

Mr Noyer's overview on the relationship between politics and central banks

Speech by Mr Christian Noyer, Vice-President of the European Central Bank, on the relationship between politics and central banks to the Estonian Central Bank at Tallinn, Estonia on 3 May 1999.

Introduction

Ladies and gentlemen:

It is a pleasure to be here today. First of all, I should like to congratulate the Estonian central bank on its 80th birthday. This also suggests that I should be modest, speaking as a representative of a central bank which is not even one year old. I am particularly delighted to be addressing the topic of politics and central banks, since this is one of the basic issues in central banking. I should like to explain to you why I think independence from day-to-day politics is crucial for a successful central bank and how this has been achieved in the case of the European Central Bank (ECB). However, independence should not mean isolation. A more open and transparent central bank is more effective. Moreover, in a democratic society accountability for policies is the logical complement to independence. In this context, I shall address the issue of how we pursue our aim to be as open, transparent and responsible as possible. I shall conclude with a brief discussion of the relationship between the monetary and fiscal authorities.

Independence as a cornerstone of central banking

Recently there has been a world-wide tendency to grant independence to central banks. This tendency is evidenced by both practical experience and academic research. By shielding monetary policy decisions from political interference, lower inflation can be maintained without having to give up economic growth. Indeed, in that sense, creating an independent central bank appears to be a good thing all round. The reason for this is that monetary policy-making under the influence of politicians tends to focus too much on short-term considerations. This can easily lead to temporary, non-sustainable accelerations in economic activity, at the expense of lasting increases in inflation and also ultimately a curbing of economic output and increases in unemployment. Politicians all over the world have come to realise this and have decided to remove the temptation to pursue short-term gains - like Ulysses, who asked to be roped to the mast in order to resist the temptation of the sirens' song - and to make their central bank independent. It should be underlined that granting this independence is, as it should be, a political decision. An independent central bank needs a clear legal mandate.

The ECB is one of the most, if not the most, independent central bank in the world. Its independence and that of the participating national central banks is firmly enshrined in the so-called Maastricht Treaty, the Treaty on European Union. This Treaty was concluded by the governments of all the EU Member States and ratified by all their national parliaments. In some cases referenda were held. The 17 members of the main decision-making body, the Governing Council of the ECB, are not allowed to take or seek instructions from anybody, politicians included. Politicians are not allowed to give such instructions. Members of the Governing Council have a term of office of at least five years. The ECB is financially independent and has a clear mandate, laid down in the Maastricht Treaty. Its primary objective is to maintain price stability and, without prejudice to this objective, it should support the general economic policies in the Community, with objectives such as economic growth and high employment.

Independence from politics should not and does not mean isolation from politics. I have already mentioned that granting the ECB independence was a political decision. More generally, the introduction of the euro and the establishment of the ECB constitute a new, important step in the process of European integration which has now been under way for more than half a century. This process is based on the political view that an integrated Europe is in the interest of stability, security

and prosperity. The European integration process is primarily a political process with, of course, important economic aspects and benefits.

It should also be underlined that the appointment of the members of the Executive Board of the ECB, as you may have noticed last year, is a political decision, to be taken at the highest political level, i.e. by the heads of state or government. I should add immediately that the Treaty stipulates that the persons to be appointed should be experts in financial matters. There are also some rules of the game which the politicians must follow in making these appointments.

It is equally important to avoid isolation in the daily conduct of monetary policy. That brings me to the issues of accountability and transparency.

Transparency and accountability

Accountability for policies is the logical complement to independence in a democratic society. The Maastricht Treaty includes a number of provisions in this respect. First, there is the mandate to pursue price stability. This provides a qualitative measure against which the ECB's performance can be measured. We have decided to enhance this by providing a quantitative definition of price stability. In addition to that, we have formulated a quantitative reference value for money growth. One of the aims of publishing our monetary policy strategy is to make our policy decisions transparent. Second, the ECB has to publish an annual report in which, inter alia, the monetary policy of the previous and current year are discussed. The President of the ECB presents the ECB's Annual Report to the European Council meeting in the composition of the Ministers of Finance and Economy (the ECOFIN Council) and to the European Parliament, which may hold a general debate on the basis of the Report. The President and other members of the ECB's Executive Board may be heard by the competent committees of the European parliament. The President has agreed to appear before the European Parliament at least four times a year. Third, the ECB has to report on its activities at least quarterly. It has been decided to go beyond this requirement and to publish a monthly bulletin. It is my view that the main way to achieve accountability is through being transparent and open. In passing, I note that transparency also enhances the effectiveness of the central bank. A central bank that is better understood is also more successful. Apart from the activities I have already mentioned, transparency is achieved in several ways. Every month, immediately after the first of the fortnightly Governing Council meetings, the President and I give a press conference. The conference starts with a comprehensive introductory statement by the President, in which he explains the decisions taken by the Governing Council and the underlying analysis and arguments. This introductory statement is published immediately on the ECB's Internet Web site (www.ecb.int). This is followed by a question and answer session attended by several hundred journalists. The questions and answers are also published on the Internet shortly afterwards. All the members of the Governing Council frequently make public speeches, give interviews and contribute to journals and books. Thousands of people visit the ECB and the national central banks each year and, for our part, we and our staff attend many conferences and other public events.

The ECB has been criticised, sometimes heavily, for a lack of transparency and for being unaccountable. I could not disagree more, as you might expect from listening to me. One of the most important criticisms is that we do not publish the minutes of the meetings of the Governing Council. I would maintain, however, that the introductory statements at the press conferences are similar to what other central banks call minutes, with the difference that we publish these statements almost immediately and other central banks only publish their minutes after a delay of at least a few weeks. In addition, our Monthly Bulletin contains an explanation of recent policy decisions and an extensive account of the economic developments underlying them. What we do not do is publish individual arguments and voting records, for several good reasons. The ECB conducts a single monetary policy for 11 countries and the governors of the national central banks do not represent their individual countries on the Governing Council, but are obliged to base their arguments on euro area-wide considerations. To publish voting records and arguments put forward by individuals would be to risk

undermining their independence by exposing them to national pressure. I do not believe that maximum transparency is the same as maximum information. It would, for example, be rather confusing and not at all transparent to publish a full transcript of the meetings. This would also diminish the frankness and quality of the exchange of views which takes place. I should like to emphasise that our concept of accountability is a collective one. We are accountable for the decisions taken by the ECB's Governing Council as a body. Therefore, our external communication focuses on these decisions and the underlying reasons for them, including arguments for and against. We are convinced that accountability is better served by a clear understanding of the decisions which we take than by a public debate on who are the hawks and who are the doves.

The relationship between the monetary and budgetary authorities

Independence should not rule out communication with politicians. On the contrary, it is important for the central bank to have a regular exchange of information and views with the budgetary authorities. According to the Maastricht Treaty the President of the ECB is invited to meetings of the ECOFIN Council whenever there are issues on the agenda relevant to the tasks of the central bank. The president of the ECOFIN Council and a member of the European Commission have the right to attend meetings of the Governing Council of the ECB. The President of the ECOFIN Council even has the right to submit motions for deliberation. However, neither has the right to vote.

Apart from these formal channels, there are also informal ways of communicating. One of these is through the so-called Euro-11, an informal meeting of the ministers of finance of the 11 Member States which have introduced the euro. The President and I are invited to these meetings and attend whenever there is anything on the agenda which is relevant to our tasks and mandate.

Thus, one side of the coin is a regular exchange of information and views. The other side of the coin is that in any such exchange of information and views the independence and mandate of the ECB should be respected. This means, for instance, that the ECB is not prepared to enter into an ex ante co-ordination of monetary and budgetary policies. We cannot promise ex ante that interest rates will be reduced if budgetary authorities promise to reduce fiscal deficits. The main problem is not even that promises and outcomes may differ, which unfortunately they sometimes do. The basic obstacle to such ex ante co-ordination is that the objective of monetary policy is to maintain price stability and that in setting interest rates to achieve that objective the stance of fiscal policy is only one of the many factors that have to be taken into account. The central bank can never make any ex ante commitment itself in relation to an announced fiscal policy. It can never react mechanistically to a given budgetary policy. Therefore, the so-called policy mix should be the result of the ECB's monetary policy aimed at maintaining price stability and fiscal policies in compliance with the Stability and Growth Pact. In the context of this Pact, EU governments have agreed to reduce their government budget deficits to close to balance or even to create surpluses in the medium term.

Should ministers refrain from speaking about monetary policy in public? My own preferred answer to this question, whatever it might be, is largely irrelevant. Ministers have always tended and will always tend to have views on interest rates and, on occasion, to make their views public. I shall not criticise them for doing so. I shall only note that I am not aware of any minister ever having asked for an increase in interest rates; the request is always for a change in the other direction. I might add that, whereas it is quite usual for ministers sometimes to voice their views on monetary policy, it is more important that the central bank focuses fully on carrying out its mandate of maintaining price stability. This is what the ECB has done, and you may be sure that it will continue to do so.