EUROPEAN PARLIAMENT

DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICIES

ECONOMIC AND MONETARY AFFAIRS

# Improving ECB's Accountability and Transparency

## NOTE

**Abstract**

ECB's accountability rules are laid down in an Intergovernmental Treaty, very unlikely to be changed. Thus, the ECON Committee should try to reach an agreement with the ECB President in order to transform the present Monetary Dialogue into a Monetary Hearing.

ECB's transparency has improved significantly over the years, but it could go further by publishing minutes and voting records of the Governing Council meetings and by better communication with markets and monetary experts through its "introductory statement" to every monetary policy meeting.

This document was requested by the European Parliament's Committee on Economic and Monetary Affairs.

### AUTHOR

Guillermo de la Dehesa
Chairman of the CEPR, the OBCE and Member of the G30

### RESPONSIBLE ADMINISTRATOR

Arttu MAKIPAA
Policy Department Economic and Scientific Policies
European Parliament
B-1047 Brussels
E-mail: poldep-esc@europarl.europa.eu

### LINGUISTIC VERSIONS

Original: [EN]

### ABOUT THE EDITOR

To contact the Policy Department or to subscribe to its monthly newsletter please write to: poldep-esc@europarl.europa.eu

Manuscript completed in September 2009.


This document is available on the Internet at:
http://www.europarl.europa.eu/activities/committees/studies.do?language=EN

### DISCLAIMER

# 1. ACCOUNTABILITY

The concept of accountability assumes the existence of a contractual relationship between a principal delegating a specific task to an agent who assumes responsibility for the proper execution of this task and enjoys a certain degree of freedom to conduct such a mandate. In the case of central banks, there are two types of independence to conduct such a task. The first is "instrument independence" if the agent is given a very specific mandate (e.g. a target inflation rate) and the agent is given freedom to choose the instruments and procedure to reach it. The second is "goal independence", in which the agent can define its inflation target as well. According to Jürgen von Hagen (1998) the ECB enjoys both freedoms as lay down in article 105 of the Treaty, that is, both to assure price stability and to use instruments which are compatible with an open, competitive economy and the delegation of powers is of great importance. Accountability is the balance to independence that assures that the latter does not become an untamed discretion. When the central bank enjoys goal independence, accountability must start with the following two questions: did you give an adequate definition of your goal? Did you achieve it using the proper instruments and procedures?

Tommaso Padoa-Schioppa (2004) defines accountability as a basic precondition for democratic legitimacy in general, meaning that institutions with power to affect the lives of the people should be subject to scrutiny of the elected representatives of the people. Thus, accountability can only be effective if there is a well specified course of actions and the principal can take to discipline the agent in cases where the answers to these questions are not satisfactory and the principal must also have a clear idea of the goals the agent is to achieve. In the context of central banking there are two different interpretations of this principal-agent relationship. In one case the principal is the government like in the UK where the Chancellor sets the inflation objective and the Bank of England must explain and defend its efforts to reach this objective, or the case of New Zealand, where the governor of the Reserve bank can be dismissed from his office if inflation exceeds a critical value set by the government.

In another case, the principal is the Parliament. This is the situation in the United States, where the Chairman of the Federal Reserve Board of Governors must regularly testify before the US Congress and explain to what extent and how the Fed monetary policy is consistent with the goals defined by Congress. Accountability is made effective by the threat that Congress can abolish or remodel the Fed by legal action. In the same way the Bundesbank was accountable to the German Parliament given that the Bundesbank Act could be changed or revoked by a simple law. Both systems are based o models of democracy, given that the central bank is vested with the power over an important public good: money and monetary policy. Its accountability should be to political bodies which themselves derive their democratic legitimacy from being elected by those affected by the performance of the central bank. That is, the citizens of the country concerned.

According to Jürgen von Hagen (1998), in the case of the ECB, the main issue is that in the EU does not have the equivalent political bodies corresponding to a national government or a national parliament. The Treaty implicitly suggests that the ECB should be accountable to the European Parliament (EP). This notion is reflected in article 109b, which holds that the EP can call the president of the ECB and the other members of the ECB Board to testify before the EP prior to their appointment and that the EP has the right to give an opinion on their appointment. But the issue is that EP does not represent an electorate consisting of all European citizens.

Since a European electorate does not exist, members of the EP represent the different nations from which they have been elected, that is, their national constituencies, although there are also party coalitions within the EP. True accountability to the EP would be justified only if the Parliament were elected in pan-European Union elections. Furthermore, the ECB is neither a creation of an EP decision, nor can it be abolished or disciplined by the EP. The ECB cannot be held accountable to the European Council (EC) either, because it would undermine its independence .and because the EC does not represent a European electorate. It can be said that, in the last instance, the ECB is accountable to the Euro Area general public al large, because they are the users of its currency and they are going to suffer the consequences of any wrong decision or policy coming from the ECB, but the public in general does not have either the means to act collectively to discipline the ECB. The conclusion is that the ECB does not have an obvious principal to be accountable to. This is an outflow of the well known general democratic deficit of the EU.

This is one of the reasons why the much debated status of the ECB is criticized as a contradiction to the common understanding of democracy. Independence does not imply the total absence of democratic control but the need for an unambiguous of the limits and the way in which democratic control is exercised. As Timo Tohidipur (2006) puts it, the main political question confronting the ECB is how this institution can maintain independence and benefit from the benefits of political autonomy and, at the same time be viewed as legitimate and accountable to the European public. The formulation and management of monetary policy in the Euro Area has been taken out of the hands of the politicians and entrusted to the technocrats of the ECB and of the national central banks. The ECB has been constructed as an institution which is based on the idea of technocratic decision-making, comparable to the early High Authority of the European Coal and Steel Community in 1952. In such a scheme, the only way to increase accountability is through transparency, at least while accountability remains limited by the incompleteness of political union in the EU.

Moreover, as Daniel Naurin (2007) shows the rules and the statute of the ECB are laid down in an Intergovernmental Treaty, which can only be changed if all member states are in agreement, so that the probability of changing them is extremely low. Therefore, the ECB is probably the most independent central bank in the world and, at the same time, its accountability is very low. Its Governing Council (GC) consists of the national central bank presidents and the six Executive Board members appointed for eight years. There are no ways for the elected political institutions to put sanctions on the GC members should they engage in agency shirking or performing poorly. These are the reasons why concerns have been raised about the democratic legitimacy of the ECB.

This is not the view of Lorenzo Bibi-Smaghi and Daniel Gros (2001) who consider that central banks have received a mandate from the government or through a legal act, to perform specific tasks in view of specific objectives and define accountability as the act of listening to criticism and responding to questions about past and future behaviour that may be put forward by a democratically elected body. But they consider that a priori there is not a trade-off between independence and accountability, if the two concepts are appropriately defined. Accountability can be seen as a complement, if not a necessary requirement of independence. A central bank cannot be fully independent if its objectives are not clearly and precisely defined and it cannot be independent if it does not give a public account of its actions, which derive from the delegation of power. In the case of the ECB they think that, although it has precise reporting obligations, its accountability can be understood in a very general sense, to be exercised not only to the Council and the Parliament but also to the public at large.

Clive Briault, Andrew Haldane and Mervyn King (1996) created an accountability index based on four criteria: a) Whether the central bank is subject to external monitoring by Parliament; b) Whether the minutes of the meetings in which monetary policy is decided are published; c) Whether the central bank publishes an inflation or monetary policy report in addition to the standard central banks bulletins and d) Whether there is a clause that allows the government to override a decision by the central bank. Bini-Smaghi and Gros do not agree with this all four criteria, mainly with the fourth that is more a criterion for independence and the third where they do not see that an inflation report adds much accountability besides the monthly reports. Finally, on the issue of publishing the minutes of the monetary policy committee, they think that it is a two-edge sword and it raises delicate issues at the ECB but, disregarding this special case, they believe that publication of votes increases transparency.

Bini-Smaghi and Gros asked themselves why the ECB in the different polls conducted with a large pool of market operators is less credible than the Fed or the Bank of England: They establish a ranking among the six major central banks: ECB, Fed, Japan, Canada, England and Germany (before joining the ECB) based on 15 objective criteria about accountability and transparency and find that the ECB comes out the more accountable and transparent after the Bank of England. Being more independent than the Bank of England and the Fed and charged with the clear objective of price stability, the ECB should in a better position to adopt, announce and implement a credible strategy. Thus, they attribute the ECB's lack of credibility to the inefficient and hesitant use of its existing procedures and its institutional setting.

For instance, the ECB has a European objective, price stability in the Euro Area, but the members of its Governing Council (GC), are not nominated on the basis of a fully European procedure. The GC members are accountable only to the European Parliament (EP) and the European Council (EC), but both bodies however do not play any role in the appointment of the NCB governors, given that their membership in the GC is automatic, not subject to a confirmation by a European body (as in the case of the Court of Justice or the Commission).and the EP does not organise hearings to confirm the appointments of the NCB governors.

Only the members of the Executive Board could be individually accountable to the European bodies that have nominated them. But it would not make any sense to publish only the votes of the Executive Board members, while the others are kept secret. That is, its members cannot be individually accountable. The solution that has been chosen is to have a collegiate accountability for the whole GC to the European political bodies and such collegiality makes confidentiality of proceedings necessary, as called for by the Treaty. They do not call for changes in the procedures and institutional setting but rather for a more consistent fixing of targets and use of channel communications and interfacing with the general public and the rest of the world.

According to Naurin (2007) the problem with these indexes is that confound accountability with transparency. In most of them (De Haan and Eijffinger; Briault, Haldene and King and Bini-Smaghi and Gros) the large majority of the criteria are about transparency and clear policy goals and not about real accountability. That is, it is possible to achieve a high degree of accountability, through transparency, even though, first, there is no sanctioning mechanism available and if any member of the GC does perform badly we have to wait for 8 years and second, the two major transparency criteria: publishing the minutes and the voting records are not met by the ECB. Therefore, transparency is not so much about the "public's right to know" but about the "public's need to understand", or what is the same, it is more important the understanding of the decisions taken that the availability of information. According to this logic, publishing more objective information like minutes and voting records may rather decrease the level of transparency, as people will misunderstand the content of this information without the banker's assistance in interpretation.

Under these serious constitutional and institutional limitations, which reduce the scope of a true accountability, what can be done in the meantime to improve ECB's accountability? The ECB is obligated, by article 109 (b) of the Treaty, to address, once a year, an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year, to the EP, the only elected institution to which it is formally accountable, but also to the Council, the Commission and the European Council. In fact, the president of the ECB has agreed to meet the ECON Committee of the EP every quarter. In addition, the other ECB Board members also meet the ECON Committee on a fairly regular basis. The problem is that the limited visibility of the hearings- as opposed to the high media visibility of the hearings that the US Congress regularly holds with the Chairman of the Board of Governors of the Federal Reserve System- indicates that accountability is far from strong. Of the 53 articles of the ECB statute only section 3 of article 15 titled "Reporting commitments", mentions that the ECB should address the above mentioned annual report to the EP the C and the EC.

According to Petra Geraats, Francesco Giavazzi and Charles Wyplosz (2008) there are several reasons why this is so: The Committee includes 51 members. It is simply impossible for such a large group, which includes MEP from all political persuasions and all nationalities, to conduct tough hearings. The event is rather unstructured and the questions put to the president of the ECB cover a wide range, from pointed questions to general declarations, including very parochial ones. Obviously, the ESCB does not bear any responsibility for this state of affairs. But the ECB could do more to enhance the status of these meetings. The title of these meetings, Monetary Dialogue, remains far short from what it should be, namely "hearings". Apparently, the ECB refuses to upgrade the title. More importantly, the president of the ECB sticks tightly to the script of the press conference that followed the previous policy-making meeting of the General Council.

In contrast to the Congressional hearings of the chairman of the Fed, which are feverishly expected, widely reported and intensely scrutinised, the European media have long learnt that there will be no news and, understandably they devote little space, if any, to reporting on the Monetary Dialogue.. While the president of the ECB cannot break stunning news every quarter, he could occasionally use the event to provide some important signals, if only to share his thoughts beyond the formal monthly press conference statements: Accountability will remain formal and not effective, as long as the Monetary Dialogue is not fundamentally restructured, a task that is incumbent upon both the EP and the ECB.

# 2. TRANSPARENCY

As it was mentioned earlier, central bankers are non-elected officials to whom very important tasks have been delegated. They must be accountable for their decisions, of course, but when confronted with powerful critics, including politicians, they cannot ignore public opinion. For this reason, transparency and communication are essential to obtaining and retaining popular support but not only to the financial markets but to the general public as well. Transparency can help to improve accountability. This issue has been taken by the CEPR in its latest Monitoring the ECB (2008) written by Petra Geraats, Francesco Giavazzi and Charles Wyplosz where they try to look for ways and means of how the ECB could still improve its accountability through further transparency and better governance.

A) They recognised that ECB has improved significantly its level of transparency in the conduct of its monetary policy in its ten years of existence. It has improved in the rankings of central bank transparency and it is ranking number 6, behind those of New Zealand, Sweden, UK, Canada and the Czech Republic, and just above the FED (Nergiz N. Dincer and Barry Eichengreen, 2007). According to Geraats, Giavazzi and Wyplosz, these improvements have taking place mainly in the following three areas:

1) Its first improvement was made the 8 of May 2003, when the Governing Council (GC) made clearer its definition of price stability by confirming that "in the pursuit of price stability it will aim to maintain inflation rates close to 2 per cent over the medium term". This was an important step in the sense that it was not targeting the midpoint of the 0 to 2 per cent inflation rate, but it did not specified how close to 2 per cent.

Otmar Issing clarified this point at a question by the press the same day, by saying that "this close to 2 per cent is not a change, it is a clarification of what we have done so far, of what we have achieved, keeping inflation expectations in a narrow range of between roughly 1.7 and 1.9 per cent and what we intend to do in our forward-looking monetary policy". Years later, medium term inflation expectations reached 2 per cent and financial markets now think that 2 per cent is the HICP objective and not just below 2 per cent, unless there is further clarification.

2) Its second improvement was also in 2003 when the GC decided to clarify the role of its two pillar strategy, by confirming that "the monetary analysis serves as a means of cross-checking, from a medium to long term perspective, the short to medium term perspective coming from economic analysis" Therefore, since then, its monetary policy assessment starts with the economic analysis, which identifies the risks to price stability over the short and medium term and it is followed by the monetary analysis, which assesses the trend inflation in the medium to long term as a cross-check.

Stefan Gerlach (2003) interprets this revised two pillar strategy by saying that the monetary pillar aims at anchoring inflation in the long run, on the assumption that money growth determines inflation at that horizon and that leaves the ECB free to use the economic pillar to limit output fluctuations in the short and medium term. But then he warns that, in the long run, it is inflation that tends to cause money growth and not the other way around. Thus, in the short run, the economic pillar drives inflation through the impact of output fluctuations and these effects determine longer-run inflation, while money is demand determined, since the ECB just sets the nominal interest rate. Guenter W. Beck and Volker Wieland (2007) argue that the monetary aggregates tend to provide a way of checking potential errors in the output gap, that is, the difference between actual and potential level of GDP as a per cent of potential GDP (a more efficient or at full capacity utilization one) and it is negative if the first is lower than the second and positive if first is higher than the second. The problem is that although the output gap is the heart of the economic pillar, it is quite difficult to measure with high reliability. Both interpretations seem to be in line with the idea that, in reality, the ECB tends to follow an inflation-targeting strategy.

3) Its third improvement has been on the publishing of its macro-econometric model and projections for the Euro Area (EA), which, since the beginning in 1999, were urged by the ECON Committee. At the beginning, it was releasing semi-annual projections for the EA, constructed by the Euro-system staff at its December Bulletin and in the following January its EA wide macroeconomic model. Since September 2004, it started to release semi-annual projections produced by the ECB staff, which are an update of those of the Euro-system staff. Now it publishes staff projections every quarter, which are expected to provide a more important input into its policy decisions, mainly when it started to publish them on the day of the monetary policy meeting.

Moreover, since June 2006, its staff projections have been based on the assumption that short-term interest rates, measured by the 3 month EURIBOR, are in line with forward rates derived from the yield curve, while the assumed path for long-term interest rates, measured by the EA ten-year nominal government bond yields, continue to be based on market expectations. Jean Claude Trichet (2006) has made clear that the GC pays a great attention to the staff projections and considers them as an important input when taking their decisions. The problem is that sometimes it is difficult to understand policy decisions in the light of its staff projections given that the GC tends to react raising rates by more than these projections would signal.

B) But Geraats, Giavazzi and Wyplosz (2008) also signal other areas in which further transparency is possible and much needed and they make interesting recommendations:

The ECB is placed only number six in the total ranking of transparency of central banks, because it is more opaque in its decision making than any of the other major three central banks (US, UK and Japan) given that it fails to publish voting records, minutes or some other timely account of deliberations of its GC meetings. Therefore, its "procedural transparency" receives one of the lowest scores as shown by Nergiz Dincer and Barry Eichengreen (2007). For this reason, the ECB has been repeatedly urged by the ECON Committee of the European Parliament, supported by resolutions of the European Parliament in 2004 and 2006, to start publishing, in its Annual Report, the minutes and the non-attributed voting records of its GC meetings. Moreover, its improved two pillar strategy continues to be insufficient to provide concrete guidance to financial markets about how it is likely to set monetary policy, so that it needs to be more transparent in decision making procedures to give more informational inputs to the markets.

1) First, there is a clear need for the ECB to publish the voting records. According to article 10 (2) of the ECB and ESCB statutes, "save as otherwise provided by for in this statute, the GC shall act by a simple majority of the members having voting right, and in the event of a tie, the President shall have the casting vote". Nevertheless, it appears that the GC does not use or has never used that decision rule but instead takes its monetary policy decisions by consensus as it has been said many times by its Presidents.

The problem with the word consensus is that it is less clear than that of simple majority. On the one hand, it can mean unanimity, general agreement and in any case a greater degree of agreement than simple majority. On the other hand, consensus can be achieved on the final decision in spite of a strong disagreement by some of its members: eventually, quantity of disagreement plays a larger role than intensity of it, so that to call consensus when a minority of members strongly disagree with the decision is inappropriate, even more if they happen to be some of the largest members of the GC. Thus a central bank that decides by consensus whether to adjust the policy or refinancing rate is more likely to be inertial than another that acts by simple majority.

Another reason for publishing the voting records is that it is more informative and helps the public to understand better monetary policy decisions. If it is by unanimous vote it shows that they see the economic outlook very clear and if is was by simple majority then their views on the economic are less clear and made the final decision a close call. If most members of the GC vote to hold the policy rate and a minority to raise it, it sends a signal that their bias is toward tightening in the next meeting and if the minority dissenters vote for a rate reduction, then the bias of the trend is toward loosening and finally if the dissenters are very few the highest probability would be for no change of refinancing rates in the next meeting.

Therefore, it provides much more information to the markets about how the GC responds to economic information which increases the predictability of its monetary policy decisions not only in the short run but also in the long run. Moreover, it will not be necessary to disclose the individual votes. In a monetary union, it could be detrimental because it could subject national central bankers to greater political pressures, mainly if he has voted for a rate raise, because he is thinking on the whole of the EA, while his country is in recession or the other way round. Moreover, Hans Gersbach and Volker Hahn (2004 and 2005) show that the publication of individual voting records can be socially beneficial when governments use them to identify and reappoint central bankers with desirable characteristics and to reappoint only those central bankers who have sown themselves highly qualified.

2) Second, there is also a need to publish the minutes of the ECB monetary policy meetings. Their publication enhances monetary transparency in three ways: On the one hand it presents an overview of the economic information that was considered at the meeting. On the other, it describes the views that monetary policymakers have of current macroeconomic and financial developments, and finally, it includes an account of the discussion of the policy choices. These are the reasons why, the publication of the meetings minutes is an important component of the communication strategy of an increasing number of central banks.

As the ECB does not publish the minutes, tries to remedy partially this problem by two other communication tools: First, in its Monthly Bulletin, presents an elaborate analysis of economic developments in the EA. Second, the GC issues an "introductory statement", after each monetary policy meeting, which is followed by a press conference by the ECB President and Vice President. But the statement provides little insight into the economic views of the members of the GC and their diversity and it is completely devoid of any information about the actual deliberations and their underlying arguments.

According to Jean Claude Trichet (2005) "we have various views inside the GC, as it is necessary… The pertinent entity, which is the GC, relies very much on a collegial, very confident and very comprehensive exchange of views. And there emerges from that exchange of views a majority sentiment which can, from time to time, be a unanimous sentiment". The problem then is that the GC fails to share its insights and collegial wisdom with financial markets and the public. The ECB introductory statement pales in comparison to the minutes of the FED FOMC and the Bank of England MPC. Unfortunately, this lack of information is not compensated by the press conference of the President and Vice President of the ECB following the GC monetary policy meetings. The argument for the ECB is based on article 10 (4) of its Statute, which states that "the proceedings of the meetings shall be confidential". But, later, the same article states that "the GC may decide to make the outcome of its deliberations public".

3) Third, there is finally a need to communicate more to the general public, to the markets and to the monetary experts. Monetary policy works chiefly by shaping expectations since its main objective is the management of inflation expectations. Most central banks use implicitly or explicitly Taylor rules, which attract attention to expectations of inflation and the output gap as the key drivers of interest rate decisions. Although the main objective of

the ECB is price stability, its aim is to achieve it over the medium term, so it needs also to take into account the effect on the real economy. This is the reason why most central banks report their forecasts on these two variables, but the ECB presents them as staff projections and emphasizes that the policy-makers (GC) do not necessarily share its staff views. So that it reduces the information value of its forecasts. But, it is important to note that, since December 2005, the ECB has improved this situation in the Introductory Statement, by complementing the staff forecasts with an explicit statement of the GC view on the balance of risks, either to the outlook or to the projections.

Nevertheless, the publication of the monetary policy committee's own expectations would provide a much clearer view of what the central banks thinks, because the policy committee, in order to communicate its forecasts, needs a negotiation among its members reflecting the relative influence of its members at that point of time. For example, since November 14 2007, the FED FOMC new procedure provides considerable information about its member's points of view, however, subjecting them to individual disclosures. The forecasts produced by each member are now explicitly based on her or his own assessment of "appropriate monetary policy". The aggregated forecasts show the range of every projection and the central tendency, which is the result of the exclusion of the three highest and the three lowest, because their range views are often very wide.

Another communication issue is related to the interest rate path. There are already four central banks that publish the expected interest rate path (Iceland, New Zealand, Norway and Sweden) The interest rate assumptions are crucial because other variables, such as energy prices, the exchange rate, assets prices or the path of the world economy are beyond their control but the short-term interest rate is the key monetary policy instrument. For a while, central bank forecasts were based on the assumption that the interest rate will remain constant over a specific horizon. But this is an inconsistent assumption. If inflation forecast indicate that inflation is diverging from its target, keeping the rates constant is not an option and it would be misleading.

Private forecasters and markets incorporate what they believe is a plausible path for the interest rate and evaluate the impact on exchange rates and asset prices, resulting in a yield curve that incorporate market expectations. This has led the ECB and other central banks to assume an interest rate path that is consistent with the observed yield curve, so that the central bank forecasts are internally consistent. But central banks forecasts are informative about expected future outcomes to the extent that the markets correctly foresee the interest rate path that the central bank intends to follow. Whatever the central bank does, it must rely upon some expected interest rate path. If it uses markets expectations, it acquiesces in these expectations, if does not, and communicates its own expected path, it has the potential to shape market expectations and produce the desired yield curve. If it does not agree with the market and does not say so, it may engage in double talk. Therefore, revealing its own interest rate path forecasts allows the central bank to bypass this problem.

Until now, most key central banks have not decided to publish their own expected interest rate paths, because their committees do not discuss it, or because its members would find it hard to agree on it, since they may agree on a trend but not on a precise path, because they do not want to be "boxed in", when future interest rates deviation from the pre-announced path would entail a loss of credibility or finally, because it may be perceive by the market as a pre-commitment. Therefore, there is the need to find a way in the middle to avoid such problems, because the market needs some indication and this is the single most frequent question asked to the ECB president at the press conferences. At the beginning answers were evasive. Now evasiveness has been replaced by the use of code words, which has made central bank watchers develop considerable linguistic skills at interpreting financial statements.

But the trade-off is not between an explicit revealed interest rate path and remaining silent, but between explicit communication and foggy signal to avoid getting boxed. The ECB has been successful in using code words resembling traffic lights, to communicate next interest rate movement. The president statement at the press conference uses three key phrases: “monitor closely”, “monitor very closely” and “strong vigilance”. Only on three occasions has used other very similar code words: “monitor carefully”, “particular vigilance” and “vigilance”. For instance, since 2005, nearly in every increase of the refinancing rate has been signalled in advance by the use of “strong vigilance” with one exception where he used “vigilance”.

Nevertheless, this system, although effective, has some limitations. First, it is short-sighted because it does not go beyond the next rate movement. So that it could be improved by giving signals beyond the next rate change, by showing a trend. Second, it does not give any indication of the refinancing rate around which the tightening process is likely to come to an end. It could be close to the neutral interest rate, at which policy is neither accommodative nor contractive. This may be a reason why the 10 year ahead implied forward overnight rate has been so volatile. Third, until now these code words have only been used to signal policy tightening and it should also be used for policy accommodating.

A way to overcome this third shortcoming is using the EBC communication about the balance of risks, in its “Introductory statement”. The overall balance of risks to price stability and to economic growth could provide a useful indication about the ECB policy inclination. President Trichet clarified, at his press conference of October 4 2007 that “we do not balance the risks to the real economy and the risks to price stability to make a judgment of which risks is more important. That is not the way to proceed. We analyse the real economy… but our decisions on monetary policy are based on the risks to price stability”.  Thus, the ECB could use this balance of risk to price stability to provide guidance about the direction of the next policy move. The rest of the shortcomings of the code words could only be eliminated by publishing the anticipated interest rate path.

# REFERENCES

Baldwin, Richard (2008) “The ECB is not like other central banks” VOXEU, August 1st

Bini-Smaghi, Lorenzo and Daniel Gros (2001) “Is the ECB sufficiently accountable and transparent?” ENEPRI European Network of Economic Policy Research Institutes Working Paper No. 7

Beck, Guenter and Volker Wieland (2007) “Money in monetary policy design: A formal characterization of ECB-style cross-checking” Journal of the European Economic Association, Vol. 5, No. 2-3

Briault, Clive, Andrew Haldane and Mervyn King (1996) “Independence and accountability” Bank of England Working Paper No. 49

De Haan, Jakob and Sylvester Eijffinger (2000) “The democratic accountability of the European Central bank: a comment and two fairy tales” Journal of Common Market Studies, Vol. 38, No. 3

De Haan, Jakob and Fabian Amtenbrink (2003) “A non-transparent European Central Bank?, Who is to blame?” CESifo Working Paper, April 1

De Haan, Jakob, Fabian Amtenbrink and Sandra Waller (2004) “The transparency and credibility of the European Central Bank” Journal of Common Market Studies, Vol. 42, No. 4

Dincer, Nergiz and Barry Eichengreen (2007) "Central bank transparency: where, why and with what effects?" NBER Working Paper 13003

Eijffinger, Sylvester and Marco M. Hoeberichts (2000) "Central bank accountability and transparency: theory and some evidence", Economic Research Centre of the Deutsche Bundesbank, Discussion Paper 06/00

Eijffinger, Sylvester and Petra Geraats (2005) "How transparent are central banks?" European Journal of Political Economy, Vol. 22, No. 1

Gerlach, Stefan (2003) "The ECB's two pillars" CEPR Discussion Paper 3689

Geraats, Petra, Francesco Giavazzi and Charles Wyplosz (2008) "Transparency and Governance", CEPR Monitoring the European Central Bank No. 6

Gersbach, Hans and Volker Hahn (2004) "Voting transparency, conflicting interests and the appointment of central bankers" Economics and Politics, Vol. 16, No. 3

Gersbach, Hans and Volker Hahn (2005) "Voting transparency in a monetary union" CEPR Discussion Paper 5155

Naurin, Daniel (2007) "Transparency, publicity, accountability- The missing links" Mimeo, Paper prepared for the CONNEX-RG 2 Workshop on "Delegation and mechanisms of Accountability in the EU", Uppsala, 8-9 March

Issing, Otmar (2003) Statement in response to a question at the press seminar on the "Evaluation of the ECB Policy Strategy" May 8

Padoa-Schioppa, Tommaso (2004) "The Euro and its central bank" Cambridge MA, MIT Press

Tohidipur, Timo (2006) "The emperor's new clothes: the ECB and the new institutional concept" German Law Journal, Vol. 06, No. 11

Trichet, Jean Claude (2005) Response at the 26th ECB Press Conference, December 1

Trichet, Jean Claude (2006) Statement at  ECB Press Conference, August 31

Trichet, Jean Claude (2007) Statement at ECB Press Conference, October 4

Von Hagen, Jürgen (1998) "The ECB: Transparency and Accountability" EMU Monitor, December

Wyplosz, Charles (2007) "Wake-up call for the ECB" VOXEU July 21