The Eurosystem: Transparent and Accountable

or 'Willem in Euroland'

CEPR Policy Paper No. 2

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This paper is a reply to some of the issues raised by Willem Buiter in his article 'Alice in Euroland' in the *Journal of Common Market Studies*, Volume 37, Issue 2, which has also appeared as *CEPR Policy Paper No. 1*. This reply will be published in the *Journal of Common Market Studies*, Volume 37, Issue 3, by Blackwell Publishers Ltd, September 1999 and is reprinted with kind permission of the publishers.

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Foreword

CEPR research has influenced policy by orienting researchers towards policy-relevant questions and encouraging decision-makers to use the results of research when formulating policy. The Policy Paper series was launched by CEPR in 1999 to provide a forum for the analysis of important policy issues by leading researchers.

The first paper in this series was ‘Alice in Euroland’ by Willem H Buiter. In this paper, Professor Buiter describes the launch of EMU as a bold step into the unknown, not unlike Alice’s fall down the rabbit hole. He argues that the legal framework, institutional arrangements and emerging operating practices of the European Central Bank should be changed and presents his own set of wide-ranging, yet specific and concrete, proposals for reform.

In this CEPR Policy Paper No. 2, Professor Otmar Issing, Executive Board Member of the European Central Bank, replies to some of the points raised by Professor Buiter. Professor Issing served on the CEPR Executive Committee during the period 1992-6. He has maintained a close involvement with macroeconomic research in Europe despite the pressures of his responsibilities first in the Bundesbank and now at the ECB. We are very pleased to take the opportunity to pursue this high-level debate on issues of such importance to the European economy – and to demonstrate thereby the relevance of the research cited by Professors Buiter and Issing on their papers.

Richard Portes
President, CEPR

9 June 1999

Summary

This paper responds to some of the questions raised by Willem Buiter in his article 'Alice in Euroland' relating to the Eurosystem's approach to transparency and accountability. Lewis Carroll's famous oeuvre suggests that the perception of reality depends on how one looks at it. In order to make sense of reality monetary policy-makers – like anybody else – have to filter, process and structure relevant information and interpret it on the basis of a coherent frame of reasoning. This is the purpose of adopting a monetary policy strategy that serves as a guide both for *internal* decision making and for *external* communication with the public. Therefore, transparency and accountability need to be discussed against the background of the stability-oriented monetary policy strategy that the ECB has actually adopted and not *as if* it were pursuing some other strategy such as direct inflation targeting.

The ECB has stressed from the very outset that it aspires to be among the most transparent and accountable central banks in the world. *How* to achieve this under the basic institutional set-up of the Maastricht and Amsterdam Treaties and under the conditions of a multi-country monetary union, however, is not as straightforward a task as is commonly assumed in the public debate. For this purpose one needs to distinguish accountability and transparency, both of which are crucial for the effectiveness of monetary policy and for the success of European Monetary Union over the longer term. This paper proposes to think of accountability as related primarily to the ECB's fulfilment of its Treaty mandate, and to the quantitative definition of price stability that has since been provided. The ECB's performance – ultimately – will have to be judged by 'deeds', i.e. observable policy outcomes.

By contrast, transparency is regarded as having primarily to do with 'words', i.e. the attempt to communicate clearly the reasoning behind policy decisions to the wider public. Complete transparency is impossible to achieve in practice and the effort to

achieve maximum transparency must balance the public's 'right to know' with its 'need to understand'. Transparency is not simply a question of making the maximum amount of information available but requires clarity to help policy-makers and the public alike to make sense of monetary policy. In the interest of both accountability and transparency the ECB has gone far beyond the already exacting reporting requirements under the Treaty. This reflects the conviction that in a democratic society accountability is the 'reverse side' of central bank independence and that transparency, to the extent that it helps the public to clearly understand monetary policy, will enhance policy effectiveness and reduce uncertainty.

In his paper Willem Buiter makes a number of specific proposals designed to enhance the ECB's transparency and accountability:

1. *Abandon attempts to create a culture of collective responsibility?*
   There are inherent limits to individual accountability of members of a collective decision-making body. Moreover, a balance has to be struck between providing adequate individual incentives and the need for effective collective decision-making. Excessive focus on individual personalities, rather than on the institution as a whole, may render the public's signal extraction problem more, and not less, difficult. Developing a common culture and speaking a common 'language' for external communication is especially important for a new institution and under the conditions of a multi-country monetary union.

2. *Publish minutes?*
   The ECB President's monthly press conferences immediately after Governing Council meetings – in conjunction with the comprehensive information provided by the ECB's Monthly Bulletins and other channels of communication – come very close to providing 'summary minutes'. They represent a quite unprecedented degree of instant 'hands-on' accountability where the arguments underlying the decisions of the Governing Council (but not individual 'opinions') are explained

and exposed to public scrutiny. This may well be preferable to publishing carefully edited official minutes usually provided with considerable delay.

3. *Publish individual voting records?*
   This would not be sufficient for substantive individual accountability, which would also require revealing the arguments, the assumptions and view of the world underlying individual votes. Few people go as far as advocating the publication of attributed minutes or verbatim transcripts and individual forecasts/models, since the effectiveness and coherence of internal discussions would suffer. In any event, the validity of dissenting views can never be verified conclusively even ex post. Thus the potential benefits of publishing votes are limited, even under the questionable model of individual accountability, while the risk of confusing policy signals is not negligible. Moreover, under the condition of a multi-country monetary union the perception of policy will inevitably continue to be coloured by national frames of reference. Publishing votes would impose an unbearable asymmetry in the burden of proof on individual decision-makers seeking to demonstrate that a particular vote had *not* been influenced by national considerations.

4. *Clarify the operational inflation target?*
   The ECB simply does not have an operational inflation target as used in strategies of direct inflation targeting. It has provided a quantitative definition of price stability, which should serve as a basis for accountability. Its stability-oriented strategy in attaining its objective over the medium-term rests on two pillars, a prominent role for money – captured by a reference value for money growth – and a broadly based assessment of the outlook for price developments and the risks to price stability.

5. *Publish the inflation forecast?*
   In contrast to direct inflation targeting the ECB strategy does *not* attempt to condense and present all relevant information through a single inflation forecast. Direct inflation targeting, moreover, does not by itself solve the transparency problem. A

single forecast can never represent a full summary statistic of all relevant information nor does it obviate the difficult task of explaining how the forecast was arrived at and how it is joined with further judgement in determining actual policy decisions. The role of forecasts under the ECB's stability-oriented monetary policy strategy is quite different and much less ambitious. To *pretend* otherwise would be a disservice to clarity, transparency and accountability.

1. Introduction

In his paper 'Alice in Euroland',[1] Professor Buiter (1999) offers a wide-ranging critique of the institutional arrangements and operating practices governing the activities of the Eurosystem in Stage Three of Economic and Monetary Union in Europe. He perceives these arrangements as being 'flawed and in urgent need of modification' [2]. Otherwise, 'they could put the common currency's survival at risk' [3]. Professor Buiter proposes a long list of 'necessary changes'. Some would require amendments to the Maastricht Treaty; others refer to the functioning and interplay of existing European economic and political institutions. The 'remedies' proposed in these two categories cannot be implemented at the discretion solely of the Governing Council of the European Central Bank (ECB). All of the many issues raised, which range from the intricacies of Article 109 in the field of exchange rate policy to the political role of the European Parliament, would no doubt merit and, indeed, require thorough analysis. This would clearly be beyond the scope of this response. Silence on these matters, however, should not be taken as implying that I, personally, agree (or disagree) with any of Buiter's points.

There is a further category of changes proposed by Professor Buiter, which 'can be made overnight, at the discretion of the Governing Council itself' [4]. All of these changes bear on the issues of transparency and accountability. It is in this context that Professor Buiter (mis)quotes extensively from my earlier remarks on these topics and confers on me the rather dubious title of 'enforcer for the ECB Opaqueness Squad' [5]. Quite frankly, it remains a mystery to me how anything I have written or said on this subject could be construed as evidence of 'disdain for the public's right to know' [6] which, in Professor Buiter's view, is, 'unfortunately, not uncommon among continental

[1] Buiter, W.H., 'Alice in Euroland', *Journal of Common Market Studies,* Volume 37, Issue 2, Blackwell Publishers Ltd, June 1999 (previously published with kind permission as CEPR Policy Paper No. 1, April 1999).
[2] Buiter (1999) p. 205.
[3] Buiter (1999) p. 205.
[4] Buiter (1999) p. 206.
[5] Buiter (1999) p. 193.
[6] Buiter (1999) p. 194.

central bankers' [7]. In his words 'the secrecy bacillus is a constant threat to openness and accountability in any organ of the state' [8]. These are strong words and it would seem hard to have any rational, dispassionate discourse on matters of 'hygiene'. Nevertheless, I shall try. In writing this response, I do not expect Professor Buiter – or perhaps any of the ECB's critics in this important matter – to 'change his mind'. It may, however, not be unreasonable to hope that he might, at least temporarily and for the sake of argument, 'change his point of view'. For the reality one perceives really depends on how one looks at it. If anything can be learned from Alice's adventures in Wonderland, it is surely this.

For this reason Professor Buiter has chosen a very fitting title for his paper. A number of features of Euroland 'do not make sense' to him. How can one make sense of reality? As Alice has shown, this is by no means a trivial question. It is also the issue at the heart of the controversy about transparency, accountability and the Eurosystem's monetary policy strategy. One of the most striking experiences of life in Euroland is that the perception of many observers of what we are doing is still heavily coloured by different national frames of reference and past institutional arrangements. To make this point, it is sufficient just to look at the widely different national press responses to decisions by the ECB Governing Council. For example, in initial reactions to the announcement of the ECB's stability-oriented monetary policy strategy commentators in different countries quickly recognised those elements that were most familiar to them, downplaying differences. Meanwhile observers have begun to recognise more clearly – and now perhaps even to overemphasise – the departures from the respective national frames of thinking they were accustomed to.

Professor Buiter is, therefore, not alone in suffering from cognitive dissonance and bafflement in Euroland. Clearly his reasoning reflects the logic of direct inflation targeting and the approach to accountability and transparency that he is most familiar with.[9] It is no surprise that he does not like what he sees. In fact he ignores – or fails

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7 Buiter (1999) p. 194.

8 Buiter (1999) p. 194, fn. 12.

9 I readily concede that none of us is free from such pre-conceptions. Hence, an alternative title for my remarks might be 'Issing in Buiterland'.

to comprehend – what he does not like to see. There is absolutely no mention, let alone a discussion, of the Eurosystem's stability-oriented monetary policy strategy and, in particular, of its first pillar – the monetary reference value. It is difficult to have a meaningful discussion of transparency and accountability without a clear understanding of our strategy. Other observers such as Svensson [10] have criticised the stability-oriented strategy as itself being non-transparent. As his answer to cognitive dissonance he, like Tabellini,[11] openly advocates that the public and the European Parliament should hold the ECB accountable *as if* it were actually pursuing a direct inflation target.

It should be obvious that, if every observer insists on seeing the ECB as he or she *wants* to see it, achieving a maximum of clarity, transparency and accountability will not be an easy task, certainly not as straightforward a task as Professor Buiter suggests. As an alternative, may I suggest that the possibility is entertained – just as a working hypothesis – not that the ECB has the 'right' approach to transparency, to accountability (there are many roads to transparency and accountability, depending on the institutional context, tradition and the monetary policy strategy), but that we 'mean what we say', even if we have perhaps not always been entirely successful in 'saying what we mean'? [12]

What the ECB has been saying – and meaning – from the very outset is that we aspire to be among the most transparent and accountable central banks in the world. I would even go further and claim that, at least in some respects and only a few months into its existence, the ECB can already be regarded as *the* most transparent and accountable central bank in the world. What we understand this to mean in practice should become clearer in the remainder of this note. I shall first touch on some conceptual issues before addressing the specific proposals that Professor Buiter advocates as mechanisms to enhance accountability and transparency.

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[10] See Svensson (1999).

[11] See Tabellini (1998).

[12] 'Then you should say what you mean', the March Hare went on. 'I do', Alice hastily replied; 'at least I mean what I say – that's the same thing, you know'. 'Not the same thing a bit!' said the Hatter … 'You might just as well say', added the March Hare, 'that "I like what I get" is the same thing as "I get what I like"!' (Carroll, 1865, p. 88).

2. Accountability and Transparency

> ‘When I use a word’, Humpty Dumpty said in rather a scornful tone, ‘it means just what I choose it to mean – neither more nor less.’
>
> ‘The question is’, said Alice, ‘whether you can make words mean different things.’
>
> ‘The question is,’ said Humpty Dumpty,‘ which is to be master – that’s all.’ [13]

In the debate on the ECB’s accountability and transparency, as in Professor Buiter’s article, the two terms tend to be deployed together (suggesting that they are more than just synonyms), but are also often used interchangeably. In my speech [14] that Professor Buiter cites extensively I have – in the spirit of Humpty Dumpty – tried to distinguish between the two concepts. This distinction, however, does not seem to have been picked up by Professor Buiter in his reaction to the quotes. I can do no more than simply repeat, again, what I said:

> *‘The issue of <u>accountability</u> for the ECB’s performance with respect to its clearly defined mandate needs to be logically separated from concerns over the <u>transparency</u> of the policy-making process itself (as opposed to the outcomes of this process).’*

I stressed that I regard *both* accountability *and* transparency as desirable for any monetary authority and as absolutely crucial for a new institution like the ECB. Professor Buiter seems to start from the opposite presumption in creating the impression that the ECB, and I personally, champion secrecy and obfuscation. Nothing could be further from the truth. The issue is *how* a maximum of accountability

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13 Carroll (1872), p. 114.
14 Issing (1999).

and transparency can be achieved under the particular conditions of a multi-country monetary union, within the basic framework laid down in the Maastricht and Amsterdam Treaties, and against the background of the stability-oriented monetary policy strategy that the ECB has adopted. This issue merits serious discussion and any contribution to the debate is welcome. However, casting an issue in terms of black–and–white, which may be helpful at times, could in other circumstances impair our ability to listen and to comprehend.

As an example of this, Professor Buiter criticises my assertion that 'for the purpose of *accountability*, what matters *most* will be the ECB's actual track record of stability performance' [15]. This assertion does not in any way contradict my earlier statement that '*transparency*, openness and clarity about how the central bank sets out to achieve its mandate are also desirable', nor does it preclude that transparency may, at the same time, facilitate accountability. While it is difficult to disentangle accountability and transparency completely in practice, I nevertheless consider it to be useful to keep the two concepts separate. The distinction I have in mind is similar to that proposed by Briault, Haldane and King [16] between *de jure* accountability and *de facto* accountability or transparency. Drawing on their terminology I argue that accountability is linked essentially to 'deeds', i.e. observable and verifiable actions, whereas transparency refers primarily to 'words', i.e. attempts to convey explanations and the thinking behind the actions.

The presumably uncontroversial point that I attempted to make by reductio ad absurdum in my remarks on 'George Orwell in reverse',[17] quoted by Professor Buiter, is that complete transparency on the underlying information set as well as the thinking and ulterior motives behind central bankers' decisions is logically and practically impossible to achieve. This reflects a deeper (philosophical) recognition of the limits of 'knowledge' and the impossibility of providing and communicating anything like a full description of reality:

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15 Buiter (1999) pp. 186-7.
16 Briault, Haldane and King (1996).
17 Issing (1999).

'Reality is never transparent. What we see from any one angle is always only part of the picture.' [18]

This point also applies to practical policy-making. As the Bank of England's chief economist, Professor Vickers has recently pointed out:

'there is surely information relevant for policy-making that is simply incapable of being put in the public domain. In that case, and with the best will in the world, optimal monetary policy cannot be absolutely transparent, nor totally boring' [19] *(i.e. predictable).*

This is by no means evidence of a 'disdain for the public's right to know', as Professor Buiter would have it, nor does it mean that central banks should not strive for the maximum degree of transparency possible.

Being aware of the limits to transparency introduces a first shade of grey into Professor Buiter's black-and-white picture. His paper contains a paragraph that makes a reference to game theory. He does not elaborate, but I presume he has models in mind that show that a case can be made in some circumstances for secrecy or ambiguity in the conduct of monetary policy. Let me make absolutely clear that I reject the idea that central banks should make imprecise announcements in order to retain room for manoeuvre to exploit 'surprise inflation' [20] or to avoid revealing 'too much' information to the markets for fear of inducing extra volatility.[21] Instead, I am rather sympathetic to the view that central banks only have a limited information advantage over sophisticated market participants, both with respect to the available data and – perhaps – also with respect to understanding how the economy works. Central banks should *not* endeavour to maintain or even create any such

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[18] This quote is not from Lewis Carroll but from the *Financial Times* (19 April 1999) where Ralph Rugoff discusses the architecture of the newly reconstructed Reichstag building in Berlin: 'In (Sir Norman) Foster's idealised vision government lives in a glass house, its actions visible to the people it is meant to serve.' However, a piece of contemporary art by Sigmar Polke displayed inside the Reichstag 'with antic irreverence calls the bluff of Foster's rhetorical exercise in transparency'.

[19] Vickers (1998).

[20] Cukierman and Meltzer (1986).

[21] Goodfriend (1986).

information asymmetry, nor should they pretend that they have some superior or magical insights.

There is, however, a further source of asymmetric information, which cannot be addressed so easily. It concerns policy-makers' interpretation of information, their reasoning and their understanding as well as their underlying preferences and intentions. In this respect, too, I tend to side with models that suggest that morre transparency is 'always good'.[22] But how can this be attained in practice? Achieving the maximum degree of transparency is not simply a question of making the maximum amount of information available. What matters most in order to make sense of reality (which is inherently non-transparent to policy-makers and the public alike) and of policy-makers' behaviour is a coherent frame of reasoning to interpret the subset of *relevant* information. In this sense, the 'public's right to know' has to be balanced by the 'public's need to understand'. What matters for transparency is therefore *clarity* as well as openness. For a new and supranational institution like the ECB, it is particularly important that it sends clear and coherent messages to the markets and the wider public. More 'words' do not necessarily mean 'more information', and 'more information' does not necessarily and, by itself, contribute to greater clarity.[23]

The ECB's stability-oriented monetary policy strategy is the key device to provide a clear frame of reference both for the internal decision-making process and for communicating the Governing Council's thinking to the general public. It represents an attempt to organise and structure the available information and to help the decision-makers and the public alike to approach and understand monetary policy decisions in a systematic way. In seeking to make sense of a world that is inherently non-transparent, policy-makers and the public sit in the same boat. When it comes to communicating the policy-makers' thinking and reasoning the public can read and listen to 'words', it can process (a limited amount of) information and try to

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[22] However, results from game theory are usually based on the rather stringent assumption of 'common knowledge' – which effectively already *presupposes* a large degree of 'transparency' about the nature of the world – and they are notoriously sensitive to slight changes in the specification of the information structure.

[23] As we know from cheap talk' games, there is a risk of so-called 'babbling equilibria' where the messages sent become completely uninformative (Farrell (1993)).

follow explanations, but it cannot read minds. Transparency can therefore never be complete and accountability must ultimately rest on 'deeds'. From this perspective, transparency could perhaps best be understood not as an attribute *per se*, but the degree to which we 'do what we say' and 'say what we do'.[24]

By contrast, 'accountability' simply means that we 'do what we are supposed to do'. Two questions arise here: 'accountable for what?' and 'accountable to whom?' Accountability can only be achieved relative to the definition of the mandate given to the central bank and ultimately the fulfilment of this mandate can only be judged with reference to observable variables. The more clearly and precisely this mandate is defined, the easier it will be to monitor the performance of the central bank. The more clearly and narrowly the mandate is defined, the easier it will also be in a democracy to justify the delegation of powers to an unelected body, since value judgements and trade-offs concerning several unranked objectives should naturally remain the preserve of democratically elected representatives. Accountability is the 'reverse side of the coin of central bank independence' [25] or the *quid pro quo* of being held answerable for the exercise of decision-making powers granted in a democratic act of delegation. The Eurosystem's formal democratic legitimacy is derived from the ratification process of the Maastricht Treaty. Given its European mandate and independent status, the Eurosystem as a whole can only be held accountable by the European public and its elected representatives.

The basis for the ECB's accountability is provided by the clear and limited Treaty mandate, in particular by the overriding 'primary objective to maintain price stability', and by the quantitative definition of price stability that the Eurosystem has since provided. The key channels for accountability are the statutory reporting requirements of the ECB to the European Parliament, the Council of Ministers and the Commission, which take the form of an annual report and quarterly reports. The President of the ECB presents these reports to, and discusses them in, the relevant committee of the

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[24] In this perspective, transparency is intimately linked to credibility. Alan Blinder (1998), p.64, for instance, has described 'matching deeds to words' as the essence for acquiring credibility.

[25] Issing (1999).

European Parliament, which can also question other members of the ECB's Executive Board. In the interest of further increasing both accountability and transparency, and going beyond the reporting requirements set out in the Treaty, it has also been decided to publish a Monthly Bulletin and to hold a press conference at least once a month, immediately after the first of the fortnightly Governing Council meetings.

3. Professor Buiter's Proposals to Further Enhance ECB Accountability and Transparency

The previous section argued for the need to balance clarity and openness in the quest for maximum, yet incomplete, transparency and emphasised the key role of the quantitative definition of price stability for monitoring the ECB's performance and ensuring its accountability. I now turn more specifically to the ECB's 'operating practices' in this area, which Professor Buiter considers 'in urgent need of modification'. I begin with the general issue of individual versus collegiate responsibility and then discuss the publication of minutes and inflation forecasts in turn.

3.a Abandon attempts to create a culture of 'collective responsibility'?

On this point I emphatically disagree, both as a matter of principle and considering the particular communication challenges in a 'multi-country' monetary union. If we continue to think of accountability as strictly referring to 'deeds' rather than 'words', individual accountability would appear to be rather difficult to conceive.[26] After all, there is only a single interest rate to be set and only a single economy to be managed, rather than a range of 'controlled experiments' that can be conducted in parallel. While there is a

[26] In this section, I abstract from the narrow legal question of ensuring the orderly discharge of statutory duties by individuals members of the Governing Council. Due to the differing appointment procedures governors of the national central banks cannot be held *individually* accountable by *European* bodies nor, conversely, Executive Board members be made subject to *national* oversight (Bini Smaghi, 1998).

legitimate concern to provide incentives for individual competence, it is hard to see how this could be verified effectively and conclusively. If one took the individual accountability view to its logical conclusion, not only individual votes, but also attributed minutes (perhaps even *verbatim* transcripts) and separate individual forecasts [27] would be required in order to distinguish individual responsibilities. Professor Buiter does not go that far, for obvious concerns that the flow of discussion may be affected adversely. Again, there are no easy answers and concerns over *individual* incentives must be balanced with the need for effective *collective* decision-making.

A committee, like any institution, is more than the mere sum of individuals, and a decision is more than the balancing of votes. Moreover, individual responsibility cannot simply be reduced to the act of voting.[28] A decision is the outcome of a process of collective reasoning which is more than a mere exchange of views. Ultimately, the public, while easily distracted by individual personalities, will judge a committee, rightly or wrongly, by the coherence and adequacy of its decisions, and the responsibility for policy outcomes will be shared. Longer-term, it would appear preferable to build up credibility and a reputation for the institution as a whole, rather than to tie it too closely to the particular individuals at the helm. Furthermore, democratic societies are based on the rule of law and a division of powers to separate institutions. It is therefore anything but obvious that focusing on individual *personalities*, rather than on the accountability of *institutions*, can be regarded as being more 'democratic', as Professor Buiter implies.

Speaking with one voice – or at least speaking 'one language' – is of particular importance for *transparency* and *clarity* in the case of the

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[27] Vickers (1999) entertains the possibility of 'tension between the individual accountability of MPC members and the apparently collective nature of the published forecasts' and asks 'how is individual freedom in voting consistent with collective ownership of the means of projection?' He argues that individual members were free to differ from the collective judgement summarised by the forecast, but he also acknowledges that 'in most circumstances one would not suppose that forecasting by committee was the optimal organisational design'.

[28] What would the mere publication of a 'dissenting vote' do for individual accountability if that vote were based on untenable arguments?

Eurosystem. The fact that most central bankers (exceptions seem to prove the rule) tend to weigh what they say in public rather carefully may have something to do with the need to avoid unnecessary volatility in the markets. On these counts, the model of individual accountability championed by Professor Buiter has certainly not been uncontroversial, at least in its initial phases, even under the far more favourable circumstances of a single nation state and a committee of smaller size, as in the United Kingdom.[29] Expecting it to work for the Eurosystem, in my view, appears to be highly unrealistic. In these circumstances the costs of learning to interpret, understand and aggregate a wide array of conflicting and 'noisy' signals would seem prohibitive, even if they were transitory. As mentioned in the introduction, it is not at all easy to have even an identical message understood the same way across the euro area! Professor Buiter himself provides evidence that even the most sophisticated of economic observers may not be immune to signal extraction difficulties when it comes to the Eurosystem, despite our best efforts at clarity.

3.b Publish minutes and voting records?

A 'culture of collective responsibility' does not mean that 'a spurious united front' should be presented to the outside world. What is required for clarity and transparency is an explanation of the reasoning behind policy decisions, including a careful weighing of the main arguments. Such decisions need to display consistency over time and should therefore always be presented within the framework of the monetary policy strategy. In this context the upside and downside risks in the interpretation of monetary developments and the outlook for price stability will be identified. What must be avoided, however, is confusion between 'arguments' and 'opinions', that issues

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[29] In the *Financial Times* of 17 July 1998 Philip Stephens remarked under the heading 'Dissent into chaos: the Bank of England's Monetary Policy Committee is more like a senior common room than a real policy making forum', that 'to put six economists in the same room is to invite what one commentator called paralysis by analysis. As a result the committee's conclusions are entirely unpredictable. There is no rhythm to the monthly deliberations. The participants seem trapped in the headlights of the latest economic indicators. The Bank finds it impossible to guide the expectations of bond and currency markets.' I am far from subscribing to this critique, but what would 'Alice in Buiterland' have made of this in my stead?

become mixed up with personalities. For the purpose of collegiate responsibility as well as for that of conveying relevant information to the public and the markets, it would be a distraction to reveal who said what and who voted this or that way.

At the monthly press conferences the President of the ECB summarises and explains the decisions of the Governing Council and the reasoning behind them. Moreover, the President and the Vice-President are available for extensive questioning, transcripts of which are made available on the ECB website. I regard this practice (which complements the more comprehensive regular assessments provided in the Monthly Bulletins), as coming very close to representing 'summary minutes'. It combines the requirement of clarity in interacting with the public with a really quite unprecedented degree of instantaneous and direct 'hands-on' accountability, literally within minutes after the meeting. Everybody knows that official 'minutes' published elsewhere with considerable delays are carefully drafted and edited documents, which have normally been checked and approved by individual members. In short, they are anything but genuine 'minutes' and, for good reason, far removed from *verbatim* transcripts.[30] Therefore, much is to be said for the approach of the ECB, which does not *pretend* to publish something which is then called 'minutes', but stands ready to submit its collective decisions for intensive scrutiny as quickly and as spontaneously as possible.

Publishing individual voting records, as advocated by Professor Buiter, makes sense from the perspective of individual accountability. The latter would, however, already be diminished to the extent that minutes are not attributed, so that it is not a straightforward matter to extract the reasons behind individual votes, or to detect differences in the assumptions underlying individual votes especially if the view of the economy is summarised in a collectively owned forecast. I do not see how, under such circumstances, the publication of voting behaviour would enhance transparency, let alone clarity and predictability.[31] Instead, the public will focus excessively on individual

[30] As emphasised by Alan Greenspan in a speech given on 5 December 1996 (cited in Krause (1999)), 'to open up our debate on monetary policy fully to immediate disclosure would unsettle financial markets and constrain our discussions in a manner that would undercut our ability to function'.

[31] Again such concerns are not exclusive to 'secretive' continental central bankers.

members' statements in trying to predict their voting patterns. It would already be an arduous task continuously to monitor and perform signal extraction for each individual committee member, but predicting the collective outcome on this basis would be challenging, to say the least.[32] The public will inevitably – and perhaps wrongly – attempt to simplify matters, e.g. by classifying members as hawks and doves, or as activists and non-activists, and then concentrate on predicting the behaviour of any perceived 'swing voter'. I doubt that this would be helpful for monetary policy.

I would prefer to abandon any pretence that there can be a meaningful and substantial (verifiable) degree of individual accountability within a collective decision-making body dedicated to a single overriding objective. Efforts to locate accountability and transparency at the level of individual members are in practice likely to undermine the necessary collective sense of responsibility and to obscure the clarity and coherence of the committee's policy signals. In the context of the Eurosystem, these arguments of principle apply with even greater force, since the members of the Governing Council inevitably will be associated with their country of origin by the public. Publishing voting behaviour would provide an observable variable, which may allow national politicians or interest groups to verify whether any pressure applied individually had had the intended result.[33] By contrast, it is practically impossible for any individual to demonstrate conclusively that any particular voting behaviour revealed had *not* been affected by any secret or overt influences.

I accept that attempts to influence policy-makers will occur even in the absence of published votes and that there is a risk of leaks and undesirable information asymmetries, which could favour 'conspiracy

Heikensten and Vredin (1998), p.29, from the Swedish Riksbank 'believe it may be meaningful to make a distinction between requiring accountability on the one hand and clarity and distinctness of policy on the other'. They conclude that 'for clarity it is less necessary to know how particular individuals have voted' and that there is 'the need to create an Executive Board that functions properly … as a team'.

32 An obvious reference here is to the contributions of Lewis Carroll, in his incarnation as the Rev. Charles Lutwidge Dodgson, to the mathematical theory of committees, a far from trivial exercise (see, for example, Black (1987)).

33 The secrecy of the ballot is a key democratic principle (in representative democracies this is often also extended to parliamentarians) which protects the individual's freedom of choice from group pressure and interference. Limits to 'openness' need not always be 'undemocratic'.

theories'. However, in an environment where perceptions of the Eurosystem and the individuals serving on its decision-making body are inevitably coloured by national frames of reference, publishing votes would invite immense pressures and lead to an enormous asymmetry in the 'burden of proof', as argued above. The efficiency of decision-making would also be adversely affected if individual members continuously had to prove that they were immune to any national considerations. Members of a committee with a clearly defined mandate should concentrate on making their individual best judgement and their best contribution to the collective decision-making process. Anything that focuses attention on personalities or nationalities, rather than on issues, is likely to distract from this task, to encourage attempts to 'play to the gallery' and thus, ultimately, to compromise personal independence.[34]

3.c *Publish the inflation forecast and clarify the operational inflation target?*

Similarly, Professor Buiter's call for the publication of the inflation forecast does not appear to be a suitable field for a 'religious' battle over the principles of openness and democracy. I fully agree with him (even though he seems to believe that I do not) that there should be a general presumption for the release of any relevant piece of information, but I would add the proviso that this holds true only if such a release would not compromise transparency, clarity and the public's understanding of the monetary policy strategy *actually* pursued. The simple truth is that the Eurosystem does not have an operational inflation target. It does not pursue a strategy of direct inflation targeting (nor one of pure monetary targeting, for that matter); to *pretend* otherwise would do nothing for transparency. The ECB Governing Council has instead provided a quantitative definition of price stability, the objective it has been assigned by the Maastricht Treaty. This provides a clear basis for accountability and a benchmark against which its performance can, and should, be judged.

[34] In practice, moreover, it will be difficult to draw a clear borderline between justified demands for openness about decision-makers' professional conduct and 'unhealthy curiosity' about personalia. In the media age the public's *demand* for openness will be 'insatiable', and it is not clear that *supply* should be infinitely inelastic.

The ECB's stability-oriented monetary policy strategy was decided last October. It has been described in more detail in the January 1999 Monthly Bulletin and we have been explaining it incessantly ever since. A monetary policy strategy is a framework for structuring and processing information in a systematic and transparent way. The framework we adopted consists of two pillars, a 'prominent role for money', as reflected in a quantitative reference value for monetary growth, and a 'broadly based assessment of the outlook for price developments and the risks to price stability'. Inflation forecasts – both those produced in-house and those furnished by others – naturally play a role in the context of the broadly based assessment. It would, however, be misleading to assume that any particular forecast is 'the' central input into policy decisions even within the second pillar of the Eurosystem's strategy. It is only one element among and alongside a wide array of indicators.

In weighing the case for publishing any form of inflation forecasts, their (limited) role within the Eurosystem's strategy must be clearly understood. Otherwise, publishing forecasts could be misleading if it leads the public to attach more significance to them than they have in the decision-making process. Such concerns are particularly relevant in the initial period, when the stability-oriented monetary policy strategy may not yet have been fully understood and when the ECB has had, above all, to build credibility by clearly demonstrating its commitment to its final objective of price stability.

In discussing whether the publication of forecasts is indispensable for accountability and transparency, the decision of the ECB Governing Council *not* to adopt a direct inflation targeting strategy must therefore always be borne in mind. Moreover, the issue is not entirely self-evident even within a direct inflation targeting framework [35] and it is not clear whether the apparent simplicity of that approach can live up to the promise of transparency by its own standards. Svensson [36] has shown that within simple economic models, inflation targeting is theoretically equivalent to inflation forecast targeting. This seems to

[35] Even central banks that pursue a direct inflation targeting strategy have not always, and everywhere, published their inflation forecasts.
[36] Svensson (1997).

offer a coherent and simple intellectual framework for thinking about and presenting monetary policy. It does not by itself, however, solve the problem of transparency. The direct inflation targeting model appears to suggest that monetary policy simply has to update the data fed into an appropriate model of the economy to generate inflation forecasts with a specified time horizon. Interest rates are then adjusted whenever the forecast inflation deviates from target.

In practice, monetary policy-making is very different from this stylised account, which academics have found very attractive. As Professor Vickers [37] has described admirably in the case of the Bank of England, no single model will be adequate for all purposes and any model requires an enormous amount of judgement and a careful specification of assumptions in order to generate the forecast used in the policy process. Vickers writes that:

> *'good forecasting generally entails use of off-model information and hence off-model models. Precisely how this is done seems to me to be literally indescribable in detail'.* [38]

He goes on to emphasise that *no* forecast can ever be a summary statistic of all relevant information, as suggested in the simple framework, but must always be supplemented, interpreted and informed by judgement and input from a variety of other sources to arrive at policy conclusions.

Attempting to organise all relevant information around a single official inflation forecast may be one of several sensible ways of structuring information. *Pretending* that this could be achieved in full in practice may, in fact, be misleading. I have difficulty in understanding why the publication of an inflation forecast, by itself, should represent a litmus test for transparency and accountability. What matters on these counts is *how* the published inflation forecast is arrived at. How is the outside observer to distinguish whether the forecast has been simply the result of feeding in data and 'pressing a button' or whether a desired ex ante forecast or fan chart has been

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[37] Vickers (1998, 1999).

[38] Vickers (1998)

obtained by manipulating the relevant assumptions in the model? In the former case of 'painting by numbers', Vickers (1999), policy would be dictated by forecasts and 'accountability of the MPC members would be a sham'. In the latter case of 'numbers by painting', policy would be 'independent of the forecast process, in which case that whole process would be a charade'. Practical policy-making operates somewhere in the middle between these two extremes. Making this process transparent remains a difficult task, no matter which strategy is pursued. Publishing an inflation forecast is no substitute for an explanation of the underlying reasoning and assumptions. On the contrary, the widely trumpeted claims for transparency and the perception of accuracy associated with inflation forecast targeting may indeed be regarded as somewhat presumptuous, if not outright deceptive.

There are therefore good reasons to assign inflation forecasts a less ambitious role and also to avoid the risk of spurious accuracy that comes with precise numerical operational inflation targets and precise invariant target horizons. For purposes of accountability and providing an anchor for expectations, it is important to provide a quantitative definition of price stability and to emphasise that price stability will be maintained over the *medium-term*. I do not believe, however, that it is necessarily helpful to go further and create the impression that monetary policy, by itself, would be able to 'fine-tune' price developments at a certain horizon and to do so on the basis of inflation forecasts *alone*. For this reason, too, the role of forecasts within the Eurosystem's second pillar of its stability-oriented monetary policy strategy is fundamentally different from that in a direct inflation targeting framework.

There are a number of further conceptual issues that need to be addressed when deciding whether and how to publish inflation forecasts. Forecasts must be based on assumptions about the future path of interest rates. Publication of an *unconditional* forecast would have to assume that rates are always set in order to achieve the objective of price stability and therefore no substantially new information would be revealed to the public.[39] For the purpose of

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[39] Making more specific assumptions about the Governing Council's own 'reaction function', which at any rate does not exist in any mechanistic, *ex ante* sense, for

conditional forecasts, the two natural assumptions to make are unchanged interest rates or using the interest rate path expected by the markets. In both cases (and in particular in the unchanged rates scenario) forecasts may result which are inconsistent with the definition of price stability and this may send wrong signals to the public. That, in turn, could affect inflation expectations and undermine the credibility of monetary policy in achieving its objectives. Reacting to variables that have a substantial 'expectations content' can also lead to self-fulfilling multiple equilibria.[40] Great care must be taken that the central bank's commitment to price stability is not perceived as being in any doubt and that it is seen as leading, rather than following, market expectations.

Finally, forecasts are subject to considerable uncertainty, even over relatively short horizons, such as one or two years ahead. In the Eurosystem this problem is exacerbated by the uncertainty about the economic environment and structural changes associated with the transition to Stage Three of Monetary Union. It is particularly important in the initial phase of the euro's life that inaccurate forecasts do not undermine the credibility, accountability and transparency of monetary policy with respect to its price stability objective. As forecasts become more accurate and as the public becomes more familiar with the Eurosystem's monetary policy strategy, the balance of costs and benefits of making forecasts available to the public can be expected to change. Papers such as that of Professor Buiter, however, show that the time when inflation forecasts could simply be presented for what they mean to the ECB without meaning too different things to different people has not arrived just yet.

4. Concluding Remarks

The ECB Governing Council has provided a quantitative definition of price stability, the primary objective assigned to it by the

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forecasting purposes would be problematic. It is also hard to find central banks that go as far as predicting (and publishing) their own future path of interest rates.

40 See Bernanke and Woodford (1997).

Maastricht Treaty. The Treaty was ratified by the parliaments of all EU Member States and was, in some cases, moreover endorsed by popular referendum. There is no question that the Treaty and that 'constitutional act' of a 'dual' delegation of authority over monetary policy to an *independent* central bank with a *European* mandate enjoys full democratic legitimacy. The Treaty already provides for ample channels of ongoing accountability of the ECB vis-à-vis the European public and its democratically elected representatives. The ECB has gone far beyond the statutory requirements of the Treaty in its efforts to strengthen its accountability and transparency further. To be successful in the fulfilment of its mandate in the long run, the ECB must win and maintain the trust and support of the European people.

This can only be done if we are clear about what the ECB has been asked to do and to be humble about what monetary policy can achieve (*and* cannot) achieve. The key to credibility and transparency is not to promise more than one can deliver. Precisely because the ECB has been assigned a clear and narrow task, it is democratically legitimate and economically sensible to grant it independence from the regular political process. And ultimately, precisely for this reason, its *accountability* can and should be based primarily, if not exclusively, on its observable record in fulfilling its mandate. This does not mean that *transparency* about how the central bank goes about achieving its mandate would not be important as well. On the contrary, transparency – appropriately defined – can be regarded as absolutely crucial for the effectiveness of monetary policy and the credibility of a young institution like the ECB.

The very purpose of a monetary policy strategy is to provide a clear and coherent framework to structure information and the decision-making process *internally* and to explain monetary policy decisions *externally*. Transparency extends beyond mere openness, but requires a degree of clarity that in fact enhances the public's understanding of monetary policy. In the final analysis, the 'words' used for the purpose of external communication must correspond to the 'deeds', i.e. they must clearly convey the *actual* internal policy process, which can ultimately, again, only be judged on the basis of observable outcomes.

The two-pillared stability oriented monetary policy strategy adopted by the ECB Governing Council is not simple, but it is honest. It reflects the special challenges and the high degree of uncertainty inevitably associated with any ‘bold step into the unknown’, a situation much like Alice’s fall down the rabbit hole. We make no claim for *complete* transparency and we do not *pretend* to live in a perfect ‘glass house’. We will continue to try to make ourselves understood, to say what we mean and to mean what we say as clearly as possible. We also stand ready to be judged by the degree of correspondence between what we say and what we do. It will, however, not be possible always to hold us responsible for each and every discrepancy between what other people think we say and believe we do relative to what they are convinced that we ought to be doing. ‘Alice in Wonderland’ makes this point. ‘Alice in Euroland’ demonstrates it.

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