

András Simor: On the road to the euro – good governance and effective partnership

Concluding remarks by Mr András Simor, Governor of Magyar Nemzeti Bank (the central bank of Hungary), at the Conference “On the Road to the Euro: Good Governance and Effective Partnership”, Budapest, 19 April 2007.

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Ladies and Gentlemen,

I should like to thank you for attending this conference, jointly organised by the Ministry of Finance and the MNB, and sharing with us your valuable thoughts on the forms and possibilities of co-operation between the Government and the central bank on the road to the euro.

- I. The introduction of the euro is a joint enterprise for us. It is not merely a legal obligation we undertook in the treaty of accession but much more than that – a unique opportunity that may enable the Hungarian economy to catch up more quickly and may ensure lasting economic and financial stability. However, we can only exploit the benefits of the common currency if we are well-prepared to enter the gate of Eurozone. In these preparations important tasks that extend beyond fulfilling the nominal convergence criteria devolve upon both the Government and the central bank.
 - a. Above all, the Government must create a balanced budget that allows sufficient room for manoeuvre as a member of the Eurozone to be able to reduce the fluctuations of growth in case of shocks to the economy.
 - b. The central bank has to prepare players in the economy to exploit the benefits arising from price stability as well as possible. We need to learn that our income can only grow at the rate our productivity grows, and inflationary expectations must be anchored.
- II. While we have to perform various tasks on the road to the euro, this is the common interest of the Government, the central bank and all players in the economy, and so we have to help and support each other. As it was emphasised in the speeches here today, the Government and the central bank can co-operate most efficiently and achieve the best joint results if the tasks and the goal to be reached are defined precisely for both parties, but thereafter independence is guaranteed in using the instruments available to attain the set targets.
- III. The central bank’s objectives in inflation targeting were jointly set by the Government and the central bank, bearing in mind the Government’s convergence programme. At the same time, as regards the way to reach the targets and achieve price stability as well as the instruments to do so there was no such unanimity of views between the Government and the central bank. The relationship between the two institutions has not until now been characterised by this situation, called by the experts instrument independence. The difference of opinions was increased by the lack of confidence between the Government and the management of the central bank. This was reflected in that the central bank expressed serious criticism of government policy in issues that were not related to the remit of the central bank as defined by law. On the other hand, the governing parties tried to influence monetary policy also during implementation.

Naturally, the central bank must be accountable. Just like any other company limited by shares, it must manage its resources cost effectively. *In the central bank there should be a responsible manager who is answerable for operation and financial efficiency*, while the owner of the central bank, the Hungarian state, should supervise its management. As regards the administration of monetary policy, however, the accountability of the central bank needs to be placed on another footing. *Clear targets that the Government supports as well need to be set, but the central bank should be afforded the opportunity of using its best expertise in employing the instruments available to achieve these jointly set goals.* The governor of the MNB should not be called to a parliamentary hearing when the Monetary Council raises interest rates but when reaching the target set for inflation is in jeopardy.

- IV. *Independence of the Government and the central bank does not mean there should be no room for coordination*, that we should disregard each other's plans and measures in fashioning our own policy. If possible, we should strengthen favourable processes but, perhaps even more importantly, we should counteract the impacts that could drive the economy off its jointly plotted course. A monetary policy that works efficiently can best support achieving the Government's objectives by more stable growth, a predictable economic environment and the lower risk premium this engenders, which is also reflected in the reduction of the costs of financing the national debt.
- V. In order to make this mutual consideration of each other and working for common goals as fruitful as possible, as well as to allow the other players in the economy to profit to the greatest extent possible from this, the Government and the MNB must adhere to the same two basic values. Our activity should be *efficient and predictable*. The speeches made during the day serve as a guide as to how the Government can improve the efficiency of its expenditure. Introducing a *fiscal regulation* strengthening long-term predictability – reducing implementation risks of fiscal policy – would be of major significance also from the viewpoints of retaining investor confidence and the administration of monetary policy.
- VI. In the central bank as well there are numerous ways to increase efficiency and predictability. We saw from Professor Eijffinger's speech that the predictability of monetary policy favourably influences the performance of the economy. Transparent monetary policy contributes to the creation of an environment with constantly low interest rates. The MNB conforms with the best international practice vis-à-vis the formal requirements of transparency: we have a set target, an inflation report and the minutes of the Monetary Council are published. I see, however, an opportunity to advance further *in clearly explaining monetary policy measures and demonstrating our future intentions. Improving considerations behind monetary policy decisions and forward-looking communication by the central bank* is indispensable for the efficient and predictable operation of the central bank.
- VII. I believe that organisational changes are needed in the central bank to make its operation more efficient than it is at present. Thorough consideration must be given to its organisational structure, the division of duties and responsibilities, and harmonising the spheres of authority for decisions and the necessary competences for good decisions. In part changes improving efficiency can be made within our own area of competence. My colleagues at the MNB are striving to run a rationally structured, smoothly operating institution that handles taxpayers' money with care. There are, however, other measures that go beyond the central bank's remit, and so I ask for Government and legislative support in bringing them about.
- VIII. According to the law on the central bank, the Monetary Council is the principal decision-making body on matters affecting the central bank's core activity. The professional preparations for these decisions are made by the central bank's expert team but, according to the present rules, of the deputy governors directing the work of and representing the expert team only one has a seat on the Monetary Council. This places a restriction on the Monetary Council's access to information in the MNB and to considerations that arise during professional debates among the team, which thereby impedes the efficiency of making decisions. I therefore propose that we create the possibility of *making the ratio of the external and internal members of the Monetary Council more balanced and better adapting to international practice*, and of giving the core activities of the central bank due representation in decision making.
- IX. Professor Gavin Bingham raised the issue of the composition of the Monetary Council being problematic from another aspect. Academic results show that in the area of monetary policy, decisions made by a body are more effective than those made by individuals as the members can deal with the information more effectively and can represent more aspects jointly. At the same time, the marginal utility derived from increasing the number of members beyond a certain point falls quickly, indeed may become negative, as in a large organisation agreeing positions becomes exceptionally complicated and time-consuming; beyond a certain level there is no opportunity to find a consensus acceptable to everyone. This is why I believe that in the long term *it is necessary to reduce the number of members of the Monetary Council*. As we have also heard, in a country the size of Hungary with a non-federal system, a 5 to 7 member Monetary Council is thought to be optimal.

- X. Another important aspect regarding the efficient and predictable operation of the Monetary Council is continuity. One way to promote this is for the *members of the Monetary Council to change gradually over several years*. It would be practical to implant this into Hungarian practice by changing at most 1 or 2 members each year.
- XI. Last but not least, at the central bank, as in every organisation, a balance needs to be created between corporate and individual decisions and responsibilities. While approval of strategic decisions is more fortunate when made by a body, one body making a decision whose implementation encroaches on the competence of another body within the institution needs to be avoided. *It is more efficient if in the area of implementing corporate decisions and in the direction of everyday work individual responsibility is placed in the foreground.*
- XII. *Clarifying the goals, accountability and an efficient decision-making structure.* These are the conditions that produce the appropriate institutional framework for the efficient and predictable running of the central bank, and efficient co-operation with the Government. I believe that the lessons of our conference today will find support in both legislation and in government circles as an efficiently working monetary policy facilitates the ability to plan and achieve budgetary targets, and helps the Hungarian economy meet the prerequisites for acceding to the Eurozone as speedily and at the price of as few sacrifices as possible.

Thank you for your kind attention. Goodbye.