member states and the monetary policy choice associated with their appointees, the author predicts that strategic delegation would lead to a single monetary policy set in accordance with the preferences of the most inflation-averse member state. This finding provides theoretical support for the perception of the European Central Bank implementing the policy of the Bundesbank rather than the policy of an average union-wide central bank.

[4] Alesina and Grilli, 1992, asked whether the voting mechanism described in the ECB draft statutes would lead to a policy that reflects the preferences of European voters. They found a problem that is common to ‘district’ systems. Using the results of the last general elections in the twelve EC countries, Alesina and Grilli found that the median European voter was currently well to the left of the median of the European Council. They go on to argue that the appointment and voting procedures described in the draft statute of the ECB would result in a monetary policy that could be very different from the preferences of the median European voter.

[5] The Barro-Gordon's social loss function assumes that central government has incentives to manipulate the money supply and boost in this way its popularity, particularly in election periods[5]. Though the government is aware that anticipated inflation will have no significant positive effect on equilibrium economic activity in the long run, time-inconsistent[5] arguments suggest why it nonetheless resorts to inflate to induce such an effect in the short run. Models developed by Rogoff and Sibert (1988)[5], with further additions by Fratianni, vonHagen, Waller, (1997))[5] also contend that the government knows that the optimum monetary policy entails some short-term sacrifices that could harm its popularity and electoral outcome. The outcome of next elections are assumed to be dictated by people's expectations over the level of output and how it compares with that expected from the challenger(s). Negative output variations may result from distinct and random causes, like a given political mind-set, exogenous shocks, or other developments, without the constituency being able to identify their true nature and impact. The asymmetry of information may then result in the incumbent being, rightly or wrongly, held responsible for their negative results in well-being. To the extend therefore that external factors obscure the real outcome of the incumbent's program and be detrimental to his/her reputation and electoral success, the incumbent has an incentive to expand output through the use of inflationary monetary policy and get in this way an advantage over the challenger(s).
It is important to note that, for some authors, the Barro-Gordon model and its variants like that referred to in this text bear little resemblance to the process of monetary policy in the US and many other countries. Empirical data does not consistently confirm the hypothesis of monetary manipulation. See among others Alan Blinder (1998) and W.D.Nordhaus (1975).

[6] Drazen views on this subject are indirectly related to the literature on central bank as a scapegoat or whipping boy for incumbent politicians. Woolley (1984) contends that "It is in effect a tacit conspiracy to discourage congressional participation in the monetary policy game, and it allows the president the opportunity to use the Fed as a scapegoat. At the same time, Congress welcomes the fact that there is an "independent" Fed that can be blamed for economic difficulties."
According to Edward J.Kane (1990) "Fed policy-makers and elected politicians are repeatedly playing a game against each other. In playing this game, the Fed's objectives are to improve the performance of the national economy and to improve the agency's standing as a public enterprise. Politicians engage in Fed bashing to make sure that these two objectives come into conflict when they either want a change in current policy or want to avoid blame for previous policy moves that have turned out to be unpopular. In this way, Fed personnel are made to face difficult trade-offs.... Each player knows how to calculate the benefits and costs that attend its various potential moves,

as well as what would constitute the best response to each move by opposing player... In exchange for playing economic-policy scapegoat, Fed officials are offered unusually long terms in office and substantial budgetary autonomy. This duality and ambiguity of function are paralleled in the very language of the Fed Act, which sets up a uniquely confusing bureaucratic structure that makes the Fed appear both 'independent' of short-run political influence and decentralized in its internal organization..."
"What you do in this world is a matter of no consequence. The question is, what can you make people believe that you have done?"

[7] In Germany, the German Federal President appoints the president of the Bundesbank upon nomination made by the government, which has in turn been agreed among the leaders of the coalition parties (in practice, the president has always deferred the nomination to the government). Appointments are for eight years, but terms are renewable: the typical length of service for Council members has been almost 13 years. In France, no official nomination procedure is mandated, although it is largely accepted that the appointment of the head of the Banque de France is the result of a joint decision by the Finance Minister, the Prime Minister, and the President of the Republic. Countries where central banks were still under direct responsibility of the government (especially Belgium, France, and Spain) were encouraged by the specific obligations of the Maastricht Treaty to increase the formal autonomy of their respective central banks. Practically in all Euro zone countries this formal independence has been now achieved. This is formally the case for nine of the twelve governors in the ECB Council, and may be considered the informal rule for the rest of them, usually for terms of five to seven years (an exception is Italy, whose governor is appointed "for life", i.e. up to the retirement age).[7] However, while recognizing that all these banks exhibit a greater degree of independence than under the previous regime, it is also generally accepted that they still remain vulnerable to government pressure.
As to the ECB, members of the Executive Board will be appointed for eight-year non-renewable terms by common accord of the governments of the member states at the level of heads of state or government, at the recommendation of ECOFIN, after consultation with the European Parliament and the Governing Council of the ECB (European Communities 1992, Article 109a). The appointment of the national central bank governor is subject to Treaty stipulations that the term of office of a governor shall be no less than five years. No term can therefore be shorter than electoral cycles for national legislatures in any member state. Any national governor who is dismissed will have the right of appeal to the European Court of Justice (European Communities 1992, Article 14). However, peers and professional media and their opinions over the performance of the appointee may make up for the absence of the appointment privileges that the bank is deprived.

[8] "There are various aspirants to the role", says Woolley. "Congress has a firm legal claim to be the final authority on the Federal Reserve's existence. It is clear that the System is not formally answerable to the president, whereas it is formally answerable to the Congress. However, the president is charged by law with responsibility for macroeconomic policy, and the Federal Reserve is obviously important in this realm. Moreover, it is the president who appoints top officials... Economists also claim some right to be considered as arbitrers of the Federal Reserve behaviour. Economists claim to speak for the public interest, and they claim the right to evaluate the technical competence of the Federal Reserve. ... Bankers form the Feds natural constituency and have been closely linked with the Federal Reserve since its founding. Bankers play a direct role in shaping economic performance and may thereby claim a special capacity to evaluate the appropriateness of Federal Reserve actions. Perhaps bankers are the most likely of all these groups to be the superior. ... Bankers certainly have the command of technical, financial, and political resources that would be necessary for a nongovernmental group to influence policy. On the other hand, it is not clear that the financial industry is able to unite behind any clear short-term policy recommendation except in extreme economic conditions. However, if bankers are not able to function effectively as superiors in the short term, they may be able to help create an atmosphere at the Federal Reserve that is not open to other interest groups."

[9] Gildea (1992) carried out a test of a possible regional bias in the voting behavior of District Federal Reserve Bank's presidents. Three separate models (district, state, local) were tested using probit analysis. Explanatory variables in each model included the ratio of an area's unemployment rate relative to the national rate, as well as other variables, such as the ratio of an area's percentage of Democratic voters to the national percentage regional for the most recent presidential election. The result was that all of the coefficients in all of the models are of the expected sign and significant at the 10 percent level or above, with a few minor exceptions. In particular, an increase in the local unemployment rate relative to the national rate or an increase in the percentage of local residents voting for a Democratic candidate in the last presidential election relative to the national average are seen to increase the probability of a Federal Reserve Bank president (a regional appointee) voting for more-expansionary policy. Other models were tested which confirmed the influence of local data on presidents' voting behavior.
Other opinions concur. Periods of economic slump in the US coincide with increased inter-state divergence of unemployment rates, implying a deterioration of local conditions relative to average levels (section 1). As it could be expected, this has also coincided with increased

divergent views among FOMC members, and a corresponding increase of dissenting votes. Number of dissents at FOMC meetings, which normally amount to two or three, climbed to five in 1982 (a year when unemployment increased by 2.2 percent and growth decreased by 2.6 percent). Dissents amounted to four in two opportunities, a most probable consequence of unexpected low growth in 1990 (0.8 percent) and in 1991 (minus 0.3 percent).

Ellen Meade and Nathan Sheets (1999) have put together cross-sectional variance of state unemployment (percentage points) and FOMC dissents (number). The result exhibits the expected positive relationship between the dispersion of state unemployment rates and the number of dissents at FOMC meetings. The authors warned however that while dissents rose with the increase of cross-section variance in the 1982-1983 period, the evidence does not appear to be overwhelming. “Furthermore, this analysis does not take into account the direction of the dissent (that is, whether the dissents registered were consistent with the unemployment data in the region).

A more recent analysis (Meade and Sheets (2002)) bears out the opinion of regional representatives being more responsive to regional economic conditions and their choices affecting monetary policy and overall economic performance than spurious correlations may suggest. Their analysis of the difference between the regional and national unemployment rate for each Federal Reserve area and for each month of an FOMC vote lends some support to the view that regional unemployment differentials did influence voting behaviour of the regional appointees. “Over the sample period, Bank presidents dissented for tighter policy when the national unemployment was 0.4 percentage point above the region’s rate. … In addition, Bank presidents dissented in favour of tighter policy with 9.9 percent probability when the unemployment rate in their region was below the national average, but only 5.2 percent of the time when the unemployment rate in their region was above the national average. Differentials in unemployment rates, however, do not seem to help explain the observed pattern of dissents by Bank presidents in favour of easier policy”.

Bernhard and Chang (1999) include data on FOMC voting by district representatives and centrally appointed (Board of Governors) members at every meeting, together with district economic data, from 1958 to 1994. Variables chosen captured major aspects of the economy that the FOMC members are meant to care about (gross product as a measure of output, income as a measure of the standard of living, wages as a measure of inflation, and unemployment). In the income equation, all coefficients were significant at the level of at least 0.85. In the wages equation, all coefficients were significant at the 0.95 level. Most of the coefficients were in the expected direction - the higher the output or wages, the tighter the policy. These results support the traditional view that FOMC members respond most strongly to output and inflation. However, the authors admit that “the results for the gross product and unemployment equations are not as convincing. Many of the variables are not

significant nor are the directions of the coefficients always as expected. All of the models are fairly good at predicting the direction of the vote with at least 62 percent correctly predicted ex post”.
Second, the authors test a possible difference between voting by district and by centrally appointed representatives. A discernible difference was found in the way that the former respond to the national conditions compared to their former colleagues. "There is both evidence that they respond differently from the BOG members with respect to the national conditions and that they are indeed sensitive to their own districts, conditions. What are the reasons for these different responses? Due to the structure of the district banks, the bank presidents are subject to different constituencies from the BOG members. The BOG members are ultimately responsible to the President and Congress - the principals who appoint them. The bank presidents are responsible to their respective boards of directors which are composed of three sets of constituents - banking interests, other business interests, and BOG members. The first two would be more interested in local conditions than national conditions since the former may affect, their businesses more. If we reasonably assume that bank presidents are interested in re-election to their positions, then it is not surprising that they would respond to district conditions."

[10] Vote trading suggests a repeated game model with reputational considerations. For an analysis based on cooperative game theory see Buchanan and Tullock (1962). See also Carlo Monticelli (1999) on strategic interaction for the allocation of the stabilization benefits from the conduct of the single monetary policy. His analysis underlines the importance of the selection of the procedures governing proposal making and voting at the ECB’s Council, left open by the Maastricht Treaty.

[11] Some basic facts:
The Board of Governors of the Federal Reserve System and the FOMC, at the top of the American system, consists of seven governors, each serving a 14-year term. “The governors are generally appointed from among the ranks of private bankers and economists, with some attention given to regional balance within the board” (emphasis added).
The Federal Open Market Committee (FOMC), the Federal Reserve principal monetary policy making unit, comprises the seven governors, plus the presidents of the twelve Reserve Banks that spread over the national territory. However, while all of district presidents attend FOMC meetings and participate in policy discussions, the voting members are restricted to five votes. The President of the New York Federal Reserve Bank has permanent voting status while the heads of the Cleveland and Chicago banks vote in alternating years. The remaining three FOMC votes rotate annually among the presidents of the other nine Reserve Banks.
The FOMC is charged under law with overseeing open market operations, as they influence the amount of reserves

available to depository institutions, in addition to setting ranges for the growth of monetary aggregates and directing operations undertaken by the Federal Reserve in foreign exchange markets. Reserves are the principal tool of monetary policy as they are meant to determine nominal and real interest rates and financial flows – bearing upon price and employment levels (at the core of the Federal Reserve mandated objectives).

The regional presence in monetary decisions provides the bank with specific information from the various participating regions, an information which is meant to be a central input to the formulation of policy[11]. And not only information “facilitates surveillance of the economy” but also it helps “a central bank to communicate with the public”. At the same time, “the Chairman (President) of the system should be strong enough to encourage diverse views in the monetary policy committee and to build a consensus for decisive and timely policy actions as needed” says Federal Reserve Bank of Richmond’s Marvin Goodfriend (1999). “The regional presence helps a central bank to get its policy message out and to gather anecdotal and specialized information on regional economies. Information gathering and dissemination are particularly important for central bank such as the Eurosystem and the Federal Reserve System, whose currency areas span large and populous regions…”. The value of local information that Reserve Bank presidents bring to the Federal Open Market Committee and the advantage in getting them involved in conveying the Fed’s message out to the public is a much highlighted issue. A “delegation of duties” by the central bank to its regional component is thus clearly established.

FOMC allegedly maintains a “collegial atmosphere … cloistered from the normal tempests of politics”. Governor Edward Kelley has still recently insisted: “There is a long tradition here - that is in my experience scrupulously observed - that there is no politically partisan component that interjects itself into the work of this central bank. We all either arrive with or very quickly adopt the viewpoint that our sole and only constituent is the American people and their economy. You will never be able to identify a partisan consideration in the discussions around this building”. (“The Region”, September 1999. Federal Reserve Bank of Minneapolis).

The American appointment system of district central bankers is indeed at arm’s length with party affiliations – and to territorial or home district particular concerns as well. The by-laws of the FOMC explicitly exclude that the appointee be instructed by their banks or serve as their representatives. It remains, however, that “The view that district presidents (i.e. potential FOMC members with voting rights) are independent of political considerations is shown to be naïve, which helps explain why board governors and bank presidents do, in fact, act so much alike” (Tootell (1996). The author found a statistically significant difference in the voting constants of FOMC members with different political heritage; the probability of a Democrat voting to tighten is lower than that for a Republican. Note also that the majority of district presidents are Republican, irrespective of whether they are sent by a Democrat-controlled or by a Republican-controlled State or District.

[12] An emblematic response would be that given by the Federal Reserve Bank of Boston: “The discussion on the discount rate recommendations (is) one of many factors taken into consideration by the President in formulating her views on monetary policy”.
Other District Federal Reserve Banks expressed similar opinions in slightly different formulations: their presidents listen to their directors, whose opinions probably influence the discussions that will take care in Washington, but the final decisions are solely theirs. Some excerpts:
“The Bank's Board of Directors discusses and votes on discount recommendations in alphabetical order. The Bank's President takes into account the Board's discount recommendations as well as other relevant economic data”. (Federal Reserve Bank of New York).
“Directors receive a briefing on current economic and financial conditions from the research staff. Directors then share their own observations, experiences, and perspectives on the state of the economy. Next they hear a recommendation on the discount rate from the Bank president, and they discuss that. Then they vote on a discount rate action. The directors' discussions pursuant to a discount rate decision are among the inputs our president may consider when he is discussing or voting on an FOMC action”. (Federal Reserve Bank of Philadelphia).
“After the go-round at the Richmond board of directors meeting, the president summarizes the national economic situation and makes a recommendation on the discount rate for the board to consider. Board members discuss the issue among themselves and with the bank president. In light of the president's recommendation and the following discussion, a vote is taken on the discount rate …. The bank president's participation in the discussion and votes on policy at FOMC meetings are fully independent of the Bank's board of directors”. (Federal Reserve Bank of Richmond).
“The views of the directors with respect to the discount rate, as well as their views with respect to current business and economic conditions, are an important part of the information President Hoenig takes into consideration when he participates in FOMC meetings”. (Federal Reserve Bank of Kansas City).
“Following discussion and motion for action, the directors vote on a discount rate recommendation to the Board of Governors. At the in-person meetings, the representatives from each branch, who are invited to each of these meetings, are welcome to participate in the discussions, but they do not vote. When participating in discussions and/or votes on policy directives at the FOMC the president is expected to exercise his or her own best judgment. Although he is not obligated to carry forward the directors discount rate recommendations to the FOMC processes, he

does give due consideration to the directors views on economic and credit conditions within our region and on national and international economic and credit developments viewed from their various vantage points”. (Federal Reserve Bank of Dallas).
“The information provided by the directors at board meetings is one source of information for the Bank's president in his preparation for FOMC meetings. In addition, a few weeks before each FOMC meeting, the directors (and the Twelfth District Advisory Council members) receive a questionnaire on the economy and on specific subjects being studied by the Bank's Research Department. This information is the basis of the Twelfth District's part of the Beige Book which is presented to all Reserve Bank presidents and the Board of Governors before each FOMC meeting. The Board of Governors' Research staff also prepares information which includes its views and input from other central banks, various government departments, and other key sources. Once a president is at an FOMC meeting, s/he also is receiving the views of the other eleven Districts. Each president and governor must vote from a national perspective without regard to the needs of one District or economic sector over another, and the FOMC's policy position is drawn from the consensus. The directors' views are a part of this complex collaboration and are valued for their closeness to and familiarity with the "grassroots" of the economy”. (Federal Reserve Bank of San Francisco).

[13] As pointed out by the Financial Markets Center, nearly one fifth (68 of 355) of FOMC votes cast by Reserve Bank presidents since 1993 have differed in kind or degree from the discount rate recommendations submitted by their boards of directors in the period immediately prior to Open Market Committee meetings. In many instances, these divergences underscore the Fed’s commitment to preserving consensus on Open Market Committee decisions and Reserve Bank presidents’ corresponding desire to maintain their influence within the Committee rather than diluting that influence by dissenting from the majority. In some cases, the divergences may indicate a president’s failure to persuade the Reserve Bank’s board of directors to tailor a discount rate request comparable to his or her upcoming FOMC vote.
According to Federal Reserve rules, discount rate requests are not binding on a Reserve Bank president’s FOMC vote (an appendix to this report contains Reserve Bank responses to a Financial Markets Center survey examining the role of discount rate recommendations on Bank presidents’ actions at the FOMC). Indeed, on a few occasions, Reserve Bank presidents have cast FOMC votes that ran counter to both their Bank’s discount rate recommendation and the Committee majority.

[14] A model by Anthony M.Marino and John G.Matsusaka (1999) investigates the economics of several decision processes that are commonly used to set budgets in both the public and private sector. The key tradeoff is that partial

delegation allows the principal to reject those projects he dislikes, but causes the agent to distort the information he transmits to the principal. See USC CLEO Research Paper No. C01-21, August 2001.

[15] Dissenting votes at FOMC are attributed to "identification to strongly held doctrinal perspectives", rather than to the influence of some kind of "principal" to the regional appointees. According to the Financial Markets Center (op.cit.), "On January 29, [2002] four Federal Reserve Bank presidents will rotate into voting positions on the policymaking Federal Open Market Committee … With the exception of Philadelphia Fed President Anthony Santomero, who is getting his first chance to vote on the FOMC after taking the Third District Bank's reins in 2000, each of the new voters has distinguished himself in past rotations by his dissents from FOMC majorities. … Since 1993, these three Bank presidents – Jerry Jordan (Cleveland Fed, monetarism), Gary Stern (Minneapolis Fed, rational expectations) and Robert McTeer (Dallas Fed, new economy optimism) – have accounted for half of all dissenting votes on FOMC policy actions. Thus, over the course of 2001, analysis of FOMC decisions will focus in part on the interplay between these individuals and their FOMC colleagues in setting the central bank's benchmark federal funds rate".