The New Governance in Monetary Policy: A Critical Appraisal of the Fed and the ECB

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The term 'governance' refers to the decision-making processes in the central bank and to the relations between the central bank and the government and/or the elected representatives. Governance comprises the traditions, institutional design, mandate, accountability, communication strategies and processes that determine how power is exercised, how citizens are given a voice, and how decisions are made on issues of public concern.

For the last fifty years, four monetary policy regimes succeeded each other. A special kind of governance corresponds to each monetary policy regime. First, until 1974, for the Keynesian regime founded on the Keynesian synthesis, the government managed directly the economic policy. The monetary policy was only one element of the global policy and under the discretion of the government.

Second, from 1974 to 1982, the Monetarist regime developed the monetary policy rule. Svensson (1999, p.636) calls this monetarist policy rule *monetary targeting*. The monetary policy became self-governing. The rule *versus* discretion debate shed light these both outdated monetary policy regimes. But if the rule (quantity theory of money) must be respected, Friedman said nothing about a specific organisation of the central bank. The theoretical framework changed; not the institutional design.

Third, during the 1980s, the basic Friedmanian policy has evolved with the rational expectations revolution. Kydland and Prescott (1977), Barro and Gordon (1983) or Rogoff (1985) provide new decisive arguments in favour of rule, and against discretion. These are the famous *dynamic inconsistency, inflation bias, reputational equilibrium, strategic delegation to a conservative banker, contract, incentive compatible mechanism.* The New classical Economics (NCE) has developed the Credibility literature to propound alternatives to the rule issuing from the quantity theory of money. The simplified chain of this new regime, called credibility strategy is: Rule – Commitment – Enforcement – Independence – Transparency – Credibility. The great novelty was the institutional design: the independence of the central bank has become a necessity for the credibility. The credibility strategy is minimalist governance, since the central bank is fully independent. Respect of the rule and transparency are enough.

Fourth, at the beginning of the 1990s, the belief in an automatic natural long-term equilibrium disappears with the New Keynesian Economics (NKE) and consequently the theoretical foundations of the rule. If the rule did not exist anymore, the independent central bank needed a new legitimacy. It is the beginning of the importance of the governance in central banking. A single or predetermined equilibrium does not exist, and strong uncertainty makes the management of expectations necessary, so good co-ordination between the central bank, the government and economic agents is therefore essential. This implies a high level of communication and a definition of the objectives of monetary policy accepted by all. There is 'confidence' when there is a mutual understanding between the central bank and the economic agents. The simplified chain of this confidence strategy is: Communication - Common understanding - Governance - Accountability - Confidence.

The generalization after 1990 of the Inflation Targeting and the unique approach of Greenspan at the Fed correspond to the choice of a confidence strategy. The new governance is today the focal point of the modern monetary policy.

The debate rule *versus* discretion is no longer relevant. Credibility *versus* confidence appears to be much more useful for understanding the changes in modern monetary policy. We point out five conflicts between a credibility strategy and a confidence strategy (Le Heron-Carré, 2005a-b): Credibility *versus* Confidence, Independence *versus* Governance, Responsibility *versus* Accountability, Common knowledge *versus* Common understanding, Transparency *versus* Openness.

After a short review of the governance in the successive monetary regime, we will develop the new governance within a comparison of the Fed and the ECB.

I A Short Review of the Governance in the Different Monetary Regimes Since 1960

I.1. The Keynesian consensus

During the 1960's, the Keynesian regime [1] was basically applied everywhere in the 'capitalist world'. The social democrat liberalism, politics and statesmen were the centre of attraction of the economic views. The naturalist or 'spontaneous' view of liberalism was rejected. For Keynesians, the statesman is the only one that can think globally and hence must deal with macroeconomic problems. He is the only one that can make global anticipations and envision an optimal situation. Because of the expectations of economic agents, particularly those of entrepreneurs that do not lead spontaneously to social optimal market equilibrium, the statesman must intervene in the market. Money is not neutral either in the short run or in the long run. Monetary policy is part of economic policy and depends on the government. The central bank is totally under political control and merely implements the decided policy. The national dimension is privileged since it is the legitimate context of economy policy. To deal with international monetary relations in terms of the Bretton Woods agreement, fixed exchange rates are preferable to the market mechanism. It is believed that sufficient quantities of reserves in foreign currencies and a reasonable exchange rate are enough to maintain the autonomy of monetary policy.

Monetary policy is part of the general framework of standard Keynesianism. The IS-LM model did not originally integrate a mechanism of price determination and the Phillips curve completed awkwardly. If the Philips curve is accepted, there is a trade-off between inflation and unemployment. Monetary policy of the Keynesian synthesis follows four principles:
[1] Monetary policy is only an element of a macroeconomic policy trying to fulfil four objectives: the 'magic square'. Monetary policy, fiscal policy, income policy and the management of public debt must be coordinated to fulfil these objectives along with one that gives priority to employment and production. A lot of emphasis is placed on the short term. Internal and external objectives coexist.
[2] Alone, the efficiency of the monetary policy is weak. Monetary policy should be avoided because of its potential negative consequences such as the instability of monetary policy instruments, financial instability, volatility of money demand *via* the speculative motive, liquidity traps and impacts on the balance of payments.
[3] The instrument is the money supply and the objective is a low and stable interest rate. The impact of monetary policy travels through the interest rate channel and the credit channel by changing the liquidity position of financial institutions. This impact, however, is judged weak and slow to manifest itself: *'One cannot push a string.'* [Porter Commission, p. 496]
[4] Official control of quantity is usually preferred to price control in the credit market and the foreign exchange market. Moreover, selective policies are justified.

For the Keynesian monetary policy, there is no governance but a government.

I.2. The Monetarist consensus

The Monetarist model imposed itself progressively during the 1970s and corresponded to a renewal of a naturalist walrassian economics based on a modified quantity theory of money. The general framework of natural laws leading a real economy to general market equilibrium was again accepted. However, following the dichotomous principle between monetary and real spheres, money does not depend on natural laws. Money is credit money and thus, as a creation of men, the market cannot manage it. Money is only neutral in the long run and, therefore, it is the role of monetary authorities to neutralize money in the short run. Inflation is only a monetary phenomenon.

Due to institutions like money, the statesman is useful to preserve natural equilibrium. The use of money for short-term objectives must be completely avoided as it is unnecessary in the long run because of natural equilibrium and would disturb the economy by causing inflation. The national aspect should be given priority.
[1] Since money should not be regulated by the government for a short-term objective and cannot be managed by the market, the central bank and technicians of money are entrusted with the aim of neutralizing money *via* a simple quantitative rule. The money supply should grow at a rate equal to the natural growth rate of production, which is dependent only on real factors.
[2] Monetary policy is effective and useful but only for one long-term internal objective: the control of inflation. Monetarists want a strict monetary discipline *via* the respect of this rule.

[3] The instrument is the short-term interest rate and the objective is the stabilization of the money supply as measured by aggregates (monetary base or monetary aggregates). The rate of interest can be changed rapidly and abruptly. The surprise effect may work. The demand for money and the velocity of money are assumed stable in the long run. This stability is reinforced if the money supply is stabilized.

[4] One has to choose a flexible exchange rate system. The external stability of money (exchange rate) is the result of internal stability (no inflation).

In its pursuit to systematically take the opposite view of Keynesianism, Friedmanian Monetarism takes many characteristics from it, a little like Marx with Ricardo. Macroeconomic analysis gives priority to economic policy and through that: the national aspect, non-neutrality of money (in the short term), institutional and historical approaches to money, consumption function linked to permanent income, importance of the interest rate, etc. To apply the monetarist framework, we did not need an independent central bank, but only a monetarist government.

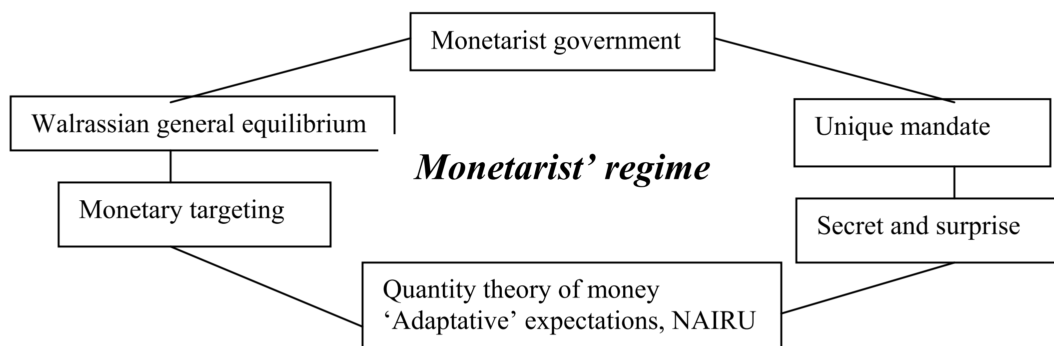

Figure 1 Monetarist regime

If Monetarism was rapidly accepted, it was subsequently rapidly rejected also at least in its initial form. According to Goodhart (1991, pp. 275-7), the macroeconomic conditions that generated a consensus around Monetarism disappeared after 1982. The demand for money was increasing and unstable. The velocity of money became unpredictable. The main target of money supply could no longer be calculated. As a Bank of Canada manager remarked in 1982: *'We did not abandon M1, it was M1 that abandoned us'*. This was the end of the perfect automatic transmission mechanism, via M3. New channels of transmission appeared in the literature and made monetary policy more complex.

1.3. The Credibility Strategy

In the 1980s, a new system in monetary policy began to appear: the credibility strategy. Credibility has evolved from new classical economics to propound an alternative to the rule issuing from the quantity theory of money. The credibility framework is a synthesis of Monetarism and the NCE, especially with the rational expectations hypothesis. The rational expectations school strengthens the binding commitments to the natural equilibrium. The credibility literature starts with Kydland and Prescott (1977) and their *time-inconsistency* and *inflation bias*, continues with Barro and Gordon (1983) – that is, *reputation* as a solution to time inconsistency, and ends with Rogoff (1985) –

strategic delegation to a conservative banker, Walsh (1995), Svensson (1997) or Woodford (2003) – neo-wicksellian approach to found a theoretical framework for the rate of interest gap.

The fundamental assumption of the monetarist and the NCE framework is the existence of a single long-term natural equilibrium (with exogenous and neutral money). The central bank knows this 'true' model of the economy and its credibility comes from the respect for this. The rule is founded on the belief in this natural equilibrium model. A fixed rule can be interpreted as a commitment to respect the 'true' model of the economy. As agents are representative and hold rational expectations, everyone knows the same model. They can observe if the central bank is respecting it. That is why there must be an automatic and unconditional commitment to the rule. Monetary policy is, therefore, a technical and economic problem. The different Taylor' rules are the last attempt to find the miraculous solution: an automatic way to determine the monetary policy. But this kind of rules is in the best way an ex-post analysis, never an ex-ante continuous decision-making process. The times are always changing. A good Taylor rule works when it is useless (stable economic conditions) and it is inefficient when it is useful (exogenous shock for instance).

There is a vertical and hierarchical relationship between the central bank and economic agents, because there is no interaction. They both refer to the same model, which is *common knowledge*. There is no communication: the common knowledge is sufficient for expectations' co-ordination and anchorage. It builds expectations; it is a *benchmark* for policymakers and agents. Full independence is the *enforcement* of the natural price stability-oriented and long-term oriented strategy, and its related culture of stability and neutrality of money.

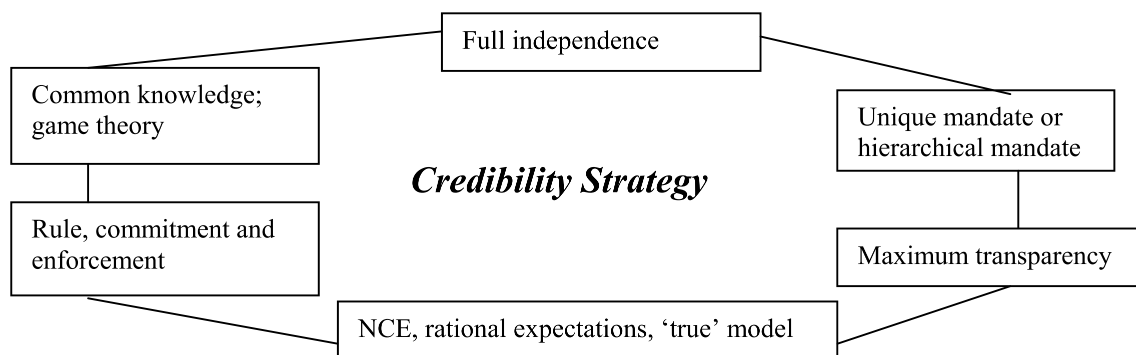

Figure 2 Independence for Credibility

The model of the economy imposes a rule on the central bank, which takes a commitment to respect it and credibility follows at once. As the true model is a common knowledge for all economic agents, complete transparency is possible and required for credibility. To avoid the inflation bias of governmental policies, the independence of the central bank becomes obviously imperative. As money is neutral in the long-run, there is no problem of democracy. The monetary policy is only a technical problem, of respect for the rule. A central bank assumes responsibility only for the respect of unique mandate: inflation.

By a strategy of 'credibility', we mean that a central bank that adopts a model of behaviour and then follows it. It says what it does, and does what it says. The simplified chain of the credibility strategy is: Rule – Commitment - Enforcement - Independence - Transparency - Credibility. As summarised by Blinder (2000, p.1422): '*A central bank is credible if people believe it will do what it says*'.

The great novelty was the institutional design: the complete independence of the central bank has become a necessity for the credibility. The credibility strategy is minimalist governance, since the central bank is fully independent. Respect of the rule and transparency are enough.

I.4. The New Governance of the Confidence Strategy

The beginning of the governance in monetary policy

At the beginning of the 1990s, the belief in an automatic natural long-term equilibrium disappears with the New Keynesian Economics (NKE) and consequently the theoretical foundations of the rule. If the rule did not exist anymore, the independent central bank needed a new legitimacy to found its strategy of monetary policy. It is the beginning of the importance of the governance in central banking. The generalization after 1990 of the Inflation Targeting and the unique approach of Greenspan at the Fed correspond to this evolution. Inflation targeting refuses the rule in monetary policy and tries to anchor directly the inflation expectations of the economic agents. Inflation targeting is not a theory but a policy framework and a communication strategy (Bernanke, 2004b). A single or predetermined equilibrium does not exist, and strong uncertainty makes the management of expectations necessary, so good co-ordination between the central bank, the government and economic agents is therefore essential. This implies a high level of communication and a consensus on the more prominent objective of monetary policy. There is 'confidence' when there is a mutual understanding between the central bank and the economic agents. The simplified chain of this confidence strategy is: Communication - Common understanding - Governance - Accountability - Confidence. With the confidence strategy, the governance is today the focal point of the modern monetary policy.

The New Keynesian counter-revolution

The confidence paradigm is founded upon the New Keynesian counter-revolution. It leads to a great shift in the nature of the economic environment in which the central bank operates. '*Uncertainty is not just an important feature of the monetary policy landscape, it is the defining characteristic of that landscape*' (Greenspan, 2003, p.1). In this literature, monetary authorities are supposed to regulate the economy that is, to try to co-ordinate agents and to 'convince' expectations. By denouncing the 'natural' single long-term equilibrium, there is no longer a theoretical or natural anchor for expectations. In order to avoid co-ordination failures, monetary institutions have to propose a focal point. A focal principle is one which, followed by everyone, involves the determination of a unique strategy. But, since there is no 'true' model, it could only be a procedural anchorage for expectations. To be accepted, this focal point has to undergo a social process of legitimacy. Central banks and

agents interact, forming an interactional learning process. The new governance is the framework of this legitimacy.

Rejecting rational expectations, New Keynesians developed different conceptual tools in order to understand expectations formation: self-fulfilling prophecies, bootstraps, animal spirits, sunspots and beliefs. With uncertainty, we cannot implement optimal rules or contracts. Because of imperfections and uncertainty, central banks and agents are in constant interaction. Monetary policy is seen as a co-ordination process. This co-ordination differs from the non co-operative conception defended by the credibility framework.

With the New Keynesians, the explanation of inflation goes over from money to expectations. Money is no longer neutral. There is no natural rate of inflation (NAIRU). In accordance with Greenspan (1996), the confidence paradigm considers inflation is an expectational phenomenon. Price stability is '*when economic agents no longer take account of the prospective change in the general level price level in their economic decision-making. …. By price stability, however, I do not refer to a single number as measured by a particular price index*' (Ibid, 2001, p.2).

The foundations of the governance

Full independence produced a 'democratic deficit' that is eliminated in the governance arrangement. Governance organises the relation between elected representatives, the government, the economic agents and the central bank. In a 'checks and balances' arrangement, governance balances the subservience of monetary policy to elected representatives on the one hand, and independence limited to instruments on the other. Governance counterbalances independence and accountability.

In a democracy, the central bank should be accountable first to elected representatives. It differs from full independence that pretends to be directly responsible to the general public, via transparency. On the contrary, there is an effective accountability in governance. Openness better suits central banks' practice than transparency. Central banks cannot be fully transparent. With openness, central banks just open a window, for complete transparency could be counterproductive. A central bank practising openness in a democratic society could be called a communicational central bank, that is to say a central bank that tries to build a consensus of the public on its monetary policy decisions. The common understanding creates the confidence link between the central bank and the agents. When viewed as a link between the central bank and public, confidence can offer different states. Confidence is a mix of verticality (social norm) and horizontality (endogenous). The conceptual tool of focal point summarised such configuration.

(1) Vertical confidence raises the question of monetary sovereignty and central bank legitimacy leads to the question of governance. The central bank's statutes, mandate and actions should be consistent with the principles, procedures and performances of democracy. The key point is that the central bank needs legitimacy to propose a focal point. It actually produces a common standard (norm) for co-ordination. In the credibility framework, independence is aimed at ensuring a

formal commitment to a technical rule. Governance relies on a democratic commitment to the dual democratic mandate.

(2) In an uncertain economic environment, the key problem is that agents and their expectations are heterogeneous. Specifically, it leads to a special emphasis on the belief-formation process and beyond on co-ordination-formation process. Co-ordination also can be produced by focalisation (endogenous), creating an autonomous collective belief (self-fulfilling prophecies). In this case the confidence strategy is horizontal.

For example, the central bank must sometimes follow the market convention. During a crisis, a new convention forces itself upon the central bank. For the financial markets opinion, it is rather a question of convention than a question of legitimacy. In this complex interaction between the central bank and markets, it is sometimes difficult to know who decides. Investigating this theoretical field, some authors describe beliefs-co-ordination as 'a signal-extraction problem' (Andolfatto, Gomme, 2003, p.4). A good illustration for these findings could be the famous signals of Greenspan towards markets. In uncertainty, we can figure out expectation-formation in terms of beliefs inference.

The governance framework

Confidence introduces a political revival in central banking. The confidence strategy starts from the evidence that the central bank is embedded in a larger democratic system. It pursues the idea that accountability is a *quid pro quo* for independence. Independence is balanced by democratic accountability, we talk about 'governance'.

Accountability is not a pure technical question, but a democratic issue. It is connected to openness because accountability means that the central bank is accountable for its action to democratic authorities, and has to take into account its democratic mandate in its day to day action. Ultimately, accountability highlights that there is no clear evidence on the benefits of total independence. It is a tough question for members of the Fed, as Meyer (2000, p.4) says: '*there is no consistent evidence of a relationship between central bank independence and real economic activity nor consistent evidence that central bank independence lowers the cost of reducing inflation or increases the effectiveness of stabilisation policy*'. A central bank is actually an independent institution with unelected officials. Central banks earn legitimacy not by the ballot box, but by procedures of accountability. As Ferguson (2002, p.2) points out: *'Such democratic accountability is even more important for central bankers, because the voting populace does not directly elect them'.* Democratic accountability reveals a mutual dependency between agents and central banks (the confidence link).

In addition to the reduction of the asymmetry of goals, a dual mandate would also facilitate the co-ordination of fiscal and monetary policies by reducing the co-ordination failures. A dual mandate signifies the reduction of monetary policy predominance over fiscal policy - that is to say the predominance of the price stability objective over the economic stabilisation objective. The confidence strategy imposes the combination of monetary policy with other policies - that is to say a policy mix.

Governance includes the institutional design, the accountability and the communications strategy. Governance must take into account four levels:

(1) The decision-making processes in the central bank (institutional design):
- Organisation of the monetary policy committee (MPC): collegial, individualistic (New Zealand), insiders/outsiders in the composition, etc
- Communications strategy: publications, statements, report, minutes of the MPC, speeches of the members the MPC
- Number of meeting of the MPC with the possibility to change the policy

(2) The relation between the central bank and the elected representatives and/or the government (institutional design)
- The mandate (unique, hierarchical or dual, explicit or implicit) from the Parliament or the government and the strategy for the medium or long-term
- Nomination of the Governor and of outsider members of the MPC
- Compulsory publications and speeches
- Override procedures in case of exogenous shock, of non-respect of the mandate
- Sanctions in case of non respect
- Institutional scheduling and period of renegotiation with the elected representatives

(3) The management of the relation between the central bank and the general economic policy
- Balance of risks (unemployment, inflation, etc), explanation of the tactical deviation (short-term) from the strategy
- Policy mix; short-term co-ordination
- Regulation of the financial markets (bubble, crash)

(4) The management of the relation between the central bank and the general public
- How decisions are made on issues of public concern (Entrepreneurs, households,…)
- Common understanding
- How the central bank find a compromise between groups with divergent views

The levels 2, 3 and 4 correspond to the accountability of the central bank.

The confidence strategy

The confidence strategy indicates a revival of politics in central banking. It is simply a reminder that the central bank is a creature of the democratic authorities that serve the public. Because central bankers are not elected by the public, they must be accountable to and under the control of elected representatives. The confidence strategy proposes to combine democracy and economy, communication and action. There is ‘confidence’ when there is a mutual understanding between the central bank and the economic agents. This ‘common understanding’, which implies a high level of communication, can be understood on two levels: in the first place one takes into account the opinions of the other party and, second, the expectations of the economic agents are similar to the strategy and conventions of the central bank. Therefore, it is possible to have credibility without confidence. The

simplified chain of the confidence strategy is Communication - Common understanding - Governance - Accountability - Confidence.

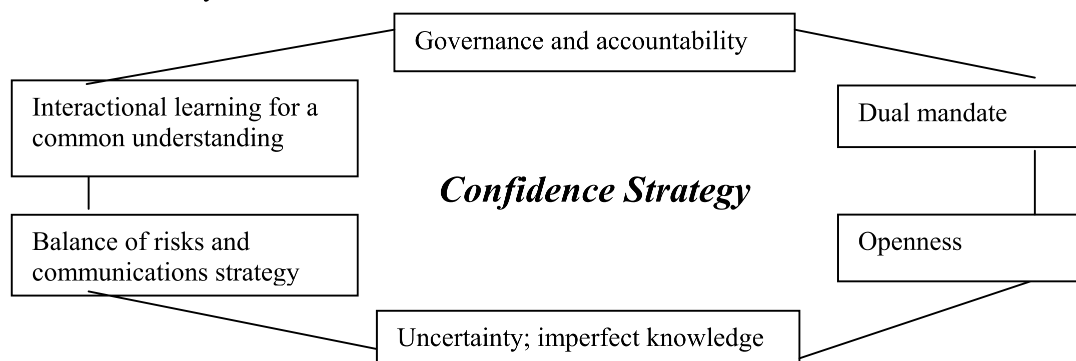

Figure 3 Governance for Confidence

II INDEPENDENCE OF THE ECB VERSUS GOVERNANCE OF THE FED: A CRITICAL APPRAISAL

Governance is the delegation of power, not the separation of power as with full independence. Governance aims to balance the independence of instrument and the dependence of goal. It means that independence is always limited in a representative democracy because it remains subservient to the elected representatives who define the mandate. Independence is linked to the credibility strategy since governance is linked to the confidence strategy. Credibility versus confidence appears to be useful for understanding the changes in monetary policy and the differences between the governance of the ECB and the governance of the Fed.

Inflation targeting stands out as the dominant regime in monetary policy today, but only the middle-sized powers (New Zealand - 1989, Canada -1991, Great Britain - 1992, for example) develop this policy, while the ECB and the Fed prefer to go their own way. The ECB is a creature of central bankers and follows an out-to-date 'credibility strategy'. The ECB is a 'new Lady in old clothes' (the credibility literature of the 1980s). On the other hand, the Fed is a creature of Congress and has changed dramatically since 1994. The Fed's strategy of 'balance of risks' can be defined as an up-to-date 'confidence strategy'. We shall analyze these both antagonistic central banks to understand the new governance, as defined above.

II.1. ECB: an extraordinarily full independence

The ECB claims that 'maximum' or 'full independence' is a condition for implementing and maintaining price stability. 'When exercising their powers and carrying out their tasks and duties, neither ECB nor any NCB (National Central Bank) nor any member 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' (Article 108 of the Treaty).

A creature of central bankers: the self governance

Unlike the Bundesbank [Buba], the ECB was not founded on the civil society. But the ECB is based on the same theory of an economic order independent from the political order (Scheller, 2004, pp. 121-5). Full independence of the ECB is the institutionalization of a monetary sovereignty. The specific German ordoliberalism cannot be directly applied to a supranational central bank such as the ECB. The Buba rests upon a constitution while the ECB is the result of a simple treaty. A simple majority in Parliament could change the Bundesbank law. ECB's mandate cannot be changed by the European Parliament. The novelty is that the economic order is radically independent from the political order. Moreover, ECB's statutes are difficult to shift because the modification of the treaty requires a unanimous vote of Euroland members.

The Buba had a social role to play: to safeguard a common good – namely, money. The ECB has two economic or technical tasks: first, to ensure price stability; and second, to support the general economic policies in the European Community. While the Buba was the inheritance of the German hyperinflation crisis of the1920s, the ECB is a consequence of the theoretical dogma of independence that emerged in the 1980s. The Buba's case illustrates that central banking is a political question. The Buba could anchor inflation expectations because it had a democratic role derived from the doctrine of ordoliberalism.

In the ECB literature, full independence is a requisite for ensuring price stability, which is presented as a public good (the common good of the Buba was money): 'The ECB's independence is a corollary of its primary objective of maintaining price stability' (Scheller, 2004, p. 121). With price stability, the ECB tries to preserve the inheritance of the disinflationary credibility earned during the 'fight' against high inflation. Price stability is presented as the wisdom of central banking inherited from 'the great experience of the 1960-1970s'.

Today, the ECB is a special kind of central bank, since it follows strictly the credibility literature of the 1980s. It is not a creature of elected representatives, but rather a creature of the folk wisdom theory of central bankers. From a theoretical point of view, the full independence of the ECB results from time inconsistency, institutional design (Persson and Tabellini, 1993) and the 'free lunch' literature. 'This evidence points to a potential free lunch: delegating monetary policy to an independent central bank with a clear price stability mandate leads to lower and less variable inflation without increasing the volatility of output' (Issing *et al.,* 2001, p. 130).

Full independence is a maximum interpretation of Rogoff's solution (1985): delegation and the conservative central banker. Delegation becomes insulation from political oversight. The ECB's full independence aims to serve its own interests: namely its reputation and its credibility. The ECB scheme does not organize the delegation, but rather the separation of monetary policy from the democratic order. To avoid short-term political pressures (time inconsistency and inflation bias), monetary policy (a political issue) moves to central banking (a technical issue). Full independence

leads to a strict separation of power, but not in order to achieve a balance of power. There is a democratic deficit.

The monetary policy committee is the Governing Concil with currently 18 members: 12 national central banks' governors (a maximum of 15 after the future enlargement) and only 6 from the Executive board. More, 3 members of the executive boards were before governor of a central bank. It is the case of the governor Trichet who comes from the Bank of France and before with Duisenberg. The monetary policy committee is under the control of the central bankers.

In the institutional design approach, the ECB's credibility is established as soon as a credible commitment to price stability is achieved. But in the credibility literature, commitment technology such as a rule (for example, quantity theory of money for monetary targeting) is insufficient to ensure credibility. In order to impose the optimal incentive structure, enforcement is required. Full independence is a constitutional law, which is extremely costly to change. So it derives from the credibility scheme: Rule - Commitment - Enforcement.

The discrepancy between full independence and accountability

Responsibility means that the central bank, and not elected representatives, has the ultimate responsibility for monetary policy in society. On the other hand, accountability reveals a mutual dependency between agents and central banks. This link of confidence rests notably on the possibility of sanctioning the central bank (override procedure).

The ECB (Trichet, 2004, p. 1) states that 'In a democracy, transparency and accountability are the quid pro quo for that independence', but full independence is inconsistent with accountability. Yet, in the responsibility approach of the ECB, effective accountability by elected representatives is impossible because it would entail its independence:

> 'If any political body – such as parliament or government – were able to intervene or influence directly the policy-making of the central bank, they would actually be taking part in the decision-making process itself and hence would share the responsibility for the policy outcomes. This would not only contradict the independent status of the central bank, but it would also render the concept of accountability meaningless'. (Scheller, 2004, p. 126)

Not only is the ECB fully independent, but the Stability and Growth Pact makes it possible to avoid the free rider and chicken game (budgetary expansion with monetary restriction) by enforcing budgetary rules. The European policy mix is dominated by monetary policy without any flexibility. For the ECB, accountability is only judged by the general public on the announced objective of price stability. 'Accountability' appears only twice in the title of a speech of an ECB board member – once each in 1999 and 2001. Accountability is not a leading concern for the ECB, while 'transparency' is used intensively.

An ineffective parliamentary accountability

The ECB is accountable to the European Parliament in the procedure of 'quarterly monetary dialogue', but it is only a formal accountability. The Parliament can change neither the ECB's law nor

its objectives or targets. It can neither remove the central bankers nor put a sanction on the ECB. There is no override procedure. It is an effective dialogue, but not an effective democratic accountability. 'Formal sanction mechanisms would be too blunt and would have potentially negative implications for the efficient fulfilment of the central bank's mandate' (ECB, 2002, p. 47).

The European Parliament has limited power, which consists in the ability to call the president and other members of the ECB board to discuss EMU monetary policy (Art. 109b). The candidates for the ECB board must appear before the European Parliament prior to their appointment. The Parliament has the right to give an opinion on their appointment (Art. 11, ECB Charter), with the exception of the president. Consequently, only Executive Board members can be accountable to the Parliament. Yet since the Parliament has only a consultative role, it is accountability without power. As Buiter (1999, p. 23) puts it, what is required is 'a European Parliament with teeth'.

Ecofin with extended prerogatives could be an appropriate arrangement to reduce the democratic shortages of the ECB. It represents a fiscal government that could take part in a dialogue with ECB in order to elaborate a policy-mix and to avoid the restrictive bias of the Stability and Growth Pact. But currently a policy-mix is impossible.

A fascinating archetype of responsibility

The ECB has developed a peculiar way of building its legitimacy. It rests on two pillars: the belief in the neutrality of money in the long run; and technocracy. First of all, money does not really matter. Inflation is a monetary phenomenon, justifying the mandate on price stability. The best gift from monetary policy to the general public is price stability. With neutral money in the long run, full independence does not imply a democratic shortage, while monetary policy becomes only a technical problem: inflation. Second, central bankers are experts. They are wise people who have to be insulated from the short-sightedness of politicians. This explains its full independence and the rejection of democratic accountability. The ECB claims to be directly responsible to the general public at large, and not indirectly via elected representatives. This direct responsibility is justified by indirectly effective democratic accountability, which is counter-productive in its reduction of independence and its credibility. Direct responsibility to the public is an elegant way of earning legitimacy without passing through the traditional legitimacy by democratic oversight or subservience to elected representatives. Parliamentary sanctions are replaced by a simple public scrutiny as a way of earning legitimacy.

This is not a fair argument, for two reasons. First, it contradicts our representative democracies (a political body is generally indirectly responsible to the public, via its elected representatives). Second, the public does not have any direct legal or constitutional power over the ECB. The public cannot change the monetary policy orientation, even if it disagrees with it. The ECB is responsible for price stability and not accountable for its economic policy.

The ECB asserts that democratic accountability is unfeasible: the ECB is an unconventional supranational central bank; there is no government in the EU; and the European Parliament has not

written the Treaty on the ECB. So the Parliament does not have the power to modify its Statute. From their own viewpoint, the ECB is only responsible to those who have voted for the Treaty – that is European citizens. For the ECB, accountability is nothing other than a duty of communication: 'Accountability is the legal and political obligation of the ECB to explain and justify its decisions to the citizens of Europe and their electoral representatives. Accountability is enhanced by a high degree of transparency' (ECB, 2002, p. 45).

Using credibility literature, the ECB justifies its doctrine of full independence cum responsibility through the principal-agent theory. In this delegation approach, the principal is the democratic authority (government or Parliament). However, the ECB's approach is based on political authority rejection, the public is the principal in the contract: 'A clearly defined mandate lies at the very heart of the aforementioned "contract" between the people and the independent central bank' (ECB, 2002, p. 50). The problem arises because the people did not write the Statute and did not give the mandate to the ECB. It explains why the ECB has a commitment to transparency and price stability, and not a commitment to a mandate as has the Fed. The people monitor the ECB's performance through the definition of price stability: 'It created a benchmark against which its performance can be assessed' (ECB, 2002, p. 50). But without any public sanction in case of non-fulfilment, the transparency on price stability does not confer a public legitimacy, it only 'imposes self discipline' (ECB, 2002, p. 61) on the ECB.

The lack of ECB' communication

Since the ECB focuses on monetary transmission channels and not expectations channels, communication is not an important side of monetary policy. Communication is only the need for transparency: you are supposed to 'say what you do and do what you say'.

> 'price stability is unambiguously assigned overriding importance. This provision reflects a broad consensus existing in the economic discipline that the maintenance of price stability is the appropriate objective of monetary policy. The consensus is rooted in the belief that monetary policy makes its best contribution to overall economic welfare by maintaining price stability.' (Issing, 2001, p. 7)

We shed light on the lack of robustness of such a 'divine coincidence' between inflation stabilization and output stabilization promoted by the price stability strategy.

Fully independent, the ECB can benefit from communication restricted to transparency. Nevertheless, the ECB (Issing *et al.,* 2001, p. 39) makes a critical appraisal of the Fed's communication. It considers that the Fed has a secret strategy that is counter-productive (and even perilous) for central bank credibility, since it depends on the president's personality. The Fed does not have an explicit nominal anchor, but a personal anchor: the Chairman - Greenspan.

ECB: the pitfalls of 'maximum transparency'

The ECB defines transparency as

> 'an environment in which the central bank provides in an open, clear and timely manner all relevant information on its mandate, strategy, assessments and policy decisions as well as its procedures to the general public and the markets. Transparency is ultimately about the genuine understanding by the public of the entire process of monetary policy-making.' (ECB, 2002, p. 59)

The ECB associates transparency with efficiency, accountability, predictability and effectiveness. More generally, it is related to 'effective communication' (ECB, 2002, p. 59).

The ECB states frankly: 'We mean what we say … even if we have perhaps not always been entirely successful in saying what we mean' (Issing, 1999, p. 505). Transparency is honesty. It clarifies the underlying policy framework of its interest rate setting. By showing a pragmatic monetarist model of the economy, the ECB attempts to improve both its reputation and its credibility. With transparency, the ECB wants to avoid time inconsistency – that is, surprise inflation. Previously, with monetarism, secrecy was aimed at reinforcing monetary policy efficiency with independence and surprise, but today, transparency aims at anchoring expectations by displaying a credible rule-like monetary policy. It is generally agreed that old fashioned secrecy was a way for non-independent central bankers to free themselves from the government (Mishkin, 2004, p. 1). Transparency is the new means used by the ECB to increase its independence from elected representatives.

Transparency is of the first importance for the ECB's legitimacy, and practically synonymous with accountability. Fully independent, the ECB does not benefit from democratic accountability: 'A high degree of transparency helps to ensure accountability to the public' (ECB, 2002). Direct responsibility to the public, through transparency, can be a substitute for democratic accountability to elected representatives.

Transparency does not mean understanding

In the literature, we find three kinds of criticisms about the ECB's communications. First, its explanations, through the two-pillars strategy, are unclear. Second, the ECB only communicates on inflation while at the same time focusing on other objectives, such as growth. It is not transparent. Third, the ECB does not communicate enough with financial markets.

Even Issing recognizes that full transparency is impossible, and prefers to talk about maximum transparency, which could be viewed as the folk wisdom of central banking: 'do what you do, but talk only about inflation' (Faust and Henderson, 2004). Communication is supposed to clarify, not to obscure the mandate and the strategy.

Fully independent, not accountable, with a weak communication, there is not a true governance at the ECB. The ECB is a creature of the central bankers; it is a self-governance. The links are cut with the political power (European Commission, European Concil, European Parlement) and with the general economic policy (Ecofin). At the time the general public is essentially concerned by the unemployment, but the ECB speaks only on inflation.

II.2. The Fed: the challenge of central banking in a democratic society

The Fed is embedded in a larger representative democracy. It benefits from an instrumental independence, but not independence for the objectives, remaining subservient to elected representatives. It is typically a governance arrangement. Kohn (2005, p. 4) [3] talks about 'the governance of central banks in democratic societies'. 'A central bank in a democratic society is a magnet for many of the tensions that such a society confronts. Any institution that can affect the purchasing power of the currency is perceived as potentially affecting the level and distribution of wealth among the participants of that society, hardly an inconsequential issue' (Greenspan, 1996, p.1).

A 'Creature of the Congress'

The Fed rejects both time inconsistency and free lunch theories: 'I have never found the literature on time inconsistency particularly relevant to central banks … There is no consistent evidence of a relationship between central bank independence and real economic activity nor consistent evidence that central bank independence lowers the cost of reducing inflation or increases the effectiveness of stabilisation policy' (Meyer, 2000, pp. 3-4).

Delegation of monetary policy by democratic authorities does not mean insulation from politics. The Fed's independence is the production of elected representatives, not of economic theory. It has a limited delegated power: 'the Fed independence is a product of congressional legislation and can therefore be diminished at the will of the Congress' (Meyer, 2000, p. 16). The Fed represents a political revival in central banking. It is a break with the consensus on independence in the 1980s that led to the full independence of the ECB.

Regarding democracy, the difference between the ECB and the Fed is important: the 'central bank exists to serve the society' (Blinder, 1996, p. 8). The Fed is a 'creature of the Congress' (Meyer, 2000, p. 6), because it remains subservient to elected representatives. So it benefits from political legitimacy. This legitimacy process is strengthened by democratic accountability procedures. It explains why accountability is a key element of central banking: central bankers 'are accountable both to the Congress from which we derive our monetary policy mission and, beyond, to the American people' (Greenspan, 2001, p. 1).

The FOMC has 19 members but only 12 vote: 7 from the board of the Governors and only 5 from the regional central banks' presidents. Voices of the outsiders are prominent, in opposition to the ECB. More, the Governor is generally not a President of a regional central bank. It is more often a practician (Greenspan) or a theoretician (Bernanke).

For the Fed, independence should be limited by a checks and balances scheme. In this government arrangement, balancing independence and accountability restricts independence.

To sum up, full independence of the ECB leads to a political separation of the monetary order in the name of a technical legitimacy. The economics of central banking justify missing politics. Full independence is a requisite for disinflationary credibility. The consequence is a democratic deficit. It differs from the governance of the Fed that rests on a delegation of power. Legitimacy is primarily

political. Governance insists on the politics of monetary policy and on the democratic founding of the Fed that explains its democratic device for prosperity.

The Fed argues that the time-inconsistency problem and, generally speaking, the credibility literature, are second order issues. Its strategy of 'balance of risks' can be defined as a 'confidence strategy'. It is now a commonplace that the Fed is no longer 'cryptic' or leading an informal '"just do it" strategy' (McCallum, 1995). It has changed since 1994. The Fed's efficiency stems from explanations (deliberative process) that allow the building of a common understanding between itself and market participants. In contrast to the ECB, the Fed does not pursue a reputation of providing a culture of stability – that is, credibility for low inflation. People have confidence that the Fed will be aggressive in response to shocks – that is, to lead stabilization policies that maintain prosperity. Hence, the Fed has a social role to play, 'regulating public conflict over inflation's redistributive powers' (Faust, 1996, p. 267).

The Fed: effective democratic accountability

The Humphrey-Hawkins procedure produces an effective accountability with a double meaning. First, there is the subservience to potential sanctions for the central bank. Presentation of the Fed's president in Congress is an effective testimony for the Congress can abolish or remodel the Fed by a simple majority. Second, accountability has an economic effect: it has an impact on market participants' expectations. This communication reduces significantly uncertainty among financial markets (Kohn and Sack, 2003). The Humphrey-Hawkins procedure reveals that political pressure on monetary policy is orientated towards more accountability from the central bank, and not towards more over-expansionary policy (time inconsistency). In the case of the Fed, accountability is the way that democratic authorities exercise their control over the independent body to which they delegated their power: 'Accountability is the critical mechanism for ensuring both that the central bank is operated in a way consistent with democratic ideals and that the central bank operates under incentives to meet its legislative mandate for monetary policy' (Meyer, 2000, p. 10).

The Fed has a democratic and institutional commitment to its mandate. Monetary policy is not rule-based on economic laws but is founded on democratic principles. However, the people do not elect central bankers directly. Legitimacy is not obtained by the ballot box, but by procedures of accountability: 'Such democratic accountability is even more important for central bankers, because the voting populace does not directly elect them' (Ferguson, 2002, p. 2). Realized by elected representatives, accountability acts as a transfer of democratic legitimacy. The Humphrey-Hawkins testimonies appear to be a procedural institutionalization of the Fed's legitimacy.

The ECB exercises its direct responsibility towards the public by monitoring its performance on the definition of price stability. It is radically different from the Fed, which is democratically accountable to Congress – which verifies the accordance with its mandate with no quantification or prioritization of the objectives. In a representative democracy, accountability exists primarily to ensure the subservience of the central bank to the elected representatives.

The 'quiet revolution' of the Fed in the 1990s: the dual mandate and communication

For the Fed, monetary policy is a 'deliberative process' (Ferguson, 2002, p. 4) between the central bank and the agents. The Fed's influence on expectations is defined as a 'discussion' (Kohn, 2005, p. 3) or a 'conversation' (Goodfriend, 2004, p. 16). The Fed's communications strategy intends to 'improve the public's understanding' (Kohn, 2005, p. 1). The Fed demonstrates that the expectations channel and communications strategy are intimately related. But the Fed puts priority on action. Communication is not a goal per se, it is aimed at enhancing action: 'Actions speak louder than words', but 'actions and words likely speak louder than actions alone' (Thornton, 2002, pp. 11-12). The Fed underwent a 'quiet revolution' in the 1990s. The turning point was around 1994. First, the Fed began to reveal its actions in real-time. Second, it started to implement a fully explicit interest policy (Goodfriend, 2004, p. 16). Third, there was the 'Jackson Hole incident', when Blinder broke the 'Secret of the Temple'. Blinder simply announced publicly that Greenspan was following the dual mandate, and that he was a hawk not only on inflation, but also on employment. It was necessary to return to the democratic mandate of the Fed: Congress had imposed multiple goals without a hierarchy or quantitative numerical definitions. Abolishing the primacy of price stability, the Fed promoted this dual mandate.

Common understanding is a critical issue, since the central bank does not perfectly control inflation. Communication is regarded as a framework and an instrument of monetary policy, as it intervenes in the expectations formation process. Numerous papers from the Fed demonstrate the efficiency of the combination between action and communication, open market and 'open mouth' operations. The latter are complementary tools in monetary policy (Gurkaynak *et al*., 2004). The central bank cannot achieve its objectives without public support– that is, without convincing inflation expectations: 'We confirm a potentially important role for central bank communications to shape public expectations of future policy actions' (Bernanke *et al.*, 2004, p. 4).

Fed communication evolved in the 1990s, and in 1994, the policy decision was immediately announced to the public. In 1999/2000, the announcement of the policy decision was accompanied by the publication of a statement giving an explanation of the current decision, and an explanation of the forward-looking decision through the economic outlook, an assessment of the balance of risks and economic conditions in the 'foreseeable' future. It demonstrates that the timing, number, organization and content of meetings are key components of communication strategy. The Fed communication strategy permits markets to concentrate their attention on eight pre-set dates per year on which it announces its key policy rate. This system is often referred to as the Bank's fixed announcement dates, or simply fixed dates. In November 2001 the ECB adopted also a system of twelve pre-set dates per year on which to announce its key policy rate.

The 1999/2000 turning point also modified the process of forming market expectations. Before 1999, agents had to guess at future official rates during the inter-meeting periods, via speeches, testimonies, interviews or macroeconomic data. After 1999, agents were advised of future monetary

policy at the time of the meeting through the Fed's communications strategy: immediate release, statement, economic outlook, balance of risks, and so on. This new communication framework also enhances the common understanding between the central bank and agents: 'not only do they have a larger effect on the level of interest rates if they are accompanied by an asymmetric assessment, but also the volatility induced by the FOMC [Federal Open Market Committee] meetings has been significantly lower since 1999. Third, market participants anticipate the next monetary policy decision earlier' (Ehrmann and Fratzscher, 2005, pp. 26-7).

Extensive and forward-looking explanations strengthen the transmission of monetary policy, reduce market participants' uncertainty and reduce transmission lags. The reason is that forward-looking information favours the common understanding of the path of future interest rates. With the expectations theory of the term structure, the Fed shapes the yield curve, thus enhancing and accelerating the linkage between short and long rates: the Fed has a stronger and earlier impact on the economy.

In contrast to the ECB, the Fed uses the expectations channel by giving no explicit nominal anchor, since there is no explicit inflation target. Inflation expectations amplify and accelerate the impact of the nominal interest rate on inflation via the real interest rate. Regarding the expectations channel, we can make the following comparison:

- The ECB tries to neutralize the inflation expectations channel. Compared with the Fed, the impact of the nominal interest decision is more certain, but lower and slower. The time frame of transmission is medium to long-term. It employs an <u>indirect</u> channel of transmission to inflation, passing through on output with a two-year lag.
- The Fed uses the expectations channel. The impact of the nominal interest rate decision is more uncertain but faster and stronger. The time-frame of transmission is short to medium-term. It employs a <u>direct</u> channel of transmission to inflation with a one-year lag.

Communications should contain relevant explanations – that is, the ability to make the central bank comprehensible to the general public. Comprehensive explanations presuppose three characteristics: explanations should be extensive, clear, and convey forward-looking information.
We need extensive explanations (justification, and motivation of central bank decisions) (Kohn and Sack, 2003, p. 29): 'Before I served on the Federal Reserve Board, I believed the Fed could and should offer much more by way of explanation. Now, having been there, I feel absolutely certain' (Blinder, 1999, p. 75). We move from 'Never explain, never excuse' to 'explaining more it is understanding better' (Ricoeur, 1985, p. 37).

The public should be able to understand the short-term tactical change in the central bank's long-term strategy (Ferguson, 2002, p. 1). Explanations should be orientated towards the future, because financial markets are uncertain about the future of the economy. [4] Forward-looking explanations ('Policy inclination', 'Economic outlook') participate in the formation of expectations for the market.

Communications strategy: enhancing both efficiency and flexibility

Communication improves monetary policy efficiency and the public understanding of monetary policy, enabling the public to anticipate or react in line with the central bank. It tries to convince agents that the Fed is pursuing the right policy, and it ensures a common understanding. The Fed and agents share a similar representation of the future path of the economy. This common understanding simplifies the link between the Federal funds rate and the market-based long-run interest rate that has a strong effect on the economy. Central bank talk enhances monetary policy transmission. By increasing the speed of transmission, communication reduces one of the major problems of monetary policy – lags: 'Given that one of the limits on the effectiveness of monetary policy are the long lags between policy actions and their effect on aggregate demand, this anticipatory effect on long-term rates potentially speeds the effect of monetary policy and, in principle, can make it more effective' (Meyer, 2003, p. 21).

Uncertainty induces flexibility – that is, tactical deviations from the strategy. This means severe shifts in the direction or in the amplitude of interest rates (from 25 to 50 base points). Flexibility is feasible as soon as market participants understand and validate tactics by following the Fed. Otherwise, agents play a non-cooperative game with the central bank, which inhibits monetary policy efficiency: 'failing to communicate with the public does not create genuine policy flexibility but only reduces the potency and predictability of the effects of given policy actions' (Bernanke, 2004b, p. 8). By ensuring public understanding, communication allows for more flexibility. Open market and 'open mouth' operations are complementary. If the Fed uses flexible policy and communication, the ECB considers that expectations are anchored by rule-like systematic policy. The Fed needs a common understanding to achieve the inflation expectations management required to link the short-term official interest rate and the long-term market interest rate. The common understanding is that the Fed is a 'statue with feet of clay' that needs public support.

Fedspeak's revolution: from cryptic statements to openness

Reviewing the Fed literature, we note that communication or 'Fedspeak' (Bernanke, 2004a) is considered to be the key aspect of its policy framework. It is linked with effectiveness and democratic considerations:

> 'Openness is more than just useful in shaping better economic performance. Openness is an obligation of a central bank in a free and democratic society. U.S. elected leaders chose to vest the responsibility for setting monetary policy in an independent entity, the Federal Reserve. Transparency of our activities is the means by which we make accountable to our fellows citizens to aid them in judging whether we are worthy of our task.' (Greenspan, 2001, p. 3)

Previously, 'Fedspeak' corresponded to the enigmatic and esoteric art of the Fed. Greenspan is famous for his declaration in Congress in 1987: 'Since I have become a central banker, I have learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said'. Nowadays, the Fed has changed: 'Fedspeak' means clear and extensive communication. [5]

In the 1990s the novelty of Greenspan's communication is less its accountability or transparency than what he explains: the dual mandate – that is, the respect of its democratic mandate. The appropriate term for the 'risk management paradigm' of Greenspan is 'openness'. This openness about the dual mandate is the cornerstone of Greenspan's Fed.

Bernanke (2004a, p. 8) exposes the counter-productivity of full transparency:

> 'Other possibilities for improved transparency may exist. Importantly as we think about these, we should not simply take the view that more information is always better. Indeed, irrelevant or badly communicated information may create more noise than signal; and some types of information provision – an extreme example would be televising FOMC meetings – risk compromising the integrity and quality of the policy-making process itself.'

Moreover, the Fed argues for limited transparency towards financial markets: 'This, of course, is not to say that a central bank will never surprise the market. As I mentioned earlier, the most important task of a central bank is to get monetary policy right. At times, getting policy right will involve taking action unexpected by the market – for example, in its timing and magnitude' (Ferguson, 2001, p. 5). Limited transparency points out the importance of independence towards financial markets, and not only on political authority, as in the case of ECB independence.

Openness also concerns inflation targets. The Fed considers uncertainty as a fundamental element of monetary policy. With the New Keynesians, the explanation of inflation moves from money to expectations. The confidence paradigm considers inflation to be a phenomenon of expectation. Greenspan prefers an implicit inflation target that gives flexibility to the policy mix. The implicit inflation target can be 2 per cent, 3 per cent or 4 per cent depending on circumstances.

In the absence of shocks, there are only eight meetings a year, when federal Open Market Committee (FOMC) can change the rate.

A central bank practising openness in a democratic society could be defined as 'communicational'; [6] that is to say, a central bank that tries to build a common understanding with the general public of its monetary policy decisions and actions. The 'central bank should be able to reduce uncertainty, focus and stabilise private sector expectations, and with intelligence, luck, and persistence develop support for its approach in policy-making.' (Bernanke, 2004a, p.4) The openness displayed inside its 'balance of risks' strategy is regarded as being consistent with its dual mandate; and the openness produced by its clear explanations of its tactical movements are understood by agents to be part of the necessary flexibility of the strategy. Communications strategy is the keystone anchoring the agents' inflation expectations.

With the refusal of the friedmanian NAIRU, with a dual mandate (numerous decisions for the employment), without an explicit inflation target (refusal of a optimal rate of inflation) and with a strategy directed on the medium term, Greenspan showed that he refuses the neutrality of the money in the long run; even if his theoretical background was the orthodox economics.

Table 1 Independence for Credibility (ECB) versus Governance for confidence (Fed)

Governance	**CREDIBILITY STRATEGY** *European Central Bank: a conservative central bank*	**CONFIDENCE STRATEGY** *The Fed: a democratic central bank*
Monetary policy strategy	• Cross-checking • Stability-orientated strategy • Medium-term orientated strategy	• Risk management paradigm • Balance of risks strategy (since 2000) • Interest rate policy (since 1994)
Independence versus Governance	• Creature of central bankers • Supranational bank • Goal and instrument independence • Quasi-unique mandate, primacy to price stability • Priority to inflation close to 2% view as the real level of the price stability • Full independence • Transparency and commitment on price stability • Monetary order linked to an independent monetary power	• Creature of Congress (Congress oversight) • Congress sets the goals. Federal Reserve Act (1977), the 'full employment and balanced growth act' (Humphrey-Hawkins Act) • Instrument independence • Dual Mandate: 'goals of maximum employment, stable prices, and moderate long-term interest rates'. • Neither prioritization nor quantification of the objectives • Balancing independence, delegated power and now governance • Openness and accountability on its dual mandate • Monetary policy as a deliberative process
Responsibility versus Accountability	Responsible directly to the public • Judicial review (Art. 230~233) • Dismissal of members of the executive Board, 'compulsorily retired' by the Court of Justice of the European Community (Art. 11.4) • Annual report to the European Parliament (Art. 113(3)). Monetary dialogue with the European Parliament. Quarterly hearings to the Committee on Economic and Monetary Affairs (Art. 113(3)) • Quarterly reports on the activities of the euro system • Rule 40a: 'Written questions to the ECB' by all members of European Parliament • Definition of price stability is a yardstick against which the public can hold the ECB accountable • No effective accountability since the European Parliament cannot change central bank law or mandate	Accountable to elected representatives • Congress has the power to overrule any interest rate decision made by the FOMC by passing a statute that the president will sign. - Congress can threaten to: - Change the structure of the Fed - Remove a governor - Specify particular qualifications for Board members - Alter the composition of the FOMC • Bi-annual hearings at Congress (Humphrey-Hawkins testimony) • Congressional report • The congress can demand accounting of policy by summoning the chairman, board members and reserve presidents to congressional hearings • Effective accountability since the Congress can change central bank law or mandate
Communication	• Monthly press conference (12/year) since 11/2001 (previously press releases every 2 weeks) • Annual report, monthly bulletin, real-time information • No publication of the proceedings of the meetings (Art. 10.4) • The Governing Council may decide to make the outcome of its deliberations public (Art. 10.4) • No publication of voting records or verbatim records • No publication of internal inflation forecasts, but publication of staff macroeconomic projections 2/year (since December 2000)	• Immediate statement after each (8/year) scheduled meeting of the FOMC • Bi-annual report and monthly reports • Immediate public announcement of FOMC decision (since 1994) • Minutes of the FOMC published 3 weeks after the meeting since 2004 with votes and naming names (previously a little over 6 weeks) • Publication of detailed verbatim transcripts after 5 years • Regular speeches by the members to outside audiences • Publication of inflation and output forecasts (2/year)
Monetary Policy Committee	• The Governing Council has 18 members. It is dominated by the central bankers - 6 from the Executive Board - 12 national central banks' governors and maximum 15 vote after the enlargement	• FOMC has 19 members but only 12 vote: - 7 from the board of Governors - 5 from regional central banks' presidents. Always New York's Fed that has responsibility for implementing decisions

CONCLUSION

With the Keynesians, the Monetarist and the credibility regimes of the new classical economics, governance was not important. Governance as a keystone of the monetary policy began only in the 1990s, when the independent central banks researched a new political legitimacy to found their action after the New Keynesian counter-revolution. Inflation targeting (New Zealand, 1989, Canada 1991, Great Britain, 1992) and the confidence regime (Fed of Greenspan after 1994) were the

starting point of this process and developed new ways for the governance in monetary policy. Alone the ECB keeps on with the old credibility. If in the facts, monetary policies of the ECB and of the Fed were very close, the theoretical foundations of these policies are completely different and on the contrary.

On the one hand, the ECB adopted the credibility strategy, which reduces the governance to a self-governance – that is to say a full independence. However the ECB has evolved since its creation and is slowly getting closer to the regime of inflation targeting. On the other hand, the Fed of Greenspan adopted a confidence regime where the governance is the keystone of its policy. But in short-term, could we see a modification in the policy of the Fed that will move it closer to flexible inflation targeting? It was the Bernanke's wish before his nomination. So a convergence of monetary policy regimes is possible in the near future.

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[1] One can find it in the Porter Report for Canada or in the Radcliff Report for the UK. By Keynesian, one means the Keynesian Synthesis represented by the IS-LM-EE model of Hicks-Hansen-Mundell-Flemming.
[3] On 'governance' at the Fed, see also Bernanke (2004b, p. 7).
[4] Contrary to the credibility framework, the myopia comes rather from the financial participants than from the government.
[5] 'The Fed chairman now intends his speeches and testimonies to be understood, not misunderstood' (Blinder *et al*., 2001, p. 73).
[6] It is related the communicational theory of J. Habermas. See the paper of Emmanuel Carré presented during this conference.

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